

## The Benefits and Dangers of Investing in With Profits Funds

(through pensions or other investments such as investment bonds or endowments)

Historically, with-profits investment has always been a safe and secure investment medium for investors who wish to avoid daily stockmarket fluctuations.

Add to this the advantage of relatively high annual bonuses (often well in excess of the rates of interest on deposits) and also the prospect of a terminal bonus at the expiry of an investment contract and it is easy to see why billions of pounds has been invested in this way.

However, in the last 18 months we believe that all the ground rules have changed. During the UK stockmarket fall starting in January 2000 the pension and investment companies have valiantly continued to add annual bonuses to investors' policies despite their funds making huge losses. These bonuses have been paid from past surpluses (reserves) which have been accumulated over more than 30 years in most cases.

Clearly, it is not sustainable to continue to pay out high bonuses from depleted funds and therefore in the last 18 months we have seen insurers make dramatic reductions in bonus rates - to the extent that at worst some policies now have a Zero annual bonus and at best, an annual bonus rate of 3% pa. Many insurers are now offering a Zero terminal bonus at expiry.

Although bonus rates are reviewed annually we cannot see that they are likely to increase for some years to come. Indeed, if there was a further sudden fall in the stockmarket we believe that this would be devastating for most funds in view of the current depleted state of reserves.

To make matters worse, the opportunity for funds to build up their surpluses is very limited. In the past, surplus was produced from charges levied on policies, from mortality profits and from investment profits. Given that charges have been heavily reduced on all new policies due to Government pressure, mortality profits are slim and the stockmarket still lacks confidence, it does not appear that surpluses are likely to increase quickly and may never revive to previous levels.

In short, we feel that the era of satisfactory With Profits investment is dead. It merely remains to consider the best time to exit and follow a new strategy.

Currently we are seeing a reduction in the penalties for surrendering With Profits investments. These penalties had been prohibitively high over the last few years but in view of the improvement in stockmarket values these have now reduced and in some cases the penalty is Zero. Therefore, there may be a window of opportunity to switch out of With Profits which could close in the future on either a temporary or long-term basis. For this reason, you should take advice urgently on any existing With Profits investments.

Benefits of With Profits	Dangers of With Profits
Consistent returns/smoothing	Current uncertainty of future return
Potential future annual bonuses	Although the funds may not decrease, bonuses could be very low or zero
Potential terminal bonus	Potential Market Value Adjuster (penalty) on encashment
Potential demutualisation bonus (Standard Life only)	Contract surrender penalties if uplifted other than at a guaranteed date
No daily fluctuations	No transparency of charges
Share in profits from charges, mortality and investment profits	Reduced likelihood of these factors producing surplus in future
	Temporary (possibly) window of opportunity to exit at low/no penalty

If you have with profits investments under a pension, endowment, bond or other investment you should review the funds and policies immediately. For an initial exploratory meeting without obligation please call the office to speak to one of our advisers at our Birmingham Offices on 0121 236 1288 or email to [nigel.johnson@keeleys.co.uk](mailto:nigel.johnson@keeleys.co.uk).

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