

Key legal concepts

LEARNING OBJECTIVES

This topic introduces basic legal concepts that underpin the provision of financial services, as well as outlining some key legislation that has particular relevance to financial services. Legislation that relates specifically to the regulation of financial services is covered in more depth in Topics 17-25.

By the end of this topic, you should understand:

- the meaning of the term 'legal person';
- features of limited companies, partnerships and limited liability partnerships;
- the requirements for a binding contract;
- aspects of agency law relevant to financial advisers;
- key concepts relating to property;
- powers of attorney and substituted decision making;
- wills and the distribution of estates;
- trusts and the role of trustees;
- insolvency; and
- scams.

This topic covers Unit 1 syllabus learning outcomes U6.1-U6.7.



THINK ...

The phrase 'legal concepts' might sound off-putting but at least some of the ones outlined in this topic are likely to be familiar to you from your work or family experience. For instance:

- If you are an employee, what kind of business do you work for? A partnership, a limited liability partnership (LLP) or a

limited company (Ltd)? Have you ever thought about what that designation means?

- Have you been involved in negotiating a contract – for example, perhaps when purchasing a home?
- Have you applied for or used a power of attorney – perhaps for a sick or elderly relative?
- Have you made a will or been appointed an executor?

16.1 What is a ‘legal person’?

A ‘legal person’ is a body that has a legal existence and can, therefore, enter into contracts, sue or be sued in a court of law. It is important to remember that this includes not just an individual acting in a personal/private capacity but also an individual acting in a formal capacity such as that of executor, as well as groups of individuals such as trustees. It also includes bodies such as limited companies.

16.2 Sole traders

As a sole trader, the owner is not considered a separate legal person from the business, meaning that they are personally liable for their business’s debts. This also means that they are entitled to keep all of the profits generated by the business, after income tax and National Insurance contributions have been paid.

16.3 Key features of companies

As noted in section 16.1, a company is a legal person (although, often, the term ‘legal entity’ is used instead). In other words, the company is legally separate from its shareholders and its individual employees.

The certificate of incorporation provides evidence of the company’s formation, and details about the company are held on the central registry at Companies House. The information held includes the shareholding and shareholders, as well as listing the names and addresses of the directors and company secretary.

The nature of the company, and the rules about what it can and cannot do, are set out in its memorandum and articles of association. For example, the memorandum normally includes the power to borrow, but may place limits or restrictions on that power in terms of amounts or purpose. Such limits will be significant if the company is considering taking out a mortgage or other form of loan.

When entering into a contract with a company, it is prudent to check that the persons entering into the contract are authorised and empowered to do so. For example, when a company director is seeking to raise funds for the company, it would be advisable to check that the company is able to borrow and also that the director in question is able to arrange a loan on the company's behalf.

Shareholders of a limited liability company cannot be held personally responsible for the debts of the company, the limit of their liability being the amount that they have invested in company shares. This is the most they could lose if the company were to become insolvent.

16.4 Key features of partnerships

A partnership is an arrangement between people who are carrying on a business together for profit. Unlike a company, a partnership is not a separate legal entity and the partners jointly own the assets. They are jointly and severally responsible for the liabilities of the partnership. This means that each partner is liable by themselves to pay back the entire amount owed to any creditor.

Partnerships should have a written agreement that sets out in detail the relationship between the partners, including proportions in which they share the partnership's profits and what will happen when a partner leaves, retires or dies.

16.4.1 Limited liability partnerships

A limited liability partnership (LLP) is one where partners have a limited personal liability if the business should collapse: their liability is limited to the amount that they have invested in the partnership, together with any personal guarantees they have given – for example, to a bank that has made a loan to the business.

As with companies, LLPs have to be registered with Companies House; they are clearly more like companies than they are standard partnerships, but the taxation of LLPs is not the corporation tax regime that applies to companies. LLPs are taxed in the same way as other partnerships: each partner is taxed on a self-employed basis (as if they were a sole trader), with their individual share of the profits being treated as their own personal income and subject to income tax.

16.5 What are the requirements for a binding contract?

Most business agreements, particularly in the world of financial services, are established as legally binding contracts. Some are made orally, some in writing and some by deed. Not all contracts can be made orally but all contracts generally are subject to certain basic requirements for them to be binding. Figure 16.1 summarises these, and an explanation of the terms is provided.

