Unit 10: Other Financial Products

Delivery Guide

Other Financial Products

Unit Aim: Review a range of personal financial products.

Unit Relevance to the Course: The products featured in this unit will be reviewed in unit 11.

Learning Hours:

Scheduled – 0

Guided – 3

Independent – 1.5

Unit 10 Learning Outcomes

Learning Objective	Learning Outcomes	Chapter Section
10.1.1	Know the differences between bank loans, overdrafts and credit card borrowing	1
10.1.2	Know the difference between the quoted interest rate on borrowing and the effective rate of borrowing	1
10.1.3	Be able to calculate the effective annual rate of borrowing, given the quoted interest rate and frequency of payment	1
10.1.4	Know the difference between secured and unsecured borrowing	1
10.2.1	Understand the characteristics of the mortgage market including: • Interest loans • Loan to value	2
10.2.2	Know the definition of and types of mortgage, including: • Repayment • Interest only • Offset	2
10.3.1	Know the basic principles of life assurance and the definition of the following types of life policy: • Term Assurance • Whole of life	3

How to use this delivery guide

Throughout this delivery guide, look out for the different icons to support the learner experience:

Understand and learn – These **compulsory** sections will help learners to develop their knowledge and understanding of the assessed learning objectives. We have also integrated the CISI micromodules into this learning. These give learners key explanations of the themes in a short, digestible manner and can be found on the CISI learning platform.

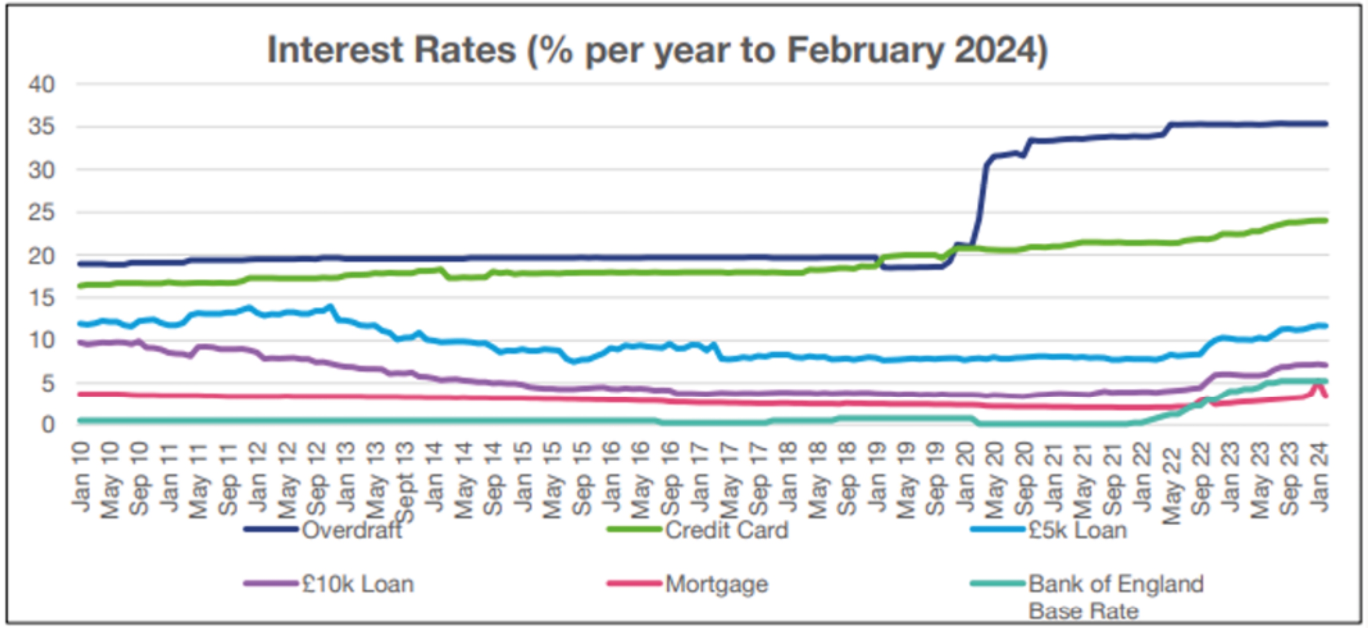
Apply and practise – These sections allow the learners to practise and test their newly acquired learning by undertaking a range of **compulsory** activities to help them prepare for the multiple choice assessment at the end of the course.

