Answers to knowledge and understanding questions

Topic 1

✓ CHECK YOUR UNDERSTANDING

1) The answer is unit of account – this is the function that allows the price of one item to be compared with the price of another.

2) Answer d) is correct. Answer b) is incorrect because the Bank of England only lends to the banks in its capacity as lender of last resort, eg when there is a run on its deposits. It does not lend to finance normal business activity.

? TEST YOUR KNOWLEDGE

1)
- Geographic location – lenders and borrowers are not necessarily able to find each other and deal directly with each other.
- Aggregation – an individual lender might not have enough funds to fulfil a borrower's requirements.
- Maturity transformation – the borrower might need funds for longer than the lender is prepared to lend.
- Risk transformation – the lender might be reluctant to lend all their funds to one borrower, in case that borrower is unable to repay.

2) A mutual organisation is owned by its members – in the case of a building society, these are savers and borrowers; for a life assurance company they are the policyholders. A proprietary organisation is owned by its shareholders and is a limited company.

3) b) Disintermediation.

4) b) To act as financial ombudsman in resolving customer complaints about banks.

5) a) The Bank of England. The Royal Mint issues coins.

6) False. Credit unions can pay interest on savings as long as they have the necessary systems and controls in place and have at least £50,000 or 5 per cent of total assets (whichever is greater) in reserve.

7) b) Retail banking. Wholesale banking involves providing funds to other financial institutions or very large corporate clients.

8) b) The Bank of England is the administrator for Sonia.

Topic 2

✓ CHECK YOUR UNDERSTANDING

1) c) Each member state is bound by the regulation in its entirety regardless of existing legislation. Answers a), b) and d) relate to directives.

2) c) The UK is not legally required to adopt or ignore a new or reformed piece of EU regulation but has the freedom to consider whether it adopts the regulation or develops its own approach.

? TEST YOUR KNOWLEDGE

1) An objective that relates to the economy as a whole, rather than to a specific sector or individual company.

2) Price stability, low unemployment, a balance of payments equilibrium and satisfactory economic growth.

3) Measures taken to expand the economy (eg reducing interest rates and taxation) increase the demand for goods and services, which is likely to result in a rise in inflation.

4) False. They aim to keep prices stable, but seeking to reduce inflation to zero is likely to increase unemployment.

5) The UK government's inflation target is 2 per cent with a maximum divergence either side of 1 per cent. It is measured by the Consumer Prices Index.

6) c) Prices are rising but more slowly than previously.

7) Paul and Amanda must have a variable-rate mortgage, so the amount they pay each month is likely to rise and fall broadly in line with changes in the Bank rate.

8) b) Increasing public spending. To achieve a budget surplus a government must cut public spending, raise taxes, or both.

9) A regulation. Member states have flexibility in the way they introduce directives.

10) The Bank of England for the UK and the European Systemic Risk Board (ESRB) for the EU.

Topic 3

✓ CHECK YOUR UNDERSTANDING

1) b) Antoine. Answer c) is not correct because three months of Max's contract are in one tax year and the rest in the following year. He will not spend 183 days in either tax year in the UK.
2) c) As Helena is not UK domiciled she will not pay IHT on overseas assets.
3) c) Any earned income that exceeds their personal allowance. The settlement from their parents (answer d) will be taxed as the parents' income, the educational grant (answer b) is tax-free, and they would not pay tax on all of their earned income (answer a), only that which exceeds their personal allowance.

? TEST YOUR KNOWLEDGE

1) False. They are liable for income tax on income generated anywhere in the world, but the UK has reciprocal tax treaties (double taxation agreements) with many countries to ensure that people are not taxed twice on the same income.
2) True, as long as their actions indicate that their change of residence is permanent and they have severed links with their original country of domicile.
3) c) Lottery prizes.
4) Non-savings income, then savings income, then dividend income.
5) True. Blind person's allowance can be transferred to a spouse/civil partner if the original recipient does not pay tax or use all their allowance.
6) Class 3.

The following answers use the tax rates, bands and allowances for 2024/25. You can find the current tax rates, bands and allowances at www.gov.uk/income-tax-rates.

7) On earnings:

   £22,000 – £12,570 (personal allowance) = £9,430

   £9,430 × 20% = £1,886

   There is no tax to pay on savings income because, as a basic-rate taxpayer, Mike has a personal savings allowance of £1,000.

8) Total income is £39,570

   Salary falls within personal allowance of £12,570 so no tax is paid on this.

   £500 of dividend income is taxable at 0 per cent.

The remaining £26,500 all falls within the basic-rate tax band and is taxed at 8.75 per cent.

Total tax is £2,318.75 (£26,500 × 8.75%).

9) Income tax:

£20,000 Gross profit

(£2,500) Allowable expenses

(£12,570) Personal allowance

(£3,070) Blind person's allowance

Taxable income: £1,860

Tax: £1,860 × 20% = **£372**

Class 4 NICs:

£20,000 – £2,500 = £17,500 taxable profit

£17,500 – £12,570 × 8% = **£394.40**

10) Tax on earned income:

£75,000 Income

(£12,570) Personal allowance

£62,430 taxable earned income

£37,700 × 20% = £7,540

£62,430 – £37,700 = £24,730 × 40% = £9,892

Savings interest:

£500 (PSA) × 0% = £0

£150 × 40% = £60

Dividend income:

£500 (DA) × 0% = £0

£6,500 × 33.75% = £2,193.75

Total tax is (£7,540 + £9,892 + £60 + £2,193.75) = £19,685.75

Topic 4

✓ CHECK YOUR UNDERSTANDING

b) £6,000. The gift uses the available nil-rate band of £325,000, leaving an excess of £25,000 above the nil-rate band. Joan died between four and five years after the gift, so the £25,000 excess is liable for IHT at 60 per cent of the full rate (ie 40% × 60%).