FIGURE 16.1 REQUIREMENTS FOR A BINDING CONTRACT



- Offer and acceptance – there must be an offer made by one party (the offeror) and there must be an unqualified acceptance by the other. This acceptance must be communicated to the other party. In practice there may be a number of counter-offers before agreement is reached.
- Consideration – the subject of the contract (often a promise to do something or supply something) must be matched by a consideration (which is frequently, but not necessarily, the payment of money). A promise to pay is valid consideration.
- Capacity to contract – each of the parties to the contract must have the legal capacity, or power, to enter into the contract. Certain parties have only limited powers to enter into a contract, for example, minors (under 18s) and those who are deemed to lack the mental capacity to safely make their own decisions. For financial institutions such as insurance companies, capacity to contract depends on being authorised by the FCA/PRA.
- Contract terms – these must be certain, complete and free from doubt. For example, when a customer engages an independent financial adviser (IFA), the IFA’s commitments are detailed in a terms of service agreement.
- Intention to create a legal relationship – as distinct from a merely informal arrangement.
- Legality of object – contracts cannot be made for illegal or immoral purposes.

- Misrepresentation, duress or undue influence – if any of these factors are involved in leading someone to enter into a contract, the contract is not binding.

CONTRACTS INVOLVING LAND

Note that all agreements for the sale of land must be made in writing and conveyances of land (the actual transfer of ownership) must be performed by deed.

16.5.1 Disclosure of information

Generally, there is no duty of disclosure between parties to a contract; most contracts are based on the principle of *caveat emptor* ('let the buyer beware'). In other words, it is the responsibility of each prospective party to the contract to satisfy themselves that they have all the information they need on which to base their decision to enter into that contract.

However, there are exceptions. For example, insurance contracts were, for many years, based on the principle of 'utmost good faith' (*uberrima fides*), whereby all material facts had to be disclosed by both parties. For an insurance policy, this meant that the person applying for the policy was required to supply all the facts that a prudent underwriter would need to decide the terms on which the policy could be issued. Non-disclosure by the customer rendered the contract voidable at the option of the insurance company.

From 2000 onwards there was growing concern from regulators and consumer groups that some insurers were rejecting claims on the basis that the policyholder failed to disclose information that they should have realised was relevant and important, even though no direct question asked for the information. The problem was exacerbated by a growing tendency for insurers to reduce the level of pre-application underwriting and effectively ask medical underwriting questions when a claim was made, at which point problems might arise.

REJECTION OF CRITICAL ILLNESS CLAIMS

Many of the cases in which insurance companies rejected claims on grounds of non-disclosure involved critical illness policies where applicants failed to disclose a condition for which they had previously visited a doctor. In many cases the doctor had confirmed that there was not a problem, or had diagnosed a minor problem that was successfully treated. On later suffering from a specified critical illness, the policyholder's claim was declined due to the non-disclosure at the application stage, even when the condition not disclosed was unconnected to the illness that prompted the claim.

In many cases, the Financial Ombudsman determined that the insurance company's rejection was unreasonable and found in favour of the policyholder. One major issue was the reliance on the applicant to decide what was relevant to disclose. Typical questions on the application form would be along the lines of: "Have you ever visited a doctor or suffered from a medical condition requiring treatment?" This required the applicant to remember all such occasions and decide which, if any, to include.

The situation regarding rejection of claims eventually led to the Consumer Insurance (Disclosure and Representations) Act 2012, which more clearly defines the responsibilities of insurance customers. It abolishes the duty of consumers to volunteer material facts when applying for insurance and instead requires them to take reasonable care to answer the insurer's questions fully and accurately. If they do volunteer information, they must take reasonable care to ensure that the information is not misleading or misrepresented.

The representations will be based on responses to specific insurer questions, because there is no duty on the consumer to volunteer information that is not asked for. The Act defines, as far as possible, the meaning of "reasonable" in this context, which depends on a number of factors including, "how clear, and how specific, the insurer's questions were". In addition, "a failure by the consumer to comply with the insurer's request to confirm or amend particulars previously given is capable of being a misrepresentation".

In the case of misrepresentation, the Act also indicates what actions the insurer may take:

- If the consumer has taken reasonable care, and the misrepresentation was honest and reasonable, the insurer has no right to refuse a later claim.
- In the case of misrepresentation due to carelessness, detailed rules allow the insurer to apply a 'compensatory remedy' to the claim, based on what

the insurer would have done had the applicant answered all questions completely and accurately. For example, if the insurer would have refused cover completely if it had been in full possession of all the facts, the claim could be rejected; if it would have excluded certain illnesses, then claims relating to those illnesses would not be met. If the claim is rejected, then the insurer must refund the premiums paid.

- If careless misrepresentation is identified in situations other than a claim, the insurer and the policyholder have the right to terminate the contract with reasonable notice. The exception to this is a policy that wholly or mainly relates to life insurance where the insurer may advise the consumer of their rights to terminate the contract by giving reasonable notice and stating that they may receive a refund of premiums paid for the terminated cover in respect of the balance of the contract term (if any).
- In the case of deliberate or reckless misrepresentation, the insurer may reject the claim completely as if the contract never existed and is not required to refund premiums paid, unless there is a good reason to do so.

