Investment products

1. Introduction

1.1. Chapter overview

With a vast range of investments available it can be bewildering for a private investor to know what to invest in. For many the easiest way of investing is to give their money to a fund manager for investment in a fund pooled with money from other people. That way the private investor can join forces with other investors and save time and money.

In this chapter you will learn about investment institutions, describing the way in which different types of pooled funds are run.

In the UK funds are either **regulated** or **unregulated**. A regulated fund is one that is subject to a strict set of rules governing the nature of its investments and its operation. The benefit to the private investor of such a fund is that it is relatively safe. The downside is that it will not be able to invest in as wide a range of investments as an unregulated fund.

Unregulated funds face no restrictions on investments, but may therefore expose their investors to more risk. They are also known as **hedge funds**.

There are several different legal forms that funds can adopt, including **unit trusts** and **investment companies with variable capital** (or ICVCs). Although the terminology describing the funds differs, broadly speaking you will see that they are very similar. Investors are usually unconcerned as to whether their fund is a unit trust or an ICVC.

This chapter also describes the firms that are involved in the operation of these funds, **fund managers** and **trustees**. Again, terminology differs but the roles played are as follows.

Fund managers are the firms that take investment decisions; they may have wide ranging powers of investment or there may be a narrow range of investments permitted.

Trustees have the job of looking after the assets of the fund and ensuring that the fund manager does not overstep their powers. A trustee will often be a well respected bank.

A third type of pooled fund is the **investment trust company**. In this chapter you will see that this is much more like a normal company than the other two, with very little in the way of regulatory control.

Other investment institutions include **pensions funds** and **insurance companies**. You will learn about the investment characteristics and features of both.

1.2. Learning outcomes

On completion of this module, you will:

Collective investment vehicles

- 16.1.1 Compare and contrast investing through direct investments in securities and assets, and investing through indirect investments
- 16.1.2 Distinguish between open and closed ended funds
- 16.1.3 Distinguish the features, risks and benefits of unit trusts, investment trusts and open-ended investment companies

- 16.1.4 Explain the additional benefits and risks of investing in split capital investment trusts
- 16.1.5 Explain the key features and objectives of Exchange Traded Funds (ETFs) and Exchange Traded Commodities (ETCs)
- 16.1.6 Explain the features and objectives of: private client funds, structured products, wraps and other platforms

Hedge funds and private equity

- 16.2.1 Explain the features and objectives of hedge funds and funds of hedge funds
- 16.2.2 Describe the various hedge fund strategies and approaches to private equity investing
- 16.2.3 Describe the potential benefits and limitations of hedge funds and private equity investing
- 16.2.4 Describe the management fee structure for hedge funds and private equity investing

Pension funds and insurance companies

- 16.1.7 Identify the characteristics and advantages Life assurance based investments and Defined Contribution pension arrangements

2. Collective investment vehicles

2.1. Benefits of investing in collective investment vehicles

We have looked at many asset classes, however, many average investors are not able to:

- Allocate the time to manage their own portfolios
- Have the expertise to construct, monitor and adjust their portfolios
- Benefit from economies of scale
- Diversify as well as with pooled investments
- Handle the administration that goes with portfolio management

Investing in a collective investment vehicle solves these problems. Pooling resources and handing over the responsibility of making the investment decisions to a manager, makes these very attractive to a lot of investors. Nevertheless, there is also a downside.

Firstly, the services provided by the management group do not come cheap; initial charges, ongoing charges and sometime exit charges are often incurred.

Secondly, although the funds managed by these vehicles are often diversified, like many investments, returns are not guaranteed.

Finally, there is a lack of control over the investment choice, and all decision making is handed over to a manager. The manager may be great, but not necessarily, and even if they are great, they are unlikely to stay managing the same fund forever.