Further your knowledge – These sections allow learners to consolidate their understanding of key concepts by reading and interacting with current, credible CISI resources to help further enhance their learning. These **optional** resources include the CISI professional refresher modules and CISI YouTube videos.

Extension Activities – Whilst these activities do not form part of the core learning, we have added lots of extension activities to enhance the learners understanding. These activities include videos and webinars from the CISI TV channel. These activities also provide help and support if learners feel that they might need an extra bit of guidance after completing the end of unit multiple choice assessments.

Introduction – The cost of credit

The graph below shows the differences in the cost of borrowing for a number of common borrowing products in the UK.



Source: Bank of England

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Module Learning Outcome 10.1 – Loans

10.1.1: Understand the differences between bank loans, overdrafts and credit card borrowing

10.1.2: Understand the difference between the quoted interest rate on borrowing and the effective rate of borrowing

10.1.3: Be able to calculate the effective annual rate of borrowing, given the quoted interest rate and frequency of payment

10.1.4: Identify the difference between secured and unsecured borrowing

Borrowing Money

Borrowing comes in many different forms, each designed to meet specific financial needs. In this section we are going to explore the differences in overdrafts, credit cards and loans. Using chapter 10 in the course workbook and any other research, **complete** the following table:

Type of borrowing	Definition	Advantages for the consumer	Disadvantages for the consumer
Overdrafts			
Credit cards			
Loans			

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Case study – overdraft rates

Mai has had some expensive bills lately and whilst these have all been paid, they have left her a little bit short of money for her next months' bills. She thinks that she only needs to borrow for about 2 weeks before she gets paid and she will also receive her annual bonus in her next month's pay too.

She decides that an arranged overdraft would be most suited to her needs so she goes onto her online banking to explore how much this will cost her.

Mai is not sure what the information means so she asks you to **explain** the overdraft details to her.

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Online Overdraft Information for Mai

We've calculated the cost of your borrowing with the **Everyday Current Account** using the information you've entered.

- You are likely to use **£500** of your arranged overdraft limit for **14 days** in the month
- You are not likely to exceed your arranged overdraft limit

Arranged overdraft cost	Arranged overdraft fees	Arranged overdraft rate
£6.54 per month	**EAR (variable)**	**39.94%**

Total overdraft cost

£6.54 per month

APR cost for comparison

39.94%

In your opinion, **what guidance** would you give to Mai about this option. What other options might also be available to her?

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Case study – a credit card dilemma

You have a credit card balance of £1,800. You want to switch to a new credit card company. You are determined not to put any more spending on your new card at all. You just want the cheapest cost over the life of the two year deal. Use the information to work out which offer you should choose.

OPTION 1 – Bank X is offering:

Minimum agreement period of two years

0% introductory rate for 14 months on all balance transfers

2.98% fee payable upon transfer of balance

16.6% APR on the balance from month 15 onwards

OPTION 2 – Bank Y is offering:

Minimum agreement period of two years

3.5% monthly introductory rate for first 12 months on all balance transfers

No fee payable upon transfer of balance

12% on the balance charged monthly from month 13 onwards

Answers

Bank X - 24 month deal	
Balance transferred	1,800.00
Fee of 2.98% on balance transferred	53.64
New balance after addition of 2.98% transfer fee	1,853.64
Introductory interest rate quoted on new balance for first 14 months	0.00%
16.6% APR interest charge on new balance for remaining 10 months	256.42
Total cost of Virgin deal	310.06