16.5.2 Remedies for breach of contract

Breach of contract occurs when a party fails to perform its side of the contract and does not have a legal justification for doing so. Several court remedies are available in these circumstances; the most common ones are as follows:

- **Damages** – the injured party seeks to obtain financial compensation for their loss. The intention is to put them in the position they would have been in had the contract not been breached by the other party, insofar as it is possible to do so with money.
- **Order for specific performance** – such an order compels the other party to complete the contract.
- **Injunction** – this is a court order preventing someone from doing something.

Of these, by far the most frequently sought is damages.

16.6 What is the law of agency?

An agent is a person who acts on behalf of another, who is called the principal. The agent can conclude contracts on behalf of the principal. In law, the acts of the agent are treated as being those of the principal. In the context of financial services, an IFA is an agent of their client and given specific powers under the terms of engagement. Another example is an estate agent, who is the agent of a person looking to sell their property.

In any kind of agent-principal relationship, it is important to ascertain how much power and authority has been granted to the agent, just as it is important that the agent is fully aware of what they can and cannot do. Some

agents are given very wide authority while some are severely restricted. For example, an IFA may only be required to give advice, on which their client can choose whether or not to act; alternatively, they may be given discretionary investment powers to buy and sell investments on the client's behalf.

An agent should only act within the authority given to them by their principal. This should be strictly observed, because, if an agent exceeds their power, it could result in their principal being liable on the contract. This happens when, although the agent acts outside of their actual authority, they act within what is known as their *apparent authority*.

Another result is that the agent may be made liable. This protects the third party to the agreement, who – if they are unable to rely on the agent's claim to have authority – must be able to hold the agent personally responsible. It would otherwise be unfair to the third party, who would have entered in good faith into the contract only to find themselves without recourse either to the principal (if there is no apparent authority) or the agent.

If the agent does exceed their authority, the principal can, if they choose, agree after the event to what the agent has done. This is called ratification.

KEY TERMS

AGENT

Acts on behalf of the principal, within specific boundaries, to conclude contracts.

APPARENT AUTHORITY

Something either done or said by the principal that leads to the impression that they have authorised the agent's actions.

PRINCIPAL

The party granting permission to the agent to act on their behalf.

RATIFICATION

A retrospective agreement by the principal to actions taken by the agent that exceed the latter's authority.

This very brief introduction cannot cover all the detail of agency law but serves to illustrate how important it is for advisers to know, understand and act within the extent of their authority.



CHECK YOUR UNDERSTANDING I

Joanne lives in London and her property in Brighton is on the market for £300,000. The property is currently unoccupied. Joanne is going away on business for six weeks and explains to her estate agent, Martin, that it might be difficult to contact her during that time. She tells him to do whatever is necessary to sell the property, as she is desperate for the money.

While Joanne is away, Martin receives an offer of £285,000 on the property from Mr and Mrs Peters. They explain to Martin that they are moving from Devon because Mrs Peters is starting a new job; they need to move immediately and will rent a property until they can sell their Devon home and buy in Brighton. In Joanne's absence, Martin accepts their offer on Joanne's flat and arranges for them to move in immediately as tenants until the purchase can go ahead.

Did Martin have authority to make this decision?

16.7 Property and property ownership

The law of England and Wales defines two distinct types of property; in this context, the word 'property' is used to refer to all types of asset, rather than its narrower sense of 'land and buildings'. The two types are as follows:

- **Realty** - property is deemed to be real if a court will restore it to a dispossessed owner and not merely provide compensation for loss. Real property tends to be distinguished by being immovable, eg land and what is attached to it, also known as real estate.
- **Personalty** - all other property is called personalty.

In relation to joint ownership of property, there are two types:

- **Joint tenants** - each joint owner owns 100 per cent of the property - there is no division of the property. On the death of any joint owner, the surviving joint owner(s) will take over legal ownership of the property. The transfer is automatic and cannot be overridden by any provisions made by a joint tenant in a will or through the laws of intestacy.
- **Tenants in common** - the joint legal owners are regarded as one single owner but are trustees of the land. However, each legal owner is also the beneficial (or equitable) owner of a defined interest (share) of the equity in the property, as agreed between them. If one owner dies, their share of the property passes to whoever is entitled to inherit it under the terms of their will or the law of intestacy.

RESPONSIBILITY FOR DEBTS

Banks, building societies and other commercial lenders usually require joint mortgages to be written on a joint and several liability basis. This means that all parties involved are equally responsible for fulfilling the terms of the agreement.

