



# SAMPLE EXAMINATION QUESTIONS :

AFP™ Certification

FINANCIAL MANAGEMENT  
FINANCIAL PLANNING PRINCIPLES  
INTRODUCTION TO INVESTMENT  
FUNDAMENTAL INSURANCE & RETIREMENT  
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INTRODUCTION TO INVESTMENT

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This sample question booklet consists of 25 sample questions on the CFP Certification Examination (Foundation Level).

The sample questions are provided to help readers familiarise themselves with the form and style of questions which they may see in the examination. They may NOT fully reflect the cognitive level of questions of the examination. For reference purpose, the sample questions are also supplemented by the corresponding suggested answers and explanations, which, if necessary, should be read in conjunction with the relevant textbooks and reference materials published and/or recommended by the IFPHK. The sample questions have been drafted to reflect current law and practice as of September 2013.

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## TABLE OF CONTENTS

| <b>SUBJECT AREA .....</b>  | <b>PAGE</b>                           |
|--|---------------------------------------|
| A. FINANCIAL MANAGEMENT (Q1 – Q6).....   | V - 4                                 |
| B. FINANCIAL PLANNING PRINCIPLES(Q7 – Q10) .....   | V - 10                                |
| C. RETIREMENT PLANNING(Q11 – Q13).....   | V - 14                                |
| D. INVESTMENT PLANNING AND ASSET MANAGEMENT(Q14 – Q19)...<br>(INTRODUCTION TO INVESTMENTS) | V - 17                                |
| E. INSURANCE PLANNING AND RISK MANAGEMENT (Q20 – Q25).....                                 | V - 23<br>(FUNDAMENTALS OF INSURANCE) |

**Question 1 (Subject Area: Financial Management)**

Jonathan is applying for a personal loan from a local bank. As part of its standard procedure for loan assessment, the bank has asked him to provide his financial information. Jonathan provides the requested information as follows:

|                                |             |
|--------------------------------|-------------|
| Bank Deposits                  | \$50,000    |
| Treasury Bills                 | \$55,000    |
| 3-month Certificate of Deposit | \$50,000    |
| Credit Card Balance            | \$10,000    |
| Listed Stocks                  | \$120,000   |
| Life Insurance Cash Value      | \$125,000   |
| MPF Account Balance            | \$350,000   |
| Mortgage Loan                  | \$1,500,000 |
| Residential Flat               | \$3,000,000 |

What is Jonathan's net worth?

- A. \$1,880,000
- B. \$2,115,000
- C. \$2,240,000
- D. \$3,750,000

\*\*\*\*\*

Answer: C

Explanation:

Net Worth = Total Assets – Total Liabilities

Total Assets= Bank Deposits + Treasury Bills + Certificate of Deposit + Listed Stocks + Life Insurance Cash Value + MPF Account Balance + Residential Flat = \$3,750,000

Total Liabilities=Credit Card Balance + Mortgage Loan= \$1,510,000

Net worth →\$3,750,000 – \$1,510,000 = \$2,240,000

Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1<sup>st</sup> edition), page 115.

**Question 2 (Subject Area: Financial Management)**

Mr. and Mrs. Yung, both aged 48 and each with a life expectancy of 90, have a current annual household income of \$600,000. They would like to retire in 12 years' time on 70% of their current income adjusted for inflation. They also wish to leave an estate of \$3 million to their only daughter, Tina, upon their deaths. The inflation rate is expected to be 3% p.a. In order to achieve the Yungs' objectives, how much capital should they accumulate at age 60 if the expected rate of return is 8% p.a.?

- A. \$7.04 million
- B. \$7.29 million
- C. \$9.36 million
- D. \$10.08 million

\*\*\*\*\*

Answer: D

Explanation:

Calculation of PV of a future stream of income:

$N=30, I=\{(1.08/1.03)-1\}=4.854369\%$

$PMT=(-600,000 \times 70\%)*1.03^{12}=-598,819.57,$

$FV=-3m$

$PV=10.08m$

Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1<sup>st</sup> edition), pages 59-62.

