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FSA Factsheet

Capital-at-risk products

Products where you could lose some or all of the money you invest (your capital)

This factsheet is for you if:

- you are thinking of investing in a capital-at-risk product.

It explains:

- the types of products that can put your capital at risk;
- how capital-at-risk products typically work;
- the main risks you would be taking;
- some points to think about before you invest; and
- where to get more help and information.



Many capital-at-risk products offer higher rates of return than savings accounts with banks or building societies. Their attraction is the possibility of higher income or capital growth. But potentially higher returns usually come at a price – you could lose some or all of the money you put in (your capital). This doesn't mean you shouldn't invest some of your money in these products. But you should only do so if you understand and can accept the risks and possible consequences. The risks should be explained to you by the firm selling the product, often in a 'Key Features Document'.

If you don't want to risk your capital, and are prepared to accept that you may get a lower rate of return, you need to look at less risky, capital-secure investments – for example, a savings account with a bank, building society, or National Savings and Investments.

What are capital-at-risk products?

These are usually share-based investments from banking, insurance or investment management firms, and can offer attractive returns. Your investment could do as well as planned, or maybe better. But if it does not, you could lose some or all of the money you put in (your capital). Capital-at-risk products usually invest in a variety of stockmarket investments such as shares or debt securities. Debt securities include corporate bonds which are loans to organisations such as companies or the government.

Products that put your capital at risk include:

- stockmarket-based investments. These include collective investment schemes (such as open-ended investment companies (OEICs) and unit trusts) and investment trusts;
- investment bonds and funds that invest in debt securities, such as corporate bond funds; and
- investments linked to the performance of a stockmarket or some other factor such as a collection of shares. These are usually for a fixed number of years (the 'term') and can be arranged to provide income or growth or a combination of both.

As an alternative, you could invest directly in:

- shares, and so benefit from any dividends paid; or
- debt securities, for which you get fixed or variable interest.

But the value of direct holdings of shares and other securities can change sharply – down as well as up.

Depending on its particular terms and conditions, the value of an investment product linked directly or indirectly to the stockmarket may have lesser, similar or greater risk.

How do different capital-at-risk products usually work?

■ Stockmarket-based investments

A wide range of stockmarket-based investments is available. The performance of the investments depends on the investment strategy adopted and general stockmarket conditions. The value of stockmarket-based investments can alter sharply because they are linked to the performance of the underlying shares or bonds (ie what your money is actually invested in).

■ Investment bonds and funds that invest in debt securities

These vary widely and include distribution bonds, with-profits bonds, unit-linked bonds and corporate bond funds. The money you invest is usually put directly into the stockmarket (in London or overseas) or into fixed or variable interest funds.

■ Investments linked to an index or other factor

With some fixed-term products, repayment of the capital to the investor (in full or in part) is linked by a special pre-set formula to the performance of an index such as the FTSE 100 or maybe a combination of indexes or some other factor – such as the performance of a collection of shares. We call them ‘structured capital-at-risk products’. Some offer a specified level of income over a fixed period, while others offer growth that depends on the performance of an index or other factor (see the examples below). These products, and the risks involved, can vary widely. For example, some may involve ‘gearing’ (the use of borrowing that can increase the amount you get back but will also increase the risks). Others can provide some element of capital protection.

An example of a structured *income* product is one that offers 6% income a year for five years, but also states that if the FTSE 100 index falls at the end of this period, the capital is reduced by 2% for each 1% fall in the index. So if after five years the index fell by 25%, someone who invested £5,000 would still have received 6% income a year over the five years (a total of £1,500) but the capital would have reduced to £2,500. So you would only get £4,000 from your original investment of £5,000.

An example of a structured *growth* product is one that offers 30% *growth* over five years, but also states that if the FTSE 100 index falls by more than 20% at the end of this period, then your capital is reduced by 1% for each 1% fall in the index. So if after five years the index fell by 50%, someone who invested £5,000 would still receive 30% as *growth* (£1,500) but the capital would have reduced to £2,500. So you would only get £4,000 from your original investment of £5,000.

What are the main risks involved with capital-at-risk products?

- Your capital can fall below the amount you put in. This loss may significantly increase if the product structure involves gearing (see above); so falls in the index to which the investment is linked can result in an even greater reduction in the capital you invested.
- The rate of return advertised might be achieved only after a set period – perhaps five years; you may not know until that date how well your investment has performed.
- The rate of return you get may depend on specific conditions being met. Even professionals may not be able to judge accurately how likely that will be.
- If you take your money out early, you may get less than you put in: for example, there may be a penalty to be paid.

Points to think about before investing

■ What is the difference between a capital-at-risk product and a savings account?

When you put your money in a bank or building society savings account, its original value doesn’t change and you also get interest. The return will be comparatively low, which

reflects the fact that you haven't risked your capital. With capital-at-risk products you may get higher returns, but you are putting your capital at risk and may end up with less than you put in.

■ How do I know which product to choose?

Consider your financial needs carefully: how much – if anything – can you afford to lose? And for how long can you afford to have your money tied up? Do your homework: shop around. Don't just look at headline information, check the detail. Capital-at-risk products are not right for you if you can't afford to lose money. But if you are willing to take risks to benefit from potentially higher rewards, there are many products to look at.

■ What charges do I have to pay for these products?

The charges vary and there may or may not be any. If there are charges, make sure you understand how they affect the value of your capital and income. Some funds deduct them from your initial investment. They may also take charges yearly, usually as a percentage of the total value of your ongoing investment.

