MQ5: Investment by Insurance Companies, Pension Funds and Trusts: Glossary of Terms 2014

Introduction

The MQ5 publication covers quarterly net investment data arising from financial transactions (investments) made by insurance companies, self-administered pension funds, investment trusts, unit trusts and property unit trusts. Balance sheet data for short-term assets and liabilities are also reported. Income and expenditure data for insurance companies and self-administered pension funds are also reported quarterly.

Users of the MQ5 publication frequently comment that they have difficulty in understanding the full extent of the quarterly published data due to a lack of understanding of financial terms and concepts. This glossary contains descriptions of financial terms used within the MQ5 publication. It is being published to aid users with the terminology.

User Engagement

Please let us know if you feel any terms need to be added to the glossary. We will seek to build this document up over time and keep users updated with the changing nature of financial concepts and terms. We would also be interested in your views as to whether this document could be improved and whether it is a useful addition to the MQ5 portfolio.

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Source

Several sources have been used to compile this glossary:

- the MQ5 publication;
- the MQ5 survey questionnaires;
- the HMRC website;
- the ONS Pension Trends glossary; and
- the online Finance glossary.

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Glossary

Acquisitions

Acquisitions refer to the procurement of assets, e.g. the purchase of gilts or shares.

Annuity

This is the payment of a regular income by a life company to an annuitant (a person who is entitled to receive benefits from an annuity) either for life or for shorter, pre-defined periods in exchange for a lump sum. In the UK annuities can broadly be classified into two types:

- A compulsory purchase annuity, which is bought from the proceeds of a pension fund and is taxable as earned income;
- A purchased life annuity, which is bought with an individual's own capital and taxed at a lower rate than a compulsory purchase annuity.

There are many different types of pension annuities, for example, standard annuities, with-profits annuities and unit-linked annuities.

Standard pension annuities are the most commonly purchased and account for over 90 per cent of the UK market. The income from a standard pension annuity is guaranteed for the rest of the annuitant's life whereas the income from a with-profits or unit-linked annuity will fluctuate depending on the investment performance of the underlying assets.

Annuity purchase has stopped being compulsory for those with large pots and will cease to be compulsory for all from April 2015.

Assets

The main sense in which the term asset is used is to describe anything owned by an individual or business that has a monetary value and generates income. Some assets are relatively easy to measure - debtors, cash and stock for example. Others are more difficult - goodwill, intellectual property and brand values. In the context of a company's balance sheet, an asset is also a deferred cost. Equipment valued at £1m in a balance sheet represents £1m that the company has spent and which is being depreciated as the equipment exhausts its usable life. The question of whether that equipment is actually an asset or a liability is really whether that asset generates more in after-tax revenues than it costs.

Balances

Amounts held in current and deposit accounts, including any term deposit, even if for 12 months or more.

Balance sheet

One of the main components of a company's report and accounts, the balance sheet provides a snapshot of everything the company owes and owns at the end of the financial period in question. On a specific date it lists: tangible assets, intangible assets, stock, debtors, cash, bank creditors, trade creditors, share capital and reserves. The profit and loss account details how a company has

performed in the previous year, while the balance sheet is more revealing about its fundamental health, indicating whether it can pay its debts and how good its cash management is.

Bond

A debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing. Generally, a bond is a promise to repay the principal along with interest (coupons) on a specified date (maturity). Some bonds do not pay interest, but all bonds require a repayment of principal.

When an investor buys a bond, they become a creditor of the issuer. However, the buyer does not gain any kind of ownership rights to the issuer, unlike in the case of equities. A bond holder, as with other creditors, has a greater claim on an issuer's income than an equity holder.. Bonds are often divided into different categories based on tax status, credit quality, issuer type, maturity and secured/unsecured. Treasury bonds are generally considered the safest unsecured bonds, since the possibility of the Treasury defaulting on payments is almost zero.
The yield from a bond is made up of three components: coupon interest, capital gains and interest on interest (if a bond pays no coupon interest, the only yield will be capital gains).
A bond might be sold at above or below par (the amount paid out at maturity), but the market price will approach par value as the bond approaches maturity. A riskier bond has to provide a higher payout to compensate for that additional risk. Some bonds are tax-exempt, and these are typically issued by municipal, county or state governments, whose interest payments are not always subject to tax. Bonds are generally traded in capital markets rather than money markets.