TEST YOUR KNOWLEDGE

1) False. Gains made on 'chattels' (movable objects such as jewellery, antiques and paintings) are exempt from CGT if their value is £6,000 or less.
2) The CGT annual exempt amount cannot be carried forward at all.
3) False. Assets must be replaced within three years after the date of disposal.
4) b) Inheritance tax would be payable on the total value of the estate above the available nil-rate band.
5) c) Immediately, at a reduced rate of 20 per cent.
6) Stamp duty reserve tax.
7) Gain: £25,400 – £11,300 = £14,100

   Taxable gain: £14,100 – £3,000 = £11,100

   Capital gains tax payable: £11,100 × 10% = £1,110
8)

Gain on flat	£47,600
Less cost of renovations	(£14,000)
Less cost of disposal (commission)	(£3,500)
Less carried-forward loss	(£4,900)
Less annual exempt amount	(£3,000)

   Taxable gain = £22,200 × 18% = £3,996 capital gains tax
9) c) In this instance, we do not have enough information to decide if the gain is eligible for private residence relief. For example, the gain may not be eligible for private residence relief if:
   - Luis has spent money renovating the house and is now selling it to release a profit;
   - Luis sold some or all of the grounds that originally came with the house after he sold the house;
   - any part of the house has been used exclusively for business purposes while Luis has owned it.
10) Nine months after the end of the relevant accounting period.

Topic 5

CHECK YOUR UNDERSTANDING

1) c) Tax is charged through self-assessment for any income above the threshold, offsetting the amount of Child Benefit received.

2) The correct answer is b). Income-based ESA is means-tested; new style ESA is based on National Insurance contribution record so is not means-tested.

3) The correct answer is c). With the basic state pension it is possible to claim a Category B pension based on the NICs of a spouse or civil partner, but this is not possible with the new state pension.

? TEST YOUR KNOWLEDGE

1) Financial advisers need to understand what state benefits a person is entitled to or already claiming in order to give appropriate financial advice. For instance, when working out the level of life assurance cover that a family needs, the income that would be available from state benefits if a family wage earner were to die has to be taken into account.

2) False. Universal Credit is replacing Child Tax Credit, not Child Benefit.

3) b) New style Jobseeker's Allowance (JSA) is paid irrespective of savings or partner's earnings.

4) c) New style Jobseeker's Allowance.

5) d) Maternity Allowance. She is not entitled to Statutory Maternity Pay because she will not have been with her employer for 26 weeks by her qualifying week.

6) Eleven weeks before the baby is due.

7) c) Employment and Support Allowance. He cannot claim Statutory Sick Pay because he is self-employed.

8) b) All three: they will be able to claim for Ethan up until his twentieth birthday while he remains in approved education.

9) d) Yes. Although 35 years' NICs are needed to be eligible for the full new state pension, Ian would have been credited with NICs for the three years that he was a carer.

10) False. The state second pension was available only to those who reached state pension age before 6 April 2016. Lydia's National Insurance contributions will build entitlement to the new state pension, which has no additional earnings-related element, therefore it is not possible for Lydia to choose to contract out.

Topic 6

✓ CHECK YOUR UNDERSTANDING

1) Refer to Topic 3.

2) Refer to Topic 3.

3) Corporate bonds pay higher rates of interest than similar gilts because of the relationship between risk and reward – the riskier the investment is considered to be, the greater the reward the investor expects.

? TEST YOUR KNOWLEDGE

1) True. Deposit accounts allow instant access to funds and they are low risk because savings are protected by the Financial Services Compensation Scheme up to a limit of £85,000.
2) b) 16.
3) False, interest is paid gross but is taxable.
4) If the investment is held in a currency other than sterling, its value might be affected by adverse exchange rates if it has to be converted to sterling. Accounts held offshore might not be covered by investor protection schemes to the same extent as onshore UK investments.
5) The coupon is the interest rate payable on the par value of a gilt.
6) a) The gilts will have a redemption date within the next seven years.
7) Running yield = coupon ÷ price paid: £3 (coupon) ÷ £107 (price paid) = 2.8%.
8) d) Corporate bonds are considered to be higher-risk investments.
9) b) A debenture is usually secured on the assets of the company.
10) False. A Eurobond is a bond denominated in a different currency from the one of the country where the bond has been issued. They can be issued by multinational organisations, not just governments.
11) c) A basic bank account.

Topic 7

✓ CHECK YOUR UNDERSTANDING

Refer to section 6.7.3.

? TEST YOUR KNOWLEDGE

1) False. Direct investment in shares is regarded as high risk because if the company fails, the entire investment is at risk. It is difficult for most investors to spread the risk effectively between a large number of companies and sectors.
2) Factors include company profitability, the strength of the global and UK economy, the strength of the market sector and the supply of and demand for shares.

3) They will not be eligible for a dividend payment in the first dividend distribution following their acquisition of the shares. The previous owner of the shares will receive this dividend payment.

4) False. A low P/E ratio indicates that the share is not in high demand and it is likely to be less expensive than other shares.

5) a) 4 – the profit is four times the dividend paid out.

6) A rights issue involves offering existing shareholders the opportunity to buy additional shares in order to raise additional capital. A scrip issue involves issuing additional shares to shareholders free of charge, the effect being to increase the number of shares in issue and reduce the share price proportionately; no additional funds are raised.

7)
   - Suitable tenants may be hard to find.
   - Properties must be in desirable locations (eg good transport links, access to local amenities, etc).
   - In times of recession, letting properties may be difficult and property prices may fall.
   - Property is less easy to realise than most other forms of investment.
   - Investment costs tend to be high and can include management fees, legal charges and stamp duty.
   - Government measures to discourage BTL have made the tax position less advantageous.

8) They are allowed a furniture replacement relief, which allows the actual cost of replacing furnishings to be offset against profits.

9) They do not pay interest; instead they are issued at a discount to their par value.

10) False. Commercial paper is generally issued for between 5 and 45 days, with 30–35 days being typical. Certificates of deposit are generally issued for between three and six months.

Topic 8

✓ CHECK YOUR UNDERSTANDING

1) There are several answers to this question:
   - A unit trust is constituted as a trust; an investment trust is a company.
   - A unit trust is subject to FCA rules on diversification; an investment trust is not.

- A unit trust issues units to customers and these represent the customers' holdings of the assets in the pooled fund. An investment trust issues shares in a fund.
- Units must be bought back by the fund manager so no secondary market is needed; shares in an investment trust must generally be sold via a stockbroker.
- An investment trust can borrow funds to take advantage of investment opportunities whereas a unit trust cannot.
- Unit trusts are open-ended (ie the unit trust manager can create more units to meet demand); an investment trust is closed-ended (ie the number of shares available is fixed).
- A unit trust can be established as an equity trust paying dividends or a fixed-interest trust paying interest. As an investment trust is a company, it only issues shares and pays income as dividends.