Bank Y- 24 month deal	
Balance transferred	1,800.00
Fee of 0% on balance transferred	0.00
New balance after 0% transfer fee	1,800.00
Introductory Monthly Interest rate charge on new balance for first 12 months	3.50%
APR equivalent on balance for first 12 months	3.56%
3.56% APR interest charge on balance for first 12 months	64.08
New balance after interest charged at 3.56% APR introductory rate	1,864.08
Interest rate quoted on new balance for remaining 12 months	12.00%
APR equivalent on new balance for remaining 12 months	12.68%
12.68% APR Interest charge for remaining 12 months	236.37
Total cost of Magic Bank deal	300.45

Scenarios

Read the scenarios below then **decide** which type of borrowing (credit card, loan, overdraft) might be most suitable for the customer and **explain** your reasons for this. **Discuss** what the drawbacks of your chosen option might be too for the customer.

SCENARIO 1

Jerome wants to purchase a new PC. He has a full time permanent job, a decent salary and whilst doing an eligibility check, discovers that is credit score/report is healthy.

Explanation and drawbacks

Credit card

Loan

Overdraft

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Scenarios

Read the scenarios below then **decide** which type of borrowing (credit card, loan, overdraft) might be most suitable for the customer and **explain** your reasons for this. **Discuss** what the drawbacks of your chosen option might be too for the customer.

SCENARIO 2

Simone has been saving for a while for a new electric bike, she's almost achieved her target but is short by about £300. She's seen a great deal online so wants to buy it quickly before the deal ends.

Credit card

Loan

Overdraft

Explanation and drawbacks

Scenarios

Read the scenarios below then **decide** which type of borrowing (credit card, loan, overdraft) might be most suitable for the customer and **explain** your reasons for this. **Discuss** what the drawbacks of your chosen option might be too for the customer.

SCENARIO 3

Mo has just got a new part time job and is looking at buying a second hand car to get to work. He can't afford to buy it outright.

Credit card

Loan

Overdraft

Explanation and drawbacks

Calculating EAR from the quoted rate

- **Watch** the YouTube video about how the effective annual rate is calculated.

- **Read** the section about EAR in chapter 10 of the course workbook along with the case study showing how the formula for calculating the effective annual rate is used.

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Calculating the EAR – practice questions

1. A lender has advertised a new credit card with a rate of 3.99% APR. In the terms and conditions it states that interest will be charged monthly. **Calculate** the effective annual rate (EAR).

2. The Moneybags Credit Card Company quotes its interest rate at 12% APR, charged on a quarterly basis. **Calculate** the effective annual rate (EAR).

Module Learning Outcome 10.2.1

Understand the characteristics of the mortgage market including:

- Interest loans
- Loan to value

10.2.2: Know the definition and types of mortgage, including:

- Repayment
- Interest only
- Offset

Mortgages

Read the section about mortgages in chapter 10 of the course workbook and:

Define the term mortgage

Explain how potential home owners are assessed in a mortgage application. What factors are taken into account?

1.

2.

3.

4.

Mortgage interest rates – match the term to the definition

1. Variable rate
2. Fixed rate
3. Capped rate
4. Tracker rate
5. Discounted rate

A – This is when mortgage repayments are set for a given period of time. If interest rates change, the amount payable remains the same.

B – This is when the interest rate on the borrowing in linked to the Bank of England base rate. You will pay the base rate plus a certain percentage.

C – This rate changes in line with the Bank of England base rate.

D – The interest rate is reduced by a certain amount for a given period of time, usually to attract switchers.

E - This protects borrowers from rates rising above a particular rate.

Types of Mortgage

Read the section about mortgages in chapter 10 of the course workbook and the example case studies.
Summarise the different types of mortgages below.

	Definition	Advantages	Disadvantages
Repayment mortgage			
Interest only mortgage			
Offset mortgage			
Buy to let mortgage			

Loan to Value (LTV)

Lenders will look at the size of the loan being requested in a mortgage application in relation to the value of the property. This is to determine their level of risk. The higher the loan to value ratio, the more risky it is to lenders. If the risk is deemed to be high, the borrower may have to pay a higher rate of interest.

