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Investment and Savings Policies from the Perspective of Estate Planning

Bachelor's Thesis
Autumn 2015
Business School
International Business

SEINÄJOKI UNIVERSITY OF APPLIED SCIENCES

Thesis abstract

Faculty: Business School

Degree Programme: Bachelor of Business Administration

Specialisation: International Business

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Title of thesis: Investment and Savings Policies from the Perspective of Estate Planning

Supervisor: Imppola, Jorma

Year: 2015 Number of pages: 45 Number of appendices: -

This thesis is a study into the use of savings and investment policies. The purpose was to find out what kind of instruments these products are and how they can be used in estate planning. The idea for this thesis came from the insurance company Fennia.

To study these products and their characteristics, literature and Internet sources were used, as well as Fennia's knowledge. The thesis is divided into six chapters that, in addition to the introduction and research environment, are about the products themselves, inheritance, pro ET contra, and, finally, the conclusion.

The results of the study and the answer to the two main questions – whether these products provide benefits in the case of estate planning, and when these products might not be suitable for such a purpose – is that savings and investment policies can be good products for the aforementioned cases. However, such details as family size and available capital to invest, as well as market conditions should be observed.

Keywords: savings policy, investment policy, insurance, finance

SEINÄJOEN AMMATTIKORKEAKOULU

Opinnäytetyön tiivistelmä

Koulutusyksikkö: Liiketalous

Tutkinto-ohjelma: Bachelor of Business Administration

Suuntautumisvaihtoehto: International Business

Tekijä: Pelkola Matti-Esko

Työn nimi: Säästö- ja sijoitusvakuutukset perinnönsuunnittelun näkökulmasta

Ohjaaja: Imppola Jorma

Vuosi: 2015 Sivumäärä: 45 Liitteiden lukumäärä: -

Tämä opinnäytetyö on sijoitus- ja säästövakuutuksia koskeva tutkimus. Tutkimuksen tarkoituksena oli perehtyä näihin tuotteisiin ja punnita niiden käytettävyyttä perinnönsuunnittelussa. Idea aiheeseen syntyi vakuutusyhtiö Fennian kautta.

Näiden tuotteiden tutkimiseen on käytetty erilaisia lähteitä kirjallisuudesta kuin myös internet-lähteitä. Myös vakuutusyhtiö Fennian tietoutta on käytetty hyväksi tutkimuksessa. Opinnäytetyö jakautuu kuuteen kappaleeseen, jotka esittelyn ja tutkimusympäristön lisäksi käsittelevät tuotteita itsessään, perintöä, näiden tuotteiden käytön argumentteja sekä lopputulosta.

Tutkimuksen tulokset ja vastaukset pääkysymyksiin – hyödyttävätkö nämä tuotteet perinnönsuunnittelua ja milloin tuotteiden käyttö saattaa olla epäedullista – ovat, että säästö- ja sijoitusvakuutukset ovat hyviä tuotteita perinnönsuunnitteluun, mutta sellaiset asiat kuten perheen koko, markkinatilanne ja käytettävissä oleva pääoma asettavat rajoituksia tuotteiden tehokkuudelle.

Avainsanat: säästövakuutus, sijoitusvakuutus, vakuutus, rahoitus

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Terms and Abbreviations

ETF	Exchange-Traded Funds
FFFS	Federation of Finnish Financial Services
CEO	Chief Executive Officer
SEC	U.S Securities and Exchange Commission

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1 INTRODUCTION

The purpose of this thesis is to study savings and investment policies – financial products that insurance companies in Finland offer to customers that are interested in long term saving. These products are studied most of all from the perspective of inheritance, as the Finnish legislation provides advantages in inheritance taxation for the beneficiaries of these savings and investment policies. The aim of this thesis is to highlight these advantages and possible shortcomings of these products against the traditional way of inheriting so that the reader can contemplate whether the products suit his or her objectives when passing on wealth is concerned.

The topic for this thesis was suggested by an employee of the insurance company Fennia. One of the reasons why the topic was suggested is because due to the accumulation of wealth and capital, many members of the older generation now have substantial savings that they plan to pass on. As savings and investment policies offer a convenient way to do so, this thesis studies them and provides information on this subject as, even though these policies have been studied before, their advantages in inheritance have not been studied so much.

