Level 3: Certificate in Financial Studies (CeFS) 600 / 8537 / X

Unit 2 – Financial Capability for the Medium and Long Term (FCML) D / 504 / 8110

June 2019 Examination

EXAMINATION COPY
Case Study Information and Data

Instructions to learners:

This material has been designed to provide background information / research material for the examination. It is intended to help students familiarise themselves with the enclosed material prior to the examination.

The information and data is made up of:
- Case study 1 information and data.
- Case study 2 information and data.

Candidates are advised to read **both** sets of case study information and data prior to the examination. At the beginning of the examination, candidates are advised to review the case studies in conjunction with the question paper before committing to answering a particular case study.

Please note:

- You may annotate the case study material.
- The figures and products featured in the case study information and data were correct at the time of writing. Learners are not expected to know current interest rates of specific products and services, nor to have detailed knowledge of changes to products and services.
- Although this material contains certain information relating to the examination scenarios and questions, additional information is provided in the examination question paper.

Case study 1: Information and Data begins on page 3

Case study 1

Will anyone insure Stephen?

Stephen, aged 17, is studying a qualification in Motor Vehicle Maintenance. Stephen has been relying on his parents to drive him to college and the garage in the next town, where he has a part-time job as a car mechanic assistant.

Stephen's parents contributed £500 toward the cost of his driving lessons. He passed his driving test two months ago after spending an additional £350 from his savings, which enabled him to complete the lessons needed.

When he needs money, Stephen can always borrow it from his parents. The expenditure on the driving lessons has reduced the balance of Stephen's savings account with NatWest to £1,850 (earning interest of 1.50% AER).

He earns £6.50 per hour working eight hours every Saturday, with the opportunity to earn more if the garage is busy during the holidays.

Stephen will be 18 years old in two months and, after completing his studies, he would like to work full-time as a mechanic. He likes the idea of being able to travel and work in a range of garages across Europe.

Stephen's parents bought him a Ford Fiesta 1.4, which, despite being six years old, has been fairly reliable. Stephen does not like the thought of being stranded if the car breaks down.

While learning to drive the Fiesta, Stephen was insured as a named driver on his mum's insurance policy. His friend Matt has suggested that Stephen could just carry on driving the car full-time as the sole main driver. However, Stephen's mum has told him, that if he is going to be the main driver of the car, he now needs to take out his own insurance policy. Stephen wants to know why car insurance for younger drivers can be expensive.

The research

Car insurance premiums in the UK vary due to different factors considered by insurance companies when assessing the risks presented by the driver they are insuring. These include: age, driving experience, insurance excess payable, type of

vehicle insured, annual mileage, existing 'no claims' discount and the history of driving accidents or convictions.

Table 1 highlights why insurance companies may feel that young drivers represent a higher cost to them, due to the increased likelihood of a claim being made:

Table 1: Young driver statistics - deaths and accidents

Fact	Proportion of drivers
Drivers aged 17-19 make up 1.5% of UK licence holders, but are more likely to be involved in fatal and serious crashes where they are the driver	9%
Drivers aged 16-19 are more likely to die in a crash than drivers aged 40-49	33% more likely than drivers aged 40-49
18-24 year olds are likely to crash within two years of passing their driving test	23%
There is a difference in the safety between young male and female drivers	Young male drivers are more likely to crash than female drivers

