

A-Z OF ISAs, PEPs & TESSAs

A

Annual Allowances

Out of ISAs (Individual Savings Accounts), PEPs (Personal Equity Plans) and TESSAs (Tax Exempt Special Savings Accounts), the only new schemes that can be commenced are ISAs. Within ISAs it is possible to invest up to £7,000 in each tax year per individual if you use all the elements of Cash, Stocks and Shares and Insurance. See ISAs below for further information.

Annual Management Charge

This is a fee paid on an ongoing annual basis by you to the managers of your investment. The amount of these charges varies from company to company and from product to product but is usually in the range of 1-2%. Annual fees are usually smaller than initial charges. If you are looking for an investment for income, it is generally wise to ensure that the annual charge is taken from the income before you receive it, rather than from the capital remaining on the account. This can result in a reduction in your investment over time and is how certain companies offer higher than normal rates of income – beware!

B

Benchmark

Some investment funds compare themselves to a Benchmark. This is often an index or combination of indices that is used to gauge how it performs over a period. This reference does not allow the investor to compare the fund against its competitors; this is easier to assess if similar funds are compared to each other on like for like basis although past performance does not guarantee future returns. Simply out performing the benchmark does not always mean a good fund.

C

CAT Standard ISAs

Some ISA plans carry what is known as a CAT mark. CAT stands for Charges, Access and Terms. What it means is the plan concerned has met, or exceeded, minimum Government guidelines. CAT standards are designed to identify savings products that are simple, clear and fair, so that savers will feel confident about choosing them. However, it doesn't mean they're suitable for all savers and in no way relates to the past or future performance of the investment. Different minimum terms apply to each part of the ISA allowance. Cash ISAs must have no one-off or regular charges of any kind, have a minimum transaction size no greater than £10 and allow you to withdraw your money in 7 working days or less. The interest rate offered must be no lower than 2% below base rate. Insurance ISAs cannot have annual fees exceeding 3% or cannot have a minimum premium of greater than £250 per annum or £25 per month. Surrender values should also reflect, over time, the value of the underlying assets of the fund and there should be no surrender penalties. Stocks and shares ISAs, meanwhile, should charge no more than 1% annual management fees each year and investment risk must be highlighted in any product literature.

Corporate Bonds

A Corporate Bond is issued by a public company, such as BP or Marks & Spencer. When you invest in a corporate bond, you are lending money to the company. In return you will receive interest at a fixed rate and the promise that your capital will be repaid at a certain date in the future. The guarantee that your capital will be returned is only as good as the company to which you are lending money. While FTSE 100 companies could be considered stable companies due to size, smaller companies are likely to be of a higher risk and consequently may offer a higher rate of interest for the added potential risk.

Convertibles

This is a type of investment, usually a class or shares, that carries the right for the holder to at some stage convert it in for another form of investment at a fixed price. In the case of convertible shares (sometimes called bonds or preference shares), these carry the right to be converted into Ordinary shares at some date or dates in the future at previously specified prices. This is usually an option and does not need to always be exercised until a specified final date. If a company were to go out of business, Convertible shareholders stand higher up the list than Ordinary shareholders.

D

Direct shares

Within certain plans it is possible to buy direct share holdings rather than collective investments such as Unit Trusts, OIECS or Investment Trusts. These plans are often called Self Select investments. These are only suitable for the professional investor who has the time and knowledge to manage the shares effectively. As such an account will normally hold only a limited number of companies at any one time, the diversity of collective investments is not provided and therefore are considered of a higher risk. Charges can be lower than managed funds as no management whatsoever is provided. Note that if shares are purchased within such an account, you do not normally qualify for any shareholder benefits such as discount cards.

E

Equity

Another name for shares, whether Ordinary, Preference or Convertible.

F

Fixed Interest Investments

This is a general term given to investments that provide an income through interest rather than dividends. These investments are otherwise known as Loan Stock that in fact better describes their format. Rather the shares you own making you a direct part owner of the company, these investments are loans to the company, in return for which the investor will receive a fixed level of interest until a specified date at which time the original issue price for the shares will be returned to the investor. These can be in the form of loans to the Government (known as Gilts) or loans to business (known as Corporate Bonds).

