

## ***Insurance Related Savings Products.***

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**Ever wondered why ICI Life was so profitable?** Some hint can be found from this cautionary tale about TERM, the heavily-promoted finance plan which covers school fees. Patrick Shallow obtained a personal quotation and, on further examination, discovered that the plan represented poor value for money.

A popular finance scheme of recent origin is one currently being offered by ICI Life. The scheme, as the literature explains, is designed to 'ease the financial burden of educating your children' by spreading the costs over later years.

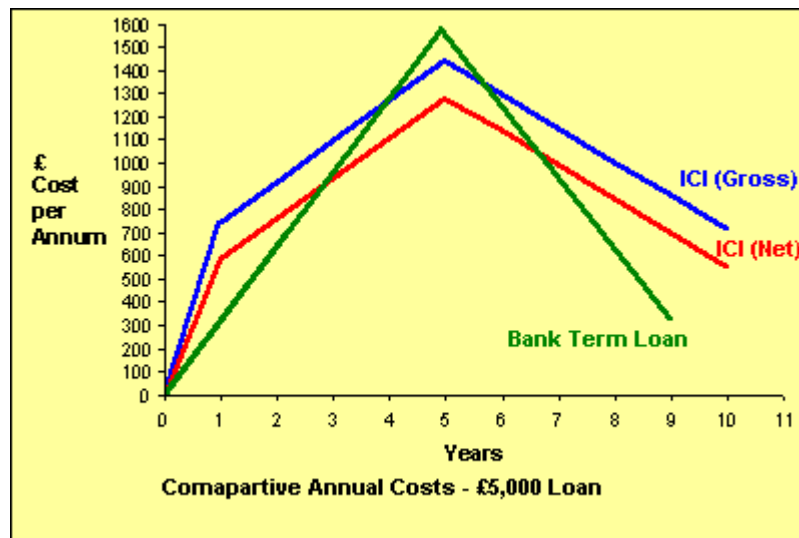
A typical situation to which the scheme is directed is where school / university fees of, say, £1000 per annum are required in each of five years but where the finance cost is spread over the succeeding ten years. Interest at 17.5% per annum is charged on the loan outstanding; capital is repaid via monthly investments in a Grobond Managed Fund at a level sufficient to repay the total sum borrowed. The scheme offers the attraction that tax relief is available at one's top rate on half the capital repayments over the period of the loan.

The scheme appears to identify a growing new need and to provide a tax efficient solution to it- one likely to appeal to those many parents with cash flows under pressure. However, the personal quotation obtained below did not fulfill this promise of tax-efficient low cost finance.

A quick calculation showed that the total sum borrowed, £5000 @ £1000 per annum was repaid over ten years by a total gross payment of £10,474 - or by £8,774 after full tax relief.

As this appeared high I was prompted to enquire as to the availability and comparative cost of a similarly phased term loan from my friendly (not very) bank manager. At the slightly higher rate of 18% per annum monthly repayment of £25.03 per £1000 produced a total cost of repayment on the same loan of £7,509 - £1,265 less than the after tax relief cost of this 'specially designed scheme'!

In view of the difficulty of comparing two such differently structured income streams I graphed the comparisons, shown below, expecting to find some advantage, in terms of net present value, in favour of the insurance package.



As the graph shows, other than briefly at the end of year five the annual rate of payment of a conventional bank loan is substantially below the gross cost of the insurance package. Only in years four to six is the annual net cost of the insurance scheme below that of the bank loan. The total cost of the insurance scheme, at £10,474 gross (£8,774 net) over ten years compares very badly with only £7,509 for the bank over nine years.

Year	Outstanding Borrowings	Monthly Interest	Gross Monthly Contribution	Gross Annual Payment
	£	£	£	£
1	1,000	14.58	47.19	741
2	2,000	29.17	47.19	916
3	3,000	43.75	47.19	1,091
4	4,000	58.33	47.19	1,266
5	5,000	72.92	47.19	1,441
6	4,167	60.76	47.19	1,295
7	3,333	48.61	47.19	1,150
8	2,500	36.46	47.19	1,004
9	1,667	24.31	47.19	858
10	833	12.15	47.19	712

A telephone call to ICI confirmed the above results but elicited by way of apology, that some £360 of the scheme's costs related to insurance cover - which was now added rose with the applicant's age! Suggesting that the high cost might, perhaps, reflect a higher than usual element of risk, I was assured to the contrary - such loans were not freely available and supporting security was often sought!

Still at a loss to understand the manifestly high cost of the finance - especially in the face of the apparently attractive rate of interest of '17.5% per annum payable monthly on the sum outstanding' - by implication a true rather than nominal rate of interest - I examined the arrangements again. These now showed that as repayments of capital, or as they are here described 'encashments of the fund', are not allowed until year six the true rate of interest is not readily apparent. To identify it, it is necessary to aggregate insurance and interest elements and, ignoring the minimal insurance cover and cost - to regard the total as the loan. The costs so derived correspond to a true rate of interest on

borrowings, after full tax relief of 39% per annum gross and net of tax relief at the top rate, 24% per annum.

Concluding glumly that the ICI scheme would not help me to 'ease the financial burden of education' I decided not to celebrate the end of the tax year with this 'tax efficient' scheme. Instead I wondered briefly - whatever had happened to the much vaunted tax relief?

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