

CFP CERTIFICATION EXAMINATION (ADVANCED LEVEL PAPER 1)**Question 26 (Subject Area: Financial Management)**

When investing in real assets such as properties or land at times of inflation, the future cash-flows from the investments are likely to rise in:

- I. intrinsic value.
 - II. nominal value.
 - III. real value.
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- A. II only
 - B. III only
 - C. I & II only
 - D. I & III only

Answer: A

Explanation: II is correct. Nominal value refers to a value expressed in money terms in a given year or series of years; it is likely to rise at times of inflation. Real value adjusts nominal value to remove effects of price changes over time. Intrinsic value refers to the actual value of a company or an asset based on an underlying perception of its true value including all aspects of the business. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), pages 63-70.

Question 27 (Subject Area: Financial Management)

Which of the following abilities of a financial planning strategy can be evaluated with reference to information provided by a financial budget?

- I. Its ability to maintain a certain level of living standard.
 - II. Its ability to maintain a sufficient amount of emergency cash.
 - III. Its ability to maintain investment risk at an acceptable level.
 - IV. Its ability to maintain wealth accumulation at a reasonable pace.
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- A. I & IV only
 - B. I, II & III only
 - C. I, II & IV only
 - D. II, III & IV only

Answer: C

Explanation: I, II & IV are correct. Living standard can be measured by the amount of consumption. The sufficiency of emergency cash is usually measured by the amount of expenses in a number of months. Wealth is usually accumulated through regular savings. These are components in a budget. Investment risk is reflected in the balance sheet. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), pages 105-112.

Question 28 (Subject Area: Financial Planning Principles)

In the early stage of establishing a relationship with a client, a financial planner should:

- I. discuss the process and concepts of financial planning with the client.
 - II. inform the client about the limitation and scope of the services that the planner can provide legally.
 - III. clarify the respective responsibilities of the planner and the client.
 - IV. explore the risk attitude of the client.
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- A. I & III only
 - B. II & IV only
 - C. I, II & III only
 - D. I, III & IV only

Answer: C

Explanation: I, II & III are correct as they are all actions that should be taken by a financial planner in Step 1 of the financial planning process. Exploring the risk attitude of the client should be done in Step 2 of the financial planning process. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), pages 342-348.

Question 29 (Subject Area: Financial Planning Principles)

Which of the following statements about determining the client's personal and financial goals, needs and priorities are CORRECT?

- I. They must be determined mutually by the planner and the client.
 - II. They must be determined with sole reference to the client's financial strengths and weaknesses.
 - III. Those relevant to the scope of engagement need to be determined in clear and measurable objectives.
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- A. I & II only
 - B. I & III only
 - C. II & III only
 - D. I, II & III

Answer: B

Explanation: I & III are correct. A client's personal and financial goals, needs and priorities must not be limited only to the client's financial strengths and weaknesses. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), pages 366-371.

Question 30 (Subject Area: Financial Planning Principles)

Evaluating the client's financial position is an important step in the financial planning process. Which of the following tasks should be completed in this step?

- I. Assessing the liabilities of the client.
 - II. Identifying the client's financial strengths and weaknesses.
 - III. Preparing cashflow statements of the client.
 - IV. Recommending appropriate insurance policies to the client.
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- A. I & III only
 - B. I, II & III only
 - C. I, II & IV only
 - D. II, III & IV only

Answer: B

Explanation: I, II & III are correct. They are all tasks that should be completed in Step 3 of the financial planning process. Recommending appropriate insurance policies to the client should be done in Step 4 of the financial planning process. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), chapter 13.

Question 31 (Subject Area: Retirement Planning)

Which of the following is/are disadvantages of defined-contribution plans from the employee's perspective?

- I. Amount of actual retirement benefit is not known.
 - II. Individual members solely account for contributions.
 - III. Investment losses must be borne by the employee.
- A. I only
 - B. I & III only
 - C. II & III only
 - D. I, II & III

Answer: B

Explanation: I & III are correct. Apart from employees, employers usually also contribute to defined-contribution plans. The Hong Kong Mandatory Provident Fund Scheme is an example of a defined-contribution plan. Please also refer to IFPHK's Employee Benefits and Estate Planning textbook (1st edition), page 53.

