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Retail Advice and Regulation

**Assignment 3 Notes**

*(Part 3 – Investment Advice and Planning and Part 4 - Legal Concepts Relevant to Financial Advice)*

*Recommended Time: 3 hours*

1. **Explain, using an example, the difference between a partnership and a limited liability partnership.**

**5 marks**

The crucial difference is the restriction of exposure to debts. As with a sole trader, each partner has unlimited liability for the debts of the partnership. HMRC treats them as self-employed for tax and National Insurance purposes and requires them to pay Income Tax and NICs on their share of the partnership’s profits.

LLPs provide owners with restricted exposure to the business debts. Their personal assets are ring-fenced away from the liabilities of the venture. LLPs, therefore, have proved attractive to professional firms that might face the risk of large liability claims, e.g., solicitors.

Any suitable example would be valid to assist the explanation.

(The relevant sections of the Study Manual are Part 4, Chapter 1.2 and 1.3)

**5 marks**

1. **Outline how you might ascertain your client’s attitude to risk, why it is important to do so and explain typical higher and lower risk investment strategies.**

**30 marks**

Answers should cover the client relationship/scoping process. In particular the information sought during discussions and methods of weighting the various elements.

An adviser to understand the client’s needs and objectives he will need to go through the following stages:

• recognise the client’s needs and objectives

• distinguish between immediate and future objectives

• quantify and qualify the objectives

• prioritise the objectives.

Investors can be placed into one of the five following risk classes:

• no risk – they are not prepared to see any fall in the value of their investments

• low risk – they are prepared to accept some fluctuation in the value of their investments in return for long- term growth but will mainly invest in secure investments

• medium risk – they will have some cash or bond investment but will have a fair proportion in asset-based investments in a diversified investment scheme or share portfolio

• medium-high risk – they will be prepared to invest outside the UK and in high-risk funds. Cash will be kept to the minimum and they may choose to sacrifice some diversification for a more focused and volatile portfolio

• high risk – they are prepared to have direct holdings in listed and unlisted shares, high risk funds and highly geared unprotected structured product. Cash will be kept to a minimum.

Capacity for Loss. The guidance recommended that “firms should ensure:

• they have a robust process for assessing the risk a customer is willing and able to take, including: - assessing a customer’s Capacity for Loss - identifying customers that are best suited to placing their money in cash deposits because they are unwilling or unable to accept the risk of loss of capital - appropriately interpreting customer responses to questions and not attributing inappropriate weight to certain answers

• any risk-profiling or asset allocation tools, where used, are fit for purpose and any limitations recognised and mitigated

• any questions and answers that are used to establish the risk a customer is willing and able to take, and descriptions used to check this, are fair, clear, and not misleading

• they have a robust and flexible process for ensuring investment selections are suitable given all aspects of a customer’s investment objectives and financial situation (including the risk they are willing and able to take) as well as their knowledge and experience

• they understand the nature and risks of products or assets selected for customers, and

• they engage customers in a suitability assessment process (including risk-profiling) which acts in the best interests of those customers.”

Lower risk

Fixed Interest

• Gilt funds

• Global Government bond funds

• Investment grade corporate bond funds Equities

• Equity income funds

• Income and growth funds

Higher risk

• Emerging market bond funds

• High-yield bond funds

• Strategic bond funds

• Alpha funds

• Smaller company funds

• Specialist funds (e.g., technology)

* 1. full answer should cover the Financial Conduct Authority’s expectations and concerns in this area.

(The relevant sections of the Study Manual are Part 3, Chapter 2.1, 2.2 and 2.4)

**30 marks**

1. **Describe how and when an adviser should report on portfolio performance to a client.**

**15 marks**

Answers should include the contents of typical reports. Examples would be useful to illustrate.

Coverage of measures of investment performance should be included:

* + Money weighted rate of return can be used to calculate investment performance for a portfolio. It allows the investor to determine the rate of return during a selected period of time for which his capital has been invested. The return on the portfolio is the difference in the value of the portfolio at the end compared with the value at the start of the period adjusted for any income or capital distributions made from the portfolio during that period.
  + Time weighted rate of return compound the results for each sub-period. This is regarded as a better measure of performance and is better suited to be an evaluation tool of investment managers’ performance: it allows comparisons to be made more easily. The time-weighted return links together elements over the whole period of investment and is not sensitive to contributions or withdrawals. Essentially it is the compounded growth rate over time, hence “time weighed”, of the actual investments for all of the sub-periods being measured.
  + Relevant benchmark is a standard against which an asset’s, or a fund’s performance can be measured. A client’s investment needs may or may not dovetail with a carefully selected benchmarked fund. An adviser should find out the asset allocation for the benchmarked fund and separately would need to establish if this met the client’s needs – indeed a benchmark could be customised for an important client or group of clients.

The investment policy statement should be reviewed on a regular basis, probably annually. Also, it may need to be changed to reflect changes in regulation, taxation, and the financial environment.

Discussion of the review process is also relevant.