**Question 3 (Subject Area: Financial Management)**

Ronald has taken out a car loan of \$280,000 to be repaid over 3 years. Interest rate is at 3.5% for the first year, 4.5% for the second year, and 5.5% for the third year. Calculate Ronald's monthly payment in the first, second and third year respectively.

- A. \$8,205; \$7,924; \$7,421
- B. \$8,205; \$8,289; \$8,334
- C. \$8,205; \$12,221; \$24,034
- D. \$8,329; \$8,329; \$8,329

\*\*\*\*\*

Answer: B

Explanation:

$N=36$ ,  $I=3.5\%/12=0.291667\%$ ,  $FV=0$ ,  $PV=280,000$

1<sup>st</sup> year  $PMT=-8,205$

Balance of the loan =  $-8,205 * PVIFA(I=3.5\%/12, N=24)=189,909$

$N=24$ ,  $I=4.5\%/12=0.375\%$ ,  $FV=0$ ,  $PV=189,909$

2<sup>nd</sup> year  $PMT=-8,289$

Balance of the loan =  $-8,289 * PVIFA(I=4.5\%/12, N=12)=97,087$

$N=12$ ,  $I=5.5\%/12=0.458333\%$ ,  $FV=0$ ,  $PV=97,087$

3<sup>rd</sup> year  $PMT=-8,334$

Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1<sup>st</sup> edition), pages 44-48.

**Question 4 (Subject Area: Financial Management)**

Which of the following types of business ownership imply that the nature of the liability of the owner(s) with respect to the business is a personal one?

- I. Limited liability company.
  - II. Partnership.
  - III. Sole proprietorship.
- 
- A. III only
  - B. I & II only
  - C. II & III only
  - D. I, II & III

\*\*\*\*\*

Answer: C

Explanation:

II & III are correct. The liability of the owners or shareholders of a limited liability company is limited to the amount of their shareholding in the company. The partners of a partnership and sole proprietors are personally liable for all claims and liabilities with respect to their business. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), page 299 and AFP Supplementary Notes (2011 edition) #004, 005 and 006.

**Question 5 (Subject Area: Financial Management)**

Ruby is 60 years old and expects to live until at least age 80. She is considering a proposal of an annuity from an insurance company. For a premium of \$250,000, the annuity will pay her \$2,500 per month for the rest of her life until she passes away. Assume Ruby invests her savings in US Treasury Bills (US T-Bills) earning a rate of return of 3% p.a. Which of the following statements about the proposed annuity and the US T-Bills are CORRECT?

- I. The rate of return on the annuity is higher than the rate of return on US T-Bills.
  - II. The rate of return on the annuity is the same as the rate of return on US T-Bills.
  - III. The rate of return on the annuity is lower than the rate of return on US T-Bills.
  - IV. The present value of benefit payments to be made from the annuity are worth more than its premium.
  - V. The present value of benefit payments to be made from the annuity are worth less than its premium.
- 
- A. I & IV only
  - B. II & IV only
  - C. II & V only
  - D. III & V only

\*\*\*\*\*

Answer: A

Explanation:

I & IV are correct.

PV=250,000; PMT=2,500; N=12\*20

Compute  $I=0.877009\%$  → annual rate = 10.524%

Also NPV=200,777.29 >0 using 3% discount rate (monthly rate: 0.25%)

Please also refer to IFPHK's Fundamentals of Financial Planning Textbook (1st edition), page 53-54.