Question 32 (Subject Area: Retirement Planning)

Tim plans to set up a retirement fund to provide an amount of \$50,000 per year over 20 years starting next year. Assume that the expected rate of return to the fund is 10% per year, how much money would he have invested today if the expected inflation rate is 6%?

- A. \$296,442
- B. \$425,678
- C. \$573,496
- D. \$693,346

Answer: D

Explanation: D is correct. It is calculated as follows:

Present value of the retirement fund after one year =
 $PV(bgn) I = \{(1.10/1.06) - 1\}$, $n=20$, $PMT = -\$50,000$,
 $PV = \$719,510$

Amount of investment today = $\$719,510 / (1.1/1.06) = \$693,346$

Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), pages 53-62.

Question 33 (Subject Area: Investment Planning/Asset Management)

Using the capital market line (CML) in analyzing a risky portfolio, _____ performance is indicated by a position below the CML, _____ performance is indicated by a position above the CML and _____ performance is indicated by a position on the CML.

- A. inferior ; optimal ; superior
- B. inferior ; superior ; optimal
- C. optimal ; superior ; inferior
- D. superior ; inferior ; optimal

Answer: B

Explanation: B is correct. The capital market line (CML) is a line used in the capital asset pricing model to illustrate the rates of return for efficient portfolios depending on the risk-free rate of return and the level of risk (standard deviation) for a particular portfolio. Inferior performance is indicated by a position below the CML, superior performance is indicated by a position above the CML and optimal performance is indicated by a position on the CML. Please also refer to IFPHK's Essential of Investments textbook (1st edition), pages 221-222.

Question 34 (Subject Area: Investment Planning/Asset Management)

Mr. A, a risk-averse investor, is considering to invest in either an US Treasury bill which currently pays a 4.5% rate of return, or a risky portfolio which pays a 8% return with a probability of 40%, and a 3% return with a probability of 60%. Mr. A asks his financial planner to help him calculate the risk premium of investing in the risky portfolio, and to give him some investment advice. Which ONE of the following statements is the MOST appropriate for Mr. A's financial planner to make?

- A. The risk premium is 0 and Mr. A should invest in the risky portfolio.
- B. The risk premium is 0 and Mr. A should invest in the US Treasury bill.
- C. The risk premium is 0.5% and Mr. A should invest in the risky portfolio.
- D. The risk premium is 0.5% and Mr. A should invest in the US Treasury bill.

Answer: C

Explanation: C is correct. Risk premium = $[(8\% \cdot 40\%) + (3\% \cdot 60\%)] - 4.5\% = 0.5\%$. Mr. A should invest in the risky portfolio because he is rewarded with a risk premium. Please also refer to IFPHK's Essentials of Investments textbook (1st edition), pages 137-139.

Question 35 (Subject Area: Investment Planning/Asset Management)

Please refer to the following information to answer Question 35 and Question 36:

Portfolio XYZ is well diversified. It has a return of 10.5%, a portfolio beta of 1.2 and a standard deviation of 5%. Assume the risk free rate is 3% and the interest rate on long-term government bonds is 6%.

What is the Sharpe measure of the portfolio?

- A. 0.9
- B. 1.2
- C. 1.5
- D. 6.25

Answer: C

Explanation: C is correct. Sharpe measure is calculated by dividing the portfolio excess return (i.e. portfolio return minus risk free rate) by the standard deviation of the portfolio. Please also refer to IFPHK's Essentials of Investments textbook (1st edition), page 628.

Question 36 (Subject Area: Investment Planning/Asset Management)

What is the Treynor measure of the portfolio?

- A. 0.9
- B. 1.2
- C. 1.5
- D. 6.25

Answer: D

Explanation: D is correct. Treynor measure is calculated by dividing the portfolio excess return (ie. portfolio return minus risk free rate) by the portfolio beta. Please also refer to IFPHK's Essentials of Investments textbook (1st edition), page 628.

Question 37 (Subject Area: Investment Planning/Asset Management)

If other factors remain constant, for an investment grade corporate bond, the higher its liquidity, the:

- A. higher its coupon rate.
- B. longer its duration.
- C. lower its default risk.
- D. lower its yield to maturity.