Today, more and more people choose to plan how their inheritance is distributed and how it is effectively given out from a taxation point of view. Those leaving behind inheritance are especially interested in how it is done effectively and prudently when taxation is considered. Especially larger fortunes are seen as something that people want to plan and a lot of people attend events where taxation of inheritance is discussed. A well-made plan can reduce the amount of tax that is paid by the inheritors and consequently benefit the inheritors.

1.1 Research Methodology

Research methods and methodology lay the basis for this thesis. Research questions, methods and materials in addition to other related information is gathered into this sub chapter to provide the reader an idea of the framework in which the study has been done.

1.1.1 Research question and sub question

The primary question of this study is whether savings and investment policies provide benefits for the beneficiaries of these products when they inherit the assets inside these policies and how great an advantage do these policies provide over the traditional way of inheriting.

The secondary question is to study under what kind of conditions the use of savings and investment policies becomes either impractical or disadvantageous. Several aspects need to be considered when planning to use these products and the customer should be aware of the different risks and conditions that can change the value of his or her investments or make the whole product unsuitable for his or her needs. These risks and conditions are what the second research question tries to ponder.

1.1.2 Research methods used in study

This thesis is written by using the qualitative research approach. The decision to use this method comes from the need to explain the limitations of savings and investment policies from a practical viewpoint. Also, the results that this study gives are not absolute and do not give close-ended solutions, but practical answers that the reader can use when considering these products. As each monetary decision made by the individuals is unique, definite answers can only be reached by assessing and calculating the individual situation and therefore broader answers are needed to provide answers for the larger group.

It should be understood that this study is not exclusively qualitative in nature; it does also share some quantitative characteristics. Northeastern University defines qualitative research as seen in the box below:

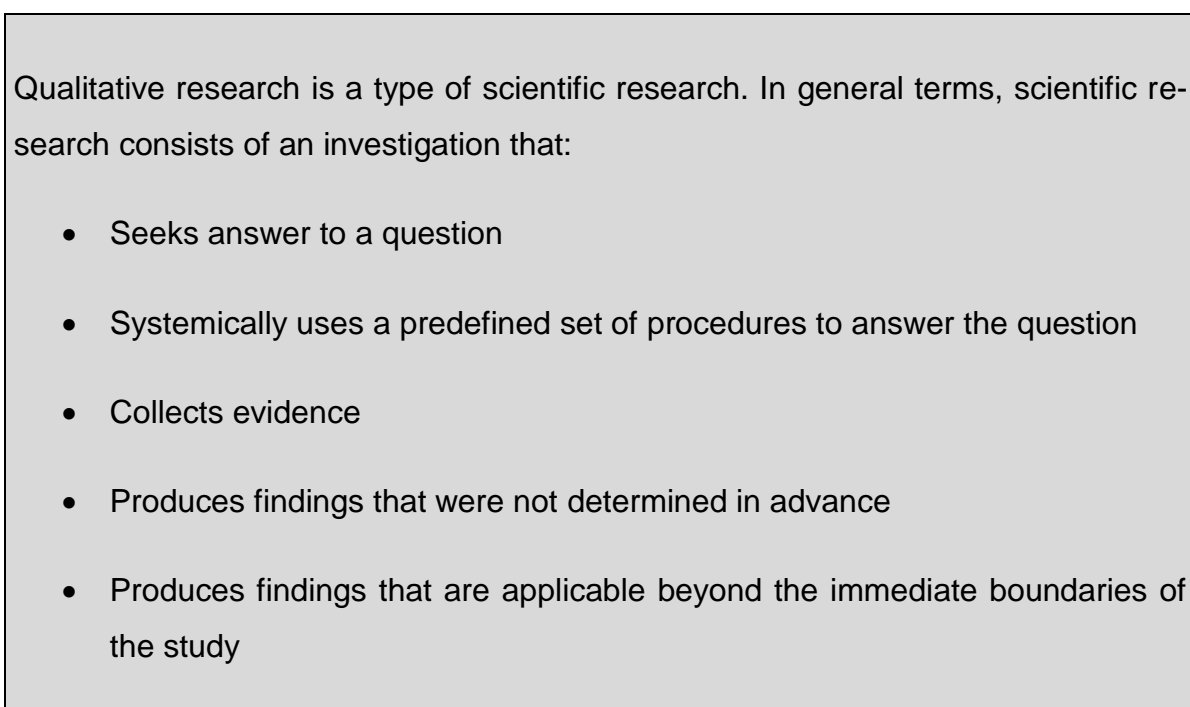


Figure 1. Qualitative research (Northeastern University website [Ref. 9.4.15]).