2)

Name	**Constituted as**	**Type of Investment**	**Open/ closed?**	**Long-term borrowing**	**Pricing**	**Initial charge**	**Annual charge**	**Control**
Unit trust	Trust	Units (bought from and sold to unit trust manager)	Open	No	Offer–bid price or single price	Bid–offer spread 3–5%	0.5–1.5%	Unit trust manager (subject to approval by trustees)
Investment trust	Company	Shares (bought and sold on the stock market)	Closed	Yes	Single price	Dealing fees	0.5–1.5%	Directors of the company
OEIC	Company authorised by FCA	Shares (bought from and sold to the corporate director)	Open	No	Single price	Initial charge 3–5%	0.5–1.5%	Corporate director (overseen by the depositary)

3) The correct answer is a). Answer b) is incorrect because there is no requirement to give notice to withdraw money from unit trusts, investments or OEICS. Answer c) is incorrect because, although collective investments offer reduced risk, they cannot be considered 'low risk'. They are 'medium

risk'. Answer d) is incorrect because investors who like to 'play the stock market' will usually buy and sell shares directly in their own name.

4) To be a qualifying policy for income tax purposes, premiums would have to be paid annually, half-yearly, quarterly or monthly over a period of at least ten years. Investment bonds involve making a single lump sum payment at the outset. As regular premiums are not made, an investment bond will be non-qualifying.

5) Refer to section 6.8 to check your summary.

? TEST YOUR KNOWLEDGE

1) b) The fund manager can create an unlimited amount of units according to demand.

2) False. They are owned and controlled by the trustees.

3) a) The unit holder.

4) c) A company that invests in the shares of other companies.

5) b) By purchasing shares of the investment trust company on the stock exchange.

6) An investment trust can borrow in order to take advantage of investment opportunities. Unit trusts and OEICs cannot do this.

7) c) There is one price, based on the value of the assets divided by the number of shares.

8) c) 20 per cent is deemed to have been taken within the investment with a potential further liability of 20 per cent for higher-rate taxpayers or 25 per cent for additional-rate taxpayers.

9) False. The investor may withdraw up to 5 per cent of the value of the original investment per annum without paying tax at the time of withdrawal but a tax liability may arise when the bond matures, on encashment of the bond or on death of the bondholder.

10) d) Noah could choose any of the above. The fact that he is a higher-rate taxpayer has no bearing on his decision – they are all taxed in the same way.

Topic 9

? TEST YOUR KNOWLEDGE

1) Yes, she can transfer money between different ISAs without contravening the maximum subscription limit.

2) An APS is allowed for someone who has died: the spouse/civil partner of the deceased is able to make an additional ISA contribution to the value of the ISA holdings of the deceased.

3) d) The right to make a cash APS lasts for three years from date of death, or 180 days from grant of administration, whichever is later. For stocks and shares, the time limit is simply 180 days after administration of the estate is complete.

4) a) The withdrawn amount counts towards Jane's ISA allowance because her provider does not offer a flexible investment facility, so she could invest a further £10,000 (£20,000 less the £10,000 initially invested).

5) Investments held within an ISA are free from income tax and capital gains tax.

6) d) Customers who owned Help-to-Buy ISAs before 30 November 2019, can save a maximum of £200 per month until 30 November 2029.

7) The Lifetime ISA aims to encourage people to save for the purchase of their first home and/or for their retirement.

8) False. The annual investment limits for Lifetime and Help-to-Buy ISAs count towards the overall annual ISA investment limit; they are not in addition to it.

9) False. Aaron's mother can transfer the Child Trust Fund into a Junior ISA. However, it is true that Aaron cannot hold both types of account concurrently.

10) A Venture Capital Trust would normally represent a higher risk to the investor than an investment trust because VCTs invest in newly established companies, which tend to be higher risk.

Topic 10

✓ CHECK YOUR UNDERSTANDING

1) Refer to Topic 5.

2) c) £47,250 (35 ÷ 60 × £81,000). Answer a) is not correct because £54,000 represents 40/60ths of his final salary, which is what Pat could have earned under the scheme had he worked for Telephonics for 40 years, not 35. Answer b) is not correct because £28,350 represents 35 per cent of his final salary, not 35/60ths. Answer d) is not correct because, although he can pay in to his pension a maximum of 100 per cent of his UK earnings, his pensionable service does not justify that level of pension.

? **TEST YOUR KNOWLEDGE**

1) d) Marta's scheme is a defined-contribution scheme, which could be either an occupational or a personal pension.

2) The lump sum allowance (LSA) is the maximum someone can take as a tax-free lump sum (unless they have protection).

   The lump sum and death benefit allowance (LSDBA) is the maximum that can be taken tax-free from a pension fund during one's lifetime and on death (ie it incorporates both tax-free lump sums someone takes while alive and lump sums paid following their death).

3) a) Basic, higher or additional rate depending upon the contributor's marginal rate of tax.

4) True.

5) c) Individuals must earn in excess of £10,000 per year to be auto-enrolled into a workplace pension scheme.

6) False. Pension providers are not obliged to offer this facility, although scheme members are free to move to a different provider if they wish to access their funds in this way.

7) b) There must not be any entry or exit charges.

8) c) 25 per cent of each UFPLS payment is tax-free.

9) Flexible drawdown arrangements were all converted to FAD on 6 April 2015.

10) An annuity provides a guaranteed income and there is no investment risk, so this would be a suitable option for Nicky.

Topic 11

✓ **CHECK YOUR UNDERSTANDING**

1) Refer to Topic 4.

