transact
take control

Transact

Guide to Investment Risks

Integrated Financial Arrangements Ltd
A firm authorised and regulated by the Financial Conduct Authority

Introduction

This guide explains the types of investment you can hold in your Transact Portfolio, how much financial risk they involve and things you should consider before investing. It should be read in conjunction with any information specific to the investment being purchased, such as Prospectuses, Key Investor Information Documents, Key Investor Documents and fund fact sheets.

For investment purposes, we will treat you as a retail client in line with the Financial Conduct Authority ('FCA') rules, because this categorisation carries the highest level of protection for you as a client.

Typically we receive instructions on your behalf from your adviser, in which case you will have had the opportunity to discuss the investments you are jointly considering and which they will recommend. However, we appreciate that you may want to send us instructions directly rather than through your adviser. Where this is the case our regulator – the FCA – and European regulations have laid down some specific rules. These rules apply to certain investments which the FCA has defined as 'complex'. So if you approach us directly to purchase an investment that is deemed 'complex', we will ask you some questions that will allow us to decide whether you have the knowledge and experience required to understand the underlying risks.

It is important to understand that an investment which is classified as 'non-complex,' does not mean it is safe or guaranteed. For example, shares listed on the main London Stock Exchange are regarded as 'non-complex', but if the company failed, its shareholders could lose all their money.

This guide does not cover every possible benefit or risk that may apply, or every possible investment, nor can it take into account your personal and financial circumstances.

Before you make any investment decision, you should speak with your adviser to ensure you understand and are prepared to accept the level of risk you are taking. You might also want to check whether the investment you wish to purchase is covered by the UK Financial Services Compensation Scheme or any overseas equivalents.

Please remember that the value of all investments may go down as well as up and you may get back less than you invested. Past investment performance is no guarantee of future performance.

Finally, there are various types of costs and charges that can be applied by each investment provider (sometimes referred to as a manufacturer), which may be reflected in the value of the investment or may be charged separately:

- Ongoing costs and charges – these are usually applied on a regular basis throughout the time that you hold the investment;
- Initial costs and charges – these can be applied when you initially buy the investment;
- Disinvestment costs and charges – these can be applied when you decide to sell the investment.

Details of the costs and charges applicable for each investment can be found in the manufacturer's documentation. These documents are available on Transact-Online and from the manufacturer.

This document is for information purposes only and should not be viewed as a recommendation. It does not, and is not intended to, constitute or substitute professional advice. For details please speak to your adviser.

What is risk?

All investments carry some sort of risk, but the level of risk varies depending on the investment you choose. In general terms, the higher the risk the higher the potential return and the higher the potential loss.

Higher risk investments, such as certain shares, offer the potential for higher returns. This may be acceptable for you if you can tolerate volatility of the stock markets. If you want to access your money at short notice, this type of investment may not be the right one for you.

Lower risk investments, such as government bonds, offer potentially lower but more stable returns, with less chance of losing money. However, returns can be impacted by inflation, which would reduce the long term value of your investment.

There are other factors that affect risk, such as:

- Changes in rules and legislations
- Fluctuations in exchange rates
- Investments in new and emerging markets
- Investments linked to commodity markets
- Investment into smaller companies
- Over exposure into a single investment
- Political change
- Economic change

If you intend to use your Transact Portfolio for the long term holding of cash, the value of your Portfolio in real terms may be eroded over time.

Attitude to risk

Your attitude to risk describes the level of risk you are willing to take on a particular investment.

There are various factors that can affect your attitude to risk. For example, your personal circumstances, investment goals and timescales and your level of knowledge and experience of different types of investment.

Investment related risks

Each type of investment has its own associated risks, some of these being:

Market Risk The risk that your investment may not perform as well as expected due to factors that affect the overall performance of the relevant financial markets	**Interest rate risk** The possibility that interest rates will fall may affect the value of your investment
Currency risk The risk that your investment will be adversely affected by fluctuations in currency exchange rates	**Political and economic risk** The risk that certain events (i.e. political upheaval, natural disasters) will weaken financial markets and economies and therefore will reduce the value of your investment
Liquidity risk The risk that your investment will be difficult to sell, for example because there are not enough buyers	**Sector risk** The risk that the value of your investment will fall because of factors impacting a particular sector within a market (e.g. the oil and gas sector within the energy market)

This guide does not cover every possible risk that may apply, or every possible investment. It cannot take into account your personal attitude to risk, your investment experience or your personal and financial circumstances.

Non-complex investments

This section addresses investments that are defined by the FCA as non-complex, such as shares.