Source: www.brake.org.uk

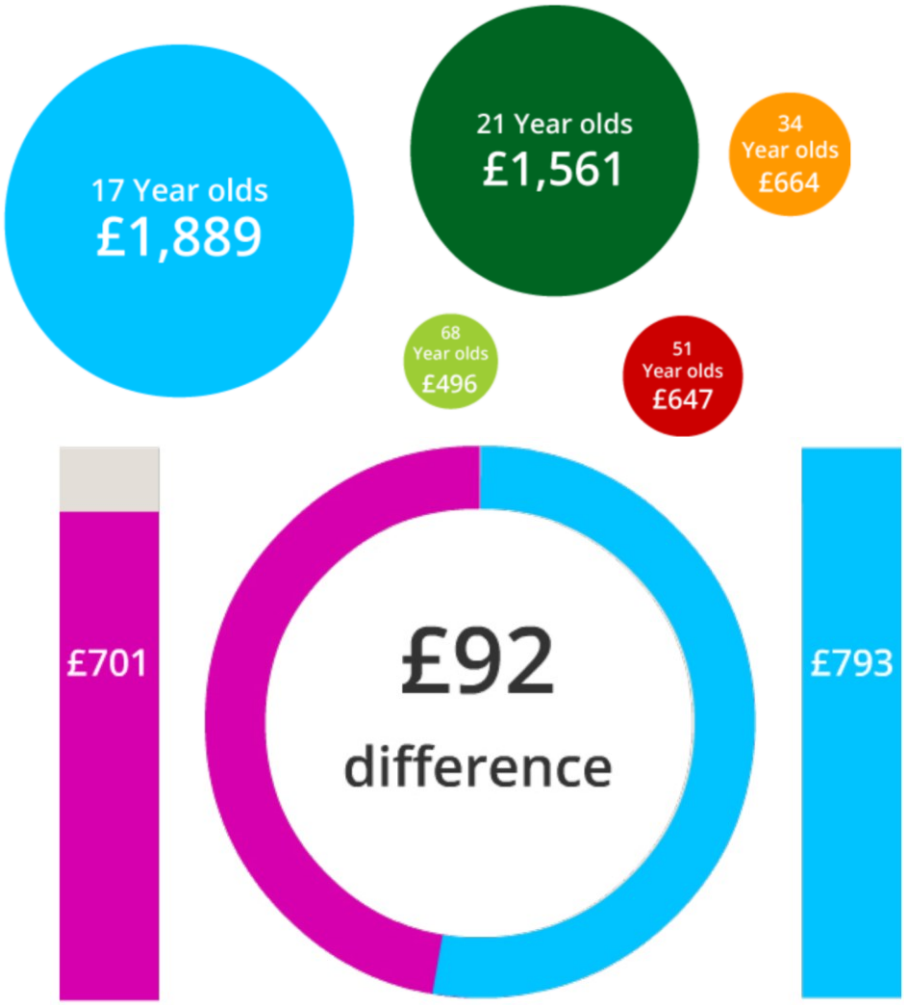
The road safety charity Brake, states that young drivers are more at risk because they over estimate their abilities, assess hazards poorly and are more likely to take risks when driving, such as speeding, not wearing seat belts and using mobile phones. Driving at night is also an additional risk.

"Young drivers have a higher proportion of crashes in the evenings and early mornings. This is particularly true for young male drivers: in the UK, male drivers aged 17-20 are seven times more likely to crash than all male drivers, but between the hours of 2am and 5am their risk is 17 times higher." (*Source*: www.brake.org.uk)

The effect on car insurance premiums charged to consumers

These additional risk factors result in car insurance premiums being at their highest for new 17-year-old drivers. The Association of British Insurers (ABI) reported that £55 is added to insurance policies to pay for fraudulent claims made by the uninsured. Chart 1 shows the average car insurance premiums paid for drivers at different ages and the average premium for male and female drivers overall.

Chart 1: Comparison of the average car insurance premiums for consumers of different ages and gender



Source: www.confused.com

Young motorists may find that they pay less for their insurance if they are a named driver on a policy for which another adult, often their parent, is named as the main driver of the vehicle, even if this is not the case in reality. This is known by the insurance companies as 'fronting' and the consequences are explained on the Tesco Bank website:

"Fronting is one of the biggest problems facing the insurance industry. The term basically describes a type of fraud, but one that many policyholders do not even realise they are committing. It can, however, have serious consequences.