Flexibility

New ISA accounts are very flexible. Although stock and shares ISAs should be viewed as medium to long-term investments, access to your capital is usually free of charge and without loss of the tax benefits accrued unlike TESSAs, subject to individual company minimum balance remaining on the account. Regular payments can be varied either up or down or even stopped without any penalties whatsoever again subject to individual company minimum investments. Such schemes are therefore very attractive for those looking to provide long-term savings in an uncertain world. Also investing on a regular basis can smooth out market volatility and allows the investor to benefit from 'pound cost averaging' (buying investments over a period that actually allows you to benefit from falls in the market).

Fund of Funds

Certain Unit Trust managers run a Fund of Funds. This type of fund invests in some or all of the other funds managed by the investment company and provides greater diversity. As the managers see fit, they will sell and buy funds to benefit from market movements and this can add a further layer of management for the investor. The problem with these accounts is that many companies may have one or two good funds but the rest will be poor. Therefore the performance of the Fund of Funds can be poor even if certain funds have done particularly well.

G

Gilts

This is an investment that is in fact a loan to the Government. The investment provides an income through interest rather than dividends. When issued the investment pays a set rate of interest for a set number of years (payable six monthly) at the end of which the capital will be returned. During the period that the investment is available, the price will fluctuate as with other types of investment although often this is less volatile than shares. However, these investments are effected by such issues as interest rates and inflation and can lose value particularly when interest rates are rising.

Gross Income

Gross income is the payment of income without the deduction of tax. Whether tax should be paid on the income will be dependent on the individual's tax position and what type of investment has produced the income.

H

Historical Performance

When selecting funds it is tempting to just look at the historical performance and compare it to other funds. Although this is a guide, it is no guarantee of future performance. It is important to also consider other factors such a fund manager changes, market sentiment for the sector that the fund is investing within and cost. All these factors and more need to be considered when selecting an individual fund or management group.

I

Individual Savings Account

Up to certain limits you can invest in Individual Savings Accounts (ISAs) and receive tax-free returns. An ISA is simply a tax-efficient 'wrapper' that sits over a savings product. You can only normally invest in an ISA with one company in any individual tax year although you are free to select a range of individual funds with the company selected for a particular tax year. An ISA is a wrapper that gives the underlying investment tax-free status; you don't pay any further Income or Capital Gains tax on returns that your ISA investment produces. When you invest in an ISA you need to choose between a Maxi ISA and a Mini ISA.

Initial Charges

This is the charge made on an investment to cover the costs of setting up the policy or product. Some schemes do not levy this charge although if levied is deducted from the sum invested. In savings products, unit trust companies often charge an initial fee around 5% but they can vary from nothing up to as much as 7.5% depending on the fund. However, charges are a fact of life and you will not be better off leaving your money in a savings account in a bank or building society. It is better to pay 5% on a stock market based investment fund which grows by 15%, giving you a net return of 10%, than a net return of less than 5% on a savings account. Perhaps surprisingly, you will not be able to get a discount on the initial charge by buying direct from the product provider. You may have cut out the broker but they'll still charge you the full amount.

Investment Trusts

Investment Trusts are companies that invest in the shares of other companies. Like unit trusts, they are collective investments that pool together the money of many investors. This money is then invested in a portfolio (or wide range) of companies that will be more varied than the small investor could achieve.

There are a number of key differences between unit trusts and investment trusts. Unit trusts are open-ended and can keep receiving funds for putting into the market from investors. Investment Trusts are closed in that they have a fixed amount of capital that is divided into shares. The investors then purchase these shares. Investment Trusts can borrow money to invest which this makes them more volatile.

J

Juniors and Infants

Individuals under the age of sixteen cannot hold ISAs. For these individuals, savings can be made either through Unit or Investment Trusts by way of a designated account in the name of parent or grandparent, or through the new Stakeholder pension scheme. The investment is taxed as if it were the child's up to certain limits.

Joint Investments

Unusually, ISAs, PEPs and TESSAs cannot be held jointly. On death the investments will either lose the tax-free status or be encashed and the money returned to the estate.

K

Kinder ways of investing

For those who are interested in ethical investments there are now a wide range of ISA and PEP funds to choose from. Different schemes define 'Ethical' by different terms and therefore it is essential that the correct funds are chosen to satisfy individual concerns.