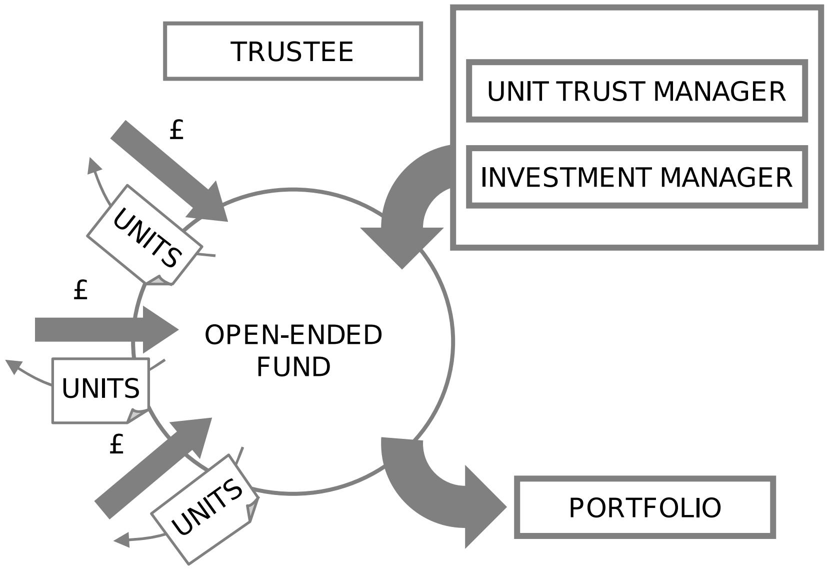
2.2. Unit trusts

Introduction

A unit trust is a form of collective investment scheme; a number of investors pool their resources which are then invested in a wide range of securities, ensuring that risks are reduced through diversification and costs are reduced by dealing in bulk. They are regulated under the Collective Investment Scheme Sourcebook (COLL) enforced by the FCA.

A unit trust is a trust, not a company.

Unit trusts are **open-ended**. They will expand or contract depending on the demand for units. In effect, the supply of units will always meet the demand for those units.



Professionals involved

There are three distinct functions involved in the activities of a unit trust:

- A unit trust manager
- A trustee
- An investment manager

The unit trust manager defines the terms of the trust, markets the trust, requests the trustees to create and redeem units, receives payments from investors and appoints the trustee.

The trustee (typically a bank or insurance company) is the **legal owner** of the underlying investments and must ensure compliance with the trust deed. It is the responsibility of the trustee to ensure adherence to the investment objectives of the trust.

The investment manager arranges for the purchase and sale of securities and for the provision of valuations for the trustee. The investment manager must decide upon investment strategy within the trust deed criteria.

In practice, the investment manager and the unit trust manager are often the same corporate body.

Types

In the UK collective investment schemes are the responsibility of the FCA. The FCA splits them into two groups:

- **Regulated schemes**, which are allowed to promote themselves to retail clients (e.g. authorised unit trusts)

- **Unregulated schemes**, which are not allowed to promote themselves to retail clients

Buying and selling units

Initial creation of units

When a new scheme is being marketed, units are issued at an initial price. The fund manager will market the fund to targeted investors and investors buy the units directly from the management group.

Subsequent issue of units

If demand exists for further units, investors can provide the manager with funds and new units are created.

The responsibility for the creation of new units rests with the trustee.

Cashing in units

Units must be bought and sold from the fund manager, they are not listed and there is no **secondary market**.

Pricing

Units can only be bought from or sold to the manager; there is no secondary market.

The price of the units is calculated by dividing the underlying assets of the fund by the number of units in issue. This exercise is usually carried out once a day at a set time (the **valuation point**).

Prices are either quoted as **one-way** (the same price to buy or sell units) or **two-way** (a higher price to buy units than to sell them).

For regulated unit trusts, the FCA lays down strict pricing regulations. It sets a spread formula which permits a spread between the bid and offer price of no more than 15%. This spread allows the fund manager to cover the dealing costs and stamp duty.

Charges

The charging structure depends on whether pricing is a single price or two-way.

Single price

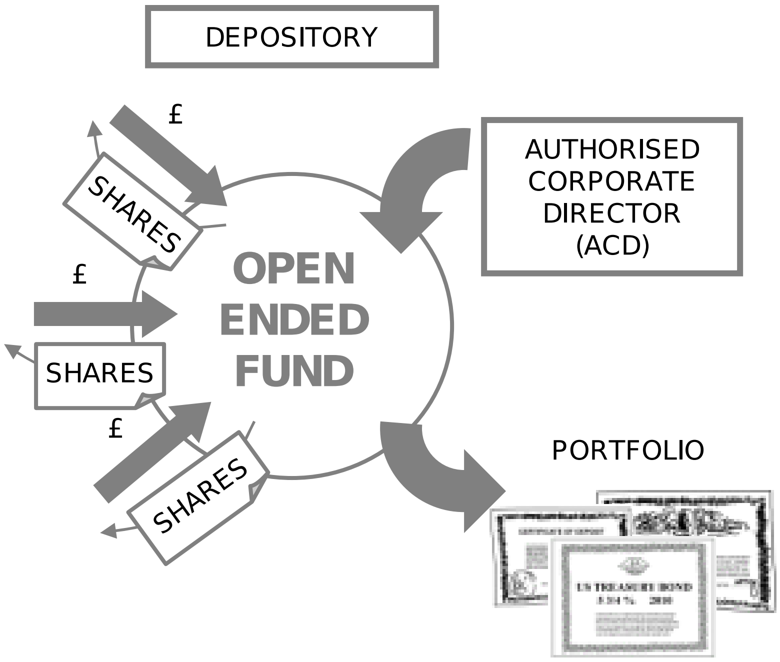
Dilution levy is where the costs of buying or selling the underlying assets are passed on to buyers and sellers of units as an additional charge.

