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Applied Financial Planning Certification Exam 1 (AFP)

CSI AFP-Exam-1

Version Demo

Total Demo Questions: 13

Total Premium Questions: 133

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Topic Break Down

Topic	No. of Questions
Topic 1, Financial Planning Process	42
Topic 2, Financial Management	25
Topic 3, Tax Planning	42
Topic 4, Investment Planning	24
Total	133

QUESTION NO: 1

Alexis has an index-linked GIC with an adjusted cost base of $20,500. The GIC was issued one year ago, has four years remaining to maturity and provides her with 60% participation in the gains of the S & P/TSX 60 Index, based on the level of the Index at maturity or at redemption prior to maturity. The GIC has a 2% fee if redeemed in the first two years. Alexis notices that the S & P/TSX 60 Index is up 25% and she would like to redeem her GIC. She asked her financial planner if she redeems her GIC, how much she would receive upon redemption. What will her financial planner tell her?

A. She will receive $20,500.

B. She will receive $25,625.

C. She will receive $23,104.

D. She will receive $23,575.

ANSWER: C

Explanation:

She will receive $23,104. An index-linked GIC credits a return determined by the index performance multiplied by the stated participation rate; Alexis does not receive the entire 25% increase in the S&P/TSX 60 Index. The applicable credited gain is 25% × 60%, or 15%. Applying that gain to the $20,500 adjusted cost base produces a pre-redemption value of $23,575 ($20,500 × 1.15). Since redemption occurs one year after issue, it is within the first two years and the stated 2% early-redemption fee applies. The fee is $471.50 ($23,575 × 2%), leaving redemption proceeds of $23,103.50. Rounded to the nearest dollar, Alexis receives $23,104. This illustrates the two central features of the product: the participation rate limits the portion of index growth credited to the investor, and an early-redemption charge reduces the amount actually paid when funds are withdrawn before the relevant fee period ends. GIC terms, including return calculations and early-redemption conditions where permitted, must be reviewed in the issuer's disclosure. See the Financial Consumer Agency of Canada's overview of guaranteed investment certificates and the Canadian Securities Institute's learning resources.

QUESTION NO: 2

Keitaro wants his spouse to receive income from his assets for life after his death, but wants the remaining capital to pass to his children from a prior marriage after the spouse dies. Which strategy best fits this objective?

A. Testamentary spousal trust naming the children as capital beneficiaries.

B. Outright gift of all assets to the spouse.

C. Adding the children as joint owners on all assets immediately.

D. Naming the estate as beneficiary of every account without trust provisions.

ANSWER: A

Explanation:

Testamentary spousal trust naming the children as capital beneficiaries. best meets Keitaro's two-part estate-planning objective. A testamentary spousal trust is created under his will and receives assets at death. Its terms can require that trust income be paid to, or made available for, the surviving spouse throughout the spouse's lifetime. At the same time, the trust preserves the underlying capital rather than transferring it outright to the spouse. On the spouse's death, the trustee distributes the remaining trust capital to the named children from Keitaro's prior marriage. This structure is particularly useful in blended-family planning because it separates the lifetime income interest from the eventual capital entitlement and makes Keitaro's intended succession enforceable through the trust terms. Depending on the assets and the precise drafting, transfers to a qualifying spouse trust may generally receive rollover treatment for Canadian income-tax purposes, postponing recognition of accrued gains until a later disposition or the spouse's death. Qualification requires that the spouse be entitled to receive all income of the trust arising before death and that no person other than the spouse may receive or otherwise obtain the use of trust income or capital during the spouse's lifetime. The will should be drafted by an estates lawyer to define trustee authority, permissible capital encroachments, and the children's remainder interest. See the CRA's guidance on transfers of capital property and the Income Tax Act, section 70.

QUESTION NO: 3

Gerard intends to make a $25,000 charitable gift this year. He owns publicly traded shares worth $25,000 that have an adjusted cost base of $9,000. He does not need the shares for his investment plan. Which strategy is generally most tax-efficient?