**Question 6 (Subject Area: Financial Management)**

Mr. and Mrs. Chan are a young married couple. The following shows some of their financial figures:

|   | Mr. Chan  | Mrs. Chan |
|---|-----------|-----------|
| Annual income:                          | \$336,000 | \$264,000 |
| Annual bonus:                           | \$28,000  | N/A       |
| Annual household and personal expenses: | \$270,000 | \$180,000 |
| Personal possession:                    | \$80,000  | \$19,000  |
| Annual interest and dividend income:    | \$15,000  | \$9,000   |
| Stockholding:                           | \$100,000 | N/A       |
| Savings:                                | \$220,000 | \$300,000 |
| Credit card and/or personal loan:       | \$80,000  | \$11,000  |

Based on the figures provided, calculate the debt ratio of the Chan couple.

- A. 0.12
- B. 0.14
- C. 0.18
- D. 0.21

\*\*\*\*\*

Answer: B

Explanation:

Net worth=Total assets-total liabilities

→ \$719,000-\$91,000=\$628,000

Debt ratio = liabilities/net worth → \$91,000/\$628,000=0.1449

Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), page 103.

**Question 7 (Subject Area: Financial Planning Principles)**

A financial planner has extracted the following information about a client from his file:

“Existing investment portfolio: aggressive  
Findings of risk-profiling questionnaire: conservative”

In light of the above, what is the BEST approach that the client’s financial planner should take?

- A. Adopt the client’s existing investment portfolio.
- B. Ask the client to do the risk-profiling questionnaire again.
- C. Discuss with the client the possible need for adjusting his asset allocation.
- D. Follow the findings of the risk-profiling questionnaire.

\*\*\*\*\*

Answer: C

Explanation:

The best approach is to take into account the mismatch between the client’s investment portfolio and the findings of risk-profiling. Please also refer to IFPHK’s Fundamentals of Financial Planning textbook (1st edition), page 325.

**Question 8 (Subject Area: Financial Planning Principles)**

Robert is a 35-year old single male who has just lost his job as a salesperson due to the recent economic downturn. Which of the following are appropriate actions that Robert's financial planner should recommend him to take in the event of a prolonged period of reduced income?

- I. Keep up his monthly savings plans.
  - II. Reduce his discretionary spending.
  - III. Reduce his financial responsibilities.
- 
- A. I & II only
  - B. I & III only
  - C. II & III only
  - D. I, II & III

\*\*\*\*\*

Answer: C

Explanation:

II & III are correct. Due to Robert's job nature and the economic situation, it is likely that Robert will suffer a period of reduced income which will last for a while. As such, he should reduce discretionary spending and financial responsibilities. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), chapter 4.

**Question 9 (Subject Area: Financial Planning Principles)**

Generally speaking, a financial planner is expected to ensure that the client's

- I. goals are prioritized in the order of importance.
  - II. investment goals are clearly stated.
  - III. risk tolerance level is maintained.
- A. I only
  - B. I & II only
  - C. I & III only
  - D. II & III only

\*\*\*\*\*

Answer: B

Explanation:

I & II are correct. Goals should be concrete and achievable and should be prioritized in the order of importance. Client's risk tolerance may change due to changes to his/her circumstances. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), pages 368-371.

**Question 10 (Subject Area: Financial Planning Principles)**

Amy and Ben are a married couple aged 30 and 32 respectively, they are concerned about their heavy debt load as below:

|      |   |             |
|------|---|-------------|
| I.   | Mortgage (interest at 4.5% p.a.):                 | \$2,000,000 |
| II.  | Unsecured credit line (interest at 6.5% p.a.):    | \$15,000    |
| III. | Amy's student loan (interest at 10% p.a.):        | \$40,000    |
| IV.  | Amy's credit card balance (interest at 18% p.a.): | \$10,000    |

Their goal is to pay off their mortgage loan as quickly as possible. List, from the FIRST to the LAST, the order in which their debt should be paid off that will be the MOST cost-effective for them.