1. Shares

Shares (also known as equities) represent fractions of a company. If you own one, you own part of the company and a portion of the company's value. You can own shares yourself, or you can pool your money with other people in an investment fund. When you own shares directly you become a shareholder, which usually means you have the right to vote on some company decisions.

Typically when a company is performing well, the value of its shares will increase creating higher demand from investors. Conversely, when a company performs poorly the value of its shares will decrease as demand from investors falls.

Another factor which can affect the price of shares is market sentiment. This is the term given to describe what people think or feel about how a company or economy is going to perform, rather than the hard facts from the data that has been published. Stock markets can fall very fast because investors panic – as soon as a group of people decide there is a problem and sell their shares, others usually follow suit and the price could 'crash' – where share prices fall sharply in a short period of time.

Types of shares include ordinary shares and preference shares. Ordinary shares typically entitle holders to one vote per share, and do not have any pre-determined dividend amounts. Preference shares, also known as preferred shares, have the advantage of a higher priority claim to the assets of a company if that company fails. Preference shares also typically receive a fixed dividend distribution. These shares often do not have voting rights.

Benefits of investing in shares

Capital growth – Capital growth occurs when the value of your investment increases. Many people invest for capital growth to build their wealth and protect it against inflation. People invest in shares because they offer the possibility that their price will rise.

Dividend income – A dividend is the distribution of a company's profit to its shareholders. Dividend payments vary greatly from company to company. It is not compulsory for a company to pay a dividend.

Risks of investing in shares

Capital risk – When a company is performing poorly or when the market perception of the company is negative, the share price may fall below the price which you originally paid for the share or even to zero. If a company goes out of business, its shares will become worthless.

Volatility risk – Share prices may fluctuate in value over short periods. This can be due to factors that apply to individual shares, market sectors or to the whole market.

Currency risk – Where shares are listed in a foreign currency, then converted to their domestic currency, investors may be exposed to fluctuations in exchange rates. Changes in exchange rates may wipe out any gains even if those shares have done well.

Timing risk – Since shares that are traded on exchanges can be traded throughout the business day, prices can fluctuate depending on factors such as the demand from other buyers. If you buy or sell shares without knowing about events that are likely to affect the price, you may inadvertently trade at the "wrong" time.

2. Regulated Collective Investment Schemes (CIS)

A CIS, which is sometimes called a 'pooled investment', is a fund that several people contribute to. A fund manager will then invest the pooled money in one or more types of asset, such as shares, bonds or property (or a mixture of all three).

The FCA regulates these schemes, including 'recognised' schemes from other countries, such as Ireland or Luxembourg.

Below are examples of authorised UK CIS:

- Unit trusts
- Investment trusts
- Open Ended Investment Companies (OEICs)
- Exchange traded funds (ETFs)

Unit trusts and OEICs are by far the most popular CIS. With a unit trust, a fund manager buys bonds or shares in companies on the stock market on behalf of the fund. The fund is split into units, and this is what you will buy. The fund manager creates units for new investors and cancels units for those selling out of the fund. The creation of units can be unlimited, hence why the fund is 'open-ended.'

OEICs operate in a similar way to unit trusts, except that the fund is actually run as a company. It therefore creates and cancels shares rather than units when investors come in and go out of the fund, but the shares still directly reflect the value of the assets that your fund manager has invested in.

By contrast investment trusts are 'closed-ended' CIS, meaning they issue a fixed number of shares when they are set up, which investors can then buy and sell on the stock market.

This means investment trust managers always have a fixed amount of money at their disposal, and will not have to buy and sell to meet investor demand for shares. This can add a degree of stability to investment trust management that a unit trust manager will not have.

ETFs aim to mimic the performance of a particular market or index such as the FTSE 100, and their value is determined by whether the index rises or falls.

ETFs differ in that they are traded like individual shares, on an exchange such as the London Stock Exchange, and can be bought and sold through brokers in the same way as any other listed stock. An ETF has holdings in every company on the index, and the ETF's manager only buys and sells holdings to reflect movements in the value of the market as a whole. This is an example of so called passive investment management.

One of the main attractions of ETFs over actively managed funds is that they are priced continuously throughout the day, whereas conventional funds are priced just once a day (by reference to the value of their underlying assets), so that you do not know what the price will be before you buy or sell.

Funds are broadly split between those that pay income back to the investor (income units) and those that accumulate the income within the fund (accumulation units). With accumulation units, the income is automatically reinvested into the fund to increase the value of the investment. Funds with an income objective typically invest in bonds and cash (or cash equivalents). Funds with a capital growth objective typically invest in equities. Whilst capital growth funds can be more volatile in the short-term than income producing funds, they can provide higher returns over the long-term.