L

Lump Sum Investments

When starting a new ISA, you do not need to use the allowance in one go. Certain Stocks and Shares ISAs have minimum investments of £500 and cash ISAs start at £10. Therefore an account can be found to satisfy most budgets.

M

Maxi and Mini ISAs

When you invest in an ISA you need to choose between a Maxi ISA and a Mini ISA. With a Maxi ISA just one ISA Manager manages the whole of your ISA for that tax-year as a stocks and shares account. With a Mini ISA you can invest in three ISA components (Cash, Insurance and Stocks and Shares) with different ISA managers. The most you can invest in a stocks and shares Mini ISA is £3,000, in a Cash Mini ISA £3,000 and in an Insurance Mini ISA £1,000 (the total being the full ISA limit of £7,000). This compares to £7,000 if you invest in a Maxi ISA investing all the allowance within stocks and shares. And, because you can't invest in both a Maxi and a Mini ISA in the same tax-year, if you want to invest your full ISA allowance in a unit trust or similar investment, you need to make sure you choose a Maxi ISA. Apparently this is a simpler investment type than the old PEP system!

Multi Fund Accounts

Certain investment companies allow investors to use their ISA as a wrapper into which the investor can place the funds of many investment groups. For the investor looking for a diverse portfolio or looking to consolidate separate accounts established over many years, these investments can prove invaluable. They allow the investor to select the top funds from the groups on offer and invest a proportion of the ISA or PEP with that company whether it is Gartmore, Invesco, Jupiter, Fidelity to name a few. These accounts save time on administration and allow a balanced portfolio to be established in a cost effective manner. On going charges are also attractive as funds within the scheme can often be switched far cheaper and easier than using a separate plan with many individual companies. We believe that these accounts are now the way forward for many investors looking to build large tax free ISA portfolios over time and also manage existing PEPs in a more efficient and lower cost manner.

N

No Tax Forms

The advantage of all these tax-free savings is that no reference needs to be made on tax forms returned to the Revenue. This is even the case if income is taken from the investments as this does not count towards Income Tax or Age Allowances.

O

OEICs

OEICs (Open Ended Investment Companies) are pooled investment vehicles that spread the investor's money across many holdings but in a company form. They are like unit trusts that they are designed to replace. Investments permitted in OEICs are the same as those currently permitted for unit trusts. OEICs in the UK are taxed in the same way as unit trusts.

P

Personal Equity Plans

Created in 1987, Personal Equity Plans (PEPs) closed to new subscriptions on 5 April 1999. You cannot now put any more money into a plan however, if you have an existing PEPs it can continue in existence and you will continue to receive tax benefits. You are able to switch existing PEP from one manager to another although you cannot transfer PEP investments into ISAs. Tax benefits of PEPs have been scaled back in the same format as ISAs. In addition to investing within a 'General PEP', investors were also permitted to invest further in the shares of one additional company. These 'Single Company' PEPs were designed to hold the shares of just one company although this rule has now been relaxed and the same investment rules apply as General PEPs and ISAs. This relaxation now allows existing Single Company PEP holders to greatly diversify their investment and this reduces risk.

Preference Shares

Preference shares are shares issued by companies but are a little different to Ordinary shares. They are considered of a lower risk as they pay a fixed dividend that is decided at the time of the issue of the shares whereas dividends from Ordinary shares can rise and fall from year to year. Holders of preference shares also have an entitlement to receive their dividends before ordinary shareholders. If a company were to go out of business, preference shareholders stand higher up the list than Ordinary shareholders.

R

Regular Savings

New ISA accounts are very flexible with regard to regular savings. Subject to individual company minimum investments, regular payments can be varied either up or down or even stopped without any penalties whatsoever. Such schemes are therefore very attractive for those looking to provide long-term savings in an uncertain world. Also investing on a regular basis can smooth out market volatility and allows the investor to benefit from 'pound cost averaging' (buying investments over a period that actually allows you to benefit from falls in the market). Minimum monthly investments can start from as low as £20.