- A. I, III, II, IV
- B. I, IV, III, II
- C. IV, I, II, III
- D. IV, III, II, I

\*\*\*\*\*

Answer: D

Explanation:

Although their goal is to pay off their mortgage, they need to pay down the debt with the highest cost of borrowing. The cost of borrowing from descending order would be: credit card (18%); student loan (10%), credit line (6.5%) and mortgage (4.5%). Please also refer to IFPHK's Fundamentals of Financial Planning Textbook (1st edition), page 95.

**Question 11 (Subject Area: Retirement Planning)**

A financial planner is writing an article on financial activities for readers over 60 years of age who have a personal profile typical for that age group. To cater for the common needs of this age group, the planner should emphasize which of the following topics in the article?

- I. Estate planning.
  - II. Long-term healthcare coverage.
  - III. Real estate investments.
  - IV. Retirement planning.
- 
- A. I & II only
  - B. III & IV only
  - C. I, II & IV only
  - D. II, III & IV only

\*\*\*\*\*

Answer: C

Explanation:

I, II & IV are correct. Estate planning, long-term healthcare coverage and retirement planning are topics relevant to this age group. Real estate investments will involve liquidity issues and high costs, and may not necessarily be suitable, therefore it should not be emphasized. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), page 328.

**Question 12 (Subject Area: Retirement Planning)**

Freshly Restaurant (Freshly) has employed Rose as a full-time waitress for 6 months. Rose receives a fixed monthly salary, and at the end of each month, she also receives her share of tips collected by Freshly. She also collects tips directly from customers. When computing contributions to the Mandatory Provident Fund Scheme, which of the following items should be included in Rose's "relevant income"?

- I. Monthly salary paid by Freshly.
  - II. Rose's share of tips collected by Freshly.
  - III. Tips that Rose collected directly from customers.
- 
- A. I only
  - B. I & II only
  - C. II & III only
  - D. I, II & III

\*\*\*\*\*

Answer: B

Explanation:

I & II are correct. Tips retained by employees themselves are not regarded as "relevant income" for the purpose of computing contributions to the Mandatory Provident Fund Scheme. Please also refer to Insurance Intermediaries Quality Assurance Examination Scheme: MPF Schemes Examination Study Notes (8th edition), Appendix IV.

**Question 13 (Subject Area: Retirement Planning)**

Richard is an Australian citizen who came to Hong Kong under an employment visa in June 2010. He was contracted to work in the Hong Kong subsidiary of an Australian-based company for a period of 12 months. Which ONE of the following statements regarding Richard's obligation to enroll in the Mandatory Provident Fund (MPF) Scheme is CORRECT?

- A. Richard is automatically exempted from joining the MPF Scheme on the basis that he is an expatriate with an employment visa.
- B. Richard is required to enroll in an MPF Scheme after he has remained in Hong Kong for 60 days.
- C. Richard is not required to enroll in any MPF Scheme during the 12 months he was in Hong Kong.
- D. Richard is not required to enroll in any MPF Scheme until he has obtained a valid Hong Kong Identity Card.

\*\*\*\*\*

Answer: C

Explanation:

Foreign employees entering Hong Kong with an employment visa for a period not exceeding 13 months are exempted persons under the MPF Scheme. Please also refer to Insurance Intermediaries Quality Assurance Examination Scheme: MPF Schemes Examination Study Notes (8th edition), Section 3.5 & Appendix III.



**Question 14 (Subject Area: Introduction to Investments)**

Which of the following statements CORRECTLY describe “H-shares”?

- I. They are traded either in Hong Kong dollars or in Renminbi.
  - II. They are issued by Mainland Chinese entities.
  - III. They are listed on the Stock Exchange of Hong Kong.
  - IV. They are referred to as “red chips”.
- 
- A. I & II only
  - B. II & III only
  - C. I, III & IV only
  - D. I, II, III & IV

\*\*\*\*\*

Answer: B

Explanation:

II & III are correct. H-shares are issued by Mainland Chinese companies and listed on the Stock Exchange of Hong Kong, and are traded in Hong Kong dollars. Please also refer to IFPHK’s Essentials of Investments textbook (1st edition), page 804.