Whether a jointly owned property is held as joint tenants or tenants in common, each owner is responsible for the mortgage. If one person is unable to make their payment, it becomes the responsibility of the other owner(s) to make up the shortfall.

16.8 What is power of attorney?

An attorney is a person who is given the legal responsibility to act on behalf of another person. Examples of situations in which the need for an attorney might arise include:

- a person who, while currently in good health, is concerned about how their affairs will be run should they become unable to manage their own finances (for instance if they develop an illness such as dementia); or
- someone with affairs in the UK who is moving abroad.

A person who does not have the legal capacity to enter into a contract (eg a minor or a mentally incapacitated person) cannot appoint someone else as their attorney.

16.8.1 What is an enduring power of attorney?

An ordinary power of attorney automatically ceases if a person becomes mentally incapacitated. This can create problems for those responsible for managing the individual's affairs. An enduring power of attorney (EPA) can continue if the donor becomes mentally incapacitated, although it has to be registered with the Office of the Public Guardian (OPG) if the attorney believes that the donor is losing mental capacity. An EPA can be revoked only with the consent of the Court of Protection.

KEY TERMS**DONOR**

Person who makes a power of attorney.

DONEE

Person who is given power of attorney. Often, they are simply referred to as the attorney.

16.8.2 What is a lasting power of attorney?

From 1 October 2007, under the provisions of the Mental Capacity Act 2005, enduring powers of attorney were replaced by lasting powers of attorney (LPAs). EPAs made before that date can remain in force, but all new arrangements must be lasting powers of attorney.

There are two types of LPA:

- **Health and welfare** – this gives the attorney power to make decisions over issues such as medical care or moving into residential care. It can only be used once the donor can no longer make decisions for themselves.
- **Property and financial affairs** – this gives the attorney power to manage the donor's bank accounts, collect benefits and sell property. It can be used even if the donor has mental capacity, as long as the donor gives permission.

In both cases, the LPA must be registered with the OPG before it can come into effect.

FACTFIND

There is more information about dealing with powers of attorney at:

www.gov.uk/power-of-attorney

16.8.3 What happens if no power of attorney is in place?

The Mental Capacity Act 2005 supports and protects individuals who lack the capacity to make their own decisions. It promotes supported decision-making, which is the process of providing support to those who need help making their own decisions. It also makes provision for substituted decision-making, where decisions are made on behalf of the individual in their best interests (for instance, by a court-appointed deputy).

If a person loses mental capacity and does not have a valid LPA or EPA in place, the Court of Protection can appoint a deputy. This process can take some time and a deputy's powers are much more restricted when compared to those of an attorney. It is for these two reasons that all clients should be encouraged to draw up an LPA if they have not done so already.

16.9 Wills

A will is a written declaration of an individual's wishes regarding what they want to happen after they have died. Although primarily concerned with how the person wishes to dispose of their assets, a will can also deal with other matters, such as giving instructions about burial.

In the UK, approximately seven out of ten people die intestate, meaning that they die without leaving a valid will. Writing a will is the first step in gaining control over an estate and is, therefore, a vital part of financial planning. It is important that clients understand the benefits of a valid will and the risks of not having one. If the client has no will, the financial adviser should recommend that they seek professional advice from a solicitor; the adviser should not become involved in writing the will themselves.

To make a valid will, two formalities must be followed. The will must be:

- in writing; and
- properly executed.

The minimum age for making a valid will under English law is 18.

The will should be a clear and unambiguous statement of the deceased's wishes in respect of their estate, and must be signed by the testator in the presence of two witnesses.

It is important that the witnesses chosen must not be beneficiaries under the will (or the spouses of beneficiaries). If a beneficiary were to be a witness, they would not be able to inherit under the terms of the will.

The terms of a will only take effect on the death of the testator, the person who made the will. Before then, the testator can revoke (cancel) or modify the will at any time. Modifications are recorded in a document known as a codicil. In the event of marriage, remarriage or entering into a civil partnership, a will is automatically revoked, unless specifically written in contemplation of the change of status.

KEY TERMS**TESTATOR**

Person who makes the will.

BENEFICIARY

A person or organisation that receives benefits under the terms of a will.

CODICIL

Document that formally amends a will.

16.9.1 Distribution of the estate

The people who carry out the procedures necessary to distribute the estate of someone who has died are known as the deceased person's legal personal representatives. The exact procedure depends on whether or not there is a valid will. The following comments apply to the law of England and Wales (Scottish law differs both in the procedures involved and in the terminology used).

