HARGREAVES LANSDOWN

INVESTING FOR CHILDREN

IMPORTANT INVESTMENT NOTES

This guide is designed for investors who want to make their own investment decisions, it is not personal advice. If you're unsure of the suitability of an investment for your circumstances please contact us for advice. Unlike cash, stock market based investments aren't guaranteed and fall in value as well as rise; you should only invest for the long term (5+ years). Your child could get back less than is invested. Yields vary over time and are not guaranteed.

Any tax reliefs and state benefits referred to are those which currently apply, but tax rules are subject to change and any benefit will depend on individual circumstances. Hargreaves Lansdown Asset Management is authorised and regulated by the Financial Conduct Authority (FCA).

Correct as at 3 January 2019.

INTRODUCTION

Give a child or grandchild a head start in life

DANNY COX
Chartered Financial Planner

Providing children or grandchildren with a good start in life is amongst the highest priorities for parents and grandparents. As with all planning, the earlier you start the better.

The first step is to decide the investment goal, and the timeframe. Do you want to support a child or grandchild through university, help them onto the property ladder, or help pay for school fees?

We start by examining some of the different types of investments available – cash, shares, and bonds. We then look at some of the various accounts available in which to hold these investments. Finally we look at minimising tax, and suggest some ways of investing as a starting point for your own research.

WHICH ASSET CLASS?

Choosing the right investments for your child could be crucial over the long term.

CASH
It is a good idea to start by considering an easy access savings account for short-term goals, pocket money or small cash gifts. There are a number of accounts aimed at children, which offer attractive rates of interest and other incentives. They can often be found using price comparison websites.

Should a bank or building society fail, UK deposits are protected by the Financial Services Compensation Scheme. The current protection limit is £85,000 per institution; more details are available at **www.fscs.org.uk**.

SHARES
Shares allow individuals to benefit from the profits and growth of companies. When purchasing shares, investors quite literally own a share of the company, which entitles them to a share in any future profits the company chooses to distribute as dividends.

Interestingly, it is often argued that shares can offer a way of keeping pace with inflation over the very long term. Companies' costs will rise, but they should be able to increase their prices too, thereby maintaining their profit margins. If profits rise in line with inflation, so should dividends, and by implication, share prices. Additionally, the best companies will find ways to increase their revenue over and above the rate of inflation, or reduce their costs, significantly increasing their profits and providing the potential for capital growth. However, there are no guarantees and prices will fall as well as rise.

Long-established companies often distribute some of their profits to shareholders as dividends, often twice-yearly, whereas new companies and those in capital-intensive industries usually reinvest profits to grow the business and therefore pay little or no dividend. The reason for buying the latter shares is that if a company grows revenue and profits, its shares normally increase in value.

GILTS AND CORPORATE BONDS

Gilts and corporate bonds, or 'fixed interest securities' as they are collectively known, are one type of investment where investors know at the outset what their income and capital return should be – under the right conditions. These securities are essentially a loan to institutions who wish to raise finance; corporate bonds are loans to companies, and gilts are loans to the UK government.

The term of the loan and repayment value is set at the outset, together with a predetermined rate of interest payable. Plainly, the security of the institution borrowing the money is of prime importance.

There are few, if any, more secure than the UK government, which literally used to edge the loan certificates in gilt, giving rise to the term 'gilt-edged securities', or 'gilts' for short. The stronger the institution issuing the loan, the lower the interest rate it needs to offer to attract finance. Conversely, less creditworthy companies and governments need to pay more to attract finance and therefore offer higher rates. If the issuer fails investors could lose some or all of their investment, and income payments could cease.

CASH OR THE STOCK MARKET?

Stock market investments are likely to outperform both deposit accounts and inflation over time. However, unlike cash, they will fall in value as well as rise, and require a sufficiently long investment horizon to ride out the inevitable volatility and provide a good chance of decent returns. Conventional wisdom suggests five years as a minimum.

The longer the timeframe, the greater the chance of shares outperforming cash. Remember, inflation reduces spending power over time. Of course there are no guarantees – cash offers stability of capital, whereas you can lose money investing in the stock market, however long you invest for.

Past performance is not a guide to future returns.

FUNDS – A SIMPLE WAY TO INVEST

One of our favourite ways to start investing for a child.

Many investors like to choose and purchase individual bonds and shares. However, this is intrinsically higher risk, as the value of the investment is linked to the fortunes of one company. If the company goes bust, those holding their shares or bonds can lose their whole investment.