**Question 15 (Subject Area: Introduction to Investments)**

A monetary policy involves the control of:

- I. interest rates.
  - II. government spending.
  - III. the supply of money.
  - IV. tax rates.
- 
- A. I & III only
  - B. II & IV only
  - C. I, II & IV only
  - D. I, III & IV only

\*\*\*\*\*

Answer: A

Explanation:

I & III are correct. A monetary policy relates to money supply and interest rates. Please also refer to IFPHK's Fundamentals of Financial Planning textbook (1st edition), page 5.

**Question 16 (Subject Area: Introduction to Investments)**

Economic indicators suggest that there will be a rise in interest rates in the coming six months. Which ONE of the following investment portfolios would be LEAST exposed to such a rise in interest rates?

- A. One-third in cash, one-third in short-term bonds and one-third in shares.
- B. One-third in long-term bonds, one-third in property and one-third in shares.
- C. One-third in cash, one-third in long-term bonds and one-third in shares.
- D. One-third in short-term bonds, one-third in property and one-third in shares.

\*\*\*\*\*

Answer: A

Explanation:

Property and long-term bonds are expected to be adversely affected when there is a rise in interest rate(s). Please also refer to IFPHK's Essentials of Investments textbook (1st edition), pages 340-342.

**Question 17 (Subject Area: Introduction to Investments)**

Which of the following are typical features of a forward contract?

- I. The price of the goods is determined at the time of making the contract.
  - II. The payment for the goods is made at the time of making the contract.
  - III. The goods will be delivered upon maturity of the contract.
- 
- A. I & II only
  - B. I & III only
  - C. II & III only
  - D. I, II & III

\*\*\*\*\*

Answer: B

Explanation:

I & III are correct. The price of the goods is determined when the forward contract is made, the goods will be delivered and cash settlement is made upon maturity of the underlying contract. Please also refer to IFPHK's Essentials of Investments textbook (1st edition), pages 534-535.

**Question 18 (Subject Area: Introduction to Investments)**

Which of the following statements CORRECTLY describe(s) a bearer bond?

- I. It usually does not have a maturity date.
  - II. It is considered to be owned by the holder of the bond.
  - III. It has no coupon payment.
- 
- A. II only
  - B. I & II only
  - C. I & III only
  - D. I, II & III

\*\*\*\*\*

Answer: A

Explanation:

Only II is correct. The holder of a bearer bond is considered to be the owner. A bearer bond has a maturity date and it can have coupon that is numbered and dated. Please also refer to IFPHK's Essentials of Investments textbook (1st edition), page 299.

**Question 19 (Subject Area: Introduction to Investments)**

The following table lists out the transactions in an investor's securities account. What is the dollar-weighted average return of this account?

| Year | Transactions  |
|------|---|
| 0    | Bought 2 shares of \$60 each  |
| 1    | Received a dividend of \$4 per share<br>Sold 1 share at \$66 each               |
| 2    | Received a dividend of \$4 per share<br>Sold the remaining 1 share at \$63 each |

- A. 9.38%
- B. 11.67%
- C. 15.53%
- D. 17.58%

\*\*\*\*\*

Answer: B

Explanation:

$$120 = (66+8)/(1+r) + (63+4)/(1+r)^2$$

$$\text{Return } (r) = 11.67\%$$

Please also refer to IFPHK's Essentials of Investments textbook (1st edition), page 134.

**Question 20 (Subject Area: Fundamentals of Insurance)**

Janis is the Human Resources Manager of Company X and she is looking for a group life insurance policy. The insurance agent informs her that Company X must ensure that a minimum number of employees will be covered under the group policy. The main purpose of this requirement is to:

- A. avoid adverse selection.
- B. ensure insurability.
- C. increase agency commission.
- D. reduce premium.