A common example of fronting is a parent looking to secure car insurance for their child who is starting university. The senior driver will state that they are the main

user, when in fact the vehicle will spend its time travelling to and from a university campus.

Many people who 'front' do not know it is illegal, and instead think they are being savvy with their insurance. But if the young driver is the owner or keeper of the car, then the policy should be in their name. At the very least, they should be declared as the main driver.

Should the insurer conclude that fronting has occurred, it may refuse to pay for any damage. If a third party was involved, the insurance company would be obliged to cover the cost of the repairs, but may try to recoup its expenses from the policyholder. If the courts become involved, the policyholder may also be charged with fraud." (*Source*: www.tescobank.co.uk)

Other providers may then refuse to insure the driver if they are found guilty of a crime to do with insurance fraud or driving while uninsured. Fronting is considered to be a form of insurance fraud (as the main driver of the car is not the person listed) as www.lv.com explain:

"In insurance law, a policyholder is bound contractually to give full and accurate information to enable insurers to correctly underwrite and price the risk. By fronting, drivers are providing false information.

The Fraud Act 2006 defines fraud as the defendant being dishonest with the intention to make a gain or to cause loss to another, while The Consumer Insurance (Disclosure and Representations) Act 2012 defines the different types of misrepresentation and the subsequent remedies available to insurers when dealing with them." (*Source*: www.lv.com)

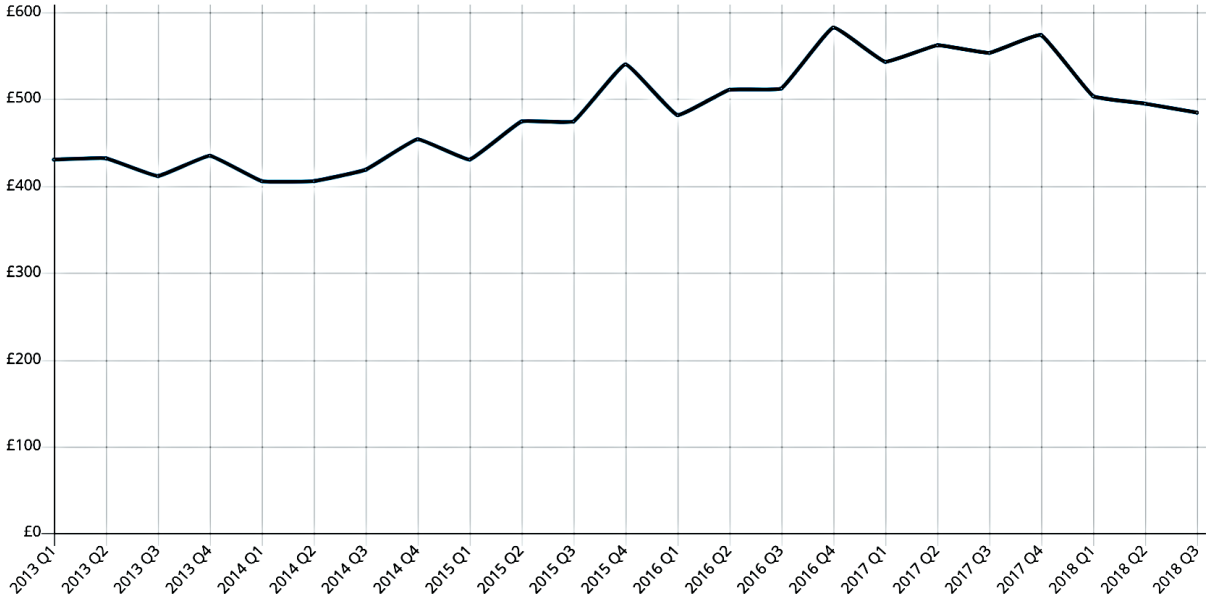
"Tackling insurance fraud remains an industry strategic priority. In 2016, insurers detected 125,000 dishonest insurance claims valued at £1.3 billion. It is estimated that a similar amount of fraud goes undetected each year. This is why insurers invest at least £200 million each year to identify fraud.