2)

Type of policy	Fixed term?	Death benefit	Surrender value?	Tax treatment of benefits
Level term assurance	Yes	Level	No	Only pays on death – tax-free
Non-profit whole-of-life	No	Level	Yes	Must 'qualify' to be tax-free on surrender (always tax-free on death)
Decreasing term assurance	Yes	Decreasing	No	Only pays on death – tax-free
With-profit whole-of-life	No	Increasing	Yes	Must 'qualify' to be tax-free on surrender (always tax-free on death)
Unit-linked whole-of-life	No	Level until value of units exceeds death benefit	Yes	Must 'qualify' to be tax-free on surrender (always tax-free on death)
Increasing term assurance	Yes	Increasing	No	Only pays on death – tax-free
Convertible term assurance	Yes	Level	No	Only pays on death – tax-free
Low-cost whole-of-life	No	Level until added bonuses exceed death benefit	Yes	Must 'qualify' to be tax-free on surrender (always tax-free on death)
Renewable term assurance	Yes	Level	No	Only pays on death – tax-free
Flexible whole-of-life	No	Level until value of units exceeds death benefit	Yes	Must 'qualify' to be tax-free on surrender (always tax-free on death)
Family income benefit (FIB)	Yes	Decreasing	No	Only pays on death – tax-free
Universal whole-of-life	No	Level until added units exceed death benefit	Yes	Must 'qualify' to be tax-free on surrender (always tax-free on death)

? TEST YOUR KNOWLEDGE

1) True – term assurances have no investment element so proceeds are paid tax-free.

2) A convertible term assurance allows conversion of some or all of the plan to a different type of plan, at a later date, without the life assured having to provide evidence of their state of health.

3) a) A decreasing term assurance will pay benefits only if the insured dies within the policy term.

4) a) It is designed to provide protection rather than investment.

5) d) Transfers between husband and wife are free of IHT so any liability generally arises on second death. A plan being set up to provide the funds to pay IHT would be set up on a joint-life second-death basis.

6) d) 'Ring-fence' the proceeds outside the individual's estate.

7) a) A with-profits whole-of-life plan has a certain level of life cover at outset that can then be increased as bonuses are added during the term.

8) b) A low-cost whole-of-life plan combines with-profits with a decreasing term assurance.

9) c) Waiver of premium cover means that premiums are not payable (ie they are waived) in the event that the insured is unable to work due to accident or sickness.

10) The answer is d). The policy is not guaranteed to repay the mortgage in full at the end of the term.

Topic 12

✓ CHECK YOUR UNDERSTANDING

1) The correct answer is c) income protection insurance. Answer a) is incorrect because ASU cover is usually designed to cover only mortgage repayments and usually for a maximum of two years. Answer b) is incorrect because critical illness cover is restricted to specific conditions and is usually paid as a lump sum, which may not cover outgoings over a prolonged period of time. Answer d) is incorrect because PMI only covers costs directly associated with medical treatment.

2) The insurance value is divided by the actual value, then multiplied by the value of the claim:

   (£25,000 ÷ £50,000) × £2,000 = £1,000 (less the 'excess' under the policy).

? TEST YOUR KNOWLEDGE

1) c) Critical illness insurance. Private medical insurance covers costs associated with treatment while income protection insurance pays a

regular income rather than a lump sum. Long-term care insurance is designed to meet the costs of care in later life.

2) True. Marco's income will reduce very rapidly if he is unable to work. He should opt for a short deferred period rather than a long one.

3) b) Marco's policy will be arranged on an individual basis whereas Lydia's policy has been arranged as part of a group scheme.

4) d) Proportionate benefits would be paid until retirement, death or the end of the policy.

5) c) Private medical insurance, to cover the cost of treatment. Critical illness cover would not cover a hip replacement, while accident, sickness and unemployment insurance and income protection insurance provide cover for people who are working.

6) False. ASU benefits are not available to policyholders who resign voluntarily.

7) False. With an immediate needs annuity, the benefits are paid directly to the care provider but they are tax-free.

8) True. This is the principle of indemnity.

9) (£25,000 ÷ £32,000) × £6,000 = £4,687.50 (less any excess).

10) False. It is a legal requirement to have third-party motor insurance, which covers injury to other people and their property.

Topic 13

✓ CHECK YOUR UNDERSTANDING

1) Refer to Topic 11.

2)

Accident, sickness and unemployment insurance	Covers mortgage repayments, usually for a maximum of two years, if the beneficiary is prevented from earning an income
Income protection insurance	Provides a regular income for an indefinite period if the beneficiary is prevented by illness from working
Mortgage protection insurance	Provides a lump sum that can be used to repay the outstanding mortgage loan if the life assured dies
Mortgage indemnity guarantee	Covers the difference between the sale proceeds after a lender has taken possession of a property and the outstanding amount on the loan

? TEST YOUR KNOWLEDGE

1) The mortgagor is the borrower and the mortgagee is the lender.
2) b) Life cover is not built in, therefore a separate life assurance policy would be needed to ensure that the mortgage could be repaid if the borrower were to die before the end of the mortgage term.
3) An ISA has an annual investment limit which might make it difficult to fund a large mortgage and/or one arranged over a short term.
4) False – MCOB rules require the lender to confirm at the outset that a credible repayment strategy is in place and then reconfirm this at least once during the mortgage term.
5) Not yet, because Chris cannot access his pension funds until he is at least 55.
6) True.
7) a) If interest rates go up, the mortgage interest rate will not exceed a pre-arranged limit, in other words, the 'cap'.
8) Home reversion plans involve the homeowner selling a percentage or all of their property to the scheme provider. The customer(s) retains the right to live in the house, rent-free (or for a nominal or partial rent), until their death(s) or until they move into permanent residential care. At that point the property is sold and the provider receives a share of the proceeds equivalent to their share of ownership.
9) The personal loan – interest rates on unsecured borrowing are generally higher than on secured borrowing because it represents a greater risk to the lender.
10) A facility that allows you to borrow more before you have paid off the initial amount borrowed. Credit card borrowing is the most common example.

Topic 14

CHECK YOUR UNDERSTANDING

1)

Stage in life	Financial needs	Suitable products
School-age young people	Somewhere to save their pocket money and gifts from relatives.	Building society account, Junior ISA, CTF account, friendly society bond.
Teenagers and students	Somewhere to put their earnings from a part-time job. Borrowing to buy a car. Borrowing to fund education.	Bank current account, personal loan, student loan/ overdraft facility.
Post-education young people	Savings for a deposit for a house. Protection against loss of income due to illness. Loan to buy house.	Building society account, Lifetime ISA, IPI, mortgage.
Young families	Protection against loss of income due to illness. Life cover protection for dependants. Bigger house. Provision for retirement.	IPI, life assurance, bigger mortgage, pension (with employer or via personal provision).
Established families	Planning for retirement. Protection against loss of income (bigger mortgage and pension commitments). Life cover protection (for children still at home). Savings/ investments over long term for surplus income and/or inheritances.	Increased pension contributions, IPI, life assurance, savings and investment products (unit trust, bonds, etc), tax planning (IHT).
Mature households	Planning for retirement. Savings and investments over the medium term to be accessible at retirement.	Increased pension contributions, savings and investment products (unit trust, bonds, etc), tax planning (IHT).
Retirement	Creating as much income as possible from pension plans and savings policies. Realising capital from property. Possible long-term care needs.	Annuities, investments that provide income, equity release, long-term care annuities.

