



# clarityRESEARCH

## Unit Trusts, OEICs and ICVCs

### Summary

1. Unit Trusts, OEICs and ICVCs are investment products designed to make it possible for a private investor with a small sum of money to invest to hold a well diversified and professionally managed portfolio of investments in a cost effective and tax efficient manner.
2. These are 'open ended' investment vehicles; the value of the units or shares fully reflects the value of the underlying assets, and units or shares are issued or redeemed as necessary to reflect demand.
3. Unit Trusts are increasingly being converted to OEICs or ICVCs. This is partly to enable the fund house to market the fund across Europe, but also to give the investors the benefit of the more flexible and transparent charging and currency structures.

### Unit Trusts

Unit Trusts are in fact true "Trusts" in the legal sense, and are controlled by a board of trustees. The Trust Deed forms the constitution of the unit trust. It is drawn up by the manager and the trustee and must state the name of the trust, the category of fund and specify the type of investments that may be held within the trust. The shares of a Unit Trust are known as "units".

An investment manager is responsible for the purchase and sale of securities and for the provision of valuations for the trustee. The trustee (usually a bank) is the formal owner of the investments. The investment manager must decide upon investment strategy within the trust deed criteria.

A Unit Trust is "Open Ended", meaning that the number of units is not fixed. New units are created for new investors, whilst the units belonging to investors wishing to sell will be cancelled. This means that the investor will deal with the unit trust manager directly, rather than via a stockbroker.

There is a difference between the buying and selling price of units, known as the bid-offer spread. The investor buys units at the higher price (offer) and may sell at the lower price (bid). The difference between the two prices will represent the managers initial charge, any broker commission and certain transactions costs incurred in the creation of new units. In addition an annual management charge will be payable from the assets of the trust. This will cover the expenses incurred in running the fund, and will be higher in the case of equity and specialised funds than for fixed interest or cash funds. The effect of these charges is set out in the Key Features/Simplified Prospectus document.

The permitted investments of a Unit Trust are controlled by the Financial Services Authority (FSA) and include company shares and fixed interest investments including gilts, corporate bonds and convertibles. Investments in property, money market deposits and warrants are allowed in funds that clearly state that these are their intended investments.

Unit Trusts may not normally hold more than 10% of their assets in cash. No holding in a single equity may make up more than 10% of the Fund, and that holding may not represent more than 10% of that companies share capital. Effectively a Unit Trust must have at least 16 holdings, although most have around 50 - 100. Other rules are imposed depending upon the sector that the fund falls into. Unit Trusts may not borrow money in order to increase the size of the portfolio.

*Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested.*

*Our views are based upon our understanding of current legislation in England & Wales. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances. You should not act on any of the information without seeking professional advice.*

*clarity is authorised and regulated by the Financial Services Authority. The Financial Services Authority does not regulate all types of Pensions, Mortgages or Taxation Advice.*





## OEICs and ICVCs

The term ICVC stands for Investment Company of Variable Capital. ICVC are structured in such a way that they can be offered on a pan-European basis. The structure has also been known as an OEIC, standing for Open Ended Investment Company.

An ICVC is structured as a company, and is controlled by an Authorised Corporate Director (ACD), who fulfils the role of fund manager. The assets of the ICVC are owned by the "Depository", whose role is similar to that of the Unit Trust Trustee.

An ICVC is also "Open Ended", meaning that the number of shares is not fixed. New shares are created for new investors, whilst the shares belonging to investors wishing to sell will be cancelled. The investor will deal with the fund manager directly.

There is a single price at which shares are bought and sold. The fund manager will levy an additional sales charge on purchases of shares. This figure will include any broker commission and certain transactions costs incurred in the creation of new units. An annual management charge will be levied in the same way as for a Unit Trust.

The permitted investments of an ICVC are controlled by the Financial Services Authority (FSA) and are the same as those for a Unit Trust. ICVCs may not borrow for investment purposes, or hold more than 10% of assets in any one company.

Investment companies usually structure their ICVC in such a way as to offer several share classes to cater for different investor needs. For example, 'Able Investments' may offer the Able ICVC. The Able ICVC may offer share classes investing in UK Equities, US Equities, European Equities, Corporate Bonds etc. This structure has advantages for the investment firm, but may also make it easier for an investor to switch between funds.

## Taxation

Unit Trusts, OEICs and ICVCs are treated in the same way for tax. Income, in the form of interest, rent or from overseas, received by the Unit Trust/OEIC/ICVC is subject to corporation tax at 20%. No tax is effectively paid on the receipt of UK dividends. Annual management expenses are offset against income (other than UK dividends), and so can be tax-relieved, provided there is sufficient non-UK equity income. Internal capital gains within an authorised unit trust/OEIC/ICVC are exempt from taxation.

The investor is liable to income tax on income from the trust and capital gains tax on gains made when he sells units.

## Equalisation

When income distributions are made, the same income per unit is paid to all unit holders. In the case of those who invested part way through the period over which the income was 'earned', this first income distribution received usually includes an 'equalisation' payment. This represents a partial repayment of the capital invested, because the price paid per unit included accrued income, in order to achieve a broad fairness between unit holders in the apportionment of the income paid. This portion of the payment is not subject to income tax.

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## UCITS Directive

The snappily named 1985 'Undertakings in Collective Investments and Transferable Securities' (UCITS) Directive established a set of EU wide rules governing collective investments schemes (in the UK unit trusts and OEICS). Funds set up in accordance with these rules could then be sold across the EU subject to local tax and marketing laws.

Two directives amending the 1985 directive entered EC law in January 2002. The first broadened the range of assets that harmonised funds can invest in, the second introduced harmonised rules for the prudential supervision of the firms that manage UCITS and introduces a harmonised marketing document, the simplified prospectus.

The FSA implementation of the first of these Directives (the 'Product' Directive) has meant that authorised unit trusts and OEICs may now have widened investment powers, for example, to include cash as an asset allocation tool, as well as equities and bonds. One of the significant changes is the permitted use of derivatives for investment purposes, rather than solely for efficient portfolio management. In addition, tracker funds are now able to invest up to 20% in one stock, rather than the 10% previously allowed. Fund management houses are beginning to take advantage of the new opportunities available under the Directive, and a number of new style (UCITS III) funds using these investment powers have now been launched. However, it remains to be seen how these structures may hold up in adverse market conditions.

Funds that have opted not to qualify as UCITS III funds are known as non-UCITS retail schemes, or 'Nurs', and cannot be marketed across Europe. A fund may decide that a Nurs structure is more suitable if, for example, they want to hold more than the maximum 20% in a single collective investment scheme (e.g. a fund of funds structure). In addition, Nurs funds can invest in a wider range of assets, such as commercial property funds or physical property, offshore funds, hedge funds, and exchange-traded funds. Nurs funds are now also eligible for ISA investment.

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