Insurance fraud cuts across every type of insurance. At one end of the spectrum, fraud may be committed by opportunists, where people encounter an opportunity within their everyday experiences and lives to invent or exaggerate a claim or to deliberately or recklessly provide false information when applying for insurance. At

the other end, there are highly organised criminal gangs, for example fraudsters involved in ‘crash for cash’ motor fraud scams.” (*Source*: www.abi.org.uk)

Consumers can reduce the premiums paid for their car insurance by approaching a number of insurance companies to find the most competitive quote for their insurance. This is known as 'shopping around' and can result in savings for the consumer, as illustrated in Graph 1 below:

Graph 1: The changing cost of car insurance (2013 to 2018)

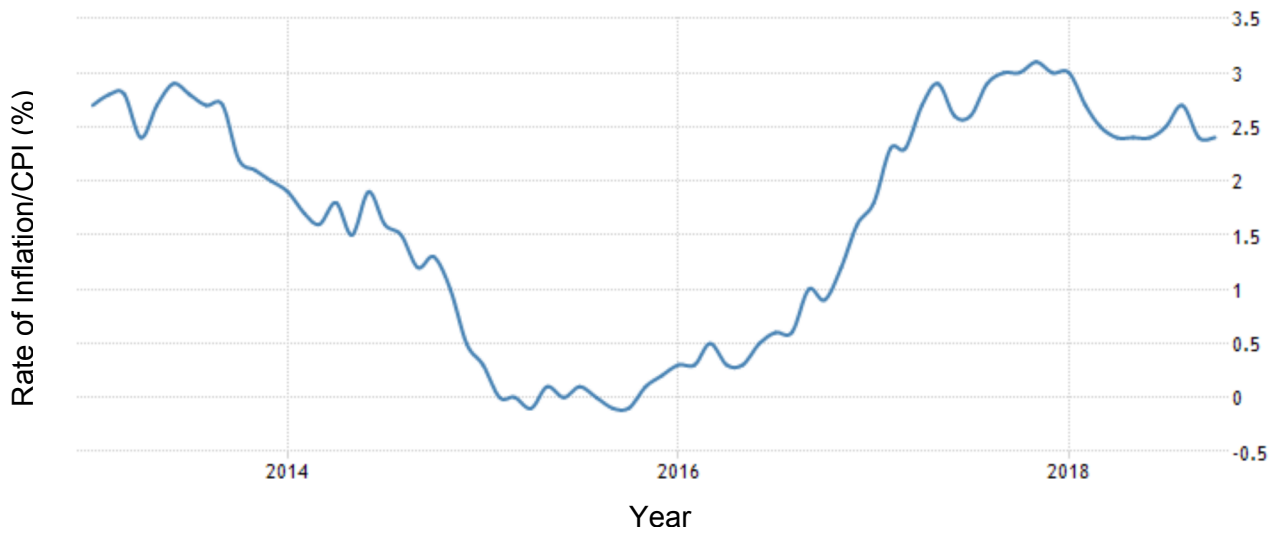


Source: www.moneysupermarket.com

The effect of inflation

Consumers are constantly faced with the effects of inflation as the prices of items, including insurance, generally rise over time. Graph 2 shows how the rate of inflation has changed over time:

Graph 2: Changes in the UK rate of inflation (CPI) from October 2013 to October 2018



Source: www.ons.gov.uk

A dangerous decision to make

The high cost of car insurance may cause some determined young motorists to drive with no insurance at all. On the website www.insurancetimes.co.uk, Clare Ruel wrote:

"The Motor Insurer's Bureau (MIB) has estimated that 25,000 learners are driving uninsured.

Those found to be driving without insurance could have their car seized by the police; receive six points on their licence, a £300 fine and further penalties.