British government securities (Gilt-edged)

Gilts are fixed income or index-linked bonds issued by the UK Government. The purchaser of a gilt is lending the government money in return for regular interest payments and the promise that the nominal value of the gilt will be repaid (redeemed) on a specified later date. It is not necessary to hold a gilt until its redemption. Like shares, they are tradable instruments, their prices move in line with supply and demand, and fluctuations in the main influences on the market such as future interest rates and inflation.

Bulk buy-outs

A bulk buy-out is when a scheme transfers all of their assets and liabilities to a regulated insurance company. These are used where an occupational pension scheme is being wound up and the benefits that have been built up are being secured by the purchase of an immediate or deferred annuity that becomes payable at retirement.

Capital

For investors, it refers to their stock of wealth, which can be put to work in order to earn income.
For companies, it typically refers to sources of financing such as newly issued shares.
For banks, it refers to their ability to absorb losses in their accounts. Banks normally obtain capital either by issuing new shares, or by keeping hold of profits instead of paying them out as dividends.
If a bank writes off a loss on one of its assets - for example, if it makes a loan that is not repaid - then the bank must also write off a corresponding amount of its capital. If a bank runs out of capital, then it is insolvent, meaning it does not have enough assets to repay its debts.

Cash
This is money, in the form of notes and coin or in deposit accounts, which constitutes payment for goods at the time of purchase.

Certificate of deposit
A certificate of deposit is a time deposit, a financial product commonly offered to consumers by banks, thrift institutions and credit unions. The advantage of these over ordinary deposit accounts is that an amount is deposited for a specified period of time (normally a year), so that the interest payable is significantly higher. If funds are withdrawn before the maturity date, a forfeit of interest rate will apply. However, they are tradable instruments, so holders needing to raise cash can sell them in the money markets at a price which will reflect the higher rate. Despite the title, actual certificates are not issued.

Claim
This is a demand by an insurance policy holder for a benefit to be paid by his/her insurer under the conditions of the policy.

Commercial paper
A short-term, discounted, unsecured note issued by banks and corporations with shorter maturities than certificates of deposit, maturities can range from 2 – 270 days but typically are around 30 days. Such notes are negotiable instruments in bearer form.

Commodities
Commodities are products that, in their basic form, are all the same so it makes little difference from whom you buy them. That means that they can have a common market price. You would be unlikely to pay more for iron ore just because it came from a particular mine, for example. Contracts to buy and sell commodities usually specify minimum common standards, such as the form and purity of the product, and where and when it must be delivered.

Convertibles
Convertibles are bonds issued by companies which can be converted into ordinary shares or preference shares at a given price at a future date. For example a convertible might pay 6% in income, and give the holder the right to 5 ordinary shares for every £20 of bond value. They are a popular means of raising capital when interest rates are high; because the interest which the company has to pay on them is lower than on an unconvertible bond (the option to convert is deemed to be worth something to the holder). From an investor's point of view, convertible bonds can be attractive if the company's stock is volatile because they provide some of the security of a bond whilst at the same time allowing the investor to convert to shares if the company's stock rises.

Corporate Bond
Corporate bonds are issued by companies to raise capital. They are an alternative to issuing new shares on the stock market (equity finance) and are a form of debt finance. A bond is basically an IOU - a promise to pay back your original investment (the 'principal') at a maturity date, plus interest payments (the 'yield' or 'coupon') at regular intervals between now and then. The bond is a

tradable instrument in its own right, which means that you can buy and sell it during its life, and its value will tend to rise and fall as interest rates change.

Creditor

A creditor is a party (e.g. person, organisation, company, or government) that has a claim to the services of a second party. It is a person or institution to whom money is owed.
The first party, in general, has provided some property or service to the second party under the assumption (usually enforced by contract) that the second party will return an equivalent property or service. The second party is frequently called a debtor or borrower. The first party is the creditor, which is the lender of property, service or money.

Debtor

A debtor is an entity that owes a debt to someone else. The entity may be an individual, a firm, a government, a company or other legal person. The counterparty is called a creditor. When the counterpart of this debt arrangement is a bank, the debtor is more often referred to as a borrower.

Defined benefit pension

A pension in which the rules of the scheme specify the rate of benefits to be paid. The most common Defined Benefit (DB) scheme is a final salary scheme in which the benefits are based on the number of years of pensionable service, the accrual rate, and the final salary. An alternative to the final salary scheme is the Career Average Revalued Earnings (CARE) scheme, which is also a defined benefit scheme. Contributions may be made by the employee, the employer, or both.

Defined contribution pension

A pension in which the benefits are determined by the contributions paid, the investment return on those contributions (less charges), and the type of annuity purchased upon retirement (if any). It is also known as a money purchase pension. Contributions may be made by the employee, the employer, or both.