1.1.3 Materials and information sources

To study and to explain both inheritance taxation in Finland and the savings and investment policies, different kinds of materials have been used.

Information on the Finnish inheritance taxation has been collected from different literature sources and internet sites, like websites of governmental entities. Also ideas and knowledge of people working in the relevant fields has been used.

To explain the theory behind savings and investment policies different source material has been utilized. Mainly information will be collected from different literature sources like books and the internet, but material from Fennia will also be used to aid in the study of these products. The material being Fennia's brochures and marketing material that is available to the customers either in printed form or in digital form.

The theory behind these financial instruments will be researched and studied by collecting information from literature, the Internet and interviews. This information will be presented in the theoretical part of the thesis and it will inform the reader of the basics. In the empirical part hypothetical examples will be given to the reader and these examples will be compared to other ways of passing on inheritance. At the end of this thesis the reader will be presented with a conclusion.

1.1.4 Limitations of study

Some limitations concerning the scope of this study have been made to prevent the study from growing too large or becoming scattered. This study mainly focuses on general ideas behind savings and investment policies and tries to produce simple and understandable, general answers for private customers. More complicated situations and scenarios are left out and only simple examples are used. This study will also comprise of investing and insurance related topics, but will only open those to a certain extent to keep the output concise. Stock market, investment products and economics will not be studied extensively.

1.1.5 Structure of study

The structure of the study consists of five parts: the introduction, savings and investment policies, inheritance, the advantages and disadvantages of savings and investment policies and conclusion, respectively. The content of the study is arranged like this to offer the reader a logical way to absorb the information.

In the first chapter the purpose and aim of the study is given and the topic is briefly opened, research questions and the scope of the study is discussed and the research environment is explained. Also the reader is given an introduction to the world of insurances and their history is discussed. The first chapter is also dedicated to giving an overview of the insurance industry and the insurance company Fennia – one of the entities offering these insurance products and the company that provided the idea, time and effort for this study. In the second and third part the theory behind inheritance and savings and investment policies will be discussed and also practical examples are given to the reader. After the theoretical part of the study the contemplating pro ET contra chapter on investment and savings policies provides the reader the possible advantages and disadvantages of these products and in the final concluding chapter, the reader will be provided with the conclusion.

1.1.6 Previous research and study

Some research has been done on this topic already – savings and investment policies are not an unknown subject in student theses nor is there a void of information when it comes to these products. However they are far less studied than for instance stocks or other saving products. Most of the information available is provided by banks or insurance companies as they sell the products, or public entities such as the Financial Supervisory Authority.

Finding easy to understand information on these products can be somewhat challenging and due to the complex nature of these instruments, the best venue for information on savings and investment policies is most likely a local bank or an insurance company. Hopefully the amount of information and its availability will increase as these products become better known.

1.2 Research environment

The environment in which this study is undertaken mainly comprises of the insurance sector in Finland. To understand how the insurance companies came to be and how the market is today, this sub chapter will open the history of insurances and also briefly tell about the insurance company Fennia.

1.2.1 Insurance companies

An insurance company is a business offering its customers products that offer coverage if the customer experiences loss, damage or injury or hardship. To receive the possible coverage the customer will pay in advance to the insurance company. The amount of premium that the customer has to pay for the coverage is determined by the insurance company by calculating the risk of occurrence and then determining the cost of replacement (BusinessDictionary [Ref.19.3.2015]).

The roots of insurances go back to the times of King Hammurabi who enacted rudimentary policies to protect persons who were at disadvantage due to some unforeseen incident and were liable at the same time. During the middle ages guilds also had a system that provided their members coverage should a member of the guild lose his means of livelihood or in case of the member's death the guild would look after the family of the deceased. During the 17th century when colonization of the Americas began investors would fund these projects together to spread the risk and after the great fire of London in 1666 these investors who had previously dealt in maritime insurances, began to offer fire insurances (Investopedia [Ref. 19.3.2015]). Since those days the insurance companies have come a long way, developing their products and calculation methods for probabilities and today they offer a wide array of possibilities for risk management.

1.2.2 Fennia briefly

Fennia is an insurance company that offers both businesses and private customers products for risk and wealth management. Fennia is a mutually owned insurance company.

