ENDOWMENT SAVINGS PLANS

The term "endowment" is frequently applied to a variety of investment products. Usually (although not always) an endowment is a regular premium insurance company savings plan for a minimum of 10 years. To be "qualifying" the plan must carry life assurance that is equivalent to at least 75% of the premiums paid during the term of the plan. A qualifying plan pays out benefits at maturity free from all taxes.

The most common endowment descriptions used are with profit or unit linked endowments. Low cost endowments are often used to repay commercial and residential mortgages.

1. WITH PROFIT ENDOWMENTS

We cannot imagine any circumstances which warrant a new with profit endowment savings plan however many people have plans which have not yet matured.

A traditional with profit fund takes premiums from the members of the fund and invests them in a range of investment vehicles, typically 35% UK equities, 5% overseas equities, 15% property and 45% fixed interest investments. In exchange for an agreed premium, the insurer will guarantee a certain sum on death and at the maturity date of the plan. This is usually described as the sum assured. Each year, the actuary of the insurance company assesses how well the investments have performed and then declares a reversionary bonus that is then applied to the sum assured, increasing the guaranteed return at the end of the plan. Once added, this bonus cannot be taken away.

A unit linked with profit fund is like a traditional fund designed to smooth out the investment returns from asset backed investments over the longer term. Unlike traditional endowments, however, unit linked with profit funds only have a sum assured for death benefit purposes. Money invested purchases units within the with profits fund. When the actuary declares the reversionary bonus, it is expressed in terms of either a rise in the value of the with profit unit price, or it purchases additional units where the units are all valued at £1.

Most funds provide a final or terminal bonus at the maturity of the plan. This bonus is designed to reflect any excess capital growth of the fund during the savings period. Terminal bonuses can represent as much as 60% of the total return on with profit endowments. Unfortunately, the investor has no idea what the terminal bonus will be until the maturity proceeds are paid. Terminal bonuses at present are frequently 0% and are likely to remain at that level for some years to come.

2. LOW COST ENDOWMENTS

A low cost endowment is a combination of a life assurance and an endowment savings plan. Low cost endowments are designed to be a vehicle for loan repayment. With an endowment mortgage, the lending source charges only the interest payable on the money borrowed. As well as paying interest to the lender, the borrower undertakes a low cost endowment savings plan that usually provides life assurance equivalent to the amount borrowed. At the end of the endowment and loan term, the proceeds of the endowment are used to repay all, or part, of the debt. Should the endowment generate more funds than the amount of loan outstanding then the investor receives the surplus tax free.

Low cost endowments can be either with profit or unit linked plans. However, it is important to understand that there is usually no guarantee that the low cost endowment will produce sufficient funds to repay all the money borrowed.

3. TRADITIONAL UNIT LINKED ENDOWMENTS

A unit linked endowment invests within any of the insurance company's range of unit linked funds. Nearly all investors choose either the with profit or the managed fund. Managed funds are typically invested 50% UK equities, 15% overseas equities, and 35% fixed interest investments. Part of the premium pays for the life assurance provided by the plan and the remainder of the investment (less charges) is placed into the fund of the investor's choice. At the end of the savings period the proceeds of the plan are paid tax free. However, unlike with profit endowments, equity backed schemes provide no guarantees as to what benefits will be achieved.

4. SUMMARY

We have not advised clients to take out any endowment savings for over 20 years.