Problem	Potential consequences
Income protection	Employer will only pay income for a short period. Have to rely on savings and state benefits to pay mortgage and other borrowing, household expenses and living expenses, etc. May lose property if mortgage not paid. Credit record adversely affected if debts not paid.
Life assurance protection	Mortgage may be paid off but fall in income may impair ability to meet household and living expenses; alternatively, outgoings might increase to pay for childcare, housekeeping, etc.
Pension provision	Low standard of living in old age. May have to sell house and trade down or move into rented property. Income from state benefits inadequate for heating, food bills, etc.
Savings and investments	Lack of diversification. Too much on deposit. Interest received less than inflation. High admin charges through too many small shareholdings. Failure to take advantage of tax-free alternatives.
Tax planning	Not taking advantage of tax reliefs, allowances and tax-free investments. Estate subject to IHT. Gifts not documented.

? TEST YOUR KNOWLEDGE

1) b) Income protection, to ensure that they can continue to make their mortgage repayments if they are unable to earn an income. An emergency fund would be useful but, at least at the beginning, would be unlikely to be big enough to cover mortgage repayments except in the very short term.

2) It is important to establish the client's domicile for tax purposes and it may be a factor in underwriting decisions.

3) b) An emergency fund. Once people have enough cash to cover their day-to-day needs, the usual approach is to build up savings in an easy-access deposit account.

4) c) Attitude to risk.

5) c) Generating income. It is not a) pension accumulation as this would take place before retirement.

6) ‘Capacity for loss’ is “the client’s ability to absorb falls in the value of their investment”, ie the extent to which the client would be adversely affected should they make a loss on their investments. This must also be taken into account when assessing attitude to risk.

7) Eligibility for state benefit; existing arrangements; affordability; taxation; attitude to risk; capacity for loss; anticipated changes in circumstances; timescale; flexibility.

8) The purpose of the product and the needs that it will address; the benefits to the client; risks and limitations inherent in the product; any product options that might be appropriate; a summary of reasons for recommending that product.

9) Indefinitely.

10) Proactive servicing is instigated by the adviser, perhaps on the basis of information obtained during the factfind about a forthcoming promotion or inheritance. Reactive servicing is instigated by the client in order to address a need, or by the client’s representatives, eg the executors of an estate.

Topic 15

✓ **CHECK YOUR UNDERSTANDING**

1) In relation to the protection of debts, term assurance (level term for an interest-only mortgage; decreasing term for a repayment mortgage) would provide a lump sum to pay off the outstanding mortgage loan.

   - Family income benefit could provide a monthly income to replace that lost or to cover additional expenditure; alternatively the benefit from this type of policy could be taken as a lump sum.
   - A level term assurance can also be used to protect living standards but would pay a lump sum which would then have to be invested in order to provide the required income.

2) A flexible mortgage might be appropriate for Kenesha – it would allow her to make overpayments to reduce the balance and help meet her stated aim of repaying the mortgage as soon as possible. An offset mortgage is another option, as placing the overtime/bonus payments in a savings account would reduce interest on the mortgage.

   A deferred-interest mortgage might suit Jacob – his earnings are likely to increase significantly as he becomes established in his career, so a product that allows him to minimise his outgoings now and pay more in interest later in the term might be appropriate. As the LTV on his property is not high, he should be eligible for this type of product.

3) Stakeholder pensions failed to secure the widespread take-up that the government hoped they would because the restrictions on charges meant that advisers found it uneconomic to give advice on stakeholder products. Those who did take out such products tended to be people who were relatively financially sophisticated and would have made private provision for retirement anyway.

4)
- Transfers between spouses and between civil partners both during their lifetime and on death.
- Small gifts of up to £250 (cash or value) per recipient in each tax year.
- Donations to charity, to political parties and to the nation.
- Wedding/civil partnership gifts of up to £1,000 (increased to £5,000 for gifts from parents or £2,500 from grandparents, or from one spouse/civil partner to the other).
- Gifts that are made on a regular basis out of income and which do not affect the donor's standard of living.
- Up to £3,000 per tax year for gifts not covered by other exemptions. Any part of the £3,000 that is not used in a given tax year can be carried forward for one tax year, but no further.

   Other transfers may be 'potentially exempt transfers' (PETs) or 'chargeable lifetime transfers' (CLTs), depending on whether the donor survives for a full seven years after making the gift.

5) A whole-of-life policy on a joint-life second-death basis.

? TEST YOUR KNOWLEDGE

1) The extent of any sickness benefit from an employer; the nature and amount of available state benefits; the number and ages of the children; and the availability of any help from family and friends with childcare and housekeeping.

2) To mitigate the adverse impact on a business's profits caused by the death or long-term illness of an important member of staff.

3) (£47,000 ÷ £400,000) × £1,500,000 × 5 = £881,250

4) It comprises an option to purchase the deceased partner's share rather than a binding contract; as a consequence, the deceased's family or heirs are deemed to receive business assets rather than cash, so business relief from IHT can be claimed.

5) d) Nigel – a fixed-rate mortgage is most suitable for ensuring that, over a specific period, repayments do not increase as a result of interest-rate rises.

6) a) The sum assured on a full with-profits endowment is set at a level equal to the mortgage debt so, as long as payments are maintained, it will guarantee to repay the mortgage at the end of the term.

7) b) To protect money against the effects of inflation.

8) c) 5.5%

Real rate of return = nominal interest/growth rate – inflation

3% (real rate of return) = x% (nominal interest/growth rate) – 2.5% (rate of inflation)

Therefore: 3% + 2.5% = 5.5%

9) b) £202.50. The £162 is the 'net' contribution. To work out the 'gross' contribution, divide the net contribution by 80 and multiply by 100 (do not add 20 per cent to the net contribution).

