

**CeMAP Module 1**  
**Revision Notes 2011-2012**





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## Introduction to CeMAP Module 1 Revision Notes

### Using the Revision Notes

These notes are designed to assist with your revision. However, **it is important that you have read and also keep referring back to your study manual** to ensure that you have a full understanding of the subject matter.

#### **Revision tips:**

The odd hour of revision here and there is not enough to gain this professional qualification. Make a revision plan and ensure that you adhere to it.

Know your strong and weak subject areas and mix them into your timetable. Do not do all the more difficult subjects at once!

Set targets that you know you can reach and tick them off when you have accomplished them.

Find somewhere quiet to revise.

- **Condense:** fitting notes onto one side of paper or onto permanent cards makes them easier to revise from, so write and cut down as you go.
- **Highlight:** target areas using colour and symbols; visuals help you remember the facts.
- **Record:** try putting important points onto a tape. If you hear them AND read them, you will have a better chance of remembering them.
- **Talk:** read your notes aloud; it's one way of getting them to register.
- **Test:** see what you can remember without notes, but avoid testing yourself on areas that you know already.
- **Time:** attempt specimen exam questions against the clock.
- **Do not overdo it:** your concentration lapses after a short space of time, so take regular breaks.
- **Focus:** look at practice questions and see how they could be asked.

#### **On the day of your examination:**

- Set off in plenty of time, allowing for bad weather or traffic.
- Make sure you know where the exam venue is and where you can park or how close the train station is.
- Make sure any documents you need (such as identification) are laid out the night before.

### Rules and Regulations

For the rules and regulations governing the conduct of the examinations please refer to the *ifs School of Finance* website:

[www.ifslearning.ac.uk/qualifications/regulations\\_and\\_policy\\_forms](http://www.ifslearning.ac.uk/qualifications/regulations_and_policy_forms)

The syllabus for this module is printed within the study manual. Please ensure you familiarise yourself with it.

**Important note:**

You are not expected to memorise specific case law names and dates, or current tax and national insurance rates and allowances. A list of appropriate tax and national insurance rates and allowances, etc., will be made available at the examination itself.

**Additional support:**

The following are available to purchase from the *ifs*, which you can either buy online via their website: [www.ifslearning.ac.uk](http://www.ifslearning.ac.uk) or call their Customer Services and pay over the phone on: 01227 818609.

- ***Specimen Papers*** – available for each unit and module in printed form. These mirror the live exam for style, coverage of learning outcomes, etc. Each is supplied with a full list of answers and justifications.
- ***Competence Development Tool*** – this popular e-learning tool features complete specimen question banks for every module with feedback linking every question to the study text. It is updated every year in line with the syllabus.

We provide our own specimen papers which are inclusive of our course costs. You may find these sufficient, however to get further test papers, visit website: [www.wizardlearning.com](http://www.wizardlearning.com) and you can download more, although there is a charge for these additional test papers, as for the *ifs* ones.

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## Section 1 – The Purpose and Structure of the UK Financial Services Industry

This topic provides a broad introduction/background to the subject by considering the:

- Nature and functions of money
- Way in which banks and other institutions act as intermediaries between those who have money to lend and those who wish to borrow
- Role of the Bank of England
- Influence of the European Union on UK financial affairs
- Structure of commercial financial organisations in the UK.

*This topic provides a summary of the key points contained in the study manual: Unit 1, Sections 1.1, 1.2, 1.3.1 and 1.3.2.*

### 1.1 Functions of Money

- Medium of exchange – requirements:
  - sufficient quantity
  - generally acceptable
  - divisible into small units
  - portable
- Unit of account:
  - common denominator against which all values can be measured
- Store of value:
  - can be used to separate transactions in time
  - adversely affected by inflation

### 1.2 Intermediation

- Surplus sector – individuals/organisations with more liquid funds than they wish to spend currently
- Willing to lend for a profit
- Deficit sector – those who have less liquid funds than they currently need
- Willing to pay to borrow funds

Financial intermediaries (e.g. banks, building societies) – borrow from surplus sector and lend to deficit sector.

- Profit margin is the difference between the two interest rates

Four elements of intermediation:

- **Geographic location** – brings together lenders and borrowers from different locations
- **Aggregation** – the average size of deposits is much less than the average size of loans
- **Maturity transformation** – the average term of deposits is less than the average term of loans
- **Risk transformation** – potential lenders do not wish to lend all their funds to one borrower because of the risk of loss on default

## Disintermediation

- Where lenders and borrowers interact directly rather than through an intermediary, e.g:
  - companies issuing shares to raise funds from the public

## 1.3 The Bank of England (BoE)

The UK's Central Bank since 1946.