Derivatives

This is a collective term for securities whose prices are based on the prices of an underlying investment, such as cash, commodities, bonds or equities. The main derivatives are: futures, options, swaps, warrants, convertibles. The attractions of derivatives from an investor's point of view are: large profits (but also losses) can be made on a small stake, because they offer 'leverage'; money can be made whether the market goes up or down, depending on the set up of the investment. This would not be true if you invested in shares where you only make a profit if the share price rises. Derivatives can be used to reduce the risk of (or hedge) an investment in the underlying instrument. In general, derivatives are high-risk investments and not suitable for the ordinary investor.

Direct investment

Direct investment is a long-term relationship between two entities. It is held to exist where the parent owns 10% or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise. It involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

Disposals

Disposals refer to the relinquishing of assets, e.g. the sale of bonds or shares.

Dividend

A payment by a company to its shareholders, usually linked to its profits.

Expenditure

Expenditure is defined as the money leaving the company and includes items such as claims, transfers, wages and tax.

Fixed assets

These are assets of a company (such as buildings and machinery) which are regularly used over a long period of time for the purpose of generating profits.

Forward market

An over-the-counter marketplace that sets the price of a financial instrument or asset for future delivery. Contracts entered into in the forward market are binding on the parties involved. Forward markets are used for trading a range of instruments including currencies and interest rates, as well as assets such as commodities and securities.

Futures

A legal agreement to make or take delivery of a specified instrument (for example, a financial instrument such as a bond, currency or share) at a fixed future date at a price determined at the time of dealing. Futures are a zero-sum game in the sense that the financial gain of one party equates to the loss of the other. In contrast to options, there is an obligation to complete the transaction. Futures contracts are forward contracts, meaning they represent a pledge to make a certain transaction at a future date. By making an offsetting trade, selling goods that had been bought in a previous contract, futures contracts can be closed.

General insurance

General insurance is defined as those companies who undertake other types of insurance such as motor, home, travel etc. This type of insurance is usually over a shorter period, i.e. yearly policies.

Hedge fund

A private investment fund which uses a range of sophisticated strategies to maximise returns including hedging, leveraging and derivatives trading.

Holdings

These are assets or stocks held by an institution and valued, in the case of the MQ5 estimates, at market value.

Hybrid schemes (pension)

An occupational pension that offers members either a choice, or mixture, of defined benefit and defined contribution rights at retirement. For example, a typical hybrid arrangement offers a defined contribution pension but is underpinned by a minimum defined benefit entitlement.

Income

Income is defined as the money coming into the insurance company and includes items such as premiums, transfers, rents, dividends and realised/unrealised investment gains/losses.

Index linked

Securities that have interest rates linked to a retail or consumer price index.

Insured fund

Fully insured funds belong to pension schemes where the schemes' trustees hold, as a sole asset, an insurance policy contract or an annuity contract. All the schemes' assets are held in one insurance company.

Insurance managed fund

Insurance managed business is where investment of the pension funds for a group of employees is managed by an insurance company. This is in the form of an investment contract in which the insurance company offers participation in one or more pooled funds.

Investment income

Income, paid from an investment, such as dividends and interest, and rental income. The income might be taxable or tax-exempt.

Investment trusts

Investment trusts companies acquire financial assets with money subscribed by shareholders or borrowed in the form of loan capital. Investment trusts are not trusts in the legal sense, but are limited companies with two special characteristics: their assets consist of securities (mainly ordinary shares) and they are debarred by their articles of association from distributing capital gains as dividends. Shares of investment trusts are traded on the Stock Exchange and increasingly can be bought direct from the company.

Leverage

The use of borrowed funds at a fixed rate of interest in an effort to boost the rate of return from an investment. Increased leverage also causes the risk on an investment to increase.

Liabilities

A liability is a financial obligation, debt, claim or potential loss.

Life assurance

Insurance that provides for a partner or family in the event of a policyholder's death.

Liquidation

A process in which assets are sold off for cash. Liquidation is often the outcome for a company deemed irretrievably loss-making. In that case, its assets are sold off individually, and the cash proceeds are used to repay its lenders. In liquidation, a company's lenders and other claimants are given an order of priority. Usually the tax authorities are the first to be paid, while the company's shareholders are the last, typically receiving nothing.

Liquidity
How easy something is to convert into cash. Your current account, for example, is more liquid than your house.

Loan
An arrangement where a lender gives money to a borrower and the borrower agrees to repay the money with interest over a period of time.