For this reason, many ordinary investors choose to invest in bonds and shares through funds, which spread the risk across a number of companies. Funds allow individuals to invest in a large portfolio with many other investors. Units or shares are sold, each representing a small but equal fraction of a portfolio of typically 50 to 100 different holdings. Funds are popular because they offer ordinary investors access to professional fund management, and the benefits of diversification on lump sums of as little as £100, or regular savings of £25 per month.

There are thousands of funds available, covering almost all asset classes, areas of the globe and sectors of the economy. We believe that for most investors, funds represent the best way to access the growth potential of the stock market or gain exposure to the bond market.

Our Wealth 50 is a list of our research team's favourite funds from across the major sectors. To find out more about the Wealth 50, please visit **www.hl.co.uk/wealth-50**

REGULAR SAVINGS

When investing for a child it is important to remember that children have time on their side, allowing them to ride out the peaks and troughs of the stock market. Most importantly, though, time allows for compound returns to take effect – a phenomenon Albert Einstein reportedly described as the "eighth wonder of the world".

Even small amounts tucked away regularly can build up a substantial nest egg. Assuming a growth rate of 5% a year after charges, the table below shows how much a relatively small monthly investment could be worth:

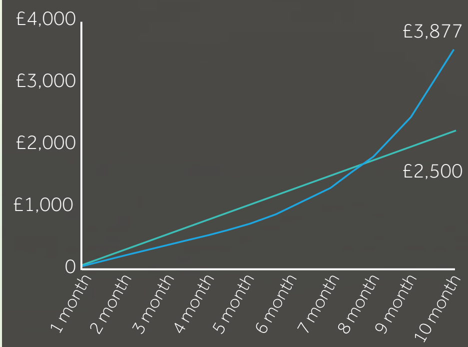
Time period	£50 per month	£100 per month	£300 per month
5 years	£3,404	£6,809	£20,427
10 years	£7,749	£15,499	£46,497
18 years	£17,333	£34,666	£103,999

Regular savings plans benefit from something called pound cost averaging. Investments will fall in value as well as rise but, with regular savings (as shown on the next page), fluctuating markets allow individuals to buy more of the investment at lower prices, so if the market eventually regains the lost ground they will count for much more. If the market rises investors profit from the increasing value of investments already made. Although there are no guarantees. Providing the individual encashes the plan when the price is higher than the average you've paid, they will make money. It is an excellent way to help smooth out the ups and downs in the market.

The graphs on the next page show what could happen to a regular savings plan in two different markets. The graphs are hypothetical, the figures used are an example and simplified but demonstrate the point that it is possible to make money from a fluctuating market. In a flat market the price of the units doesn't change. So each month £250 invested buys 250 units, then after 10 months the investor has 2,500 units, worth £2,500. In a fluctuating market, each £250 invested buys more units as the price falls which are then worth more as the market recovers – accumulating a total of 3,877 units, worth £3,877 at the end of the same period.

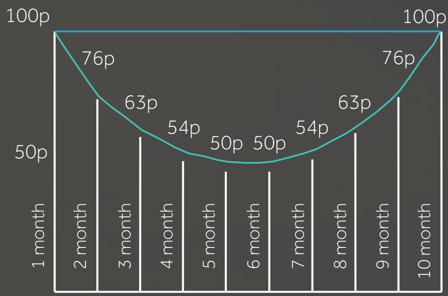
Remember investments can fall as well as rise in value so you could get back less than you invest. This is an illustration, not a projection of what a child might receive, and inflation will reduce the spending power of capital over the long term.

VALUE OF A REGULAR SAVINGS PLAN



- Value of regular savings plan in a flat market
- Value of regular savings plan in a fluctuating market

PRICES IN TWO DIFFERENT MARKETS



- Price – Fluctuating market
- Price – Flat market

Please note this is an illustration not a projection.

WHICH TYPE OF ACCOUNT?

JUNIOR ISAS
Junior ISAs are tax-efficient investment and savings accounts for children. In practice they are extremely similar to 'adult' ISAs. There are two types available – Cash Junior ISAs and Stocks & Shares Junior ISAs. Children can hold one of each type of account at the same time.

Similarly to adult ISAs there is no capital gains tax and no UK tax to pay on income. No withdrawals are allowed before age 18, when the Junior ISA will be converted into an 'adult' ISA and the child will have full access to their capital.

Junior ISAs are available to all children in the UK under the age of 18. However, children born between 1 September 2002 and 2 January 2011 will need to transfer, or have transferred, their Child Trust Fund to a Junior ISA first in order to open the account (see below).

The annual subscription limit for the 2018/19 tax year is £4,260.