A. Sell the shares, report the capital gain, and donate the after-tax proceeds.

B. Donate the shares directly to the registered charity.

C. Transfer the shares to a TFSA before making the donation.

D. Borrow against the shares and donate the borrowed funds.

ANSWER: B

Explanation:

Gerard should donate the publicly traded shares directly to the registered charity. A direct gift of qualifying publicly listed securities generally provides a charitable donation receipt based on the shares' fair market value and results in a zero capital gains inclusion for the accrued gain. This allows Gerard to make the intended gift without realizing taxable capital gain on the $16,000 appreciation.

If Gerard sells the shares first and then donates the cash, he would generally realize a capital gain on the sale, even though he would receive a donation tax credit for the cash gift. Donating the shares directly is therefore often preferable when the charity can accept the securities and the shares are appropriate to dispose of.

QUESTION NO: 4

Mina has $20,000 in a savings account earning 3% before tax. She also has a $9,000 credit card balance at 22%, a $7,000 unsecured line of credit at 10%, and a $14,000 car loan at 4%. Her marginal tax rate is 35%. Which liability should she target first?

A. Car loan.

B. Credit card balance.

C. Unsecured line of credit.

D. No debt; keep all funds in savings.

ANSWER: B

Explanation:

Credit card balance. is the appropriate first target because eliminating debt produces a guaranteed return equal to the interest rate no longer paid. Mina’s savings account earns 3% before tax, but interest income in a non-registered savings account is generally fully taxable at her marginal rate. At a 35% marginal tax rate, the 3% savings return is only 1.95% after tax (3% × 65%). This is substantially lower than the 22% annual cost of the credit card balance.

Using available savings to reduce the credit card balance therefore replaces a low, taxable return with a certain and much larger interest saving. The $9,000 balance can be repaid in full while still leaving funds available. This approach follows the standard debt-repayment principle of prioritizing the highest-cost borrowing first, particularly revolving consumer debt, where interest is typically not tax deductible for personal-use borrowing. After addressing the credit card balance, Mina can reassess her emergency-fund needs and direct any additional surplus toward the next highest-rate liability.

For consumer guidance on prioritizing and paying down debt, see the Financial Consumer Agency of Canada’s debt repayment guidance. The CRA confirms that interest income must generally be reported as income: CRA: Interest and other investment income.

QUESTION NO: 5

A retiree holds most of her investments in interest-bearing GICs inside a non-registered account while her TFSA is invested in cash. She has unused TFSA room and wants to improve after-tax efficiency without increasing total portfolio risk materially. What should the planner consider?

A. Holding more interest-bearing assets inside the TFSA.

B. Moving all assets into speculative equities.

C. Withdrawing RRIF minimums and gifting them immediately.

D. Borrowing to invest in the non-registered account.

ANSWER: A

Explanation:

Holding more interest-bearing assets inside the TFSA is appropriate because it improves asset location while preserving the retiree's conservative investment approach. Interest earned on GICs in a non-registered account is generally fully included in taxable income in the year it is earned or credited. By contrast, investment income and growth earned within a properly structured TFSA are not taxable, and qualified TFSA withdrawals are generally tax-free. Using available TFSA contribution room for GICs or similar low-risk interest-bearing holdings can therefore reduce annual taxable interest without requiring a change to the underlying asset class, term structure, or capital-preservation objective.

The planner should first confirm the retiree's remaining contribution room and ensure that contributions do not exceed it, as excess contributions can result in a monthly tax. Practical implementation may involve allowing existing GICs to mature before contributing cash to the TFSA, or selecting suitable TFSA GIC terms that match anticipated liquidity needs. The planner should also retain enough accessible cash for planned spending and emergencies. This recommendation applies the core tax-planning principle that fully taxable interest income is often especially valuable to shelter in a registered account. See the Canada Revenue Agency's Tax-Free Savings Account information and its guidance on reporting investment income.

QUESTION NO: 6

A client asks when his RRSP must generally be converted to a retirement income vehicle. What should the planner explain?