Local authority debt
This includes local authority bills, and unsecured money lent to local authorities, with a maturity of less than 12 months.

Local authority investment
A bond issued by a local authority in order to raise capital for its budget. These have a maturity of 5 years or greater.

Long-term insurance
Long-term insurance is defined as those companies who undertake life assurance, pensions and critical illness business. Such companies provide either protection in the form of life assurance or critical illness policies or investment, in the form of pension provision.

Managed fund
A fund managed for a number of independent investors by an investment company. The fund is invested in a wide range of securities so as to keep risk to a minimum.

Market value
The quoted price at which investors buy or sell a share of common stock or a bond at a given time. This is also known as "market price".

Money market
A market in which money and other liquid assets such as bills of exchange and Treasury bills, generally of less than 12 months maturity, can be lent and borrowed in order to satisfy the short-term (from overnight to several months) cash flow requirements of banks and other institutions. Personal investors with large sums of money to deposit can also gain access to the money market via the commercial banks.

Mortgage
A loan in which the borrower (the mortgagor) offers a property and land as security to the lender (the mortgagee) until the loan is repaid. Repayments of the loan are usually made on a monthly basis over a long period of time, typically 25 years. In the UK, the most common forms of mortgage are the repayment mortgage and the interest only mortgage. Mortgage rates might be fixed for a period of time or floating.

Mutual fund
A collective investment scheme operated by an investment company that enables small private investors to invest in a diversified portfolio of shares, bonds and other securities. These are known as an open-ended fund since there is no fixed amount of capital in the fund. If new investors want

to invest, the fund can issue new units, accepting the money into the pool. Funds are managed by professional fund managers who invest in securities to achieve desired objectives such as capital growth, income or a combination of the two.

Net inflow (total net assets)

Net inflow is derived from total net investment minus borrowing (including share capital issues where applicable).

Net investment

Net investment is the difference between levels of acquisitions and disposals.

Occupational pensions

An arrangement (other than accident or permanent health insurance) organised by an employer (or on behalf of a group of employers) to provide benefits for employees on their retirement and for their dependants on their death. Occupational pensions are also referred to as trust-based and are a form of workplace pension.

Open ended investment company (OEICs)

An open-ended investment company is a type of company that allows investors to collectively pool together money to invest in various opportunities. As money is invested, shares are created. When a shareholder requests to sell shares, that money is then redeemed. The value of a share varies with the value of the OEIC's net portfolio value (NPV).

Options

An option gives the buyer or holder the right but not the obligation to sell shares (or other financial instruments) at a fixed price on or before a given date. The seller or writer has the obligation to buy. Every put option has an exercise price, the price at which the holder is entitled to sell the shares to the option writer. If the price of the share falls below the exercise price, the option is said to be in the money and to have an intrinsic value that is equal to the difference between the two.

Ordinary shares

Ordinary shares are the most common form of share in the UK. An ordinary share gives the right to its owner to share in the profits of the company (dividends) and to vote at general meetings of the company.

Overseas securities

Overseas securities are shares, stock, or other securities issued by a government or public or local authority of a territory outside the UK or by any other body of persons not resident in the UK. This includes both overseas shares and overseas debt securities.

Personal pensions

An arrangement where the contract to provide contributions in return for retirement benefits is between an individual and an insurance company. Such plans may be taken out by individuals on their own initiative – for example, to provide a primary source of retirement income for the self-employed, or to provide a secondary income to employees who are members of occupational schemes. Alternatively, they may be facilitated by an employer (a group personal pension or group stakeholder pension). Personal pensions are a form of defined contribution pension.

Preference shares

These are shares in a company which give their holders an entitlement to a fixed dividend but which do not usually carry voting rights. The important difference between preference and ordinary shares are:

- The dividend on ordinary shares is uncertain and variable (high when the company does well, poor or non-existent when it does badly). Preference shareholders get a fixed dividend which, if not paid, usually accrues until it can be.
- Each ordinary share usually carries a vote. Preference shares do not usually carry a vote unless dividends fall into arrears.
- In the event of a winding up, preference shares are usually repayable at par value, and rank above the claims of ordinary shareholders (but behind bank and trade creditors).

Preference shares may be issued with the right of conversion into ordinary shares. These are called convertibles.

Premium

Financial cost of obtaining an insurance cover, paid as a lump sum or in instalments during the duration of the policy. A failure to pay premium when due automatically cancels the insurance policy which, upon payment of the outstanding amount within a certain period, may be restored.