Junior ISAs can be transferred between providers. The account is held in the name of the child, but opened and managed by a parent or guardian. Once opened anyone can contribute to a child's Junior ISA. More details can be found at **www.hl.co.uk/jisa**

CHILD TRUST FUND TO JUNIOR ISA TRANSFERS
Parents are able to transfer their child's Child Trust Fund (CTF) to a Junior ISA.

CTFs were launched in 2005 as a way to encourage parents to save tax-efficiently for their children's future. Most children born between 1 September 2002 and 2 January 2011 would have received a £250 voucher from the government, which could be used to set up a CTF.

However, CTFs never really caught the public's imagination and of the 6.3 million CTFs that were opened, less than a quarter received additional contributions.

Junior ISAs, on the other hand, have proved more popular with parents as they typically offer more competitive charges and greater investment choice to enable potentially greater returns.

If parents don't know where their child's CTF is held or who the registered contact is for the account, they can check with HMRC by calling them or visiting: **www.hmrc.gov.uk/tools/childtrustfundclaim/ctfaccount.htm**

More information about transferring CTFs to Junior ISAs can be found at **www.hl.co.uk/ctf**

BARE TRUSTS

If a Junior ISA isn't appropriate – for example, to invest a larger sum, or if capital is required before age 18, perhaps for school fees – a bare trust could be considered.

The account belongs to the child but is held in the name of the adult trustee. This might sound complicated, but in fact it is extremely easy to set up.

Trusts are legal arrangements where money or assets are held by a person (known as the trustee) for the benefit of another (the beneficiary). Commonly, money (or assets) can be passed as a gift into the trust and held or invested until such time as the trustees distribute money or assets to the beneficiaries. Trusts can allow individuals to retain control over when and how monies are distributed.

Trusts are useful for saving for children, because they allow money to be passed on before children are old enough to be given the money directly. Trusts are also useful for inheritance tax (IHT) planning in that gifts to trusts may reduce the value of an individuals' estate and thereby can reduce the amount of IHT paid upon death.

Bare Trusts are the simplest type of trust and are created when gifts are made into an investment account with the intention of creating a trust. The child is the beneficiary and there are normally two adults acting as trustees. The child becomes entitled to have the investments transferred into their name at 18. However, a trustee may be able to distribute money earlier, for example to meet school fees.

The designated account offered by Hargreaves Lansdown is called the HL Junior Investment Account. It is simply an HL Fund & Share Account which belongs to the child but is held in the name of the adult trustee. As well as completing the application form investors should complete and retain the 'Election for Bare Trust' form, which confirms the intention to create a Bare Trust.

SELF INVESTED PERSONAL PENSIONS (SIPPS)

Parents and grandparents can contribute to pensions for a child. This can provide an excellent foundation for their retirement plans at a time when retirement ages and the cost of a decent pension are rising. One of the great advantages of starting to save for retirement early is maximising the benefits of compound growth.

Furthermore investors are often wary of handing large investments over to children on their 18th birthday. Invest in a pension and you can be certain their money is ring-fenced for their retirement (pensions can't usually be accessed until age 55, rising to 57 from 2028).

The government offers generous tax breaks. Most people, including children, can normally have up to £2,880 a year paid into a personal pension – such as the HL SIPP – which the government will boost to £3,600 with basic-rate tax relief.

A child whose family had contributed £300 each month for 18 years could have a pension pot worth over £500,000 by the time they reached age 65 (assuming 5% annual growth and a charge of 1% a year), even if the child saved nothing more in adulthood. The actual figures will depend on the investment returns actually achieved and the charges applied; remember all investments can fall as well as rise in value so your child could get back less than is invested. Inflation will also reduce the spending power over time.

Please note that the tax rules and state benefits for pensions, and in particular tax reliefs, are likely to change substantially between now and the child's retirement and this adds an element of uncertainty as to how the benefits might be taken.

TYPE OF ACCOUNT – AT A GLANCE

	HL JUNIOR ISA	HL JUNIOR INVESTMENT ACCOUNT	HL JUNIOR SIPP
Who is eligible?	Any child resident in the UK. However, children born between 1 September 2002 and 2 January 2011 will need to transfer their Child Trust Fund to a Junior ISA in order to open the account (see page 11)	Any child resident in the UK	Any child resident in the UK
How much can be invested?	£4,260 (2018/19)	No subscription limit	£3,600 gross (£2,880)
When can the money be withdrawn?	No access until age 18 (except in the case of terminal illness or death)	No restrictions, although money can only be used for the benefit of the child. The child is entitled to the money at age 18	No access until retirement (except in the case of terminal illness or death)
In whose name is the account held?	The child	The trustee (usually a parent or grandparent)	The child
What are the tax benefits?	✓ Tax-free growth ✓ No UK tax on income	Tax liability usually falls within child's tax allowances. If income from parental gifts exceeds £100, this is treated as parent's income for tax purposes	✓ Tax-free growth ✓ No UK tax on income ✓ 20% tax relief on contributions ✓ When benefits are taken, 25% is usually tax-free and the rest taxable as income.
How can I manage my child's account?	✓ Online ✓ Tablet or smartphone app ✓ Telephone ✓ Post	✓ Online ✓ Tablet or smartphone app ✓ Telephone ✓ Post	✓ Online ✓ Tablet or smartphone app ✓ Telephone ✓ Post

Tax rules can change and the value of any benefits depends on individual circumstances.