■ How long will my money be tied up?

With most investments you should expect to tie up your money for some time. Some capital-at-risk products offer returns if you leave your capital with them for a fixed number of years. Other investments can continue indefinitely.

■ Can I cash in my investment?

Yes, you can usually cash in. But with some products you have to pay a penalty (known as a redemption penalty) if you cash them in before the maturity date. As a rule, never tie up money you may need in the short or medium term.

■ If the investment period is fixed, what happens at the end of it?

At the end of a fixed period your investment will mature and you should get its maturity value. But the maturity value may be reduced by charges or a final adjustment if, for example, it depends on the value of an index. Depending on the terms and conditions of the product, you could end up losing some or all of your capital. Also, any income or growth you have received may be subject to tax.

■ Will I get the advertised rate of return?

This depends on the terms and conditions under which you have invested. Often the advertised rate merely illustrates what is possible, and is no more certain than that.

Checklist

Decide how important it is to keep your capital intact.

Remember that many investments are meant for the long term and are not for savings you may need quickly.

Remember: capital-at-risk products should usually form only part of your total portfolio of savings and investments; and the value of such investments (and the income or growth from them) may fall as well as rise.

Take advice if you are unsure whether or not an investment is right for you.

Remember it's your money, and your decision as to what to do with it.

Don't invest unless you fully understand what you're investing in.

Don't run a risk you can't afford.

Complaints

The value of investments can shift unpredictably, and can fall as well as rise. This is not usually a valid reason for complaint. In some cases though, your purchase of a financial product could turn out badly because the firm you dealt with did something wrong. Problems can arise for many different reasons, for example:

- incorrect or misleading information;
- failure to give adequate warnings about the risks of a product;
- failure to draw attention to a particularly strict condition in the contract; or
- unexpected or excessive charges.

If you consider that your investments have not been, or are not being, managed properly, you should first take the matter up with the firm that sold you the product, who may be able to resolve the matter quickly. If, however, you are not able to resolve this with the firm, you can approach the Financial Ombudsman Service (see *Useful contacts*). The **FSA guide to making a complaint** gives many useful tips.

Useful contacts

FSA Consumer Helpline

Website: www.fsa.gov.uk/consumer

Tel: 0845 606 1234

Financial Ombudsman Service

Website: www.financial-ombudsman.org.uk

Tel: 0845 080 1800

Information on capital-at-risk products and other investments is available from:

Association of Investment Trust Companies (AITC)

Website: www.itsonline.co.uk

Brochureline: 0800 085 8520

Investment Management Association (IMA)

Website: www.investmentuk.org

Information Line: 020 8207 1361

Useful FSA publications:

- FSA guide to financial advice
- It pays to shop around
- With-profits policies
- With-profits bonds
- Challenging unfair contract terms
- FSA guide to making a complaint

All are available from the FSA Consumer Helpline.

Some technical terms explained

Bond	A form of debt issued by companies and governments to raise money. It is an agreement under which a sum is repaid to an investor after an agreed period of time.	Investment bonds	Investment bonds are typically lump-sum investments with insurance companies that have a small amount of life assurance.
Capital	The money you invest.	Investment trust	A company quoted on the Stock Exchange, whose sole business is investing in stocks and shares.
Collective investment scheme	A way of pooling small contributions from lots of people into a single investment fund.	Open-ended investment company (OEIC)	A type of collective investment scheme structured as a company in which investors can buy and sell shares. The price of the shares is based on the value of the investments the company has invested in.
Corporate bond (also known as fixed interest securities)	Issued by companies when they want to borrow money.	Rate of return	The change in the value of your investment taking into account both income and growth.
Corporate bond funds	Funds that invest in a selection of individual company bonds.	Shares (also known as equities)	A stake or share in a company.
Debt securities	Another name for a bond (see definition of 'bond').	Unit-linked bond	A type of investment bond (see definition of 'investment bond').
Distribution bonds	A type of investment bond that provides a regular income.	Unit trust	A type of collective investment scheme set up under trust. Its portfolio of investments is unitheld and investors take a stake in the fund by buying these units. The price of a unit is based on the value of the investments the trust has invested in.
Gearing	The use of borrowing potentially to increase the amount you get back, but which will also increase the risk.	With-profits bond	A type of investment bond (see definition of 'investment bond').
Gilts, gilt-edged stock	Bonds issued by the government to help fund its spending. Gilts are also known as government bonds.		



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We produce a range of user-friendly factsheets and booklets which are available from our website and helpline.

If after reading this factsheet, you have any general queries, our helpline will try to clarify things for you.

We can tell you if a firm or individual is authorised and help you if you have a complaint and don't know who to contact. But as the regulator, we can't recommend firms or advisers, or tell you whether a particular product or investment is right for you.

Our website, www.fsa.gov.uk/consumer, is designed to help you understand financial services and get a fair deal.

Use the site to:

- Shop around with our comparative tables – including mortgages, pensions and ISAs.
- Check whether a particular firm or person is authorised – if you use an authorised firm you have access to complaints procedures and compensation schemes if things go wrong.
- Order any of our wide range of consumer publications.
- Report any misleading financial advertising.
- See explanations of financial products in plain English.
- Read recent alerts that we have issued.

If you have difficulty with this material in its current format or language, please call the Consumer Helpline on 0845 606 1234 (calls charged at local rates).

To help us maintain and improve our service, we may record or monitor calls.