Profit and loss statement

A set of accounts, usually prepared annually, which depict a company's trading performance and are normally read in conjunction with the balance sheet and cash flow data. Part of the net profit after tax may be used to pay a dividend with the balance being retained within the business for future investment.

Property unit trusts

Property unit trusts invest predominantly in freehold or leasehold commercial property yet may hold a small proportion of their investments in the securities of property companies. Their assets are held in the name of a trustee and are managed on a co-operative basis by a separate committee (elected by the unit holders) or company.

Provisions

These are liabilities that appear on a balance sheet estimating costs that cannot currently be estimated.

Realised/unrealised gains and losses

Gains or losses are "realised" when a stock is actually sold. Unrealised gains and losses occur when the value of the stock changes prior to it actually being sold (gains and losses being respectively an appreciation or depreciation in value relative to the purchase price).

Reinsurance

The mitigation or spreading of all or some of an insurance risk by an insurer by sharing it with other insurers in return for the payment or part payment of premiums.

Repo (re-purchase agreement)

A repurchase agreement - a financial transaction in which someone sells something (for example a bond or a share) and at the same time agrees to buy it back again at an agreed price at a later day. The seller is in effect receiving a loan. Repos were heavily used by investment banks to borrow money prior to the financial crisis.
Repos are also used by speculators for short selling. The speculator can buy a share through a repo and then immediately sell it again. At a later date the speculator hopes to buy the share back from the market at a cheaper price, before selling it back again at the pre-agreed price via the repo.

Securities lending

When one broker or dealer lends a security (such as a bond or a share) to another for a fee. This is the process that allows short selling.

Self-administered pension funds

A self-administered pension scheme is defined as an occupational pension scheme with units invested in one or more managed schemes or unit trusts. The trustees of these types of schemes can employ either an in-house fund manager to make the day-to-day investment decisions or they can opt to use an external manager, e.g. an insurance company, to manage the investment (see also insurance managed fund).

Shareholder

The owners of shares in a company.

Shares

The ownership stake in a company that represent a proportional claim on the profits and assets of the company.

Short-term assets

Short-term assets are defined as those maturing within one year of their originating date, including loans repayable at lender’s option within one year of the date of issue.

Spot market

A market in the underlying instrument (for example, shares, commodities, etc) on which a futures or options contract is based. This market is for immediate delivery, typically with settlement in two days, as opposed to future delivery. Also known as cash market or physical market.

Stakeholder pension

Available since 2001, a flexible, portable, personal pension arrangement (provided by insurance companies) with capped management charges, that must meet the conditions set out in the Welfare Reform and Pensions Act 1999 and be registered with The Pensions Regulator. They can be taken out by an individual or facilitated by an employer (a group stakeholder pension).

Stock

There are two commonly used meanings; first, it is the term for shares. The two main types of stock are common stock and preferred stock. The equivalent terms in the UK are ordinary shares and preference shares. In the UK, stock was traditionally used to mean fixed interest securities like

gilts (e.g. Treasury Stock). Second, in accounting terms, stock refers to inventory that is, goods that a company has produced but not yet sold.

Stockbroker

A broker dealing in stocks and shares on behalf of a private or institutional client and possibly offering investment advice. Private investors need to use a broker for most share dealing.

Swaps

Swaps are traditionally the exchange of one security for another to change the maturities of a bond portfolio or the quality of the issues in a stock or bond portfolio, or because investment objectives have changed.

Currency swaps involve the purchase/sale of a currency in the spot market against the simultaneous purchase/sale of the same amount of the currency in the forward market.
An interest rate swap is an arrangement in which two parties agree to exchange periodic interest payments, at agreed intervals, over an agreed period, but without any principal being paid. The most common and simplest deal involves one party paying a fixed rate of interest and the other paying a floating rate.

Transactions

The process of acquisition and disposal of assets.

Unit trusts

These include open ended investment companies but they do not cover other unitised collective investment schemes (e.g. unauthorised funds run on unit trust lines by, for example, securities firms and merchant banks, designed primarily for the use of institutional investors) or those based offshore (Channel Islands, Bermuda etc.) or in other EU Member States. Unit trusts are set up under trust deeds, the trustee usually being a bank or insurance company. The funds in the trusts are managed not by the trustees, but by independent management companies. Units representing a share in the trusts’ assets can be bought from the managers or resold to them at any time.

Warrants

Warrants are securities issued by a company (often an investment trust) which give their owners the right to purchase shares in the company at a specific price at a future date. The warrants are tradable in their own right, and their value will go up and down as the price of the shares to which they relate goes up and down.