If there is a valid will, it will name the person or people the testator has chosen to be executors. The role of the executors is to ensure that the actions specified in the will are carried out. The duties of an executor can be time-consuming and onerous and it is not uncommon for executors to appoint a solicitor to carry out all or part of their duties. Note that an executor can also be a beneficiary of the will.

Before they are able to distribute the estate, the executor(s) must apply for a grant of probate. This gives them legal authority to carry out the testator's instructions, as set out in the will.

If there is no will (or the will is invalid), an appropriate person (such as a spouse or other close relative) acts as an administrator and applies for the grant of letters of administration, rather than probate. The administrator's responsibility is to deal with the estate as prescribed by the rules of intestacy (see section 16.8.2).

In certain circumstances it may be advantageous, following the death of the testator, for the beneficiaries under a will to vary the way the estate has been allocated. This can be achieved by executing a deed of variation. All those who would be affected by the deed must be over 18 years of age and must be in agreement on the terms of such a variation. A deed of variation is often executed for tax purposes: a change in beneficiaries or in the relative shares received that could reduce the inheritance tax (IHT) liability, for example. To be effective for tax purposes, the deed of variation must be executed within two years of the death, and HMRC must be informed within six months of its

execution. The variation must not be entered into for any consideration of money or money's worth.

KEY TERMS

EXECUTOR

Person named by the testator as being responsible for carrying out the wishes expressed in a valid will.

GRANT OF PROBATE

Legal authority for executors to distribute an estate according to the terms of a valid will.

DEED OF VARIATION

Legal agreement by the beneficiaries to alter the terms of a will, after the death of the testator.

MONEY'S WORTH

Provision of goods/services in lieu of a cash payment.

16.9.2 Intestacy

A person who has died without having made a valid will is said to have died intestate. This includes the situation where the deceased has left a will that turns out to be invalid. If a will makes valid provision for the distribution of some of the assets of the estate, but not of others, this is referred to as partial intestacy.

The distribution of the estate of a person who has died intestate is determined by a complex set of rules known as the rules of intestacy. They are very specific and there is no flexibility or discretion for their variation by the person dealing with the estate. In many cases – especially if the estate is a large one – the distribution of the assets may not be as the deceased would have wished. In particular, it is not necessarily true – as many people believe – that a surviving spouse or civil partner will receive the whole estate.

The main rules are as follows. Please note that for the purpose of these rules, the word 'spouse' includes civil partner and 'children' includes more distant descendants, eg grandchildren or great-grandchildren, and so on.

- **If the deceased leaves a spouse but no children** – the spouse inherits the deceased's entire estate.
- **If there is both a spouse and children** – the spouse inherits the deceased's personal chattels, plus the first £322,000, plus half of the residue above

£322,000 absolutely; the other half of the residue in excess of £322,000 is divided equally between the children.

- **If there are children but no spouse** – the estate is shared equally among the children.
- **If there is neither spouse nor children** – the estate goes to the parents of the deceased, or (if they are dead) to the deceased's brothers and sisters.

This is just a summary of the main rules (Figure 16.2 provides further details) and, ultimately, if no blood relative can be found, the estate will pass to the Crown.

KEY TERMS

INTESTATE

Having died without leaving a valid will.