£162 ÷ 80 × 100 = £202.50

10) If a donor receives any benefit from a gifted asset, the asset is treated for IHT purposes as remaining in the donor's estate.

Topic 16

✓ CHECK YOUR UNDERSTANDING

1) There is no cut-and-dried answer to this question. Martin certainly didn't have 'actual authority' to make that decision, but he might have had 'apparent authority'. Would it be reasonable to assume that in saying "do whatever is necessary" Joanne accepted that this might include creating a tenancy and accepting an offer that is £15,000 less than the asking price? If the property had been on the market for a long time, Joanne might decide to ratify Martin's decision. If, on the other hand, this was the first offer, or she had already rejected an offer around £285,000, she might feel differently about the way Martin acted.

2) a) Marian's husband inherited her entire estate. Parents only inherit if there is no spouse or children.

b) Ian's wife inherited £336,000 (ie the first £322,000 plus half the excess above that figure); Ian's children inherited £7,000 each (ie the remaining £14,000 of the estate shared between them).

? TEST YOUR KNOWLEDGE

1) False. There is no information here to suggest that the partnership is a limited liability partnership (LLP) so Jagdeep has unlimited personal liability.

2) None. As a limited company, Allenton Engineering Ltd is a separate legal entity and shareholders would not be liable for its debts.

3) a) There must be payment or a promise to provide payment. In a contract, one party provides goods or services, the other makes payment or a promise to pay.

4) No. Contracts for sale of land must always be in writing and the transfer effected by deed.

5) c) They act as agents of their client.

6) Mortgage lenders usually insist that joint mortgages are written on a joint and several liability basis because this means that all parties are equally responsible for carrying out the full terms of the agreement. Therefore, whether a jointly owned property is held as joint tenants or tenants in common, each owner is responsible for the mortgage, so if one person cannot make their payment, it is the responsibility of the other(s) to make up the shortfall.

7) c) A witness cannot inherit under the terms of a will.

8) a) An administrator. (An executor distributes the estate of a person who has made a valid will.)

9) d) Enduring powers of attorney can only be revoked with the consent of the Court of Protection. They must be registered with the Office of the Public Guardian.

10) a) They are only able to borrow nominal amounts of money.

Topic 17

✓ CHECK YOUR UNDERSTANDING

1) With-profits business relates to certain life policies issued by life assurance companies. In addition to the sum assured under the policy, the policyholder receives a share of the profits of the life company, payable either during the term (reversionary bonuses) or at maturity or on death of the life assured (terminal bonuses).

2) d) A financial provider of this nature would be regarded as systemically important. It would be regulated by the PRA in relation to its prudential status and the FCA in relation to its conduct of business.

3) a) High-Level Standards.

   b) Business standards – specifically, the Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB).

   c) Business standards – specifically, Conduct of Business Sourcebook (COBS).

d) Specialist sourcebooks – specifically, the Consumer Credit sourcebook (CONC).

e) Redress.

? TEST YOUR KNOWLEDGE

1) b) The weaknesses exposed by the 2007–09 financial crisis and a number of major mis-selling scandals drove the changes to regulatory bodies in 2013.

2) False. This is the key role of the FPC, the Financial Policy Committee.

3) a) Conduct regulation requires firms to ensure that products and services they supply to consumers meet the consumers' needs, and to act appropriately and deal fairly with consumers.

   b) Prudential regulation aims to ensure that businesses are established and run on a sound financial basis, to limit the risk of a business failing and to minimise the impact on consumers and the wider economy if a business does fail.

   c) 'Systemically important' refers to financial institutions that play a key role in the national and global economy. If they were to fail, it would have a significant adverse impact on the national or global financial system.

4) i) Protecting consumers from bad conduct by securing an appropriate degree of protection; ii) Protecting financial markets, by protecting and enhancing the integrity of the UK financial system; iii) Promoting effective competition by promoting effective competition in the interests of consumers. Its secondary objective is international competitiveness and growth (to facilitate the UK economy's international competitiveness and its growth over the medium to long term, subject to alignment with international standards).

5) Rules impose binding obligations and firms can face sanctions for not complying with them. Guidance explains the rules and indicates ways in which firms can comply but is not binding and firms are not required to follow it.

6) Competition powers; product intervention powers; power of disclosure; power to take formal action against misleading financial promotions.

7) c) The FCA principles do not specifically require a firm to maintain an independent compliance function.

8) d) The redress sourcebook is concerned with complaints and compensation.

9) b) Information must be clear, fair and not misleading.

10) The FCA's four outcomes for the key elements of the firm–consumer relationship are:
    - products and services;
    - price and value;
    - consumer understanding;
    - consumer support.

Topic 18

CHECK YOUR UNDERSTANDING

1) See Topic 17.
2) Due to their size, customer numbers and market presence, some firms could have a large potential impact on consumers or their relevant markets, so they require the highest level of supervisory attention.
3)

A firm must pay due regard to the interests of its customers, and treat them fairly	One of the Principles for Businesses
Consumers are provided with clear information at all stages, before, during and after a sale	One of six FCA outcomes for fair treatment of customers
Making sure relevant markets function well so that consumers get a fair deal	FCA strategic objective
Focusing on firms' culture and governance – examining a firm's purpose and the effectiveness of governance strategies used to identify and mitigate risks	One of eight key FCA principles for supervision
Removal of one of the firm's permitted regulated activities or a narrowing of the description of a particular activity	One of the FCA's enforcement powers
An employer must be satisfied their employee has achieved an adequate competence level of knowledge and skill to operate under supervision	A TC requirement for demonstrating initial competence