Answer: D

Explanation: D is correct. Higher liquidity leads to lower liquidity premium, hence lower required rate of return, which in turn causes higher price. Therefore, the bond yield will be lower. Please also refer to IFPHK's Essentials of Investments textbook (1st edition), page 306.

Question 38 (Subject Area: Insurance Planning/Risk Management)

Jane is 30 years old now and is considering taking out a life insurance policy. The quotations for four different policies have been obtained, all based on level premium payable by yearly installments. Which ONE of the following policies is MOST LIKELY to charge the HIGHEST annual premium?

- A. 35-year endowment life insurance policy.
- B. 35-year term life insurance policy.
- C. 65-year paid-up non-participating whole life insurance policy.
- D. Non-participating whole life insurance policy.

Answer: A

Explanation: A is correct. It is an endowment life insurance policy that normally requires a high premium, and compared with the other options, is most likely to charge the highest annual premium. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), chapter 11.

Question 39 (Subject Area: Insurance Planning/Risk Management)

Ricky and Susan are a married couple and each of them has taken out a whole life insurance policy with beneficiary details as below:

Insured	Primary Beneficiary	Contingent Beneficiary
Ricky	Susan	Ricky's brother, Tommy
Susan	Susan's sister, Janet	Ricky

Ricky and Susan were involved in a traffic accident. Susan passed away at the scene and Ricky passed away one month later. Which ONE of the following statements about entitlement to the life insurance benefits in this case is CORRECT?

- A. Tommy is entitled to the benefits under both Ricky's and Susan's policies.
- B. Tommy is entitled to the benefits under Susan's policy and Janet is entitled to the benefits under Ricky's policy.
- C. Janet is entitled to the benefits under both Ricky's and Susan's policies.
- D. Janet is entitled to the benefits under Susan's policy and Tommy is entitled to the benefits under Ricky's policy.

Answer: D

Explanation: D correct in this case. The contingent beneficiary will be entitled to the death benefits upon the death of the primary beneficiary. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), pages 227-228.

Question 40 (Subject Area: Insurance Planning/Risk Management)

Please refer to the following information to answer Question 40, Question 41 and Question 42:

Derek is the owner of a factory in Hong Kong. A German buyer recently placed an order with Derek, included in the contract is a provision that Derek should hold the buyer harmless of any liability incurred due to his products. Derek was required to take out product liability insurance for the exporting products and set up new testing equipment in his factory in order to meet the safety standards in Germany. Derek then approached a few insurance companies for product liability insurance on the exporting products, however the insurance companies refused to insure only the exporting products, but offered to insure all his factory's products instead. Derek expected that it would take 10 years for him to cover the set up cost of the testing equipment. He ultimately decided to give up the contract with the German buyer.

What type of risk management approach has been adopted by the German buyer for applying the hold-harmless provision in the contract with Derek?

- A. Avoidance.
- B. Prevention.
- C. Retention.
- D. Transfer.

Answer: D

Explanation: A hold-harmless provision is the same as an indemnity. By including the provision in the contract with Derek, the German buyer is getting an indemnity from Derek for any losses that it may suffer. The nature of an indemnity is to transfer risk. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), pages 17-19.

Question 41 (Subject Area: Insurance Planning/Risk Management)

In requiring Derek to insure all his products, the insurance companies are MOST LIKELY protecting themselves against which ONE of the following issues?

- A. Adverse Selection.
- B. Moral Hazard.
- C. Morale Hazard.
- D. Physical Hazard.

Answer: A

Explanation: Adverse selection is the tendency of the persons whose exposure to loss is higher than average to take out insurance. By requiring Derek to insure all his products, the insurance companies are protecting themselves against higher exposure to product liability claims in Germany. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), page 48.

Question 42 (Subject Area: Insurance Planning/Risk Management)

In giving up the contract with the German buyer, Derek is MOST LIKELY to have taken which ONE of the 6 steps in the risk management process?

- A. Consideration of alternatives and selection of risk treatment device.
- B. Evaluation and review.
- C. Evaluation of risks.
- D. Implementation of the decision.