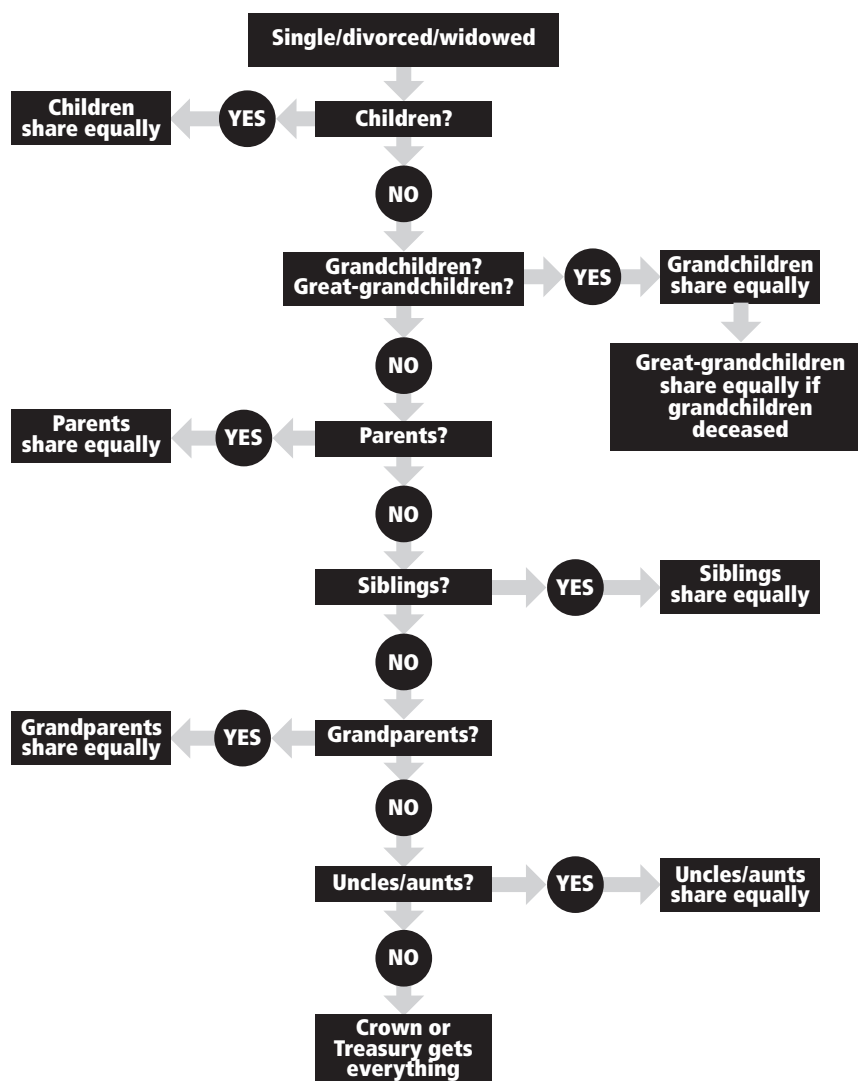
ADMINISTRATOR

Person given the role of distributing the estate according to the rules of intestacy.

LETTERS OF ADMINISTRATION

Legal authority to distribute the estate of a person who has died without leaving a valid will.

FIGURE 16.2 INTESTACY RULES – SUMMARY



CHECK YOUR UNDERSTANDING 2



- Marian was married but had no children, although her parents were still alive. She died without leaving a will. The value of her estate was £600,000. How much did her husband inherit?
- Ian, who made no will, left an estate of £350,000. How much did his wife and each of his two children inherit?

16.10 Trusts and trustees

A trust (also known as a settlement) is a method by which the owner of an asset (the settlor) can distribute or use that asset for the benefit of another person or persons (the beneficiaries) without allowing them to exert control

over the asset while it remains in trust. Depending on the nature of the trust, the beneficiaries may eventually become the absolute owners of the asset.

The settlor is the person who creates the trust and who originally owned the assets placed in the trust (the trust property). Once it is placed in trust, the asset is no longer owned by the settlor (unless the settlor is also a trustee – see below).

The beneficiaries are the people or organisations that will benefit from the trust property. They may be named individually or referred to as a group, eg “all my children”.

The trustees are the people, appointed by the settlor, who take legal ownership of the trust property and administer the property under the terms of the trust deed. The trustees, who can include the settlor, are named in the trust deed. Trustees must be aged 18 or over and have mental capacity. If a trustee dies, the remaining trustees, or their legal personal representatives, can appoint a new trustee.

KEY TERMS

SETTLOR

The person who creates the trust and originally owned the assets held within it.

TRUST DEED

Document that sets out how the trust is to be managed, by whom and for whose benefit.

TRUSTEE

Person named in the trust deed as legal owner of the trust property, with responsibility to look after and distribute the trust property in line with provisions in the trust deed.

Trustees have a number of duties:

- They must act in accordance with the terms of the trust deed. If the trust deed gives them discretion to exercise their powers (eg discretion over which beneficiaries shall receive the trust benefits), the agreement of all the trustees is required before a course of action can be taken.
- They must act in the best interests of the beneficiaries, balancing fairly the rights of different beneficiaries if these should conflict. For example, some trusts provide income to certain beneficiaries and, later, distribution of capital

to other beneficiaries; in such a situation the chosen investment must preserve a fair balance between income levels and capital guarantee/capital growth.

Under the Trustee Act 2000, trustees who exercise investment powers are required to:

- be aware of the need for suitability and diversification of assets;
- obtain and consider proper advice when making or reviewing investments;
- keep investments under review.

CREATING AND ADMINISTERING A TRUST

George is 65 years old. He has two grandchildren, Chloe aged seven and Mark aged five. He puts £500,000 in trust for his grandchildren's education. Once the money has been put into the trust, it no longer belongs to him – he has made a gift. He names his daughter Sue and his friend Bob as trustees. The money has got to last a long time (16 years until Mark finishes university) so it must be invested and used wisely. Sue and Bob will decide how to invest the money (shares, property, gilts, accounts, etc) and what it is spent on (school fees, uniform, books, school trips, etc). They must agree all their decisions together.

