Case: Roger

(Reference date: 1st April, 2019)

Roger, aged 29 years, is working with a multinational company since December 2012. You are a CFP[CM] practitioner and a Registered Investment Adviser. Roger has approached you for preparing his Financial Plan. He is staying in his own house at Ahmedabad. His wife Angela, aged 31 years, is a fashion designer. She has set up a boutique in a rented space. She earned a net profit of Rs. 5.5 lakh in the previous financial year. They have a son, Mark of age 4, and a year old daughter, Stephanie. Roger is also supporting his parents to the extent of Rs. 20,000 per month. They stay at their ancestral house at Surat. The family's monthly household expenses are Rs. 40,000 p.m. (excluding insurance premium and EMIs). Roger normally gets 10% increase in his gross salary year-on-year in the beginning of every financial year, apart from bonus. The bonus for the previous financial year at Rs. 3.3 lakh (net of tax) shall be credited to his account at the end of this month. He has taken a family floater Health policy for Rs. 15 lakh (premium paid in the previous year is Rs. 16,268).

Roger's monthly salary (for FY2019-20):

Basic Salary	:	Rs. 60,000
DA (forming part of Salary)	:	50% of Basic salary
House Rent allowance	:	Rs. 18,000
Conveyance Allowance	:	Rs. 6,250
Executive Allowance	:	Rs. 10,000

Couple's Current Assets & Liabilities (As on 31st March, 2019)

Assets:		
House	:	Rs. 75.00 lakh (Current market value, purchase cost Rs. 40 lakh)
Car	:	Rs. 4.00 lakh (Depreciated value)
Public Provident Fund - PPF[1]	:	Rs. 4.90 lakh
Insurance – Money Back policy[2]	:	Rs. 3.00 lakh (Sum assured)
Child Plan – Life insurance[3]	:	Rs. 12.00 lakh (Sum Assured)
Gold ornaments[4]	:	Rs. 4.50 lakh
Equity Mutual Fund schemes[5]	:	Rs. 7.85 lakh
Portfolio of Equity Shares[6]	:	Rs. 3.95 lakh
Bank fixed deposits[7]	:	Rs. 4.00 lakh (Principal, in Angela's name from her business income)
Bank account – Roger	:	Rs. 0.75 lakh
Bank account – Angela	:	Rs. 0.95 lakh
Liabilities:		
Home loan[8]	:	Rs. 17.85 lakh (Principal outstanding)
Car Loan[9]	:	Rs. 3.05 lakh (Principal outstanding)

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[1] Opened in December, 2013 in the name of Roger

[2] Purchased on 25th October, 2015; annual premium paid Rs. 14,798; 20-year policy with 20% of sum assured payable on survival on 5th, 10th and 15th years and the balance on maturity

[3] Purchased when Mark was 2 year old; term of 20 years; annual premium Rs. 41,374

[4] Gifted on marriage in November 2013 at then value Rs. 1.75 lakh.

[5] Three schemes; current assets value in one scheme is Rs. 2.5 lakh, in second Rs. 3.5 lakh with monthly Systematic Investment Plan (SIP) of Rs. 10,000; the third is Equity Linked Saving scheme, invested Rs. 1 lakh in March 2017.

[6] The Demat account in which Roger and Angela are respectively first and second holders was started in 2015

[7] Three deposits; Rs. 2 lakh made on 1-July-2016 for 3 years at 9.75% p.a., Rs. 1 lakh made on 1-July-2017 for 2 years at rate 9.25% p.a. and Rs. 1 lakh made on 1-July-2018 for 1 year and 1 day at 8.75% p.a. (interest is payable quarterly and is credited to Angela's account)

[8] Home loan of Rs. 24 lakh for a 15-year term taken in April, 2013 at rate of interest fixed for first 3 years at 10% p.a., and floating thereafter at 1.5% above RBI Repo rate.

[9] Car loan of Rs. 5.5 lakh taken in April, 2017 at a fixed interest of 11% p.a. for a 4-year term; Car cost Rs. 8 lakh.