Considering recent research that found a third of younger drivers are wrongly blamed for motor incidents, valid insurance could be vital. Richard Browning, director at the firm Nextbase, highlights that younger drivers are still 'penalised with sky high car insurance.'

However, companies like Insurethebox are supporting young drivers using telematics data to support insurance premiums."(*Source*: www.insurancetimes.co.uk)

The consequences of driving without insurance or being found guilty of 'fronting' an insurance policy include being fined and having six penalty points being added to the driving licence. Drivers who incur 12 or more penalty points within a three-year period

could be disqualified from driving and new drivers who receive six penalty points within two years of passing their test will be made to retake the test. This may also affect their ability to get insurance in the future.

Case study 2: Information and Data begins on page 11

Case study 2

Sachi is interested in friendly societies

Sachi, aged 25, works for a large local insurance company in Sheffield, Yorkshire. She was born in Sheffield and her family still lives there. She budgets very carefully and always aims to save as much money as possible in each tax year. She has had a number of promotions and now earns £39,000 per year. Her first priority is to be as tax-efficient as possible in her savings. She has already put the maximum amount allowed into her tax-free ISAs for the year, depositing into a cash ISA and into a stocks and shares ISA. She also benefits from tax relief on her pension contributions.

She has been going out with her boyfriend for over five years and they have been talking about the possibility of getting married in a few years' time and starting a family. They will continue to live locally as they both like the sense of community generated by the local council, businesses and residents.

She believes that as a hard-working young woman, she should be able to earn as much interest as possible from her savings accounts without having money taken away as tax.

She has discovered from an article in a monthly personal finance magazine, however, that there is another way to save tax-free in addition to ISAs. This is through friendly societies.

She had never heard of friendly societies and has asked you to find out more about them, especially in terms of the possibility of having another tax-free way to save. She has heard that they sell a range of products called tax-free savings plans, sometimes called tax-exempt savings plans. She wants to know if their rates of interest are better than the rate she is getting on her cash ISA, especially if she saves/invests for the medium term. She would also be interested in them if they have strong foundations in local communities and good ethical and sustainability reputations.

The research

Friendly societies

If a customer wanted to find tax-free or nearly tax-free investments, they have been able to purchase ISAs and make pension contributions for some years. Another way to invest nearly tax-free is through a friendly society.

Friendly societies can offer nearly tax-free returns way above the average for the investment market for similar products, but a few have not grown very well and might actually offer much less than the market average, especially when you factor in inflation.

"Friendly society savings plans offer tax-free advantages for long term investments. You can save up to £25 a month or £270 annually into a friendly society investment. The fund grows largely free of tax. You choose how long you want to save for. The tax free limit of £270 a year is in addition to your annual ISA allowance." (*Source*: www.which.co.uk). Where taxable, dividends are liable to 10% taxation.

Friendly societies range a great deal in size, from the giant LV= (formerly Liverpool Victoria) with 1.1 million members (with over 30,000 investing in tax-exempt plans) and over £18bn in assets, to smaller ones such as Red Rose Assurance in Blackburn with approximately 18,000 members and £19.5m in assets.

Friendly societies are mutuals, owned by their members, who can influence the policies of the society. They do not have shareholders like most providers and are managed for the benefit of the members. Many are locally based, serving local communities. They are authorised by the Prudential Regulation Authority (PRA) and regulated by both the PRA and the Financial Conduct Authority (FCA). They are covered by the Financial Services Compensation Scheme for 90% of any single investment, with no limit. They argue that they are in a better position to give good returns on investments because the profits are returned to the business and members after the cost of running the business is removed.

Friendly societies offer tax exempt plans for children as well. "These children's savings plans are only available through friendly societies. These are mutual benefit organisations, which means they're owned by their members to work for the

advantage of those members. You can choose to pay into the plan for between 10 and 25 years.