A. By the end of the year he turns 71.

B. On the day he turns 65.

C. Only when he stops working.

D. Only after all RRSP assets are withdrawn in cash.

ANSWER: A

Explanation:

By the end of the year he turns 71. is correct because an RRSP has a legislated maturity deadline tied to the annuitant's age, rather than retirement status or the date at which government retirement benefits might begin. The RRSP must mature no later than December 31 of the calendar year in which its annuitant reaches age 71. Before that deadline, the client can generally choose an eligible maturity option, including transferring the RRSP assets to a registered retirement income fund (RRIF), using the funds to purchase an annuity, or withdrawing the funds as taxable cash. The selection should be integrated with the client's expected cash-flow needs, tax position, investment preferences, spouse or common-law partner considerations, and estate objectives. If the client transfers assets to a RRIF, there is ordinarily no immediate tax on the transfer itself, provided it is completed properly; however, annual minimum RRIF withdrawals are required beginning in the following calendar year. The Canada Revenue Agency confirms both the age-71 maturity rule and the available maturity choices in its guidance on matured RRSPs. Further details on minimum annual payments appear in the CRA's RRIF guidance.

QUESTION NO: 7

Jaycee has created an investment portfolio for his client, Adam, which is designed to achieve his long-term objectives and is consistent with his risk tolerance and constraints. It also has to be reassessed periodically to ensure that the long-term benchmark mix continues to reflect Adam's circumstances. Which asset allocation strategy is Jaycee utilizing?

A. Active.

B. Integrated.

C. Tactical.

D. Strategic.

ANSWER: D

Explanation:

Strategic. is correct because the portfolio is established from Adam's long-term financial objectives, risk tolerance, and personal constraints, then reviewed periodically to ensure its policy—or benchmark—asset mix remains suitable as his circumstances evolve. This is the core purpose of strategic asset allocation: setting a durable, diversified target mix among asset classes that is intended to deliver an appropriate long-term balance of expected return and risk. The target mix is based on the client's investment policy and planning needs, rather than on short-term market expectations.

Periodic reassessment is an important part of the strategic process. Changes in income, time horizon, liquidity needs, family circumstances, tax position, or risk capacity can justify revisiting the long-term policy allocation. In addition, rebalancing may be used to bring actual holdings back toward that target after market movements cause weights to drift. The CFA Institute describes strategic asset allocation as the long-term normal portfolio mix selected to meet investment objectives and constraints; see its asset-allocation overview. A client-specific investment policy and its role in guiding portfolio decisions are also outlined by the CFP Board's Standards of Conduct.

QUESTION NO: 8

Nadia is a self-employed architect whose income depends on her ability to practise architecture. She could likely teach part-time if an illness prevented her from performing architectural work. Which disability-insurance feature is most important if Nadia wants income protection specifically for an inability to continue in her own profession?

A. An any-occupation definition of disability.

B. An own-occupation definition of disability.

C. A shorter mortgage amortization period.

D. A guaranteed investment certificate with a longer maturity.

ANSWER: B

Explanation:

An own-occupation definition of disability is most appropriate because it focuses on Nadia's inability to perform the duties of her regular occupation as an architect. Depending on the policy wording, she may remain eligible for benefits even if she is capable of earning income in a different occupation, such as teaching.

An any-occupation definition is less protective in this situation because benefits may cease or not be payable if Nadia can perform work for which she is reasonably suited by education, training, or experience. The planner should also review the benefit amount, elimination period, benefit period, residual-disability provisions, exclusions, and existing emergency savings before a policy is selected.

QUESTION NO: 9

A client says, “I want to retire comfortably as soon as possible.” Which response best reflects the financial planning process?