Goals:

1. Accumulate in a fund, higher education expenses of Mark and Stephanie. Expenses at their respective age of 18 years are Rs. 4 lakh p.a. (current cost) required for four years, cost escalation 8% p.a.
2. Marriage expenses of Rs. 10 lakh (current cost) for each child at around their respective age of 25 years, cost escalation 9% p.a.
3. Retirement corpus at Roger's age of 58 years to sustain current equivalent household expenses until the expected life of last survivor; retirement expenses to be drawn using two asset class buckets.
4. A bigger house valued at Rs. 1 crore today, 5 years from now by disposing of the current house and foreclosing the loan.
5. Build a separate fund for vacation expenses of Rs. 1.5 lakh p.a. (current cost), first expenses to be drawn after 5 years and thereafter every year continuing up to the year of Roger's retirement, cost escalation 7% p.a. A suitable investment regime needs to be devised to achieve this.

Life Parameters:

Roger's expected life	:	75 years
Angela's expected life	:	80 years

Assumptions regarding gross returns in various asset classes:

1)	Equity & Equity MF schemes/ Index ETFs	:	11.00% p.a.
2)	Balanced MF schemes	:	9.50% p.a.
3)	Bonds/Govt. Securities/ Debt MF schemes	:	7.50% p.a.
4)	Liquid MF schemes	:	6.00% p.a.
5)	Gold and linked investments	:	6.00% p.a.
6)	Real Estate appreciation	:	6.50% p.a.
7)	Bank/Post Office Term Deposits	:	6.50% p.a. (for tenure exceeding 1 year)
8)	Public Provident Fund/EPFO	:	7.75% p.a.

Assumptions regarding economic factors:

1)	Inflation	:	4.50% p.a.
2)	Expected return in Risk free instruments	:	5.00% p.a.

Cost Inflation Index:

FY	CII	FY	CII	FY	CII	FY	CII	FY	CII
2001-02	100	2005-06	117	2009-10	148	2013-14	220	2017-18	272
2002-03	105	2006-07	122	2010-11	167	2014-15	240	2018-19	280
2003-04	109	2007-08	129	2011-12	184	2015-16	254	2019-20	289
2004-05	113	2008-09	137	2012-13	200	2016-17	264		

1) Before beginning work on Roger's Financial Plan, you have drafted a document outlining the scope of engagement and sought Roger's help to mutually define and determine the activities that may be necessary to pursue. Roger asked you about relevance of such a document. What do you explain about "Letter of Engagement"?

[2 marks]

A. It is a professional requirement under FPSB's Code of Ethics.
B. It is a professional requirement under FPSB's Practice Guidelines.
C. It is a necessary legal requirement as per Contract Act 1872.
D. It is a document for his personal record.

2) You have finished analysis of Roger's financial situation and risk profile. Which of the following is the next appropriate step in the financial planning?

[2 marks]

A. Specify financial goals which can be achieved within Roger's financial situation based on the information collected
B. Fix the scope of engagement based on the available information already collected
C. Consider such assumptions of investment returns, inflation, tax rates, etc as to maximize the chances of achieving Roger's goals
D. Identify other issues that may potentially impact Roger's ability to achieve financial goals

3) You are constructing a financial plan for Roger in your capacity as a Registered Investment Adviser. Roger asks you to bring the execution of financial plan also in the "scope of engagement". What will you tell him?

[3 marks]

A. You can provide execution services outside the scope of engagement, which will not be documented in the letter of engagement.
B. You can provide execution services through one of your trusted distributors, who you will supervise. The remuneration aspect will not form part of the scope of engagement for financial planning.
C. In order for you to comply with SEBI regulations, execution services will be provided by one distributor, who is part of your family. Initial commission received will be shared with Roger, but not subsequent trail commissions. This shall not be part of the scope of engagement.
D. As a Registered Investment Adviser, you are mandated to comply with segregation of advisory and its execution at the client level. The execution services can be independently sourced from another professional.

4) Roger wants to insure his own house at Ahmedabad and his ancestral house ay Surat. What should you advise him as the basis of such insurance?

[2 marks]

A. Insure the houses for values equal to their respective reconstruction cost, used to bring each house back to its original condition, in case of happening of defined perilous event/s.
B. Insure the houses equal to their respective market values as applicable to similar house/s situated in the same locality.
C. Insure the houses for their respective stamp duty value considered at the time of registering the property in the name of Roger and his father.
D. Insure to the extent of the houses' respective municipal values, on the basis of which house tax is levied by the local municipal authority.

5) The child plan in the name of Mark has a deferment period of 10 years and vesting date being the policy renewal date after Mark attains majority. 25% of the sum assured can be withdrawn in each of the first three years from the vesting date. How do you explain this policy feature to Roger?