MINIMISING TAX

The simplest way to minimise tax is to use a Junior ISA or Junior SIPP (see pages 11-13). Investments held in these accounts are free of capital gains tax and there is no UK tax to pay on any income. As the investments are held in the name of the child, no tax liability falls on the parents either. Please remember that tax rules can change and the benefit of tax shelters depends on the child's circumstances.

BARE TRUSTS

Investments outside a Junior ISA or SIPP are liable for tax. The investments belong to the child but are held in the name of the adult trustee. This means it's necessary to consider the tax position of both the child and the donor.

- **The child's tax position**

Children have the same personal income tax allowance (£11,850 in 2018/19) and capital gains tax allowance (11,700 in 2018/19) as adults. This means while deposit savings accounts and other investments, such as unit trusts and shares in a Junior Investment Account, are taxable, the sums involved usually fall within their allowances and no tax is due.

- **The donor's tax position**

Children can only benefit from tax-free income of up to £100 per year on gifts given to them by a parent. If they receive more, the parent must pay tax on all interest or dividends at their highest rate.

There are no such problems if a grandparent, other relative or family friend have contributed the capital. Only interest or income over the child's personal allowance would be taxable and then in the hands of the child.

INHERITANCE TAX AND GIFTING

Parents and grandparents are often keen to contribute to children's savings as a way of rolling wealth down the generations and potentially reducing inheritance tax (IHT).

Each person is allowed to give away up to £3,000 a year IHT-free. This is known as the annual gift exemption. On top of this, they can give up to £250 each to any number of recipients each year, though not to anyone who has also received a gift that makes use of another exemption.

They can also make 'gifts out of income' free from IHT. These are regular payments made out of excess income. As long as these payments have no detrimental effect on the standard of living, they are immediately exempt from IHT. This exemption can be useful for those wanting to contribute to regular savings investments for children.

Sums which don't qualify for any exemptions are usually treated as potentially exempt transfers (PETs). Providing the donor survives seven years following the gift, these PETs will also be IHT free. If not these PETs will be added back into the donor's estate for the purposes of calculating IHT, although any growth in the value of the gift is immediately free of IHT. Making these gifts as early as possible reduces the potential amount of inheritance tax payable on these amounts, and increases the chance of it not being payable at all.

Our Investors' Guide to Saving Inheritance Tax has more details – you can download or request a copy via our website.

UNIVERSITY COSTS AND SCHOOL FEES

Education funding is one of the most common reasons to save for children. According to the Independent Schools Council, the average fee per term for day schools was £4,473 (2017), so it is easy to see why parents and grandparents try to save in advance.

University costs are commonly met by the student through tuition fee loans and maintenance loans. Tuition fees for UK students are currently up to £9,250 a year, and these are set to rise each year, increasing in line with inflation.

Students can apply for a loan to cover tuition fees (up to a maximum of £9,250 in 2018/19) and a means-tested maintenance loan to help with living costs (up to £11,354 for students in London; up to £8,700 outside London).

Overall, the cost of a three-year university education starting in September 2018 could be over £50,000.

Funding for education costs

School fees are often met from the parents' disposable income. The alternatives include contributions from grandparents or other relatives, releasing equity from a property, usually through an offset mortgage, or from savings and investments. ISAs are an obvious choice since they are tax-efficient, enabling you to cash in funds or take income from the investment without any tax concerns. This tax year (2018/19) each adult can invest up to £20,000 in their ISAs.

For those who have already used the ISA allowance, a Bare Trust may be an option. There is usually no tax to pay provided the gains made at the point of encashment are within the child's capital gains tax allowance (11,700 in 2018/19). At age 18, any remaining investments are automatically passed into the child's name and can be used for a variety of purposes including helping with the cost of university.

The same tax rules detailed on page 16 apply. For this reason, care is needed when money is invested by a parent to keep income below £100 a year. Grandparents can invest unlimited amounts into Bare Trusts, although they should keep the IHT gifting allowances in mind.

