

Unit-Linked

A flexible and transparent solution

In simple terms, a unit-linked is a life insurance contract that is linked to one or more investment funds (not technically, but in the sense of an autonomous group of assets). Unlike a conventional pure risk insurance policy, it may provide investors with both insurance and investment under a single integrated contract. As a life insurance contract, it covers the risk of death or survival of a given insured person; as a contract that is linked to an investment fund, it offers the advantages of an investment vehicle.

The nature of the contract, however, is that of an insurance policy. Albeit linked to investment funds, the contract (insurance policy) is underwritten by an insurance company authorized for this type of product. The investor is the policyholder, who can either be the insured person himself/herself or appoint a different insured person whose life is covered by the policy. It is also the policyholder who appoints the beneficiaries of the

insurance, whether in case of survival whether in case of death, depending on the policyholder's purposes.

In addition to the insurance company, this type of product typically involves several other parties subject to professional and compliance rules, like the asset manager, the custodian bank and the insurance intermediary – feature that provides confidence and legal certainty to the unit-linked policy vis-à-vis other investment products.

How does it work? Whilst part of the premium paid by the policyholder may be used to provide life insurance coverage, the whole or the remaining part is invested in one or several investment funds, at the policyholder's choice, taking into consideration his/her investment objectives, risk tolerance and investment horizon. Premium can be single, regular or flexible depending on the product in question.

The type of fund that is linked to the insurance policy will depend on the products offered by each insurance undertaking. Some specialized insurance companies offer tailor made products built according to the investor's needs.

It's up to the policyholder to choose the investment fund (or funds) linked to the insurance policy, based on his/her risk tolerance and preferences. The fund's portfolio may include different types of assets, such as shares, fixed-interest securities, money market instruments, property, derivative instruments, etc. The policyholder typically has a choice of funds having different characteristics to which premiums can be allocated. The information on the funds' portfolio and investment rules is mandatorily provided to the policyholder previously to the policy subscription.

The premium invested by the policyholder, after deducted any applicable fees or charges, is converted into a given number of fund units, each of which has a net asset value that is stated on a regular basis, depending on the chosen investment funds. In simple terms, the cash value of the policy corresponds, at each moment, to the total value of the investment fund times the proportion of the number of units held by the policyholder to the total number of units in the investment fund. This means that the value of a

unit-linked policy directly depends on the value of the investment funds to which it is linked, which in turn depends on the value of the assets kept in the fund's portfolio.

The portfolio allocated to the investment fund underlying the unit-linked policy does not give the policyholder any right of ownership over the portfolio. The fund remains the sole property of the insurance company; nonetheless, the allocation grants to the policyholder a contractual claim against the insurance company in accordance with the provisions stipulated in the agreed insurance policy.

Policyholders are usually allowed to make changes or to switch funds throughout the duration of the unit-linked policy, which confers flexibility to the investment, depending on the policyholder's investment needs or objectives at each moment. Policyholders are also allowed to "transport" their policies to another EU member State when they change of address, which ensures maintenance of the investment notwithstanding any changes in the client's personal or professional life.

From a client perspective, unit-linked policies can be designed to do almost anything a conventional risk policy can, with the advantage that they can also offer more flexibility. The major disadvantage of conventional risk policies lies in the fact that the cash value of the policy at a particular time is not always clear to the client. The transparent nature of a unit-linked policy has a major appeal to policyholders who wish to monitor the progress of the value of their investment. Further advantage of unit-linked policies is that the policyholder has control over the degree of investment risk, by directing premiums to the investment funds most appropriate in relation to his/her risk tolerance.

Unit-linked products can be structured in many different ways and have a wide range of application, like family protection, inheritance or tax planning, saving for retirement, mortgage or loan repayment, employee pension, executive benefits, etc. In addition, these products typically benefit from a tax deferral regime, depending on the tax regime applicable in each country.

Insurance intermediaries have a key role in advising the client – among a range of products available at the market – on which unit-linked policy is more suitable to the client's objectives, as they have the ability (and responsibility) to explain the main features of the product, including commission terms and conditions, and to explain how the product meets the client's needs.

Under the recent EU Insurance Distribution Directive (IDD), insurance intermediaries became subject to reinforced obligations in terms of disclosure of information and professional requirements, which necessarily increased the level of client protection and ensured a higher quality of service to investors that search unit-linked policies, when in comparison with other types of products. •



João Espanha

With 30 years of career behind him – and appointed as Tax Specialist by the Portuguese Bar Association –, his work consists on providing legal and tax advice to individuals and businesses, with emphasis on tax advice on life insurance. João often represents clients in disputes with the tax authorities and in judicial proceedings and he is also a tax arbitrator at the CAAD, where he is frequently appointed by the taxpayer in large-scale complex disputes. His large experience affords him an overall view of the problems, thus contributing to offering effective solutions to clients. João is founding Partner of Espanha e Associados Law Firm.



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Has worked at Espanha e Associados since 2005, providing ongoing assistance to national and foreign clients from insurance and banking sectors. She is very focused on practical solutions and has excellent understanding of client's needs. Her work involves providing legal advice on day-to-day activities (new products, commercial partnerships, drafting documentation related to products, etc.) and on more complex transactions, such as setting up foreign undertakings in Portugal (through branch offices or through freedom to provide services) or assisting on the internationalisation of Portuguese companies. She has a wide experience in what concerns life insurance, in particular unit-linked insurances. Leonor is Senior Associate of Espanha e Associados Law Firm.