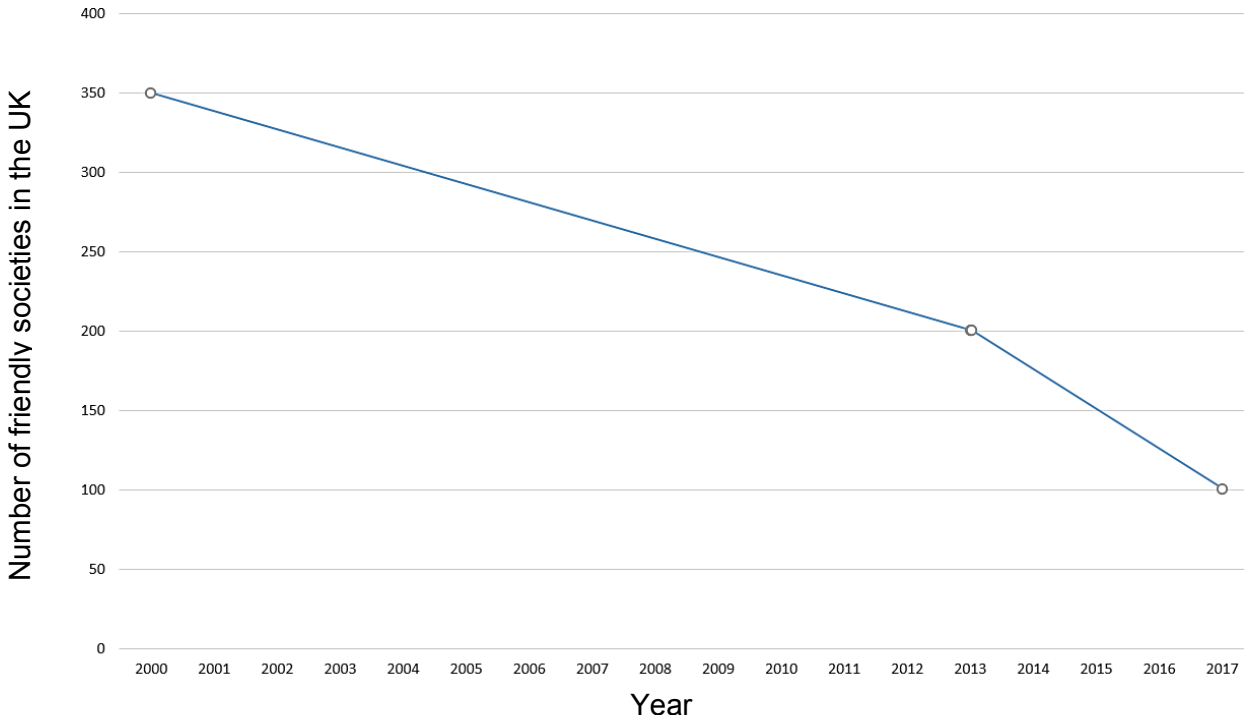
Money is invested in a share-based investment fund for the term length you choose. The maximum amount you can pay in is £270 a year, or £300 a year if you pay in £25 each month. On the maturity date, the child must be at least 16 and you must have paid into the plan for a minimum of ten years. As long as you continue to pay into the plan for a minimum of ten years, your child won't pay Capital Gains and Income Tax on any gains or income." (*Source*: www.moneyadviceservice.org.uk)

Payments received from a friendly society are treated as dividends, as members are stakeholders in the company. There was a £2,000 dividend tax allowance in 2018/19, which meant any earnings from dividends below that level were tax-free.

Andrew Townsley, Chief Executive of one of the friendly societies, Kingston Unity, has stressed the change in attitude towards saving since the credit crisis of 2007–08: "Since the financial meltdown in 2007 it's fair to say that the attitude that many people have towards money has changed dramatically. Previously the trend was towards spending rather than saving, but now the tide is beginning to turn in favour of saving instead of splurging. But finding the right savings products to meet your individual needs can be difficult. The tax exempt savings plan is a product that is exclusive to friendly societies and enables consumers to maximise the amount they can save tax-free." (*Source*: www.moneyobserver.com)

Before the development of large-scale government and employer health insurance and other financial services, friendly societies played an important part in many people's lives. Some of them developed into large mutually run financial institutions, typically insurance companies, and continue to have a role based on solidarity and democracy without an objective to make a profit.

