



ABI LIFE AND PENSION FUND SECTORS – LAUNCH OF NEW DEPOSIT & TREASURY SECTOR

A guide for consumers

November 2009

KEY POINTS

The ABI have set up a new Life and Pension fund sector. The new sector will be called the ABI Deposit & Treasury sector. The new sector will contain money market funds that have stricter limits on the type of assets that they can invest than the existing ABI Money Market sector. The existing ABI Money Market sector will stay the same for the time being.

The definition for the new ABI Deposit & Treasury sector is:

- Funds in this sector are not ‘no risk’ funds but, to satisfy the sector parameters they must have stability of capital as the principal and overriding objective.
- Funds must invest 100% of their assets in sterling denominated permitted instruments.
- Permitted instruments must not have a final maturity greater than 12 months.
- The investment quality of each of the permitted instruments must be closely matched with the fund’s objective of stability of capital.
- The permitted instruments for this sector are:
 - Current Account Cash
 - Time Deposits (including call accounts)
 - Certificates of Deposit
 - UK Treasury Bills
 - UK Short Gilts
- Insured funds that track a recognised cash index, such as the Bank of England base interest rate, can be included.

A glossary describing the different instruments in detail can be found at the end of this document.

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QUESTIONS AND ANSWERS

What are the ABI Sectors?

- The ABI Life and Pension Sectors group together life and pension funds which invest money in similar assets.
- The sectors are managed by a committee of representatives of ABI member companies.
- The committee checks to ensure that funds in sector follow the sector's rules. Although a small number of sectors are not checked on a regular basis.
- There are 35 different ABI Life and Pension sectors.

What is the ABI doing to the ABI Money Market sector?

- The ABI is creating a new sector for some money market funds, which is called the ABI Deposit & Treasury sector.
- The new sector will sit alongside the existing ABI Money Market sector.
- We are taking the simpler funds from the existing ABI Money Market sector and moving them to the new ABI Deposit & Treasury sector.
- Funds in the new sector will be limited to investing in more simple instruments.
- All the instruments held by funds in the new sector must have a maturity of 12 months or less.

Is the new sector completely safe?

- No investment is completely safe. There is always risk of losing money.
- Funds in the new sector must have stability of capital as the principal and overriding objective.
- Generally funds in the new sector are unlikely to deliver a high return but they are also unlikely to lose money.
- However, in a period of sustained low interest rates the charges you pay on your fund may be more than your fund grows by. And so you could lose money.

What are money market funds?

- Money market funds are sometimes called ‘cash funds.’
- They are a type of fund offered by Life and Pension companies and other investment companies.
- People are able to invest their pension in money market funds, or buy an investment bond that invests in a money market fund.
- Money market funds try to provide investors with a return that is similar to a bank account. But they are not the same as a bank account.
- Money market funds invest in the money markets. The money markets are financial markets where money is borrowed or loaned between Governments, banks and companies. This money is loaned for short periods, usually less than a year.
- There are many different types of financial instruments available on the money markets. Some are very simple like fixed term deposits, others are more complicated, like asset backed securities.
- Money market funds that qualify for the new ABI Deposit & Treasury sector can only invest in a limited range of financial instruments traded on the money markets.
- Money market funds that remain in the wider ABI Money Market sector are able to invest in the full range of financial instruments traded on the money markets.

My money is in a fund in the old sector should I move it?

- You should avoid doing anything without speaking to a professional financial adviser or the company through which you made the initial investment.
- The funds that are staying in the existing ABI Money Market sector are likely to have a broader range of objectives and invest in a wider range of financial instruments.
- Some funds in the ABI Money Market sector use a wider range of financial instruments to achieve similar objectives to those in the new sector. This may not mean that such funds are less safe than those in the ABI Deposit & Treasury Sector, just that they are more complex.

- Some funds in the ABI Money Market sector may be trying to deliver slightly higher growth for investors. Those funds seeking slightly higher growth are likely to be more risky.

Are funds in the new ABI Deposit & Treasury sector or the existing ABI Money Market sector similar to bank accounts?