? TEST YOUR KNOWLEDGE

1) Permission under Part 4A of the Financial Services and Markets Act 2000 to carry out specified regulated activities.
2) False. Investment in shares is a regulated investment.
3) d) There is no need to pay attention to how long someone has worked in the industry; an individual may have worked in the industry for many years but have a poor track record, while an individual who is new to the industry may have good credentials.
4) d) Yvette. The 'fit and proper' requirements include a check of financial soundness, and missing mortgage repayments would have adversely affected Yvette's credit rating.
5) The regime was introduced in order to clarify responsibilities within a firm, thus making it easier to hold individuals to account for a particular failing. Prior to its introduction, the FCA and PRA had found it difficult to determine individual responsibility when seeking to take action against firms in the financial services industry.
6) The employee's:
   - technical knowledge and application;
   - skills and expertise;
   - understanding of changes in the market and to products, legislation and regulation.
7) Most firms are supervised as a portfolio. Here, the FCA groups firms that share a common business model. These firms are supervised through a mixture of targeted supervisory work depending on the markets they operate in and programmes of communication and education.
8) a) The firm may no longer be able to carry out one or more of its regulated activities.
9) Restitution refers to the FCA's power, with a court order, to require a person or firm to forfeit any profit made as a result of contravening an FCA rule. Redress applies to a situation in which an identifiable customer has made a loss as a result of a contravention of an FCA rule; the FCA, with a court order, can require that the loss be made good.
10)
   - Pillar 1: proactive firm or group supervision.
   - Pillar 2: event-driven, reactive supervision.
   - Pillar 3: issues and products.

Topic 19

✓ CHECK YOUR UNDERSTANDING

1) The main functions of the Bank of England are:
   - issuer of banknotes;
   - banker to the government;
   - banker to other banks;
   - adviser to the government;
   - manager of the UK's gold and foreign currency reserves;
   - lender of last resort.

   The main reason why Northern Rock approached the Bank for assistance was because of the Bank's role as lender of last resort; Northern Rock could not obtain the funds it urgently needed on the interbank market so it had to ask for emergency funding from the Bank.

2) The CRR is a regulation so all its terms were binding in full on all the UK businesses to which it applied. The CRD is a Directive so the UK government had some discretion as to how best to implement its requirements within the UK. The CRD requirements have been included in the PRA and FCA Handbooks.

? TEST YOUR KNOWLEDGE

1) b) Prudential Regulation Authority.
2) The FCA is the prudential supervisor for smaller firms that, in general, would not present a risk to the wider financial system if a particular one were to fail. Therefore, the regulator concentrates its resources on managing a firm's failure in an orderly way to mitigate the impact on its customers.
3) d) Capital adequacy requirements are based on the principle that shareholders, not depositors, should bear any loss.
4) Capital as a percentage of the risk-adjusted value of assets.
5) Under Basel II, instead of simply calculating their capital requirement as a percentage of the total value of their assets, firms were required to categorise each asset according to the risk it represented and hold more capital in relation to the riskier assets.
6) a) 10.5 per cent.
7) b) The net stable funding ratio.

8) To reduce the risk of an insurance company being unable to meet its claims; to reduce losses suffered by policyholders should an insurer be unable to meet all claims in full; to establish a system of information disclosure that makes regulators aware of potential problems at an early stage; and to promote confidence in the financial stability of the insurance sector.

9) d) MIFIDPRU details the prudential requirements for MiFID investment firms.

Topic 20

✓ CHECK YOUR UNDERSTANDING

1) The law of agency. When carrying out designated investment business, the adviser acts as the agent of the client.

2) a) Place of birth generally determines a person's domicile for tax purposes, which might be a consideration in relation to choice of investments.

   b) The number and ages of any dependants the client has will inform recommendations relating to protection needs, estate planning and perhaps planning for school or college fees.

   c) Advisers need to know the following:

   — how the clients feel about current arrangements (or lack of them) in each area;

   — their objectives within each area, now and in the future;

   — why they have certain arrangements, or goals or views;

   — their willingness to take action in each area;

   — the likelihood of change in their situation.

3) 'Capacity for loss' means the customer's ability to absorb falls in the value of their investment without it having a material impact on their standard of living. It is important to take account of this when discussing the risks involved in particular products and the customer's willingness to accept such risks.

4) a) Indefinitely.

   b) Five years.

   c) Three years.

   Refer back to Topic 14 for further information.

TEST YOUR KNOWLEDGE

1) Retail clients are assumed to have least expertise in relation to financial services and consequently require more support from the adviser. Dealings with retail clients are more highly regulated than those with eligible counterparties or professional clients.

2) a) No recommendation is provided.

3) c) A restricted adviser generally focuses on a limited selection of products or providers.

4) As the individuals are not existing customers, contacting them by telephone would constitute cold calling, which is not permitted in relation to mortgage contracts. Additionally, cold calls may only be made at an 'appropriate time of day' – evenings (to 9.00pm) and Saturdays would be permissible but not Sundays.

5) c) Advisers have discretion to determine their charging structures but they must pay due regard to the best interests of the client.

6) d) The client agreement letter.

7) a) Gilt-edged securities. Key features or key information documents must only be provided in relation to packaged products, and gilt-edged securities are a direct investment rather than a packaged product.

8) a) 30 days from the date when the contract begins or from the date on which the client receives contractual terms, if this is later.

9) c) Suitability reports are not required for mortgages, although many lenders do issue them.

10) b) She invested a lump sum into a unit-linked plan. The value of the investment fell between the date of her original investment and her cancelling the bond.

Topic 21

✓ CHECK YOUR UNDERSTANDING

1) No – although Lydia will be living in the house initially, Ella and Martin's primary motivation in purchasing the property is as a business investment. Additionally, if they buy a four-bedroom house, Lydia will presumably be occupying less than 40 per cent of the property.

2) Mortgages are regulated under the Mortgages and Home Finance Sourcebook (MCOB).

TEST YOUR KNOWLEDGE

1) d) The mortgage arranged for Décor Plus would not be a regulated mortgage.
2) a) Cold calling, because it is an unsolicited real-time promotion.
3) Execution-only transactions are permitted only for business borrowers, high-net-worth individuals and mortgage professionals. Even if Maurice were a high-net-worth client, it would not be possible to carry out the transaction on an execution-only basis because it is not possible to opt out of advice for an equity release scheme such as a lifetime mortgage.
4) c) This statement is untrue because it is not possible for a customer to withdraw from the contract once the mortgage is completed.
5) a) Repayments on a personal loan. The others are examples of basic essential expenditure.
6) False. ICOBS 6 requires firms to ensure customers are given appropriate information about a policy; what is appropriate may vary depending on the customer's knowledge, experience and ability, and the complexity of the product.
7) Eva may cancel her policy within 30 days as it is a protection policy.
8) True.
9) d) Basic advice may be provided for stakeholder products.
10) Focused advice is provided when the customer has set parameters for the areas they wish to discuss. Simplified advice is provided when the adviser sets out specific areas of a customer's needs for which they are providing advice.