16.11 Insolvency and bankruptcy

Insolvency arises when:

- a person's liabilities exceed their assets; or
- a person cannot meet their financial obligations within a reasonable time of them falling due.

Bankruptcy takes the position a stage further and arises when a person's state of being insolvent is formalised under the terms of a bankruptcy order.

The primary UK legislation on insolvency is the Insolvency Act 1986, but this has been subject to amendments over the years.

16.11.1 Bankruptcy

A person can apply to have themselves declared bankrupt, or a creditor may petition to have someone else declared bankrupt if they owe (or are owed jointly with other creditors) £5,000 or more. Most bankruptcy orders remain in force for 12 months, during which time the person is said to be an undischarged bankrupt. If individuals do not comply with the terms of the bankruptcy order

it may remain in place until the official receiver or insolvency practitioner is satisfied that their requirements have been met.

During the period of bankruptcy, the individual's possessions are, in effect, surrendered to an official receiver, who can dispose of them and use the money raised to pay off the creditors. The only exceptions are clothing, household items and work-related items.

Although bankruptcy cancels most kinds of debt and allows people to make a fresh financial start, it comes at a price: it normally makes it more difficult to obtain credit in the future and it can affect employment prospects. Bankrupts are unable to borrow, other than nominal amounts, during the period that the order is in force. An undischarged bankrupt will be unable to open a current account, but may be able to open a basic bank account.

Even after the end of the period, the person must, by law, disclose the existence of a previous bankruptcy when applying for a mortgage. This may mean that it will be more difficult for them to obtain a loan or that they may be charged a higher rate of interest to cover the greater perceived risk.

16.11.2 Individual voluntary arrangements

An individual voluntary arrangement (IVA) is an alternative to bankruptcy, under which the debtor arranges with the creditors to reschedule the repayment of the debts over a specified period. An IVA can be set up only if creditors who represent at least 75 per cent of the debt agree to the arrangement. The scheme must be supervised by an insolvency practitioner.

In recent years, a large market has arisen for firms that assist individuals with significant personal debts to enter into IVAs. In most cases they are able to arrange for interest to be frozen, for a reduction in the amount of the debt, and for legal protection from creditors if the terms of the IVA are met. The firms are generally able to persuade lenders to write off part of the debt in exchange for a reasonable guarantee of receiving repayment of the remainder. In many cases this is better for the lender than simply writing off the debt or selling it to a debt recovery firm.

An individual with an IVA will find it difficult to obtain credit while the IVA is in place, and creditworthiness is likely to be impaired even after the end of the arrangement.

KEY TERMS

INSOLVENCY

A situation in which liabilities exceed assets or an organisation or individual cannot meet their liabilities within a reasonable period of them falling due.

BANKRUPTCY

Legal process triggered by the insolvent individual or by creditors where the individual owes a minimum of £5,000. A bankruptcy order usually lasts 12 months.

INDIVIDUAL VOLUNTARY ARRANGEMENT

Agreement by creditors who represent at least 75 per cent of the value of the debt to reschedule an individual's debt repayments.

COMPANY VOLUNTARY ARRANGEMENT

Agreement by creditors who represent at least 75 per cent of the value of the debt as to how to manage company liabilities, with the aim of avoiding the business going into administration.

OFFICIAL RECEIVER

Official appointed by the court to identify and distribute the assets of a bankrupt individual or business and investigate the reasons for the bankruptcy.

INSOLVENCY PRACTITIONER

Appointed by the court or by the official receiver (in consultation with creditors) to identify and manage the distribution of an individual's or company's assets. Insolvency practitioners must be licensed to practise.

16.11.3 Company voluntary arrangements

The company equivalent of an IVA is the company voluntary arrangement (CVA). Under the terms of the Insolvency Act 1986, a company that is in temporary financial difficulties (but which its directors believe to have a viable long-term future) can make a binding agreement with its creditors - including HM Revenue & Customs - about how its debt and liabilities will be dealt with.

In this way, the directors retain control of the company and it can continue to trade. A CVA can be proposed by the directors of the company, or by a liquidator if one has been appointed, but not by the creditors. However, many creditors may feel that it will be to their advantage for the company not to go

into administration. As with IVAs, creditors representing 75 per cent of the company's debt must agree to the CVA being set up.

16.12 Scams

As mentioned in Topic 10, an adviser's role in relation to scams is to be aware of such schemes and to advise a customer to be mindful of the potential risk.

The FCA operates ScamSmart, a website designed to help consumers protect themselves against pension and investment scams. In addition to providing information on how to spot a scam, the website informs consumers how to avoid them.