(The relevant sections of the Study Manual are Part 3, Chapter 3.3 and 3.4)

* + 1. **marks**

1. **Describe the main types of trusts and how they can be created.**

**10 marks**

Answers should cover:

* + Bare trusts
  + Interest in possession trusts
  + Discretionary trusts
  + Accumulation trusts
  + Settler interest trusts
  + Employee benefit trusts

In addition, answers should cover the 3 certainties when discussing the creation of trusts. As only 10 marks are available for the whole question only brief detail is required for each element.

(The relevant sections of the Study Manual are Part 4, Chapter 6.2 and 6.5)

**10 marks**

1. **Outline the differences between Enduring and Lasting Power of Attorney.**

**15 marks**

The Enduring Powers of Attorney Act 1985 was introduced to allow for an individual holding a Power of Attorney to continue to act for the Donor in the event of his mental incapacity. An enduring power can only authorise Attorneys to make decisions about the Donor’s property and financial affairs. While the Donor has full mental capacity, an enduring power usually confers the same powers as a general Power of Attorney. In this case the enduring power does not have to be registered before it can be used, unless there is an express condition requiring registration. The enduring power must be registered with the Office of the Public Guardian (OPG) as soon as the Donor starts to lose capacity. This registration may be cancelled on the Donor’s recovery.

An Enduring Power of Attorney must meet the following requirements:

• established before 1 October 2007 (it does not need to have been registered)

• the Donor and Attorney had mental capacity

• the Donor and Attorney were over age 18 and not bankrupt

• satisfies the conditions of the Enduring Powers of Attorney Act 1985

• the Attorney registers the enduring power with the OPG as soon as the Donor starts to lose capacity.

An enduring power can be revoked by the individual at any time, except that if it has been registered it can only be revoked with the consent of the Court of Protection. It is automatically revoked if the Donor or the appointed Attorney becomes bankrupt or dies

The Mental Capacity Act 2005 introduced a new format: the Lasting Power of Attorney. There are two different types of Lasting Power of Attorney:

• Health and Welfare Lasting Power of Attorney (sometimes called a Personal Welfare Lasting Power of Attorney)

• Property and Financial Affairs Lasting Power of Attorney.

The Donor must be over 18 with mental capacity and the Attorney must be over 18 with mental capacity and not be bankrupt. If the Donor is or becomes bankrupt, the bankruptcy order would restrict the Donor’s/Attorney’s powers re dealings on property.

A Lasting Power of Attorney automatically ends if:

• the Donor or the Attorney dies

• the Donor or the Attorney becomes bankrupt)

• a marriage or civil partnership between the Donor and the Attorney is dissolved or annulled

• the Attorney lacks the mental capacity to make decisions

• the power is “disclaimed” (or rejected) by the Attorney

(The relevant sections of the Study Manual are Part 4, Chapter 1.6.1 and 1.6.2)

* + 1. **marks**

1. **Explain the difference between bankruptcy and insolvency.**

**10 marks**

Marks are available for defining each concept and then explaining the difference. An example to illustrate would be helpful.

Bankruptcy tends to affect individuals whilst insolvency is more commonly used to refer to companies.

(The relevant sections of the Study Manual are Part 4, Chapter 3.1 and 3.2)

**10 marks**

1. **Write brief notes on the following forms of property ownership in the UK:**

* 1. **Freehold.**
  2. **Leasehold.**
  3. **Commonhold.**
  4. **Shared ownership.**

**15 marks**

Approximately equal marks are available for each section of this question. Therefore, answers are only required to be brief, with approximately 3-4 marks available for each. Examples would be helpful.

If a property is freehold, it means that the individual owns the property and the land on which it is built outright (subject perhaps to restrictive covenants). A freehold property remains the property of the owner until he decides to sell it or dies. When the owner dies, it is part of his or her estate and can be bequeathed to his or her heirs.

Under a leasehold agreement, the land on which a property is built is not owned outright by the owner of the property. Instead, it is leased to the property owner for the period stated in the lease. The leaseholder pays a ground rent to the freeholder. The land and any property on it would revert to the freeholder who owns the land outright when the lease expires. The length of a lease diminishes over time; its initial term is typically for 99 years although leases do exist for up to 999 years. The duration of the lease purchased has a direct bearing on a property’s value.

Under commonhold, owners of the flats are called unitholders and they own their flats in perpetuity. Land is commonhold land if:

(a) the freehold estate in the land is registered as a freehold estate in commonhold land,

(b) the land is specified in the memorandum of association of the commonhold association as the land in relation to which the association is to exercise functions, and

(c) a commonhold community statement makes provision for rights and duties of the commonhold association and unitholders (whether or not the statement has come into force).

Shared ownership are schemes operated by housing associations which allow a purchaser to buy a share in a property, usually 25%, 50% or 75%, while paying a rent to the housing association for its share of the property: the scheme is called Help to Buy: Shared Ownership. The purchaser will then be able to buy additional shares in the property from the housing association over time until they eventually own 100% of the property. Shared ownership properties can be sold, with the new owner taking on the existing owned/ rented split and being given the option to increase their ownership as above. Modified versions of the scheme are available to the over 55s and for people with disabilities

(The relevant section of the Study Manual is Part 4, Chapter 4.1, 4.2, 4.3 and 4.4)

**15 marks**