Certain funds are categorised as Undertakings for Collective Investment in Transferable Securities (UCITS) funds, meaning that they are easily purchased and sold, and that they are compatible with the investment needs of retail investors.

The type of fund you choose will depend on your investment goals and attitude to risk. For example:

Equity funds invest in a range of company shares that offer capital growth with an opportunity to receive dividends.

Multi-asset funds invest in a diverse range of assets. These can be an efficient means of reducing risk.

Specialist funds target countries or sectors by exploiting the expert knowledge of their fund managers.

Benefits of investing in funds

Pooling – By pooling your money with other investors you can take advantage of investment opportunities more easily than if you bought the individual assets yourself. Fund managers are professionally trained and experienced, constantly watching and managing their fund.

Diversification – Bonds, commodities and cash funds are inherently diversified, because they combine a variety of assets. If the value of one share or asset goes down, there may be others whose value goes up to compensate for it.

Liquidity – You can sell your funds immediately. Normally, the money takes a few days to come into your account.

Risks of investing in funds

Counterparty risk – Funds may enter into contracts with other parties. Where that party fails to carry out its obligations, the fund may experience a decline in its value, a loss of income and possible additional costs.

Currency risk – Changes in foreign currency exchange rates may adversely affect the value of the fund.

Emerging markets risks and political and economic risks – Certain events (e.g. political upheaval, natural disasters) may weaken financial markets.

Gearing risk – Some funds may borrow money to increase potential returns. This can magnify gains if the fund performs well, but may magnify losses if it does not.

Liquidity risk – It might not be possible to sell your funds immediately.

Market risk – The market may decline in value.

3. Bonds

Governments, other public bodies (such as local authorities) and companies will often raise money by issuing long-term bonds that promise to pay an income.

Short term bonds are sometimes offered by governments and blue chip companies. They may not provide an income, but provide capital growth upon redemption. Typically, these are offered for periods of 3-12 months.

The price of long-term bonds can fluctuate significantly depending on current interest rates. Generally, if interest rates fall, the value of a long-term bond will rise; conversely, if interest rates rise, the value of a long-term bond will fall.

Note that bonds in this context are investments held within a Wrapper, not the Transact life company bonds.

Benefits of investing in bonds

Low volatility – Typically the volatility of bonds is low.

Liquidity – Bonds are often easy to sell quickly.

Legal protection – If a company becomes insolvent, you may receive some money back.

There are a variety of bonds to fit the different needs of investors.

Risks of investing in bonds

Interest rate risk – Long-term bonds are subject to interest rate risk, meaning that their market prices will generally decrease in value if the income paid is less than the interest that could be earned on money deposited elsewhere.

Section 2 Complex Investments

1. Exchange Traded Products (ETPs)

It is important to note that ETPs are different to ETFs. As explained above, an ETF is an open ended index tracking fund which attempts to follow the performance of an index to produce the same investment return. Some of the indices ETFs follow are well known, such as the FTSE 100, but others are less well known. You might hear ETFs also being called 'passive' or 'tracker funds', where the aim is to mirror a market index.

ETPs are either exchange traded commodities (ETCs) or exchange traded notes (ETNs).

ETCs track the performance of an underlying commodity such as oil or gold. ETCs give investors direct and cost effective exposure to the performance of commodities. This removes the need to physically hold crates of gold or barrels of crude oil.

ETCs are commonly used to diversify an investment portfolio as they can give a broad representation across entire commodity sectors and different geographic regions. For example, an agriculture ETC may invest in cotton, corn, coffee, sugar and wheat of different weightings.

ETNs track the performance of an index (FTSE 100) or underlying commodity (oil or gold). They can track the same underlying commodities on which ETCs are based, but ETNs can also offer exposure to other underlying non-commodities. ETNs are typically issued by banks, in which case they are subject to the credit risk of the issuer; in other words, if the bank becomes insolvent the ETNs may become worthless.

Benefits of investing in ETPs

Choice and ease of access to markets – The range of ETPs trading on the London Stock Exchange covers a wide range of markets, such as agriculture, energy, livestock and metals. Investors can use ETPs to access markets which are otherwise difficult and complex to reach.

Cost efficiency – It is more cost effective to trade ETPs than to hold physical assets like oil or gold. Holding physical assets can be costly, impractical and in some cases impossible for most investors.

Liquidity – ETPs are traded on an exchange, meaning you should always be able to see a price.

Portfolio diversification and flexibility – ETPs can be used on their own or in combination with other investments. You can trade in and out of ETPs as easily as ordinary shares giving you greater flexibility and control.

