



**FACT FILES**  
**UNITED KINGDOM**

## Recent developments in investment product design

By Nick Edwards, FIFP, CFP, PFPS, Chartered Financial Planner  
Director, Consultniks Limited

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## Summary

This fact file looks at developments in investment product design since 1999.

It examines the features of the main types of investment product and how these may have changed over the last 10 years or so. It also looks at new types of investment products that have been introduced and highlights any differences from previous products which these may have superseded.

We have seen PEPs replaced by ISAs and the phasing out of TESSAs. Child Trust Funds - which, although they have not really caught the public's attention, offer a tax-effective means of saving for children.

The popularity of life assurance investment bonds has plummeted, especially for with-profits bonds, but product providers have reacted with new offerings and the introduction of "open-architecture" products. We are also starting to see the re-emergence of qualifying life assurance policies, offering tax-effective savings solutions to those who are subject to rising higher rate taxation.

Fund supermarkets, which did not exist in this country 10 years ago, have evolved into platforms and wraps, and their continued growth looks almost assured over coming years, and continue to grow apace.

The open-ended product market has evolved from unit trusts to open-ended investment companies (OEICs), whilst the closed-ended market faced challenges with the "splits" fall-out in the early 2000s. Structured products have undergone significant development and today's offerings are almost unrecognisable from the guaranteed growth and income bonds available at the end of the last century.

Contracts including derivatives have now moved into the mainstream market, although hedge funds still remain largely for specialist investors.

Continuing globalisation, the challenges created by the recent economic situation and the single EU market mean that investment product design will continue to change over coming years.

## Recent developments

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## Introduction

The investment market has changed significantly over the last 10 years, and many of the products that dominated the marketplace in the late 1990s have now all but disappeared. There have also been a significant number of changes to taxation and regulation over the last decade, forcing product providers to rise to the challenge.

## The retail marketplace in 1999

In 1999, the UK retail investment market was dominated by dual-priced, open-ended unit trusts and by UK domiciled, single premium life office products, with by far the largest market share enjoyed by with-profits bonds. The investment trust sector was dominated by income producing split capital “zeros”. Insurance companies had taken advantage of limited issue guaranteed income and growth bonds, underpinned by derivatives, with an increasing range of products offering enhanced returns or capital guarantees dependent upon the performance of an equity index or indices.

It is salutary to observe that, arguably, none of the above retain their 1999 pre-eminence today, and some have almost completely disappeared.

## The key drivers for change

Over the last 10 years, product providers have been under unprecedented pressures to radically overhaul their investment product portfolios. These pressures have arisen not only from domestic tax and regulatory changes, but also from the increasing influence of EU directives and the impact of the single European market. In addition, and not to be underestimated, has been the compelling catalyst of an almost universal recognition within the industry itself that the previous models of the 1980s and 1990s were broken.

More rigorous regulation, a more interventionist government, more volatile and less predictable investment conditions and the growth of technology, with its potential to empower and inform the consumer, had all created an ever more competitive environment that would require better, fairer and more innovative products.

Finally, perhaps we should not discount completely the psychological effect of a new millennium. It is common already to hear people talk disparagingly about the 20th century in the same fashion that a previous generation might have derided Victorian values. The notion of “new products for a new millennium” may be more than just glib marketing.

## Key events

After his resignation as prime minister in 1963, Harold MacMillan famously reflected on the reasons that lay behind the perceived failures of his administration, musing sadly, “events, dear boy, events”. Similarly, the events of the past decade have helped to shape the investment products of today.

- In the early days of the new Labour government's first term in office, the then chancellor, Gordon Brown, announced the replacement from April 1999 of personal equity plans (PEPs) with a new, all-embracing alternative, the individual savings account or ISA.
- In July 2000, the [House of Lords ruled against Equitable Life](#) in the landmark guaranteed annuities case, triggering the collapse of the UK's oldest and most revered mutual life assurance company.
- The attacks on 11 September 2001 prompted a dramatic loss of confidence in world stock markets, which had already suffered major losses following the implosion of the “tech bubble” over the previous 12 months. The subsequent bear market lasted until 2002 and led to the collapse of “split capital” investment trusts which had been widely marketed as low-risk investments in the late 1990s. A compensation scheme for investors, based on 40% of the loss, was eventually agreed in March 2006.
- In November 2001, the new single UK regulator, the [Financial Services Authority \(FSA\)](#), assumed its full responsibilities.
- In December 2001, the EU adopted the July 1998 UCITS (undertakings for collective investments in transferrable securities) directive, which has since evolved and is now commonly known as UCITS III.