[3 marks]

A. The sum assured shall be applicable when Mark attains 18 years of age; withdrawal of Rs. 3 lakh each can be made during age 18, 19 and 20 of Mark, and full maturity on his age 22.
B. The sum assured shall be applicable when Mark attains 10 years of age; withdrawal of Rs. 3 lakh each can be made during age 18, 19 and 20 of Mark.
C. The sum assured shall be applicable when Mark attains 12 years of age; withdrawal of Rs. 3 lakh each can be made during age 19, 20 and 21 of Mark.
D. The sum assured shall be applicable when Mark attains 18 years of age; withdrawal of Rs. 3 lakh each can be made during age 12, 13 and 14 of Mark.

6) You observe that Roger is not covered adequately in case of any exigency with his life. You estimate an exclusive life cover to sustain 75% of current household expenses, after deducting 20% towards consumption by Roger himself. Such expenses required shall account for inflation year-on-year and shall sustain until Sumedha's expected life. You consider the proceeds of the policy invested in a debt mutual fund scheme, the returns wherefrom have an average tax impact of 8%. What sum assured of such term insurance do you determine?

[4 marks]

A. Rs. 81 lakh
B. Rs. 86 lakh
C. Rs. 1 crore
D. Rs. 1.08 crore

7) Roger tells you that he did not opt for his employer's retirement plan. You analyze the current financial situation of the family in order to independently construct a retirement plan. You have studied and discussed with the family economic and life parameters. What processes do you find relevant to follow in preparing a retirement plan for Roger and Angela?

[3 marks]

A. Invest whatever little they can have towards dedicated retirement savings in equity assets; the couple still more than 25 years left to retire, there can be always be a catch-up with larger contributions later; the important goals of children's education, repaying loans, etc. should take precedence.
B. Invest a fixed sum in debt instruments on an ongoing basis up to retirement. Create fixed assets such as a second house which can be let out prior to as well as post retirement to generate a steady secondary retirement income.
C. Estimate the size of retirement fund needed on retirement considering life expectancy of the last survivor; find out the amount of periodic saving that can be directed to an asset allocation for wealth building in the long term to realize such retirement fund; also identify assets that can be held till retirement which can be liquidated/converted to yield a supplementary retirement income.
D. Focus on other important goals such as children's education, Angela's business, etc. Retirement is still some 30 years away and with good asset base in general, funds can be carved out later to address the retirement goal.

8) You draw a retirement fund strategy, in consultation with Roger and Angela, to draw the retirement expenses from two buckets: Bucket One has first 5 years of expenses drawn from liquid funds; Bucket Two has the expenses for the remaining years until the expected life of the last survivor, drawn from debt funds. You suggest that in order to cover risk of longevity, they should have a buffer of a lump sum Rs. 1 crore available at the expected life of Roger which should be invested on retirement in the balanced funds. Consider the current household expenses adjusted for inflation count for retirement expenses, which are drawn year in the beginning for every year from the respective buckets. What value of retirement corpus do you advise the couple to accumulate?
[5 marks]

A. Rs. 2.90 crore
B. Rs. 3.28 crore
C. Rs. 4.25 crore
D. Rs. 3.04 crore

9) You inform Roger and Angela about taking exposure to Gold as an asset class through Sovereign Gold Bonds (SGB). Which of the attributes about the SGB is correct?
[2 marks]

A. The Capital Gains on redeeming these bonds on maturity are exempt from income tax.
B. They work like zero-coupon bonds.
C. The quoted prices of SGBs usually are very close to ruling Gold prices.
D. The redemption price on maturity is guaranteed not to be below the issue price of the respective SGB.

10) You make a strategy to provide for the vacation expenses of Roger's family. Based on his goal what parameters shall you consider?
[4 marks]

A. The goal being five years from now, Roger is advised to invest in bond funds a certain sum of money every year. Any windfall of money including bonuses can be directed to this fund to make it self-sustaining.
B. You advise Roger to invest the present value of money required in the fifth year in 5-year fixed deposit of bank to gain advantage of taxes, and repeat the exercise every year until five years from retirement.
C. The vacation goal is aspirational; has high cost escalation. Roger can consider moderate to high risk instruments to invest a certain sum of money. He is advised to postpone withdrawal from fund if the corpus after 5 years is not sufficient. In future, higher amount can be directed to this fund.
D. You advise Roger to invest a lump sum equal to three initial years' vacation expenses in a liquid fund for tax efficiency, with a certain sum every year in tune with escalated cost of vacation in the same fund to retain the tax efficiency of withdrawals towards vacation.