Risks of investing in ETPs

Market risk – An ETPs underlying assets may decline in value due to factors affecting either the markets generally, or particular segments, economic sectors, industries or companies within those markets.

Tracking error risk – This is the difference between the performance of the ETP and the asset(s) it tracks. Tracking error depends on the market conditions at the time, and can either be in your favour or against you.

Counterparty risk – Certain ETPs use derivatives (see below) with other third party counterparties rather than purchasing the assets themselves. If the other party providing these derivatives fails, the ETP may lose part or all of the money it had invested.

Liquidity risk – In certain circumstances, it may be difficult for an ETP to buy or sell an asset within a reasonable time at a fair price, which may reduce the ETP's returns.

2. Unregulated Collective Investment Schemes (UCISs)

If a collective investment scheme is not authorised or recognised by the FCA, it is considered a UCIS. UCIs, including alternative investment funds (AIFs), are not subject to the same restrictions (limited or very complicated product literature not easily understood by retail clients) as authorised funds are, in terms of their investment powers and how they are run. A UCIS is based outside the UK and typically invests in assets that can be extremely difficult to value – such as fine wine, film production and forest plantations.

Furthermore, these types of investment are generally illiquid as they are not traded on an established exchange, which means it can be difficult to get your money at short notice.

In the event that the UCIS cannot meet its liabilities, it is unlikely to be covered by any regulatory compensation scheme. An example of a UCIS is a hedge fund. Typically hedge funds are privately owned, actively managed funds where the fund manager may often have invested some money of their own into the fund. They can be expensive to invest in because there may be a 'success fee' in addition to the normal fund management fees.

Hedge funds often use sophisticated investment strategies and have a tendency to be highly volatile. There may be delays in withdrawing money from such funds. They may also employ high levels of borrowing (also known as 'gearing') which can magnify both gains and losses.

Many hedge funds also operate in jurisdictions where there may be less regulatory oversight than the United Kingdom.

Benefits of investing in a UCIS

Investment strategies – Unlike regulated CISs, which are subject to investment and borrowing restrictions aimed at ensuring a prudent spread of risk, UCISs may have significantly wider investment and borrowing powers in order to meet their investment strategies.

Source of diversification – UCISs can have a place within an investment portfolio. For example, if an investor has a high tolerance for risk and capacity for loss, a small portion of the investor's investment portfolio could be dedicated to a number of UCISs, with the intention that the potentially high returns from successful UCISs would offset the losses from unsuccessful ones.

Risks of investing in a UCIS

As UCIS are not subject to the same investment and borrowing powers that regulated CISs are, they are generally considered to be high risk investments and you should always ensure that you understand all the risks before investing.

Fees – Fees may be very high and difficult to understand; particularly high exit fees may act as a disincentive to selling your investment.

Volatility risk – Prices may fluctuate greatly over short periods of time.

Pricing risk – As there are few restrictions on the types of asset that can be purchased, some assets may be difficult to value, leading to the potential for price inaccuracies.

Liquidity risk – You should be aware that there may be delays in selling your investment, and opportunities to buy and sell may be infrequent.

Regulatory risk – UCISs that operate in jurisdictions outside the United Kingdom may be subject to less regulatory oversight and protection.

3. Structured products

A structured product is a fixed-term investment whose pay-out depends on the performance of something else, like a stock market index.

There are two main types of structured product:

- **Structured deposits** – Structured deposits are similar to a fixed term savings accounts, except that the rate of interest you receive is dependent on the performance of a stock market index or other securities. For example, if the stock market index falls, typically you will get no interest, but you are likely to get some or all of your original deposit money back.
- **Structured investments** – Structured investments are commonly offered by insurance companies and banks. Your money is invested in a security by the provider, which typically has two underlying investments; one to protect your capital and another to provide the rate of return. The return you get depends on how the stock market index or other securities perform. In addition, if it performs badly or the firms providing the underlying investments fail, you might lose some or all of your original investment.

Benefits of investing in structured products

Returns – When interest rates are low, stock markets are volatile and bonds look expensive, the returns available on structured products can appear relatively attractive.

Flexibility – There is a wide range of structured products, based on different indices and offering returns in different ways and over different time periods. Some will pay an annual return, provided the targets are met; others will pay out at the end of the term. The level of risk also varies depending on the underlying index or security chosen.

Capital protection – Many structured products offer some capital protection, so, for example, your capital will only be at risk if the chosen index falls past a pre-determined level.

Tax – The return on other growth products may be treated as a capital gain and be subject to capital gains tax (CGT) rather than income tax. That means you can use your CGT allowance to shelter profits.

Any tax liability will depend on individual circumstances and it may change at any time.