These directives were designed to allow collective investment schemes to operate throughout the EU based on authorisation from a single member state.

- On 9 July 2002, the Treasury published the [Sandler Review](#) into medium- and long-term savings in the UK. Among its findings, the report concluded that many consumers were being poorly served by opaque, costly investment products and by advisers who preferred to simply sell managed products without due consideration of principles of asset allocation and diversification. Thus, Sandler not only led directly to the advent of a range of simple, low cost stakeholder products but also contributed to the growth in diversified multi-manager funds, such as funds of funds and manager of manager funds. The review, and the implementation of its recommendations (allied to the collapse of Equitable Life and falling investment returns), also sounded the death knell for traditional with-profits structures and led to the introduction of a new range of more innovative and transparent risk-managed products.
- 2002 saw the abolition of the polarisation regime that had existed since the early 1990s. Part of the objective of the de-polarisation process was to provide clarity in the minds of consumers regarding the scope and cost of advisory services. In November 2008, the FSA published the final draft of its Retail Distribution Review (RDR), a tacit recognition that the 2002 reforms have not achieved their desired effect. We are still awaiting the final form of the RDR. Nonetheless, since 2002, it is fair to say that the new rules, allied to increased regulatory scrutiny of product commissions has seen a steady movement away from a product-centric approach to investment advice and towards a more holistic, fee-based structure, which has, in turn, driven product providers towards lower cost, more transparent products.
- In November 2006, the chancellor abolished stamp duty on non-UK-resident exchange traded funds (ETFs), leading to the emergence of the ETF as a new, low-cost, closed-ended investment vehicle.
- The FSA's new conduct of business rules were introduced as a key element in the UK's compliance with the EU's markets in financial instruments directive (MiFID). In November 2007, these rules introduced the industry to principles-based regulation and formalised the concept of treating customers fairly, thereby further encouraging the development of lower cost, fair and transparent products.

## Investing in the 21st century

Perhaps even more relevant than all of the above to the way products have developed over the past 10 years has been the inherent volatility of global markets, as was starkly illustrated during 2008. This has led directly to innovative product design in areas such as structured products, absolute (that is, non-correlated) return funds and other risk-controlled areas, for example life settlements.

Furthermore, the way that investors and their advisers buy and sell funds and manage portfolios has changed beyond recognition over the last decade with the advent of open-architecture products and transaction platforms. In 1998, most funds held in life policy tax wrappers were insured funds, managed by the life office itself. In 2008, the life policy tax wrapper is typically simply a means to holding a wide range of assets, such as unit trusts and open-ended investment companies (OEICs), managed by external (third party) investment managers.

At the same time, the growth in the amount and accessibility of information via the internet is leading to more discerning and informed investors, thus increasing the pressures for product design to be clear, simple and cost-effective. Investors and their advisers now engage with principles such as asset allocation, diversification, cash-flow and goal planning to a degree that would have been unimaginable 10 years ago.

The globalisation of world markets has also impacted on product design with providers looking beyond the parochial needs of the UK resident investor and seeking to market their offerings overseas. This has resulted directly in a growth in cross-border products and the "importing" of overseas product structures to the UK. For example, we have seen the virtual demise (certainly in terms of new launches) of the UK-centric unit trust and the emergence of the UCITSIII compliant OEIC.

## Product tax wrappers

### Individual savings accounts (ISAs)

ISAs were introduced on 6 April 1999, from which time no new personal equity plans (PEPs) or tax exempt special savings accounts (TESSAs) could be opened, although contributions could continue to be made to