11) Towards the goal of marriage of their children, you suggest Roger to make maximum permissible subscriptions to his PPF account in the beginning of every financial year and extend the account twice beyond initial maturity for terms of 5 years each with similar subscriptions. The third term of 5 years is continued without further contribution. Roger shall withdraw about 50% of accumulation for the marriage expenses of Mark and the remaining for the marriage expenses of Stephanie. What are the expected individual withdrawals and shortfalls in meeting the marriage expenses?
[5 marks]

A. Mark Rs. 51.5 lakh, 16% shortfall; Stephanie Rs. 64.8 lakh, 18% shortfall
B. Mark Rs. 50.5 lakh, 17% shortfall; Stephanie Rs. 63.2 lakh, 20% shortfall
C. Mark Rs. 52.3 lakh, 14% shortfall; Stephanie Rs. 65.9 lakh, 17% shortfall
D. Mark Rs. 45 lakh, 26% shortfall; Stephanie Rs. 56.7 lakh, 28% shortfall

12) For the higher education expenses for Mark and Stephanie, Roger starts accumulating funds with monthly investment of Rs. 20,000 in an aggressive asset allocation yielding 12% p.a. After 7 years the allocation is moderated to yield 9% p.a. and while the investment is raised to Rs. 30,000 p.m. After 12 years, the funds accumulated are shifted to suitable debt instruments from which distribution towards higher education is made as proposed. What excess/shortfall of funds you expect after 12 years by following this investment strategy?
[5 marks]

A. Shortfall Rs. 44.72 lakh
B. Shortfall Rs. 20.26 lakh
C. Shortfall Rs. 19.12 lakh
D. Excess Rs. 27.59 lakh

13) Roger asks for your guidance regarding different modes of tax efficient estate planning which can help in creating and distributing family assets. You opine that a Trust would be a more appropriate option because______.
[2 marks]

A. there is no taxation applicable on trust income
B. they have fixed rate of tax which is far lower than tax rates for individual assessees
C. future capital gains tax on assets transferred to trust could be lower
D. all future earnings from assets transferred to trust are exempt

14) Roger's equity portfolio has 1,000 shares of M/s. ABC Ltd. which he accumulated very close to the average cost of Rs. 1,205, transactions conducted between April 2015 and July 2017. The grandfathering price of M/s. ABC Ltd. as on 31st January, 2018 on the National Stock Exchange was Rs. 1,380. Roger wishes to sell entire holding of the company at a target price of Rs. 1,650 before April 15, 2019. What would be approximate tax payable on this transaction in the assessment year 2020-21?
[3 marks]

A. Data insufficient; unless exact dates of purchase and respective cost prices are available, tax cannot be computed.
B. Long term capital gains of Rs. 2.70 lakh subject to the category exemption of Rs. 1 lakh, taxable at 10.4%.
C. Nil taxation.
D. Long term capital gains of Rs. 4.45 lakh subject to the category exemption of R. 1 lakh, taxable at 10.4%.

15) Angela wants to invest the maturity proceeds of all her fixed deposit investments in a series of Sovereign Gold Bonds (SGB). You advise her to invest in a series issued in 2016 which is being quoted at 2,900 since long against its face value of Rs. 3,150 having coupon of 2.75% p.a., with interest payment dates being 30^{th} September and 31^{st} March. If she could purchase the said SGBs at the given quoted price, what tax liability would she have for AY2020-21 solely on account of maturity of her fixed deposits and its subsequent investment in SGBs?
[5 marks]

A. Rs. 9,375 is added to Angela's income under "Income from Other Sources" and is taxable at tax slab applicable to her.
B. Rs. 33,803 is added under "Income from Other Sources" to Roger's or Angela's income, whichever is higher, and is taxable at tax slab applicable.
C. Rs. 61,928 is added to Angela's income under "Income from Other Sources" and is taxable at tax slab applicable to her.
D. Rs. 21,589 is added to Angela's income under "Income from Other Sources" and is taxable at tax slab applicable to her.