Dilution adjustment (swing) is where the costs of buying or selling the underlying assets are passed on to buyers and sellers of units by incorporating them within the unit price.

Two-way price

With two-way pricing, the spread (difference between the bid and offer) is retained by the fund manager.

2.3. Open-ended investment companies (OEICs)



An OEIC is a form of collective investment scheme. A number of investors pool their resources which are then invested in a wide range of securities, ensuring that risks are reduced through diversification and costs are reduced by dealing in bulk.

An OEIC is a company, not a trust.

OEICs are open-ended. They will expand or contract depending on the demand for shares.

OEICs are often referred to as **investment companies with variable capital** (ICVCs).

Professionals involved

The Authorised Corporate Director (ACD) is responsible for investment decisions and pricing. The ACD is equivalent to the fund manager of a unit trust. A **depository** will have custody of the scheme assets and will also ensure that the ACD acts within the regulatory framework. The depository is equivalent to the trustee of a unit trust.

Buying and selling shares

Shares can only be bought from or sold to the Authorised Corporate Director. There is **no secondary market.**

The price of the shares is calculated by dividing the underlying assets of the fund by the number of shares in issue; this exercise is carried out once a day at a set time (the valuation point).

Prices are quoted on a one way basis; this means that the same price is charged to buy or sell units. The FCA sets down the pricing regulations.

2.4. Unit trusts vs. ICVCs

Table 14. Unit trusts vs. ICVCs

	Unit Trust	ICVC
Legal status	Trust	Company
Pricing	One or two way	One way
What the investor buys	Units	Shares
Managed by	Manager	Authorised corporate director
Assets held by	Trustee	Depositary

2.5. Investment powers of collective investment schemes

We have discussed the difference between regulated and unregulated funds.

Regulated funds can be compliant with the Undertakings for Collective investment in Transferable Securities directive. This European Directive allows the marketing of units in UCITS compliant schemes throughout the European Economic Area (EEA). However, there are restrictions on the investment powers (the scheme property) of the fund.

In general the restrictions limit the scheme property to:

- • Transferable securities
- • Approved money market instruments
- • Units in CIS
- • Derivatives and forwards transactions
- • Deposits

Transferable securities are typically shares and bond that trade on an eligible market. This market should display the following characteristics:

- • Regulated
- • Regular hours
- • Recognised by a regulator
- • Open to the public
- • Adequately liquid
- • Has adequate arrangements for settlement

Below is a summary of the investment powers:

Table 15. CIS restrictions (I)

Investments	% of NAV
Borrowing	Max 10%

Investments	% of NAV
Single issuer securities	Max 5% (can be 10%)
Units in CIS from a single fund	Max 20%
Government securities from a single issuer	Max 35%

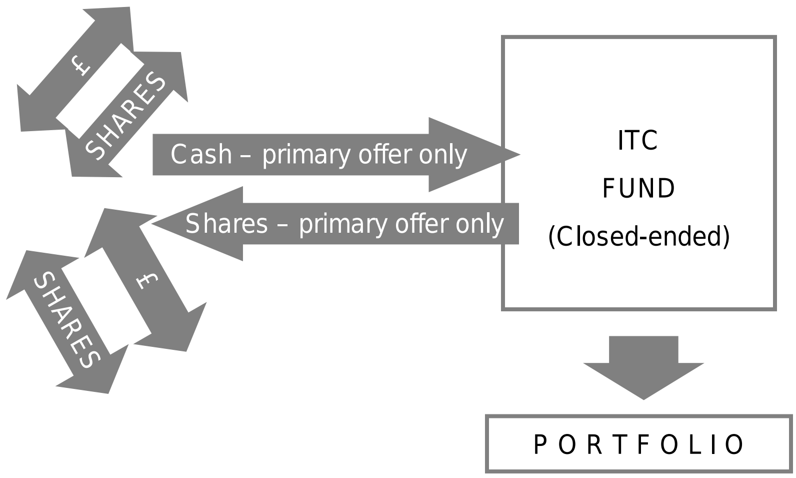
Table 16. CIS restrictions(II)