For example

Sian wants to buy a flat for £250,000 and needs to borrow £210,000. Her LTV will be

$$\frac{\text{Amount to borrow}}{\text{Value of the property}} \times 100 = \mathbf{84\%}$$

In other words, Sian needs to borrow 84% of the value of the property.

An LTV of 84% might impact on Sian's mortgage options as this would be deemed to be high. Mortgage providers prefer larger deposits so the loan to value ratio would be smaller and therefore less of a risk to the mortgage provider.

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Who would you lend to?

Lou is looking to move from their flat into a 2 bedroom house. They have found a buyer and will make £60,000 profit when the sale goes through. The 2 bedroom house is valued at £230,000. Lou earns £48,000 per year.

What is the LTV ratio?

What recommendations would you make to Lou about their mortgage options?

Would you lend the required amount to Lou?

Who would you lend to?

Roisin and Oscar have saved £20,000 deposit for their first home. They have seen a flat valued at £210,000. Both work full time and currently have a joint income of around £70,000 a year. Oscar's contract is temporary.

What is the LTV ratio?

What recommendations would you make to Roisin and Oscar about their mortgage options?

Would you lend the required amount to Roisin and Oscar?

Extension Activity – The current UK housing market

Watch the Channel 4 broadcast (March 24) about the UK housing market and answer the following questions

- Summarise the trends in the UK housing market
- What challenges does the UK housing market currently face?
- What challenges do home owners currently face?

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Extension Activity – Other mortgage fees and charges

When arranging a mortgage there are many other fees and charges to consider. These include:

Booking Fee – Sometimes charged just to apply for a mortgage – not normally refundable, even if you don't get accepted for the mortgage.

Broker Fee – Charged by a mortgage broker if you use one for advice or to arrange the mortgage for you.

Arrangement Fee – Charged to set-up the mortgage itself. AKA product fee or completion fee.

Valuation Fee – Charged by the mortgage provider to value the property to ensure it is worth the amount being borrowed.

Early Repayment Charge – The lender may impose this charge if you want to repay all or part of the mortgage early.

Exit Fee – Charged by the lender when you repay the mortgage, even if you are not repaying it early.

Can you think of any other costs, expenses and/or taxes that are paid when purchasing property?

Money Saving Expert has produced a comprehensive guide to mortgages.

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Module Learning Outcome 10.3.1

Know the basic principles of life assurance and the definition of the following types of life policy:

- Term Assurance
- Whole of life

Life Assurance

Read the section about life assurance in chapter 10 of the course workbook and **answer** the following questions:

1. What is life assurance?

2. What is the difference between whole of life and term assurance?

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Life assurance – True or False?

	True	False
1. Term assurance provides permanent cover.		
2. Whole-of-life policies are normally taken out for the insured sum itself.		
3. Term assurance pays out a lump sum if death occurs within a specified period.		
4. A life policy is an insurance policy in which the event insured is a death.		
5. Life cover is often used to pay off the principal in a mortgage in the event of a death.		

End of Unit 10
Multiple Choice Assessment

Test your knowledge

1. What happens when an individual's current account balance falls below zero?

   A. The account is described as being in overdraft

   B. The account is frozen until the balance is replenished

   C. The bank refuses to honour any further transactions

   D. The bank charges the individual a fixed fee

2. How are authorised overdrafts different from unauthorised overdrafts?

   A. Authorized overdrafts are charged a lower rate of interest

   B. Authorized overdrafts are not subject to fees

   C. Authorized overdrafts are agreed upon in advance with the bank

   D. Both a) and c)

Test your knowledge

3. What is one advantage of paying the full balance each month on a credit card?

   A. The customer does not have to pay any interest

   B. The customer is rewarded with cashback on all purchases

   C. The customer can defer payments to a later date

   D. The customer can transfer balances from other cards without paying a fee

4. What is the effective annual rate?

   A. The annual percentage rate (APR)

   B. The quoted rate divided by the appropriate frequency

   C. The true cost of borrowing

   D. The interest rate charged on credit cards

Test your knowledge

5. What is the purpose of the annual percentage rate (APR)?

   A. To make comparisons easier between different lenders

   B. To calculate the borrower's creditworthiness

   C. To determine the true effective rate of borrowing

   D. To determine the fees charged by the lender

6. What amount is paid out under a Term Assurance contract in the event of the policyholder surviving to the end of the policy term?