If a consumer is unsure as to whether a pension or investment opportunity is a scam or not, they can complete a short questionnaire on the website. The questionnaire asks them about the type of opportunity they are considering, how they found out about it and whether the promoter mentions money from their pension pot. On submitting their answers, the FCA will then confirm whether or not the opportunity is regulated or not and whether or not they suspect it is a scam. The consumer can then check if the promoter is in the list of firms to avoid.

Consumers can also report a scam or an unauthorised firm via the website.

SCAMS

Full details of ScamSmart are available at:

www.fca.org.uk/scamsmart

For more details on how consumers can protect themselves from scams you can visit:

www.fca.org.uk/consumers/protect-yourself-scams

In the past, where a victim of a scam had been deemed to have been negligent by their bank or pension provider, perhaps because they had been tricked into providing their personal details by what appeared to be a genuine employee and then had their money taken from them, or because they transferred their pension into what they believed was an FCA-regulated pension fund, it was very unlikely they would see their money again.

However, the Financial Ombudsman has raised the bar on what it views as negligence to counteract increasingly sophisticated banking scams. This means it will be harder for banks and building societies to reject complaints and may mean refunds for many who have lost money in the past.

Now, if a scam victim has been tricked into handing over details that enabled someone else to take money from their account, the financial institution needs to be able to demonstrate that the victim was 'grossly negligent' in doing so in order to refuse a refund. This is a much higher standard than simply being careless or negligent. If they cannot prove this, then the victim must be refunded with interest.

For pension transfers, The Pensions Ombudsman is now likely to side with the victim if the firm that transferred the pension did not have sufficient warnings and checks in place to protect the member from such scams.

OMBUDSMAN RULINGS

For full details of two Ombudsman rulings you can go to:

www.financial-ombudsman.org.uk/decision/DRN-3236266.pdf

www.thisismoney.co.uk/money/beatthescammers/article-6595823/Join-fraud-fightback-Landmark-ruling-paves-way-bank-scam-victims-money-back.html

**THINK AGAIN ...**

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- explain what is meant by the term ‘legal person’?
- describe how liability for debts differs between a limited company, a partnership and limited liability partnership?
- summarise the requirements for a contract to be legally binding?
- outline how agency law affects financial advisers?
- outline the process for distributing an estate, both where there is a valid will and in cases of intestacy?
- explain the general duties of a trustee?
- describe the financial restrictions imposed on a person declared bankrupt?

Go back over any points you don’t understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.



Test your knowledge

Use these questions to assess your learning for Topic 16. Review the text if necessary.

Answers can be found at the end of this book.

- 1) Jagdeep is a partner in Pascoe & Partners. In the event that the business becomes insolvent, her liability is limited to the amount she has invested in the partnership, together with any personal guarantees she has given. True or false?
- 2) Jagdeep is also a shareholder in Allenton Engineering Ltd. If the company were to become insolvent, what personal liability would she have for its debts?
- 3) For a contract to be valid, there must be consideration. What does this mean?
 - a) There must be payment or a promise to provide payment.
 - b) Both parties to the contract must be aged 18 or over.
 - c) Both parties must be open and honest in their dealings with each other.
 - d) There is a right to cancel the contract.
- 4) Rebecca owns a small paddock that she no longer needs for her horses. The neighbouring farmer has offered to buy it and they shook hands on the sale over a drink at the pub. Later, the farmer changed his mind and tried to withdraw from the purchase. Rebecca argued that their agreement in the pub constituted a contract and he must honour it. Was she right?
- 5) Which is true of independent financial advisers in terms of agency law?
 - a) They act on behalf of a network.
 - b) They act on their own account.
 - c) They act as agents of their client.
 - d) They act as agents of their company.
- 6) Why do mortgage lenders insist that joint mortgages are always written on a joint and several liability basis?
- 7) Which of the following statements about the requirements for a valid will is correct?

- a) An executor cannot be a beneficiary.
 - b) There must be a minimum of one witness.
 - c) A witness cannot inherit.
- 8) Harry has died without leaving a will. His estate will be distributed by:
- a) an administrator.
 - b) a solicitor.
 - c) an executor.
 - d) an official receiver.
- 9) What role does the Court of Protection play in relation to enduring powers of attorney?
- a) Enduring powers of attorney must be registered upon execution with the Court of Protection.
 - b) Any action taken by attorneys must be agreed by the Court of Protection.
 - c) The Court of Protection retains a list of all those qualified to act as attorneys.
 - d) Enduring powers of attorney can only be revoked with the consent of the Court of Protection.
- 10) One of the financial restrictions placed on undischarged bankrupts is that:
- a) they are only able to borrow nominal amounts of money.
 - b) they are unable to buy goods, except for their own consumption.
 - c) they are unable to contribute to protection policies.
 - d) they are only able to work on an employed basis.