Investments	% of a single institutions securities owned
Non-voting shares	Max 10%
Debt securities	Max 5% (can be 10%)
Money market instruments	Max 10%
CIS Units	Max 25%

2.6. Investment trusts

Introduction

INVESTMENT TRUST COMPANY (ITC)



An investment trust company (an ITC) is a company with a fixed share capital whose shares are listed on the London Stock Exchange. The company's fund is invested in the shares and bonds of other companies, thus offering diversification to investors.

An investment trust is a public limited company, not a trust.

Investment trusts can borrow funds. They are not subject to FCA restrictions on their powers. They are governed by company law, the FCA's Listing Rules (LR, PR, DR) and tax law.

Investment trusts are **closed-ended**. After their launch they do not normally expand or contract in size.

Variations of investment rusts are real-estate investment trusts (REITs) and venture capital trusts (VCTs).

There are two types of investment trust.

Conventional investment trusts

This ITC structure is set up to run indefinitely.

It issues two classes of share, ordinary and preference, both of which receive twice yearly dividends.

Split capital investment trusts

Introduction

A split capital ITC is set up like another but with the specific intention of being wound up in a set period of time. At the point of liquidation all investors will be repaid.

There are three basic classes of share that can be issued in a split capital ITC. These are:

- Zero dividend preference shares
- Income shares
- Capital shares

Zero dividend preference shares (zeros)

These are considered lower risk shares in an ITC.

Zeros receive no income during the life of the share. Instead all of the return comes in the redemption value on the wind-up date. This redemption value is pre-specified and, to an extent, guaranteed – the zero-holder will be the first to be paid on liquidation of the assets in the fund. However, if the ITC has taken on any debt, the lenders will need to be repaid first, and, potentially, this may not leave enough money for the zeros-holders.

Income shares

These are considered medium risk shares.

These are most like ordinary shares in a company. They receive most of the income generated by the ITC in regular distributions. Often these also have a pre-specified redemption value, although priority is below the zeros.

Capital shares

These are considered the most risky share.

Typically there is no income paid out on these shares. Instead the full return is received in the redemption value, rather like a zero. The key differences are two-fold. Firstly, the redemption value is not specified up front but is based on a proportional payout of the value of assets. Secondly, these shares are the last to be paid out.

If all the available funds have been used up paying other classes of shares, capital shares receive nothing. However, if the fund has done very well, there could be substantial funds remaining, giving excellent upside potential for the holders of capital shares.

Regulation of investment trusts

Investment trusts are not subject to FCA restrictions on their powers. They are governed by the Companies Act, London Stock Exchange requirements and tax law.

Buying and selling shares

Once the trust has been launched, shares can only be bought in the **secondary** market on the London Stock Exchange.

The price of the shares is fixed by **supply and demand**. It will not necessarily be the same as the value of the underlying investments of the fund (or **net asset value**).

- If share price > net asset value/share, the shares are trading at a **premium** (to net asset value)
- If share price < net asset value/share, the shares are trading at a **discount** (to net asset value)

In practice, investment trusts usually trade at a discount to their net asset value. This may facilitate a takeover of the ITC and subsequent asset sales to realise value.

The amount of the discount is not static; it tends to widen as the stock market weakens and narrow as it strengthens. Movements to the discount accentuate market performance.

Gearing and leverage risks

Gearing, which can also be known as 'leverage' (particularly in the US), is the process whereby companies, such as investment trusts, borrow money to expand their businesses. Investment trust professionals use the term 'gearing' a lot and point to it as one of the greatest advantages that investment trusts have over, for example, traditional unit trusts and ICVCs. Essentially, gearing means the ability to borrow money in order to invest.

The idea is that by taking out such borrowings, the capital growth and income received by the ordinary shareholders of a trust will be boosted by borrowings. The return on this extra investment, minus the costs of borrowing the money, gives the shareholder an enhanced or geared profit. Such borrowings, which can be in the form of loan stock, debentures or preference shares as well as straightforward bank loans provide scope for additional investment, but also carry a fixed liability.

Gearing magnifies what is going on in the actual investment portfolio of a trust. If its value is increasing then any gearing will cause it to increase at a faster rate, and the more gearing the portfolio has, the greater the magnification will be. However, if its value is decreasing then any gearing will cause greater losses.