   A. The amount insured plus accrued bonuses

   B. Nothing

   C. The amount insured only

   D. The greater of the amount insured or the value of underlying investments

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Test your knowledge

7. A credit card company is quoting a flat rate of annual interest at 18% per annum, charged half-yearly. What is the effective annual rate?

A. 18.18%

B. 18.09%

C. 19.18%

D. 18.81%

8. How would ‘effective annual rate of interest’ be described to a new and unsophisticated borrower?

A. This is the rate of interest that you actually pay on the loan, regardless of its duration

B. This is the rate of interest that applies only if the loan is of a year’s duration or more

C. This is the adjusted rate of interest after including payment protection insurance

D. This is the rate of interest that is quoted to you at the time you take out the loan

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Test your knowledge

9. A mortgage which takes account of your monthly salary payments and any savings held with the same institution is known as:

A. Repayment mortgage

B. Lifestyle and income mortgage

C. Offset mortgage

D. Interest only mortgage

10. A £5,000 loan is taken out over a three year period by a higher rate taxpayer. If the quoted interest rate is 8% p.a., charged on a quarterly basis, what is the effective annual rate of borrowing?

A. 8.02%

B. 8.16%

C. 8.24%

D. 8.00%

Test your knowledge

11. Under which ONE of the following types of mortgage does the monthly payment normally comprise a combination of interest and capital?

A. ISA

B. Endowment

C. Repayment

D. Pension-linked

12. A credit card company is quoting a flat rate of annual interest at 16% per annum, charged half-yearly. What is the effective annual rate?

A. 16.53%

B. 16.64%

C. 16.08%

D. 16.98%

Test your knowledge

13. A credit card company quotes its interest rate at 10% per annum, charged on a quarterly basis. If money is borrowed at the outset and no repayments are made for a year, the effective annual rate over the year will be (rounded to two decimal places):

A. 10.50%

B. 12.50%

C. 10.38%

D. 10.08%

14. Which of the following is not true about unsecured loans?

A. The loan is not linked to the item that is purchased with the loan

B. The lender is more likely to lose its money in comparison with secured loans

C. They are typically used to buy consumer goods

D. A mortgage is an example of an unsecured loan

Test your knowledge

15. Which of the following statements about Loan-to-Value ratios is false?

A. The higher the loan-to-value ratio, the more risky the mortgage is deemed by lenders

B. Mortgages with higher loan-to-value ratio are likely to be subject to higher rates of interest

C. The lower the loan-to-value ratio, the more risky the mortgage is deemed by lenders

D. Borrowers with larger deposits and therefore lower Loan-to-Value ratios tend to be offered lower rates of interest on their mortgage

Test your knowledge

16. A mortgage which charges interest at 2% above the base rate of interest is known as which of the following

A. A variable rate mortgage

B. A fixed rate mortgage

C. A capped mortgage

D. A tracker mortgage

17. The difference between a lender`s quoted interest rate and its effective annual rate, NORMALLY relates to what key factor?

A. Tax relief on the interest payments

B. Frequency with which interest is levied

C. Payment protection insurance to cover interest during sickness

D. Discounts for making interest payments early

Monitoring my progress – Unit 10

My multiple choice assessment mark is ___ / 17

I am happy with the progress that I made on the multiple choice assessment

___ Yes ___ No

To improve my knowledge and understanding, I now need to….

1.

2.

3.

Need more help?

If you feel that your multiple choice score can be improved further, complete the end of unit 10 multiple choice questions in the course workbook.