Risk

When selecting an investment it is important that you are aware of the risks involved. Every type of investment contains a degree of risk whether it is the risk of your building society deposits being eroded by the effects of inflation every year, or buying shares in a company that may go into liquidation. There is a risk and reward balance that needs to be achieved and most investors can have an involvement in share markets at a risk level to which they feel comfortable. It is important that the investor is aware of the real risk and not the perceived risk

that can be very different for each individual and the part of their finances that are being considered. Short-term savings should always be within cash accounts of one form or another whilst long-term savings can be used for other purposes such as ISAs.

S

Stocks and Shares

This is the generic term for shares in a company. Purchasing a share for a particular company makes you a part owner and therefore you can potentially benefit from the growth in the business through an increase in share price and also a proportion of the profits each year through a dividend. With an 'Ordinary' share there is no guarantee of the value or the dividend and although there is the potential to participate in the profits of the company, as a part owner, your capital invested is at risk should the company perform badly, or in the worst case go into liquidation. In this last case it is often the 'Ordinary' shareholders who are last to receive any compensation, if any at all, from a liquidated company.

Self Select ISA Accounts

These plans allow the investor to choose and buy direct share holdings. These are only suitable for the professional investor who has the time and knowledge to manage the shares effectively. As such an account will normally hold only a limited number of companies at any one time, the diversity of collective investments is not provided and therefore are considered of a higher risk. Charges can be lower than managed funds. Note that if shares are purchased within such an account, you do not normally qualify for any shareholder benefits such as discount cards.

T

Tax Benefits

An ISA will allow you to invest up to certain limits tax-free each year. Whilst unlike pensions there is no tax relief on money put into ISAs on entry, the investments you hold within an ISA grow free of all income and capital gains tax. Instead, you are not liable to pay income or capital gains tax on the proceeds of an ISA. However, changes to the taxation of company earnings means that ISA investment managers (and those managing Personal Equity Plans (PEPs)) cannot take the tax credit on dividend income. The interest from deposits and from Fixed Interest investments still attracts a 20% tax credit whether within an ISA, PEP or TESSA.

TESSA Accounts

Tax-Exempt Special Savings Accounts, or TESSAs, were five-year savings accounts that enabled you to receive interest gross - without the deduction of any tax. The TESSA capital was transferred into the cash component of a maxi ISA, or cash mini ISA, or a special ISA, called a TESSA-only ISA, which was set up specially to receive transferred TESSA capital. TESSAs are often transferable so it pays to shop around and keep an eye on the rates of interest received.

Tracker Funds

Tracker funds, sometimes referred to as 'index funds' aims to replicate or copy the performance of a given share index. To do this, the fund managers could buy every share in a given index e.g. - they could buy all the shares in the FTSE 100 index. However, it is possible to construct a fund that tracks the index without buying every share. Because tracker funds do not involve time consuming research by analysts and expensive stock selection and company visits, it ought to be possible for the charges levied on investors to be lower than is ordinarily the case. The performance of tracker funds can be erratic, particularly in times of volatile markets where there are no options to move in and out of shares as markets move up and down.

U

Unit Trusts

A unit trust is an open ended collective investment. It is open ended because the number of 'units' in each trust will vary according to supply and demand. It is collective because it puts together the money from many different investors for a professional investment manager to look after. It is the job of the unit trust fund manager to make sure the money is invested properly and to deliver the investors the very best returns. Most unit trusts use the money given to them by unit holders to buy ordinary shares, or equities, but with more than 2,000 unit trusts managed by around 200 management companies, there are a great many different types from which to choose. Some unit trusts are very general and hold a large number of shares in different companies, spreading investments into overseas companies in some cases. Others are more specialised, giving the unit holders access to a particular geographic area or a particular type of investment, such as Fixed Interest Investments. It is important to decide what level of risk you want to take before choosing a unit trust. In any event though, unit trusts are a way of spreading risk across a larger number of ordinary shares than might otherwise be possible.

Important Information

Information is based on Braunton IFA Ltd's interpretation and cannot be held liable for any errors or omissions. Any information is by no means implied as specific recommendations and you are strongly advised to take independent advice before proceeding with an investment or other policy and legal advice before commencing any form of trust. Past performance is no guarantee of future returns. The returns from stock market investments can rise as well as fall particularly in the short term and if you surrender early you may not get back your original investment. Your home may be repossessed if you do not keep up repayments on your mortgage.

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