- Central banks typically act as bankers for the Government, supervise the economy and regulate the money supply

Other roles of the Bank of England:

- Issuer of bank notes
- Banker to the banks:
  - all major banks have accounts at the BoE for deposits, clearing etc.
- Adviser to the Government
- Responsibility for implementing monetary policy:
  - the Monetary Policy Committee (MPC) of the BoE sets interest rates in order to meet the Government's inflation targets
- Management of UK's official reserves of gold and foreign currencies
- Lender of last resort – making funds available if the banking system is short of liquidity
- Roles formerly but **no longer** carried out by the BoE:
- Management of new issues of gilt-edged stocks (transferred to the Debt Management Office of the Treasury)
- Authorisation and regulation of the UK banking sector (now carried out by the FSA). The Chancellor of the Exchequer announced in June 2010 that these regulatory functions will be returned to the Bank of England, possibly as early as 2012.

## 1.4 Types of Commercial Organisations

### *Proprietary and Mutual*

- Proprietary – public or private limited companies, owned by shareholders:
  - shareholders receive share of profits as dividends and can vote at shareholders' meetings
- Mutual – owned by members, e.g. building societies owned by depositors and borrowers:
  - many large building societies have de-mutualised and become proprietary banking institutions

### *Credit Unions*

- Financial co-operatives run for the benefit of members, who are linked in some way. Can now accept members based on several different criteria.
- Traditionally operating in poorer sections of society, they can help to combat financial exclusion.
- They provide savings and loan facilities. Each £1 of savings buys one share in the credit union.
- Shares pay dividends typically 2%.
- Can now accept deposits.
- Loans charged at typically 1% per month on the reducing balance (maximum permitted 2%).
- Authorised and regulated by the FSA.

### ***Retail and Wholesale***

- Retail banking – High Street banks and building societies:
  - provide the common services to personal and corporate customers
- Wholesale banking – generally much larger transactions:
  - raising money through money markets in which banks recycle surplus funds directly with one another or through money brokers
  - LIBOR – the rates at which banks lend to one another – used as a reference rate for corporate lending
  - building societies can raise funds on the wholesale money markets, up to 50% of their liabilities

## **1.5 The influence of the European Union**

The UK is a member of the EU – since 1973 – but not of the Eurozone.

Many of the UK's financial (and other) laws are the result of EU legislation, e.g. laws and regulations relating to:

- Banking
- Investment
- Life assurance
- Financial advice
- Compensation for losses
- Money laundering
- Data protection

European laws are decided upon by the European Parliament that consists of elected MEPs, and the Council of Ministers who are Government representatives from member states.

The two most common types are:

- **Regulations** – they have direct application in all member states
- **Directives** – they are binding 'as to the result to be achieved'
  - i.e. each member state must pass local legislation to implement the objectives of the directive
  - normally this must be done within two years of the directive being agreed

This leads to **five** levels of regulation in the UK:

- **First Level** - European legislation (regulations and directives that impact on the UK)
- **Second Level** - Acts of Parliament (e.g. Financial Services and Markets Act 2000)
- **Third Level** - Regulatory bodies (monitoring regulations and issuing rules and requirements)
- **Fourth Level** - Policies and practices of institutions (the bank's own procedures)
- **Fifth Level** - Arbitration/ombudsman schemes (e.g. Financial Ombudsman Scheme)

## **1.6 Money Transmission and Clearing**

Money transmission services:

- Cash provisions, ATMs
- Current accounts, basic bank accounts
- Cheques
- Debit cards
- Direct debits and standing orders
- Credit transfers

**Clearing:** the process of settling between banks the transfers of money that result from customers' use of cheques, debit cards, direct debits, etc.

Clearing banks have established their own systems in conjunction with other clearing banks. Other banks must establish an agency arrangement with a clearing bank.

UK Payments Administration (formerly APACS).

- Cheque and Credit Card Company
- Voca Ltd, formerly Bankers' Automated Clearing Services (BACS) – electronic clearing, e.g. direct debits
- Clearing House Automated Payment System – electronic same-day Interbank transfers for high-value payments

**Test Yourself**

**(Test 1)**

Check your understanding of this topic by writing brief answers to the following questions:

1. Jonathan looks around a shop and works out that he can buy nine packets of sweets, or two model cards for the same price as one CD. Which function of money has enabled him to reach this conclusion?
2. What is the main source of profit for financial intermediaries?
3. How do financial intermediaries use *maturity transformation* to assist their customers?
4. Who authorises and regulates banks and building societies?
5. Who is entitled to the profits made by a building society?
6. Can building societies raise funds on the wholesale money markets?
7. How quickly must UK legislation be introduced to give effect to EU directives?

**Answers to Test 1**

1. As a unit of account, money provides a common denominator for comparing values.
2. The excess of the interest they charge to borrowers over the interest they pay to depositors.
3. They offer a different range of terms (periods) for their loans and their deposit products. Deposits are, on average, shorter-term than loans.
4. The Financial Services Authority (although as early as 2012, this responsibility will be returned to the Bank of England.)
5. Building societies are mutual organisations owned by their members, both depositors and borrowers. Profits are applied for the benefit of members.
6. Yes, up to 50% of their funds could be raised in this way.
7. Within two years of the directive being agreed.