A. Recommend a higher-return portfolio immediately.

B. Ask the client to select a retirement mutual fund.

C. Translate the statement into measurable goals, assumptions, and time frames.

D. Ignore the statement until the client reaches age 60.

ANSWER: C

Explanation:

Translate the statement into measurable goals, assumptions, and time frames. is correct because an effective financial planning engagement starts by clarifying the client’s broad objective and converting it into information that can be analyzed. “Comfortably” and “as soon as possible” are meaningful personal preferences, but they do not yet provide enough detail to calculate whether retirement is feasible or to develop recommendations. The planner should establish a target retirement date or range, estimate desired retirement spending, identify expected income sources, document current assets and liabilities, determine savings capacity, and identify assumptions such as inflation, investment return, tax treatment, and longevity. The client’s priorities and willingness to accept trade-offs are also essential, because an earlier retirement date may require increased saving, lower spending, altered investment expectations, or continued part-time income.

Once these inputs are documented, the planner can assess the gap between projected resources and retirement needs, evaluate strategies, and present recommendations that are aligned with the client’s circumstances and objectives. This approach reflects the core financial planning sequence of defining the engagement, gathering information, analyzing the client’s situation, developing recommendations, implementing the agreed strategy, and monitoring it over time. Financial Planning Canada describes financial planning as a process for helping clients identify and work toward their life goals: What Is Financial Planning?. Its professional standards also emphasize collecting and analyzing relevant client information before recommendations are made: Standards of Professional Responsibility.

QUESTION NO: 10

Todd, a financial planner, is meeting with Vanessa, a new client, to review her investment goals and objectives. During the meeting, Vanessa states that she believes the markets are very efficient and should reflect all available information in the price of securities. She is looking for an investment option that will reflect a similar level of risk and return characteristics as the Canadian market. What investment option should Todd recommend with Vanessa that would reflect her opinions?

A. Canadian neutral balanced fund.

B. Canadian value mutual fund.

C. Canadian exchange-traded fund.

D. Canadian hedge fund.

ANSWER: C

Explanation:

Canadian exchange-traded fund is the appropriate choice, provided the ETF is designed to track a broad Canadian equity-market index. Vanessa’s view that security prices incorporate available information is consistent with an efficient-market perspective. In practical portfolio construction, that perspective supports obtaining diversified market exposure at a low cost rather than attempting to identify mispriced securities through active security selection or market timing. A broad Canadian equity ETF generally holds securities representing the Canadian market or a major Canadian market index, so its performance characteristics are intended to closely follow that market, subject to fees, tracking difference, and the particular index methodology. ETFs also offer diversification through a single traded fund and disclose their investment objective and holdings information, allowing the planner to confirm that the selected product provides the intended Canadian-market exposure. The Ontario Securities Commission explains that ETFs are investment funds that can provide diversified exposure and trade on an exchange; see its ETF overview. Todd should still complete know-your-client and suitability analysis, including Vanessa’s time horizon, risk capacity, liquidity requirements, and tax circumstances, before selecting a specific

ETF. The relevant efficient-market belief and desire for Canadian-market-like risk and return make a broad Canadian ETF the best fit among the available choices.

QUESTION NO: 11

Richard reviewed his divorce settlement from his partner Alex with his advisor Maria. He is deciding between providing a lump sum spousal support payment of $60,000 or making monthly payments. If Richard's income is $200,000 and Alex's income is $40,000, what should Maria advise Richard about the tax implications for both Richard and Alex in regard to the lump sum payment?

A. Richard will deduct the payment and pay taxes on the remaining $140,000 of income, and Alex will pay taxes on the lump-sum payment of $60,000.

B. Richard will deduct the payment and pay taxes on the remaining $140,000 of income and Alex will pay taxes only on his earned income of $40,000.

C. Richard will deduct half of the lump-sum support payment and pay taxes on the remaining $170,000 of income and Alex will claim the other half of the lump-sum support payment in addition to his earned Income of $40,000.

D. Richard will pay taxes on the entirety of the $200,000 and Alex will pay taxes only on his earned income of $40,000.

ANSWER: D

Explanation:

Richard will pay taxes on the entirety of the $200,000 and Alex will pay taxes only on his earned income of $40,000. For Canadian income-tax purposes, a genuine lump-sum spousal support payment is generally treated differently from qualifying periodic support payments. The payer cannot deduct the lump sum from income, so Richard's taxable income is not reduced by the $60,000 payment. Accordingly, his income for purposes of this scenario remains $200,000. Correspondingly, Alex does not include the lump-sum amount in taxable income. Alex therefore pays tax on the stated $40,000 of earned income, assuming there are no other sources of taxable income or deductions relevant to the calculation.