Unit trusts vs. ITCs

Table 17. Unit trusts vs. ITCs

	Unit Trust	Investment Trust
Legal status	Trust	Company
Pricing	Net asset value	Supply and demand
Market	Primary	Secondary
What the investor buys	Units	Shares
Borrowing powers	10% no gearing	Restricted by company's constitution only. Can be geared

Exchange-traded products (ETPs)

Introduction

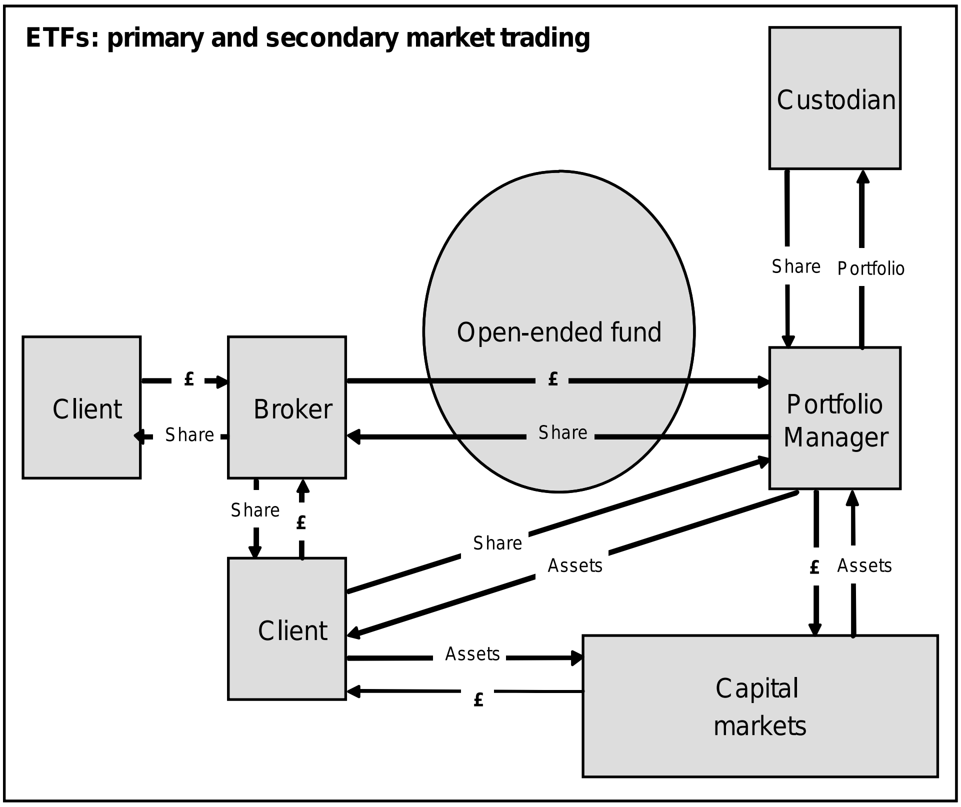
Exchange-traded products (ETPs) offer investors the opportunity to track a large range of diverse indices with relatively low running costs. They are useful to investors in allowing them to gain exposure to a range of markets that they may otherwise not have gained access to.

Two key types of ETP are:

- Exchange-traded funds (ETF) – these typically track equity indices
- Exchange-traded commodities (ETC) – as the name suggests, these typically track commodity indices

Construction

Essentially an ETP is an open-ended fund (like a unit trust or ICVC) that can be traded on the secondary market (like an ITC). One of the major attractions of an ETP is that participants can be involved in both the primary and secondary markets of these funds. For example, in an ETF, an investor can buy the share on the secondary market and hold or trade it like any other share. Alternatively an investor can exchange shares for a proportion of the assets in the portfolio on the primary markets; either cancelling or creating the shares.



To create an ETF, the FCA will require a review of the fund to make sure it is UCITS-compliant and to obtain recognition status. The FCA performs the review upon submission of the UCITs prospectus by the firm to the FCA. 'Recognition' status allows the fund to be marketed to private investors.

Characteristics of ETFs

ETFs have rapidly grown in popularity due to some of their specific features below:

- ETFs are open-ended, therefore are not significantly affected by the impact of supply and demand. The value of the unit is based on the net asset value per share
- ETFs are essentially tracker or index funds, benefiting from the full diverse nature of the index that they track
- ETFs are traded on the secondary markets so prices are quoted in real time and change throughout the day
- ETFs have very low charges, due to the impact of the primary markets. As clients of the fund can look for discrepancies between the share value and net asset value, there is a great deal of activity on the primary markets. This keeps the fund well balanced and accurately tracking the index without a great deal of intervention from the manager
- ETFs are not subject to stamp duty
- ETFs can be shorted, just as any share can

Some ETFs have metamorphosed into exchange-traded commodities (ETCs). These give exposure to commodity prices and returns without the traditional need for complicated OTC trading or derivative transactions.