- No, funds in these sectors are not like bank accounts. These funds do pay you an interest rate and they are not generally covered by deposit protection schemes, such as that offered by the FSCS.
- When people put their money into a fund in either of these sectors they are making an investment not a deposit. And every investment involves some risk.
- These funds club together investors' money and invest it into a mix of financial instruments that are traded on the money markets.
- To reduce risk money market funds spread their investment over a number of different financial institutions and across different types of financial instruments.

Why can't my money just be held as cash?

- Current regulations mean that it is usually not possible for Life and Pension policyholders to switch their investments into a bank account, or cash in their investment, without forgoing a number of benefits.
- This is why these types of funds are offered by Life and Pension companies.

What is the rate of return on a money market fund?

- Money market funds are not like bank accounts which offer a variable or fixed rate of interest.
- Investment professionals manage money market funds and invest in financial instruments to grow the investment.
- The amount an investor gets back depends on how each of the fund's investments perform. An investor may see the value of their investments go up or down.

GLOSSARY

DEPOSIT & TREASURY SECTOR

Below is a brief description of the instruments that funds in the new Deposit & Treasury sector can invest in:

Current Account Cash

This is the money held by investment companies in their central reserves. This is not an investment but simply a place for money to be held temporarily before being invested.

Time Deposits (including call accounts)

Time deposits are similar to bank savings accounts or current accounts, because money is deposited with a financial institution for safekeeping. Time deposits may only be withdrawn after a specified time, without incurring a penalty. The time of deposit spans from overnight to one year. A call account is a deposit with a financial institution that can be withdrawn at any time.

The important difference between these deposits and a high street saving account is that deposits made by institutions do not qualify for deposit protection schemes.

Certificates of Deposit

This is a document produced by a bank in return for a deposit of money. It promises that the bank will pay a fixed interest rate for a specified period (up to 12 months). In many ways it is the same as a time deposit. However, certificates of deposit can also be traded between other institutions. This means that funds may be able to get their money sooner by selling the certificate before its final maturity date.

UK Treasury Bills

A UK Treasury bill is a UK Government backed debt instrument. The Government issues them when they need to raise money for short term spending needs. Treasury bills can be issued with maturities of 1 month, 3 months, 6 months or 12 months. The money raised is used to help the Government manage its cash flow. Once a Bill matures the investor receives the face value of the Bill back. Treasury bills do not provide a rate of interest but as they are usually bought at a price below face value then the investor receives more money back than they spent buying it.

UK Short Gilts

UK Gilts are a UK Government-backed debt instrument. They are issued when the Government wants to raise money for capital spending. They are different from UK Treasury Bills because they pay an interest rate, known as a coupon, every six months. Gilts also have longer maturities. Once issued by the Government Gilts are traded between institutions. Funds in the new sector are only allowed to hold gilts that have a maturity date of below 12 months.

MONEY MARKET SECTOR

The wider Money Market sector can invest in all of the above instruments but it can also invest in the below instruments:

Asset Backed Securities

An asset-backed security is a bond issued by an institution that is backed (collateralised) by loans, leases or receivables against assets. Problems can occur if the valuation of the assets backing the security varies dramatically, or if the income from those assets reduces. However, to prevent this issuers may include a greater value of underlying assets than the face value.

Commercial Paper

Commercial Paper is a short-term debt instrument issued by companies and financial institutions. The maturity Commercial Paper will not usually be longer than 270 days. A variant of CP known as Asset-Backed CP also exists.

Floating Rate Note (FRN)

This is usually a corporate bond that pays a variable rate of interest linked to a reference rate, often the average interest rate that Banks will lend money to each other over one or three months. The rate of interest paid by FRN's will adjust according to the reference rate either every three months or every six months.

These instruments may have a final maturity a number of years into the future. But because the rate of interest is reset at regular intervals they usually behave in a 'cash-like' manner. A variant of FRNs known as Asset-Backed FRN also exists.

Mortgage-Backed Securities (MBS)

These are bonds that receive the cash flows from a pool of mortgage repayments. The mortgages in the pool for the security may be residential or commercial.

Repurchase Agreements

This is a short-term form of borrowing whereby a dealer in Government securities borrows money, often on an overnight basis, by selling a government security to an investor. They will then buy back the security on an agreed date, such as the next day.

Short Dated Bonds

These are fixed rate corporate bonds within in one-year of final maturity. Once they reach this date they become 'cash like' in their behaviour.