Finally, don't forget inflation. School fee inflation was higher than normal inflation rates in 2017 at 3.6%. You'll need to consider when the child's education starts and how the fees might rise between now and then, as well as how much they will increase while the child is at school.

Discretionary trusts

These work more effectively for investors saving for beneficiaries where the proceeds are not necessarily distributed at age 18. The advantage of a discretionary trust is the trustees have the 'discretion' or power to pay the proceeds at whatever time or age the trustees see fit.

The trustees also have the power to pay income or capital in whatever proportions they choose and can vary the amounts between beneficiaries. This provides the trustees with much greater control and flexibility than a Bare Trust.

Trusts ensure certainty; the money in a trust fund specifically earmarked for education will be used for school fees and university costs. This provides comfort for those who may not be around when the child is going through the education system. The trustees can even pay the school direct.

Securing a child's education

Every recession sees an increase in the numbers of children unable to continue their private education as parents fall on hard times. Schools generally offer insurance plans which will help cover fees in the event of redundancy, illness or death. Protecting a child's education in this way is important but should not be considered in isolation from other life, health and employment insurance needs.

A three-year university education starting in 2018 could cost over £50,000

WAYS OF INVESTING FOR CHILDREN

RICHARD TROUE
Head of Investment Analysis

The investment world can seem bewildering, for new and seasoned investors alike. However, getting started is easier than you might think, and there are a number of ways in which our expert research can help.

The Wealth 50

There are over 2,500 funds available to private investors – an overwhelming level of choice. To help investors sort the wheat from the chaff we produce the Wealth 50, which is a list of our favourite funds across the major sectors. This is one of our solutions for investors who like to choose their own funds.

We've also negotiated savings on the ongoing charge for every Wealth 50 fund. The full list of Wealth 50 funds can be accessed by visiting **www.hl.co.uk/wealth-50**

Which funds you choose will depend on your individual circumstances, investment time horizon, and savings goals. However, when investing for children, particularly those of a young age, it is often possible to take a long-term horizon and a little more risk with your investment choices. This can lead to areas such as UK Smaller Companies and overseas shares, including those listed in higher-risk Asian and emerging markets. Please remember all investments fall in value as well as rise and your child might get back less than is invested.

The HL Multi-Manager Funds

Investors looking to delegate a little more responsibility to us could consider our range of HL Multi-Manager funds. They provide an easier way to access our best investment ideas in a single, convenient investment. The process is overseen by a team of investment professionals who build and run the portfolio, monitoring its performance and ensuring it exposes investors to a wide mix of funds and levels of risk to meet the requirements of various types of investor. This provides an extra level of reassurance – the day-to-day management is taken care of by Hargreaves Lansdown's first-rate, highly-qualified investment professionals. We believe the great benefits – diversification and a wealth of experience – of multi-manager funds justify the additional cost of this approach. Investors will still need to check that the fund meets their objectives.

The HL Multi-Manager funds can appeal to any type of investor, but they make a great first investment for those who are just getting started. Many of our clients use them as a core holding, to offer broad exposure to a key area or theme. This is often complemented with other investments in funds or shares according to personal preference.

Our range of HL Multi-Manager funds includes a variety of options depending on whether you're looking for income, growth, or a combination of the two. HL Multi-Manager funds are managed by our sister company HL Fund Managers.

More information can be found by visiting **www.hl.co.uk/mm**

WHY INVEST WITH HARGREAVES LANSDOWN?

Hargreaves Lansdown has been helping clients choose and manage their own investments since 1981, and we now look after over £86 billion on behalf of 1 million clients.

The experience gained over four decades has enabled us to develop a service tailored to the needs of private investors. 98.1% of our clients rate our service good, very good or excellent*, we win numerous industry awards and our clients' continued loyalty has created an enormously successful, and financially secure, blue-chip company.

Financial security is important. It gives you confidence that we shall be around to help you for the long term and allows us to invest in knowledgeable staff and the latest technology. In this way we endeavour to offer an investment service that will always be second-to-none.

Introducing the HL Service. We offer low-cost, easy-to-manage account, providing access to a wide range of investments and products, including a Junior ISA, Junior SIPP and Junior Investment Account.

If you ever have a query, you can simply call our Bristol-based Helpdesk. There are no automated telephone lines – you get straight through to a real person who can almost always answer your queries straight away.

We also aim to offer all the tools and information needed to make more informed, and hopefully more profitable investment decisions.

*Hargreaves Lansdown Client Satisfaction Survey, February 2017, completed by 1,694 clients.

For queries about Investing for Children please call our Helpdesk on **0117 900 9000**

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