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Canada Life

Unleashing the full potential of investment bonds using SPS

Investment bonds have many virtues and some restrictions. However, it is possible to get far more from them if you take the right approach.

Why choose an investment bond?

The use of different tax wrappers can produce different outcomes for investors and with increasing awareness and knowledge, advisers are seeking more variety in the assets that can be held within each wrapper. For the right client it can be important to make sure that the widest possible investment choice is available within a single product wrapper.

Investment bonds can provide a number of tax advantages, such as tax deferral and tax efficient withdrawals – these advantages, and others, can appeal to certain investors. The lack of any UK or local tax in an international bond can increase the potential for long-term growth but also makes them able to hold a myriad of investments, as they do not have to account for tax on any income or growth within the bond itself.

Watching the collectives

In many instances the underlying assets are collective investments, held directly through a platform or run as a portfolio by an investment manager.

Platforms can be an attractive option for those seeking to utilise a wider range of investment flexibility and can reduce the transaction charges from the bond provider. However the investor will be paying a platform charge and so this will need to be weighed up against the potential transaction charges. For example someone who is not anticipating the need to switch often may prefer to invest directly under the bond as the transaction charges may be cheaper than the platform charges. For those anticipating active and frequent switching, the platform charge may be a more attractive option.

The use of a discretionary investment manager means that the adviser and investor can work together to select a suitable manager to run a portfolio. The investor can then nominate this manager and they will operate to the agreed mandate and in many case they will do so as custodian, taking ownership of the assets under the bond.

What are the (usual) restrictions?

Whether the bond holds collectives, platforms or a discretionary investment manager, and some bond providers allow a combination of multiples of all three, the underlying assets are usually restricted to cash deposits and collective investments; for example unit trusts, OEICS and investment trusts.

The restriction is due to The Personal Portfolio Bonds (Tax) Regulations 1999 which effectively limit the type of asset that can be held under an investment bond. The assets permissible under these regulations, broadly include insured life funds available from the bond provider, unit trusts and OEICs, approved investment trusts and cash deposits. Other investments such as some ETFs are also allowable, but notably direct investments in shares and corporate bonds cannot be held.

Investing in a wider range of investments, such as direct investments in equities and corporate bonds would breach these rules and incur a 15% annual deemed chargeable gain-irrespective of how the investment has performed. This can be very expensive for the investor.

When selecting a discretionary fund manager, advisers and investors will want to do so based on the investment manager's expertise and style. Restricting the investments in which they can invest could constrain the manager's options as, unless they run bespoke collectives, the investment manager will need to find suitable funds to use. These could take a similar approach to the investment manager's in-house style and for many this solution will be acceptable as the investment manager can select the asset allocation and the fund manager, who they believe, is best suited to those assets. For example some fund managers may be better at managing North American or Far East equities than others, and some may be better at managing fixed interest assets than others.

In some instances, because of the permissibility rules the investment manager will create a portfolio in its own OEIC or unit trust wrapper and the bond provider can then invest in the collective, providing the fund itself meets the permissibility rules. Due to the cost of running a specific fund on this basis , this can be restrictive and not a viable solution for many investors.

Is there a better way?

Another option is to effectively remove the restrictions that the Personal Portfolio Bonds regulations impose.

The regulations state that where wider investments are used the bond will be treated as a personalised bond if the underlying assets are 'selected by, or by a person acting on behalf of, the holder of the policy or contract or a person connected with him (or the holder of the policy or contract and a person connected with them)'. By removing or distancing the client and their adviser from the investment management can mean that the rules do not apply and the underlying investments that can be held are only limited by what a life assurance provider can invest in, as it is the insurance company that owns the underlying assets. This will include direct investments.

The investment manager can be nominated and appointed with a broad mandate agreed with the investor. However any ongoing communications must go through the provider and not direct to the investor or their adviser and they must not be allowed to influence the underlying asset selection. Whilst this type of investment may not be suitable for all, it can offer distinct advantages:

- The investment manager can construct a truly bespoke portfolio designed to meet specific objectives - for example income generation. This can be valuable where the investment has a specific purpose and could apply to trustee investments such as a discounted gift trust.
- The management style adopted by the investment manager can be used without being constrained by the style of the underlying collective funds being used allowing the investor to potentially benefit from the manager's expertise.
- The charges could be lower than using actively managed collectives as trading direct holding may be lower than trading and holding funds.
- The chance of inadvertently holding non-permissible assets is reduced as the bond allows a wider investment choice.

How does the solution work in practice?

Due to the compliance process that needs to be in-place this solution is not available under every international bond. Canada Life does offer this through the Premiere Europe Account available from Canada Life International Assurance (Ireland) as a standard investment option, known as the Segregated Portfolio Service. The Premiere Europe Account is a true open architecture bond allowing access to the widest possible range of investment solutions. These solutions include access to almost any permissible asset from around the world, whether accessing them directly through their accounts, through a platform or investment manager. Non-permissible assets are available by using the Segregated Portfolio Service with selected investment managers.

The benefit of having this solution as a standard investment option is that if the adviser and investor no longer want to use the service or want to start using it, then they can switch in and switch out at any time without the need to surrender the bond.

The use of Ireland as a jurisdiction for the provider means that the investment manager's fees should not be chargeable to VAT, due to the way in which the Irish Revenue Commissioners treat VAT on the fees.

This investment solution can provide the right investor with a truly bespoke portfolio which would not normally be available. This can help them meet their objectives and add value to an advisers firm's proposition.

The value of investments may fall as well as rise and investors may not get back the amount invested.

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About Canada Life:

Canada Life is part of a group of companies controlled by Great-West Lifeco Inc., a diversified financial services holding company headquartered in Winnipeg, Canada. Through its subsidiary companies, Lifeco has operations in Canada, the United States, and Europe. Great-West Lifeco and its insurance subsidiaries have received strong ratings from major rating agencies.
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