There is a strong argument when investing that suggests sticking to a passive indexing approach and keeping the costs low will gain the highest return in the long run. ETFs are a useful way to achieve this.

Other methods of indirect investment

Private client funds

Overview

Private client funds describes a situation where a client has a private account with a brokerage. The brokerage then enters into deals on behalf of the client.

Accounts are normally reserved for wealthy individuals, and may be managed in one of four different ways:

- Execution only – The client makes the investment decisions and the broker implements the transactions
- Advisory dealing – The client generally makes the decisions but the on occasion may ask the broker for advise
- Portfolio advisory – The broker reviews the client's objectives and provides advise on construction of the portfolio and ongoing changes. The client makes the final decisions on what should be transacted
- Portfolio discretionary – The client allows the broker to make all decisions on investment strategy and the broker buys and sells assets under blanket permission provided at the start of the relationship

Performance measurement

Due to the very specific nature of these funds, benchmarking can be quite difficult. In order to help private client fund managers in performance measure the Wealth Management Association (WMA) create a range of Private Investor Indices that are tailored to specific objectives (growth, income or a balanced) and risk appetites.

The WMA used to be called APCIMS.

Structured products

Structured products are a combination of a security and a derivative – typically an option. They have a fixed life at the end of which payments to the investor will be made.

Some of these products are reasonably common and have been discussed previously.

More common structured products

- A callable bond is a standard bond issued by a company or investment bank with a call provision attached to it. The call provision entitles the issuer to buy back the bond (repay the loan) early. Like any call option the exercise price and the date will be specified in the investment.
- A putable bond is a very similar investment. However, a put provision entitles the holder of the bond to sell back the bond (demand repayment) early.
- A convertible bond, such as convertible loan stock, we saw in the debt chapters, the bond effectively becomes an option on shares as soon as the share price rises above the conversion price (NV / ratio). Convertibility, where the bond can be converted into a certain number of equities, is often seen as a low risk way of gaining exposure to an equity price increase.
- Index-linked notes link the coupon on the bond to a specified inflation index. This is often described as a bond with an inflation swap packaged together, where the fixed coupon of the bond is swapped for a floating inflation index.
- Commodity linked bonds could take many forms. One example could be a bond with a commodity index swap attached to it, allowing the fixed coupon on the bond to be replaced with a floating rate based on the return of a specified commodity index. Another example could allow the investor to convert the bond into a specified quantity of an asset on redemption. Alternatively the bond could feature both of these elements.

Three main categories of structured product

- Structured deposit – A fixed term deposit account where the interest is linked to the performance of a specified asset. For example, if over the term of the deposit the FTSE 100 stays above 6500 points, you will get 6% on your deposits. If not, you receive no interest. Although the deposit is likely to be protected by the Financial Services Compensation Scheme (FSCS) in the UK, any interest will not.
- Structured capital protected product – Often a package of a zero-coupon bond with a long option, giving capital protection (through the bonds) with potential upside (through the option). These are not protected by the FSCS.
- Structured capital at risk product – Places some or all of the investor's capital at risk to gain additional return.

Structured products can be invested in directly and as such are eligible for inclusion in tax efficient wrappers, such as individual savings accounts (ISA) and self invested personal pensions (SIPP)

Wrap accounts and other platforms

Fund supermarkets

Recently in the UK, investments in unit trusts and ICVCs have been available through fund supermarkets. They offer investments in funds provided by a range of different fund managers all under one roof, thus acting as consolidators of client orders. They also handle the associated administration, contacting and placing of deals with managers, keeping records of investments and issuing investor statements.

Wrap accounts

A wrap account (or wrap service) is a means of consolidating and managing an investor's investment portfolio and financial plans. Wrap fee services are offered by many financial institutions. Often wrap services are offered for a fee.

Wrap services usually enable investors to select from an extensive range of UK and offshore funds and assets – including Unit Trusts, OEICs, Investment Trusts, equities, gilts, cash, structured products, VCTs, Hedge Funds, ETFs, ETCs and other investment products. The service can then be used to allocate these assets to the most appropriate tax wrappers – including ISAs and pensions plans. Both investors and advisers can then view a holistic picture online of the complete portfolio – all in one place, from anywhere in the world – 24/7.