Risks of investing in structured products

Liquidity risk – You may be tied in for long periods of time without the ability to withdraw your money. If you are allowed to withdraw your money early, you may have to pay a fee dependent on the nature of the investment and the timing of your withdrawal, meaning the fee cannot always be determined before you invest.

Market risk – The level of the index or price of securities may have to be within a particular range or above a particular level in order for a return to be paid, which makes structured products vulnerable to unexpected events that have a significant short-term market impact.

Inflexibility – While you can sell funds or shares if you change your view of markets, you cannot make any changes to the way the structured product is set up.

Return risk – The return on structured products may be derived by reference to the performance of a number of assets, indices or price levels. The interactions between these variables are highly complex, resulting in you not necessarily understanding how your return is calculated and under which circumstances the return is payable. In addition, structured products are sometimes described as offering 'capital protection' – but this doesn't necessarily mean that your money is completely safe. There are two common types of protection at maturity:

- **Full protection** – Also described as '100% capital protection', 'capital security' or a 'capital guarantee'. This means that the amount you receive at the end of the term should be at least equal to the amount originally invested.
- **Partial protection** – How much of your original money you get back depends on the performance of the index or securities your investment is linked to, and only a proportion – say 90% - is protected by the capital 'guarantee'.

In either case, there is still a risk of capital loss, as described above, if the company providing the guarantee runs into trouble, or if you end the structured investment before maturity.

Limited upside – The return on structured products is generally capped, so that, if markets rise above a certain level, you will not receive the full benefit.

4. Other investments that are potentially difficult to sell

These are investments that may not be easily or quickly sold without a significant loss in value. Some examples of this type of investment include investments containing a derivative, as well as property, classic cars, antiques and works of art.

Investments containing a derivative

Although you might hold an investment which itself contains a derivative, you cannot directly hold, or purchase and sell, a derivative on Transact.

An investment containing a derivative (typically an 'option' – see below for a description) allows either the person who sells the investment (typically a company) or you, as the investor, the right to take some action in the future.

Let's assume company ABC issues a bond with an option contained within it. The option allows you to convert the bond into shares of company ABC. This is known as a convertible bond. In this scenario you have the right to convert your bond into shares of company ABC at a certain time. The benefit to you is that the bond protects your money if the market drops but allows you to participate if the market goes up, i.e. by opting to convert to shares in the company.

However, where you have opted to convert your bond to shares and company ABC fails, you will have a lower priority in the list of creditors than an investor holding an ordinary bond.

Along with convertible bonds, derivatives can be contained in other investments such as structured products and certain shares.

An option is the most common type of derivative. It gives the buyer the right, but not the obligation, to buy or sell the underlying assets. A premium is paid to buy the right from the seller, who receives the premium in return for taking on the obligation to buy or sell the underlying assets if the buyer decides to buy or sell.

Benefits of investments containing derivatives

Risk management – Derivatives can be used for either hedging or speculation. Hedging is a strategy which uses derivatives to reduce risk whereas speculation is taking a view in which direction markets may move in the future.

Risks of investments containing derivatives

Market risk – Derivatives, just like any type of investment, are subject to market risks. They carry the market risk applicable to the asset or rate they are 'derived' from.

Counterparty risk – Counterparty risk happens when the other party – the buyer or seller – defaults on the contract. For example, in the case of an investment containing an option to purchase an asset at a pre-determined price, the value of that investment will be adversely affected if the writer of the option does not deliver the asset at the pre-agreed price.

Volatility risk – A derivative may be more susceptible to price volatility than the asset it 'derives' from, magnifying the effect of volatility on an investment containing that derivative.

Pricing risk – Derivatives have the added risk that further money (known as 'margin') may need to be paid after the derivative has been purchased if markets move adversely. Where an investment includes a derivative making margin payments, this can magnify the adverse effect on the price of the investment.

Conversion risk – The risk and return profile of an investment containing a derivative which converts from a lower risk asset to a higher risk asset where a pre-set threshold is reached may be adversely affected following conversion. For example, a convertible bond with relatively low market risk which converts to a share in a company that is typically distressed and so subject to much higher levels of market risk with less certain returns.

M055 Version (7) January 2018

"Transact" is operated by Integrated Financial Arrangements Ltd, 29 Clement's Lane, London EC4N 7AE.

Tel: (020) 7608 4900 Fax: (020) 7608 5300 email: info@transact-online.co.uk web: www.transact-online.co.uk

Registered office: as above; Registered in England and Wales under number: 3727592

Authorised and regulated by the Financial Conduct Authority (entered on the Financial Services Register under number: 190856).