Graph 1: The number of friendly societies in the UK 2000–17



Source: www.friendlysocieties.co.uk

The first friendly societies in the UK were formed towards the end of the eighteenth century, and by the end of the nineteenth century there were about 27,000 in existence. The largest today, LV=, can trace its history back to 1843.There were about 350 in 2000, with approximately 8 million members and customers, but since then the number of friendly societies has declined, largely as a result of mergers. Now there are less than 100 in operation.

The friendly societies' website has stated: "Many have remained locally based, while others have grown into national organizations, offering sophisticated financial services products to their members." (*Source*: www.friendlysocieties.co.uk.)

The growth of some societies has created marketing opportunities for some, such as TV advertising:

Source: LV.com's Youtube channel

Life cover

"Most friendly society tax-exempt savings plans include life insurance cover. This means that if you die during the term of the plan, your estate will receive the guaranteed sum assured stated in your personal illustration, plus any bonuses.

Some of your monthly premium is used to buy life cover, which will pay out if you die before the end of the term. The rest of the premium is invested."
(*Source*: www.which.co.uk)

Life cover is something that needs to be considered in financial planning, especially if a person is married: "When one partner dies, a household's living costs go down, but they are not likely to be reduced by half because the economies of scale will be reduced. If the deceased was in employment, household income will be reduced, and if he or she was doing much of the household's unpaid work, household expenses will have to go up to replace the benefits of that work. In most cases, this means that a person's death leaves their household worse off, not only emotionally but financially too."
(*Source*: Callaghan, Fribbance and Higginson (2007) *Personal Finance,* page 353)

Interest rates on cash ISAs

Sachi is concerned that the rate of interest she is receiving on her cash ISA (2.2% fixed rate) is below the rate of inflation (2.3%) (January 2019) and she is not alone in experiencing that concern.

Writing in January 2018 for the *Daily Express*, Harvey Jones said, “people blame today’s low savings returns on the Bank of England’s decision to slash base rates to near zero, but it is not the only culprit. Savers have even more reason to rue something called the Funding for Lending Scheme (FLS), which has unwittingly encouraged banks and building societies to snub savers and pay record low rates on deposits.” (*Source:* www.dailyexpress.co.uk)

Funding for Lending Scheme (FLS) has encouraged banks to pay record low rates on deposits

The Bank of England launched the FLS in July 2012 to encourage banks and building societies to lend money and boost the UK economy.

However, the scheme had one unintended consequence. Previously, high-street banks and building societies funded their lending by attracting deposits from savers, now they no longer needed to bother.

Anna Bowes, director of savings website SavingsChampion.co.uk, says savings rates crashed as a result: “The FLS had an immediate and disastrous impact on the savings market and it is yet to recover.”

The FLS was expected to be a temporary measure, but it was extended repeatedly and expired at the end of January 2018. A follow-on called the Term Funding Scheme (TFS), launched in August 2016 to give lenders another £100bn, and expired in February 2018.

Sarah Coles, personal financial analyst at wealth advisers Hargreaves Lansdown, says there is a long way to go with the last year the worst on record for cash ISAs: ”However, there are signs we have reached a turning point, as rates climb. The end of the FLS and TFS could be just the shot in the arm the ISA market needs.” (*Source*: www.express.co.uk)

Recent years have seen multiple drops in interest rates, largely due to the falls and continued low levels of the Bank rate announced by the Bank of England since 2016.

With many expecting the Bank of England to increase base rates further this year, Cole says that savers can now be more cheerful about the outlook.