The potential benefits to investors are:

- They only have one counterparty to deal with, saving a lot of time dealing with a diverse range of fund managers, financial institutions and other product providers
- Investors can view their entire portfolio all in one place, enabling them to keep track of their current financial position on a daily basis, however complex their financial affairs are
- They also receive a single consolidated annual tax statement, comprehensive six-monthly statements, documentation of all purchases, sales, deposits and withdrawals
- The most professional wrap services make no charge for re-registering assets in specie, on or off the platform

Offshore funds

An offshore fund is essentially a unit trust, with the exception that it is domiciled overseas. As with a unit trust, investors' money is pooled and then invested in the shares of companies and/or other assets.

The fund itself also does not pay UK tax.

Fund of funds

These are funds where the manager invests in other hedge funds rather than the underlying assets. The fund manager's skill here is in picking those hedge funds that will be particularly successful.

The benefit of an investment in this type of fund is that it theoretically splits your investment among a number of different funds and therefore provides diversification. A fund of funds may be open to new clients and also have existing investments in other hedge funds that are now closed to new clients. By investing in the fund of funds it is possible to get exposure to these closed schemes.

A drawback to the structure is that the investor is effectively paying two sets of management costs. Returns will be reduced by the management charge of each of the invested hedge funds and on top of this the funds of funds manager will also take fees on any profits.

3. Hedge funds and private equity

3.1. Hedge funds

Any scheme in the UK that is not a regulated scheme is an unregulated scheme. Unregulated collective investment schemes (UCIS) **may not** promote themselves to retail clients. They are deemed to have more risk and face lower levels of regulation. This can lead to a lack of transparency in regard to what the manager is doing, what investments are in the portfolio and how they are performing. Instead of general marketing, these funds would target:

- Wealthy investors
- Institutional investors
- Charities
- Other UCIS

An example of an unregulated scheme would be a 'hedge fund'.

Introduction

Only funds that are regulated by the FCA can be freely advertised in the UK. It is worth noting that although the fund itself will not be regulated it is still required that the fund manager has FCA authorisation.

Characteristics

A common feature is the use of investments and risk management to generate positive returns (absolute returns) regardless of the direction of the market.

Strategies employed to achieve this include:

- Short selling
- Borrowing to enhance gearing
- Use of derivatives

Charges tend to be based on both a flat fee (1-2%) and an additional management fee (20-25%) based on the positive returns generated by the fund.

Fees

Due to the active nature of many hedge funds, the fees can be substantial. They are typically divided into:

- Fixed fees – approximately 1% or 2% (but can be as high as 5%) of the assets under management
- Management fees – can be substantial and in some cases 25% of any upside performance

Classification

Hedge funds are classified in terms of their general investment objectives:

- **Event driven**: seeking returns by investing in securities that will be affected by specific events such as mergers and restructuring

- **Market neutral**: seeking returns that have no or little correlation with a traditional market. Usually employing arbitrage techniques these funds tend to be quantitative in nature
- **Long/Short funds**: looking to adopt directional views on markets, industrial sectors and countries using equity and fixed interest securities. A fund might go long on securities it thinks will rise and short on those it believes will fall
- **Tactical trading**: taking a view on the market prices of a variety of asset classes based on technical analysis or a more fundamental analysis type approach. Systematic approaches use computer models based on technical analysis, whereas discretionary managers use a less quantitative and more holistic approach.
- **Fund of funds**: these funds attempt to spread the risk of investing in one actively managed fund – relying on the investment decisions of one person only – by combining the units of many hedge funds in the portfolio of assets. It is worth noting that a fund of hedge funds is still considered a hedge fund by the FCA. Also, as with all funds of funds, these expose the investor to two lots of management fees.

3.2. Private equity

Private equity is often divided into two areas:

- Venture capital – brand new companies i.e. a Dragons' Den scenario
- Buy outs – existing plcs being bought out to become private companies

Venture capital is very risky. Anyone who has seen the program Dragons' Den will know that for every business idea that becomes successful there are plenty of ones that fail.

Buyouts involve established companies that have proven products, a customer base, experienced staff and overall a lot less risk than venture capital investments. In a buyout, a publicly quoted company is bought out and turned into a private company. Often debt plays a large role in this, leading to the term **leveraged buy-out**.

Private equity funds typically requite investors to commit capital for fixed period of time, for example 10 years. This allows the companies in the portfolio to grow or recover before they are sold on and the portfolio is liquidated.