Answer: D

Explanation: Derek has already decided on which risk management approach to adopt. His action of giving up the contract with the German buyer is an implementation of his decision. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), pages 25-33.

Question 43 (Subject Area: Tax Planning)

Identify from the following cases where married person's allowance will be granted to the taxpayer who files the tax return for the year of assessment 2010/11:

- I. Mr. P has been married to his wife for 10 years. His wife has no assessable income for the year of assessment 2010/11.
 - II. Mr. Q has been separated from his wife since the year of assessment 2009/10, but he is maintaining his wife by paying a monthly alimony of \$10,000.
 - III. Mr. R was divorced from his wife in the year of assessment 2009/10, but he is still maintaining his ex-wife by paying a monthly alimony of \$12,000.
- A. I only
 - B. I & II only
 - C. II & III only
 - D. I, II & III

Answer: B

Explanation: I & II are correct. To qualify for married person's allowance, the taxpayer must be married for all or part of the year of assessment, and the spouse did not have any income chargeable to Salaries Tax during the year. Please also refer to Section 29 of the Inland Revenue Ordinance.

Question 44 (Subject Area: Tax Planning)

Under the Inland Revenue Ordinance, which of the following is/are grounds for a taxpayer to apply to an assessor for correction of errors in a tax return or the assessment?

- I. There was an arithmetical error in the calculation of the amount of the tax charged.
 - II. There was an omission in any tax return submitted.
 - III. There was an error in the statement submitted with respect to the tax charged.
- A. III only
 - B. I & II only
 - C. II & III only
 - D. I, II & III

Answer: D

Explanation: I, II & III are correct. A tax assessor appointed under the Inland Revenue Ordinance has the power to correct an assessment. Please also refer to Section 70A of the Inland Revenue Ordinance.

Question 45 (Subject Area: Tax Planning)

XYZ Limited is considering providing medical benefits to its employees. Which of the following ways of providing such benefits will be efficient to the employees in the context of Salaries Tax?

- I. Arranging group medical insurance cover for the employees and paying the insurance premium for all employees.
 - II. Contracting with a few designated doctors to provide medical consultation to employees free-of-charge.
 - III. Reimbursing employees' medical expenses for different doctors of their own choice upon presentation of the medical bills.
- A. I only
 - B. I & II only
 - C. II & III only
 - D. I, II & III

Answer: B

Explanation: I & II are correct. Employee benefits that represent a discharge of an employee's own personal liability by the employer will be taxable. Therefore III is taxable and not efficient to employees under Salaries Tax. Please also refer to Section 9 of the Inland Revenue Ordinance.

Question 46 (Subject Area: Estate Planning)

Which of the following is/are reasons for an individual to set up a trust for estate planning purposes?

- I. To avoid probate.
 - II. To reduce estate planning costs.
 - III. To protect vulnerable beneficiaries.
-
- A. I only
 - B. I & II only
 - C. I & III only
 - D. I, II, & III

Answer: C

Explanation: I & III are correct. A trust is not part of a deceased person's probate estate. It can be used to provide for vulnerable beneficiaries. The cost for setting up a trust is usually high. Please also refer to IFPHK's Employee Benefits and Estate Planning textbook (1st edition), Chapter 8.

Question 47 (Subject Area: Estate Planning)

Generally speaking, a financial planner is expected to carry out which of the following activities in his client's will-making process?

- I. To co-ordinate with other members of the estate planning team.
 - II. To review the will to ensure the contents fulfill the client's objectives.
 - III. To recommend the client appointing him as the executor of the will.
- A. I only
 - B. I & II only
 - C. I & III only
 - D. II & III only

Answer: B

Explanation: I & II are correct. A financial planner is not expected to recommend himself as the executor of his client's will. Please also refer to IFPHK's Employee Benefits and Estate Planning textbook (1st edition), pages 117-118.

