CAMPBELL & McCONNACHIE

chartered financial planners

Collective investment schemes

Unit trusts and OEICs in focus.

Collective investment schemes, such as unit trusts and open-ended investment companies (OEICs), are shared funds in which a fund manager pools capital and invests into assets including stocks, bonds and property.

Both OEICs and unit trusts are also known as open-ended funds as there is no limit to how many shares or units that can be created.

But what do you need to know about investing in collective investment funds? How do unit trusts and OEICs differ, what's their tax treatment and how can they benefit your investment portfolio?

Unit trusts

Unit trusts are the most widely-used type of collective investment fund available in the UK.

These funds are divided into units, each with the same value, and the price of a unit is determined by dividing the fund's net asset value by the number of units.

These are open-ended funds, meaning additional units are created for new investors and cancelled for those leaving the fund. Unit trusts, therefore, grow and shrink depending on the number of investors holding units.

Unlike shares in listed companies, unit prices do not continuously rise and fall with the market, but are valued once a day – usually around noon – to reflect the current value of the underlying assets.

OEICs

As collective investment schemes, OEICs are very similar to unit trusts.

Like unit trusts, OEICs are open-ended funds whose values are directly linked to their net asset value.

The value of the company increases when its assets perform well, and decreases when they perform poorly. Like unit trusts, OEICs are also valued once a day.

The difference is that OEICs are companies, subject to company law, rather than to trust law like unit trusts.

Investors can buy company shares – rather than units – when they put money into an OEIC.

Legally speaking, investors in OEICs are owners of the company's underlying assets whereas investing in unit trusts does not grant you ownership.

However, in practice this does not make a lot of difference to investors.

Unit trusts v OEICs

	Unit trusts	OEICs
Structure	Unit trusts sell units of a trust, and are governed by trust law.	OEICs sell shares in the company, and are governed by company law.
Pricing	Unit trusts feature two separate prices: the **bid price** and the **offer price.** The bid price is the price at which the investor buys the unit, while the offer price is the price at which they sell the unit. The higher bid price incorporates the initial charge of the unit trust.	OEICs have a single price, and the initial charge is paid separately.
Management	Assets held in unit trusts are managed by fund managers, with the trustees responsible for overall governance.	OEICs assets are managed by fund managers, with corporate directors responsible for overall governance.

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Collective investment schemes

Choosing a fund

There are more than 2,000 unit trusts and OEICs available to investors, which can make choosing a fund to invest in tricky.

To help you identify where you want to put your money, you should consider:

- what type of asset you want to invest in (shares, bonds, property)
- if there is a particular sector you're interested in (technology, stocks, mining)
- where in the world you want to invest (UK-based companies, emerging markets)
- your investment aims (income or growth).

Your returns

Your return is classed as your gain or loss plus any income.

How your returns are made depends on whether you have **income units** or **accumulation units.**

Income units gain and lose value on a daily basis and pay out interest and dividend income to investors at regular intervals, while accumulation units reinvest any income generated back into the fund.

Whether you choose income or accumulation units will depend upon your goals and there are several planning options available to you.

For instance, you could reinvest the income from income units or opt for accumulation units if you want to draw regular income from the value of the fund.

Costs of investment

The minimum investment amount will depend both on the fund and whether you pay a lump sum or make monthly instalments.

Some funds will ask for a £500 minimum lump sum investment or £50 a month, while others will require you pay £1,000 to purchase units or shares.

Since the Financial Conduct Authority banned commission from charges being paid to advisers and brokers, fund charges have lowered significantly.

This means that any advice you need to pay for will have to be agreed between you and your adviser and paid for separately.

While annual management charges used to be around 1.5% (not including other expenses), these days you can expect to pay a total (including other expenses) of 0.85% to invest in active funds.

Selling your holdings

Making a withdrawal from open-ended funds is usually simple.

Funds that hold mainly liquid assets, such as those that can be sold easily, allow you to sell your unit or share during business hours on the day of your choosing.

You may face more restrictions when dealing with funds that have a lot of illiquid assets in their portfolios, such as property or other assets that take time to sell.

Such funds may have monthly, quarterly or biannual windows in which you can make withdrawals.

Tax

The tax treatment of income from collective investment schemes is the same for unit trusts and OEICs.

Income taken as distributions (whether interest, dividends or yield) from OEICs and unit trusts will be subject to dividend tax at your marginal rate: 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.

Remember also that the dividend allowance was reduced from £5,000 to £2,000 at the beginning of the 2018/19 tax year.

This means that you will be taxed on any dividend income exceeding £2,000.

Capital gains tax (CGT) is also chargeable on any gain on the disposal of shares in an OEIC and units in a unit trust.

CGT will be charged based on your marginal rate band: 20% if you're a basic rate taxpayer and 28% if you're a higher or additional rate taxpayer, but only for gains in excess of your annual allowance which is currently £11,700.

Benefits of collective investment funds

Diversification

The quantity and range of assets held by unit trusts and OEICs provide investors with an easy option to diversify their investments.

This diversification ensures the risk is spread, lessening the impact of a poorly performing company on your returns.

Simplicity

Building a similar portfolio of assets yourself requires expertise and significant amounts of time spent on research.

By investing in unit trusts and OEICs, you pass on responsibility to a professional fund manager who will be better able to make the right investment decisions.

Regulations

The regulatory framework that governs unit trusts and OEICs separates the underlying assets bought by the fund from the business that operates the fund.

This ensures that your investments are ring-fenced if the fund manager, trustee or corporate director encounters losses elsewhere.

Talk to us about your investment options.

Important information

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future change.

This document is solely for information purposes and nothing in it is intended to constitute advice or a recommendation. You should not make any investment decisions based on its content.

The value of investments can fall as well as rise and you may not get back the full amount you originally invested.

While considerable care has been taken to ensure the information in this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information.

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