Fees are similar to hedge funds: divided into fixed fees and carried interest (management fees). The **carried interest** will be paid if the performance of the fund exceeds a pre-agreed level, referred to as the **hurdle** rate.

4. Pension funds and life assurance companies

4.1. Pension funds

Features

A pension fund is an investment scheme where the contributors are saving for retirement.

- Contributions to an approved pension fund are free of tax
- Whilst investments are in the fund any capital gains or income are not subject to tax

Defined contribution schemes

These are schemes where the contributions are invested. The aim is that the investment will grow over time and the final value of the investments determines the pensions paid.

Defined benefit schemes

These are schemes that guarantee to pay a pension of a certain size once the employee retires, i.e. a fixed percentage of the employee's final salary.

As these funds aim to meet a future liability, they are often referred to as liability driven investments (LDIs).

In the US and the UK, there has been a noticeable shift towards defined contribution and away from defined benefit schemes by employers. Personal pensions are usually of the defined contribution type.

Self-invested Personal Pensions (SIPPs)

A Self-invested Personal Pension (SIPP) allows an investor to choose their underlying investments themselves.

4.2. Insurance companies

There are two types of insurance company: **general insurance**, which offers short-term risks such as car, household and holiday insurance; and **life assurance**, which offers cover against loss of life.

Life assurance

Types of life fund

Life assurance policies may be split into two groups: **term** and **whole-of-life**. Because of the long-term nature of life funds, fund managers tend to pick inflation resistant investments such as equities and land.

Term assurance

Term life assurance policies provide cover for a pre-determined period only. If the subject of the policy dies within a specified period, the policy pays out. However, if the person dies after the pre-determined period has expired, no payout is made. In its pure form it tends to be the cheapest form of life insurance as there is no savings element.

Sometimes, the policy has a savings element built in and is known as an **endowment**. Endowment policies pay out a sum at the end of the term, as well as covering the individual in the event of death. They are effectively savings plans with life assurance added on.

Endowment payouts are exempt from any requirement to pay tax. They are sometimes called **qualifying** policies, as they qualify for tax exemption. Endowment payouts are therefore gross as there is no tax deduction.

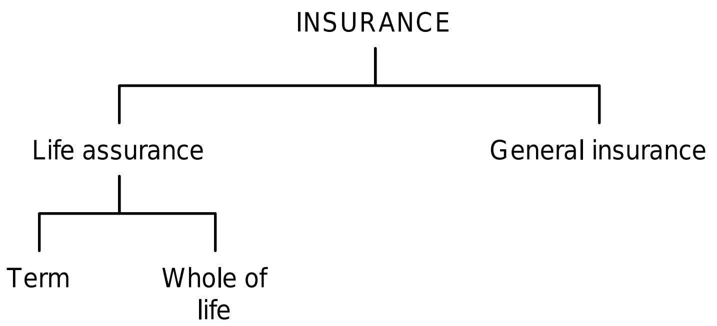
Whole-of-life

Whole-of-life policies, on the other hand, provide cover for the whole of the subject's life, i.e. they pay out whenever the subject dies.

General insurance companies

General insurance policies provide cover for short-term risks such as household contents, motor and travel insurance. These contracts are normally renewed on an annual basis.

Insurance funds: summary



5. Investment products: summary

5.1. Key concepts

Collective investment vehicles

- 16.1.1 Compare and contrast investing through direct investments in securities and assets, and investing through indirect investments
- 16.1.2 Distinguish between open and closed ended funds
- 16.1.3 Distinguish the features, risks and benefits of unit trusts, investment trusts and open-ended investment companies
- 16.1.4 Explain the additional benefits and risks of investing in split capital investment trusts
- 16.1.5 Explain the key features and objectives of Exchange Traded Funds (ETFs) and Exchange Traded Commodities (ETCs)
- 16.1.6 Explain the features and objectives of: private client funds, structured products, wraps and other platforms

Hedge funds and private equity

- 16.2.1 Explain the features and objectives of hedge funds and funds of hedge funds
- 16.2.2 Describe the various hedge fund strategies and approaches to private equity investing
- 16.2.3 Describe the potential benefits and limitations of hedge funds and private equity investing
- 16.2.4 Describe the management fee structure for hedge funds and private equity investing

Pension funds and insurance companies

- 16.1.7 Identify the characteristics and advantages Life assurance based investments and Defined Contribution pension arrangements

Now you have finished this chapter you should attempt the chapter questions.