Please refer to the following information to answer Question 48, Question 49, Question 50 and Question 51:

Mathew is 50 years old and single. He was employed for over 14 years as a full-time chef of a restaurant. However, Mathew had a car accident 3 months ago and his right shoulder was badly injured as a result. Mathew spent a month in hospital, and his doctor told him that he is now severely disabled because he will not be able to use his right shoulder for the rest of his life. The accident occurred when Mathew was going to work in a bus operated by his employer, and the driver of the bus was successfully prosecuted by the police for his careless driving that caused the accident. Mathew's claim under the Employees' Compensation Ordinance was successful. Mathew recently checked with an insurance agent of Great Insurance Company as to his needs for whole life insurance. He learnt that, due to his disability, the cover will require a longer waiting period and a higher-than-standard premium level. He did not take out the cover.

Mathew and his father jointly own a flat in Tuen Mun as tenants-in-common where they live together with Mathew's 52-year-old elder brother, Mark. The flat is fully paid up and has a current market value of around \$2,800,000. Mathew's father intends for Mathew to take up his share in the flat on his death. Neither Mathew nor his father has made wills, and apart from Mark they do not have other living relatives.

Question 48 (Subject: Insurance Planning/Risk Management)

Mathew is currently eligible for assistance under which TWO of the following government social welfare schemes in Hong Kong?

- I. Comprehensive Social Security Assistance Scheme.
 - II. Emergency Relief.
 - III. Social Security Allowance Scheme.
 - IV. Traffic Accident Victims Assistance Scheme.
-
- A. I & II only
 - B. I & III only
 - C. II & IV only
 - D. III & IV only

Answer: D

Explanation: III and IV are correct. Mathew satisfies the current eligibility criteria for the Social Security Allowance Scheme and the Traffic Accident Victims Assistance Scheme. For details, please refer to the website of the Social Welfare Department.

Question 49 (Subject: Insurance Planning/Risk Management)

Which of the following factors are relevant to Mathew's success in his claim under the Employees' Compensation Ordinance for the traffic accident?

- I. The operator of the bus in which Mathew traveled.
 - II. The party liable for Mathew's accident.
 - III. The period of time that Mathew had been employed by his employer.
 - IV. The purpose of Mathew's travel in the bus.
-
- A. I & II only
 - B. I & IV only
 - C. I, III & IV only
 - D. II, III & IV only

Answer: B

Explanation: I and IV are correct. The identity of the operator of the transport in which an employee traveled and the purpose of the travel are relevant factors for a claim to succeed under the Employees' Compensation Ordinance. Please also refer to IFPHK's Employee Benefits and Estate Planning textbook (1st edition), page 16-17.

Question 50 (Subject: Insurance Planning/Risk Management)

Which of the following statements in relation to Great Insurance Company's requirements for Mathew's life insurance cover are CORRECT?

- I. A longer waiting period is required to enforce the principle of indemnity.
 - II. The level of premium quoted is a result of the use of a different mortality table.
 - III. The level of premium quoted violates the Disability Discrimination Ordinance.
 - IV. The purpose for the level of premium quoted is to avoid adverse selection.
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- A. II & IV only
 - B. I, II & III only
 - C. I, III & IV only
 - D. II, III & IV only

Answer: A

Explanation: II and IV are correct. People whose exposure to loss is higher than average have a tendency to require greater protection cover than others. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), page 48 and 324.

Question 51 (Subject: Estate Planning)

Assume that other factors remain constant. Which of the following statement(s) about the succession of the Tuen Mun flat is/are CORRECT?

- I. If Mathew and his father pass away at the same time, ownership in the flat will be distributed according to the Intestates' Estates Ordinance.
 - II. If Mathew predeceases his father, his share in the flat will automatically pass to his father without having to go through the probate process.
 - III. If Mathew's father predeceases Mathew, his share in the flat will be distributed between Mark and Mathew.
- A. I only
 - B. I & II only
 - C. I & III only
 - D. II & III only

Answer: C

Explanation: I and III are correct. Tenants-in-common do not have the right of survivorship. Therefore the distribution of the flat will be governed by the Intestates' Estates Ordinance. Please also refer to IFPHK's Employee Benefits and Estate Planning textbook (1st edition), page 185, and section 4 of the Intestates' Estate Ordinance.

- End of Sample CFP Certification Examination Questions (Advanced Level Paper 1) -