\*\*\*\*\*

Answer: A

Explanation:

Adverse selection refers to the tendency of persons whose exposure to loss is higher than average to purchase insurance to a greater extent than those whose exposure is less than average. Adverse selection works in the direction of accumulating bad risk and causes the insurance plan to be unviable. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), page 48.

**Question 21 (Subject Area: Fundamentals of Insurance)**

Bill submitted his proposal for a whole life insurance policy with a sum insured of \$1,000,000 and paid the first premium of \$2,000. He has passed the medical check-up, and the underwriting process was duly completed. If Bill dies before the policy was issued, how much will his beneficiary recover under the policy?

- A. \$0
- B. \$2,000
- C. \$998,000
- D. \$1,000,000

\*\*\*\*\*

Answer: D

Explanation:

The beneficiary could get the sum insured as the life insurance contract is a valid contract, although the actual policy document has not yet been issued. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), pages 150-152.



**Question 22 (Subject Area: Fundamentals of Insurance)**

Which of the following is/are the effects of the principle of indemnity in insurance?

- I. It prevents the insured from profiting from insurance.
  - II. It reduces physical hazard.
  - III. It reduces moral hazard.
- 
- A. I only
  - B. III only
  - C. I & III only
  - D. I, II & III

\*\*\*\*\*

Answer: C

Explanation:

I & III are correct. The principle of indemnity maintains that the insured should not profit from insurance. The principle of indemnity cannot reduce physical hazard. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), page 5 and page 153.

**Question 23 (Subject Area: Fundamentals of Insurance)**

Ronald purchased his life insurance policy 5 years ago and committed suicide last month. When the insurance company processed the claim, it was found that Ronald had not fully disclosed information about his health condition in the life insurance proposal form. In the circumstances, the insurance company \_\_\_\_\_ payment under the policy by reason of the \_\_\_\_\_ clause.

- A. can reject; entire contract
- B. can reject; suicide
- C. cannot reject; incontestable
- D. cannot reject; ownership

\*\*\*\*\*

Answer: C

Explanation:

In accordance with the incontestable clause, the validity of the insurance contract cannot be questioned for any reason whatsoever after it has, during the lifetime of the insured, been in force for some time, typically 2 years. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), pages 226 -231.

**Question 24 (Subject Area: Fundamentals of Insurance)**

Which of the following statements with respect to a disability income benefit rider in a life insurance policy are CORRECT?

- I. Income benefits will be provided during the insured's disability.
  - II. Death benefits will be reduced if income benefits are provided to the insured.
  - III. A waiting period normally applies before income benefits are provided to the insured.
- A. I & II only
  - B. I & III only
  - C. II & III only
  - D. I, II & III

\*\*\*\*\*

Answer: B

Explanation:

Only I & III are correct. There will be no deduction of the death benefits if the insured receives income benefits during the period of disability. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1st edition), pages 247-248.

**Question 25 (Subject Area: Fundamentals of Insurance)**

Which of the following statements regarding a convertible term life insurance policy are CORRECT?

- I. The insured has the option of converting the policy subject to the provision of satisfactory evidence of insurability.
  - II. The insured has the option of converting the policy without having to provide evidence of insurability.
  - III. The insured has the option of exchanging the term life insurance policy for a permanent health insurance policy.
  - IV. The insured has the option of exchanging the term life insurance policy for some other type of permanent life insurance policy.
- 
- A. I & III only
  - B. I & IV only
  - C. II & III only
  - D. II & IV only

\*\*\*\*\*

Answer: D

Explanation:

II & IV are correct. A conversion provision gives the insured the option to exchange the term insurance policy for some category of permanent life insurance policy without having to prove insurability. Please also refer to IFPHK's Fundamentals of Risk and Insurance textbook (1<sup>st</sup> edition), page 199.

**- End of Sample CFP Certification Examination Questions (Foundation Level) -**