The Canada Revenue Agency distinguishes a lump-sum payment from periodic support payments, which may be deductible to the payer and taxable to the recipient when the payments and written agreement or court order meet the required conditions. The characterization of the payment matters: a one-time amount paid to settle support obligations is generally a non-deductible, non-taxable capital payment. Maria should ensure the settlement documentation clearly identifies the payment's nature and obtain legal and tax advice if the arrangement includes mixed or installment-based payments. See the CRA's guidance on support payments made and support payments received.

QUESTION NO: 12

Miles tells Rasheed, his financial planner, that he would like to assign the growth assets in his portfolio to his children. Rasheed recommends Miles freeze his estate. What is the primary risk associated with an estate freeze?

A. Once the children hold the common shares, they can vote to withhold payment of the preferred dividend.

B. The preferred shares taken back by the taxpayer may provide inadequate Income because of inflation.

C. Once the estate freeze is in place, no future growth of the assets can occur.

D. It is easy to unwind an estate freeze, but the amount of income paid to the taxpayer will be inconsistent from year to year.

ANSWER: B

Explanation:

The preferred shares taken back by the taxpayer may provide inadequate Income because of inflation. In an estate freeze, Miles generally exchanges growth-oriented common shares or other appreciating property for preferred shares with a value fixed at the time of the freeze. New common shares, often held directly or indirectly by the children, receive the future appreciation. This can effectively cap the value included in Miles's estate while shifting subsequent growth to the next generation.

The central planning risk is that Miles has surrendered the future growth that might otherwise have supported his own changing financial needs. If the preferred shares have a fixed redemption value and a fixed or limited dividend entitlement, inflation can reduce the real purchasing power of both the retained capital and the income it produces. Over a long retirement, expenses such as housing, health care, and living costs may rise materially, leaving the frozen interest insufficient. Accordingly, an estate freeze should be supported by detailed cash-flow projections, a review of other available assets and income, and appropriate flexibility in the share design. The Bank of Canada explains how inflation diminishes purchasing power over time at its inflation overview. CRA information on corporate-share transactions and reorganizations is available through its corporations tax guidance.

QUESTION NO: 13

The Andersons, a young couple, meet with their financial planner to review estate-planning opportunities. They recently had a third child and are looking for the most cost-effective strategy to put in place during their working years to increase their estate value and reduce the tax burden at death for the benefit of their children. What should the financial planner recommend?

A. Update beneficiary designation to the estate on their registered plans.

B. They should each have permanent life insurance plans in place.

C. Set up a joint savings account with automatic monthly contributions.

D. Put in place a term survivorship life insurance policy.

ANSWER: D

Explanation:

Put in place a term survivorship life insurance policy. A survivorship policy insures both spouses and pays its death benefit when the second insured dies. This timing aligns with the estate-planning need because assets commonly pass to the surviving spouse on the first death, often using the spousal rollover, while the larger estate-tax and settlement need generally arises on the survivor's death. The insurance proceeds provide cash when the children ultimately inherit, helping fund final income-tax liabilities, probate and estate-administration costs, and other debts without requiring investments or family assets to be sold at an unfavourable time. In this context, "reduce the tax burden" means providing tax-efficient liquidity to meet tax payable by the estate; it does not mean that the policy itself eliminates the deceased's tax liability. Term survivorship coverage is generally a cost-effective way for a young couple to obtain substantial coverage during their working years because one policy covers two lives and its benefit is deferred until the second death. Life-insurance death benefits are generally received tax-free by the beneficiary, which preserves more value for the children. See the Canada Revenue Agency's discussion of life-insurance policy taxation at CRA: Life insurance policy income and the CSI AFP program overview at CSI Applied Financial Planning.