Topic 22

✓ CHECK YOUR UNDERSTANDING

1) This initiative is a good example of the FCA's strategic objective to ensure that markets work well so that consumers get a fair deal, and also of its operational objective of securing an appropriate degree of protection for consumers.
2) Refer back to section 17.6.

? TEST YOUR KNOWLEDGE

1) b) A further advance for house repairs of £15,000. Regulated mortgages, including further advances for any purpose, are exempt from the CCAs. Rather, these loans would be regulated under MCOB.
2) It allows consumers to compare products more accurately, as the APR includes not only the interest rate but also any fees and charges that apply to the product.
3) False. Partnerships with three partners or fewer and sole traders are covered by the CCAs, as well as 'ordinary' borrowers and unincorporated associations.
4) Fourteen days from the conclusion of the agreement, or from the point the consumer receives the agreement if this is later.
5) c) The lender must advise the applicant of the reason for rejecting their application and provide details of the credit reference agency used.
6) False. Full permission is required for debt counselling services that are carried out on a commercial basis.
7) One hundred per cent of the original amount borrowed.
8) A representative example that includes a representative APR.
9) True. These provisions are included under CONC 5: Responsible lending.
10) Debt collection and debt administration.

Topic 23

? TEST YOUR KNOWLEDGE

1) a) It could mean that they had knowingly become involved in the process of converting criminal property.
2) False. Transferring, disguising, concealing or converting criminal property is an offence, no matter what form of criminal activity the funds derive from.
3) True.
4) d) A member of staff who has reasonable grounds for believing that a person is involved in money laundering is obliged to report the suspect transactions.
5) b) By alerting the customer to the fact that they were suspicious about the unusual transaction, the cashier potentially committed the offence of 'tipping off'.

6) a) The threshold is €15,000, meaning that customer due diligence will be carried out in a greater number of situations.

7) 25 per cent.

8) d) Identification procedures must always be carried out for new clients, so the most likely reason why Forward Bank did not carry them out in this case is that the procedures were carried out instead by an intermediary.

9) The National Crime Agency.

10) c) The firm should review and if necessary improve the firm's processes and training in the light of the report.

Topic 24

✓ CHECK YOUR UNDERSTANDING

1) Member states have discretion as to how they implement a Directive: it is binding as to the outcome that must be achieved, but member states can implement it in the way that best fits their national circumstances and existing legislation. A regulation sets out the rules that must apply across all the member states (ie it is binding as to the outcome *and* to the means of achieving the outcome).

2) a) The requirement to provide insurance policyholders with clear and accurate information about the essential features of the products offered to them is addressed in ICOBS 6.

   b) The rules relating to cancellation rights are addressed in ICOBS 7.

3) The requirements for intermediaries to have the necessary general, commercial and professional knowledge and skills are covered in the Training and Competence section of the High Level Standards area of the FCA Handbook.

4) a) The information the intermediary must provide to the customer regarding how to complain, and whether the intermediary is independent or restricted is covered in ICOBS 4.

   b) The assessment of the customer's needs and the summary of reasons for recommending a particular product are addressed in ICOBS 5.

? TEST YOUR KNOWLEDGE

1) A data controller is legally accountable for the purposes for which data is processed and the way such processing is carried out. A data controller is a 'legal person' but not necessarily a 'natural person', ie it might be an organisation rather than an individual.

A data processor is a person who processes personal data on behalf of the data controller.

2) Sensitive data includes information about an individual's:
   - race;
   - religious beliefs;
   - political persuasion;
   - trade union membership;
   - sexual orientation;
   - health;
   - biometric data;
   - genetic data.

3) c) This statement is incorrect. The principle actually states that data must not be kept for longer than is necessary. In a financial services context, this will be determined by the record-keeping requirements relating to specific products or to money-laundering rules.

4) The maximum penalty for a criminal offence in relation to UK GDPR is the higher of £17.5m or 4 per cent of the organisation's worldwide turnover of the previous financial year.

5) False. The Pensions Regulator is responsible for occupational pension schemes and for personal pension schemes where the employer has a direct pay arrangement.

6) The Pension Protection Fund provides compensation payments to members of defined-benefit pension schemes if a firm becomes insolvent with insufficient funds to maintain full benefits for scheme members.

7) c) Life assurance is not subject to MiFID.

8) Receipt and transmission of orders from investors, execution of those orders on behalf of customers, investment advice, discretionary portfolio management (on a client-by-client basis, in accordance with mandates given by investors), and underwriting the issue of specified financial instruments.

9) True.

10) a) The FCA. Note that d) the IDD is the abbreviation for the Directive that governs insurance distribution, not for a regulatory body.

Topic 25

? TEST YOUR KNOWLEDGE

1) c) Adjudication. Note that option d) conciliation is not one of the options available under alternative dispute resolution.
2) A contract or notice is deemed to be unfair if it causes a significant imbalance in the rights and obligations of the various parties to the contract to the detriment of the consumer.
3) d) The net asset value must be less than £5m, not £6.5m.
4) d) A firm must ensure the complaint is investigated by a person of sufficient competence, who, where possible, is not someone directly involved in the matter under complaint.
5) Eight weeks.
6) False. For complaints that are resolved by close of business on the third working day following receipt, the firm must provide a summary resolution communication to the complainant, advising them of their right to refer the matter to the FOS should they remain dissatisfied with the firm's response.
7) c) Five years.
8) Complaints to the FOS must be made within six months of receiving a final response, six years of the event that gives rise to the complaint, or within three years of the time when the complainant should have become aware that they had cause for complaint, whichever is the later.
9) a) The Financial Ombudsman Services. The Pensions Ombudsman Service only deals with complaints relating to the running (ie administration) of personal and occupational pension schemes. The Money and Pensions Service does not get involved in pension complaints. The Financial Services Compensation Scheme deals with compensation for customers who have lost money through the insolvency of an authorised firm.
10) One hundred per cent of the value of the policy with no upper limit.