According to Fennia's website (Fennia [Ref. 19.3.2015]), Fennia group consists of three different entities;

- Fennia, an insurance company
- Fennia Life for life insurances and savings and investment policies
- Fennia Asset Management Ltd

Fennia's roots go back to the year 1882 when the Fire Insurance Limited Company Fennia was established. In 1928 the Entrepreneur's Mutual Insurance Association was established and in 1983 these companies were merged to become the Mutual Entrepreneur's Insurance Company. In 2001 the company became Fennia (Fennia [Ref.19.3.2015]).

In 2014 the company had over one thousand employees total working in these three companies that make up the group. On the same year Fennia reported good financial performance with a € 728 million in revenues and the groups CEO, Antti Kuljukka, speaking highly of the year (Fennia [Ref. 9.4.2015]).



Figure 2. Fennia's logo in black and white

1.2.3 History of insurance companies in Finland

The first insurance companies came to the Finnish market at the time of the 19th century, one of the first companies being the Finnish Maritime Insurance Society, a company that insured sailing ships and operated till 1983. However Finland has a history of “primitive insurance laws” that go back to the early middle ages. During those times people living in the country side had the right to receive firefighting assistance, but were also mandated by law to provide it (Rantala & Pentikäinen 2009, 24). Today the four biggest insurance groups control around 80 to 90 per cent of the market – a character shared with other Nordic markets. In Finland many companies operate either as limited liability companies or as mutually owned companies or as groups that have a combination of both (Insurance companies in Finland 2009, 5).

In 2013 the domestic premiums gathered by the Finnish insurance companies were over 22 billion Euros, a nine percent increase to a little over 20 billion in 2012. The return of investments was good: 7,1 percent and the financial solidity remained at good level (Insurance companies in Finland 2014, 4).

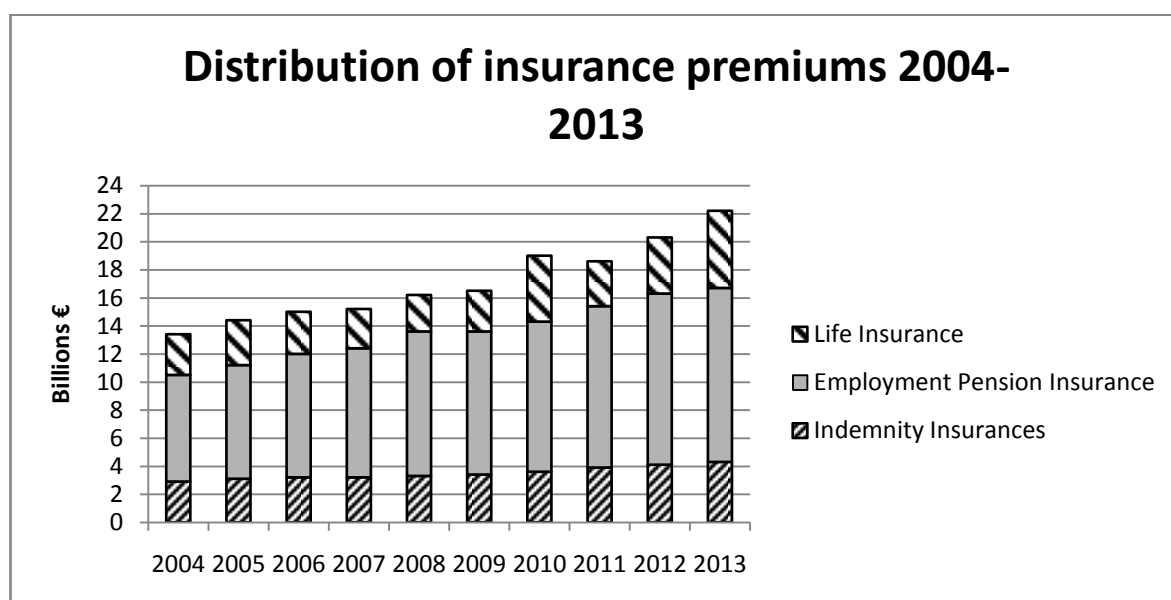


Figure 3. Distribution of insurance premiums (Insurance companies in Finland 2013, 4)

1.2.4 Characteristics of Finnish insurance markets

Finns have, compared to other Nordic countries, prepared relatively weakly against possible damages. Homes, summer cabins and boats are insured against accidents but substantial gaps still exist for example in home and car insurances. Also, risks related to personal accidents have not been properly identified nor have customers insured themselves against this kind of adversities. This is projected in the amount of life insurances and in the amount of voluntary healthcare insurances that Finnish people have (Insurance companies in Finland 2013, 3).

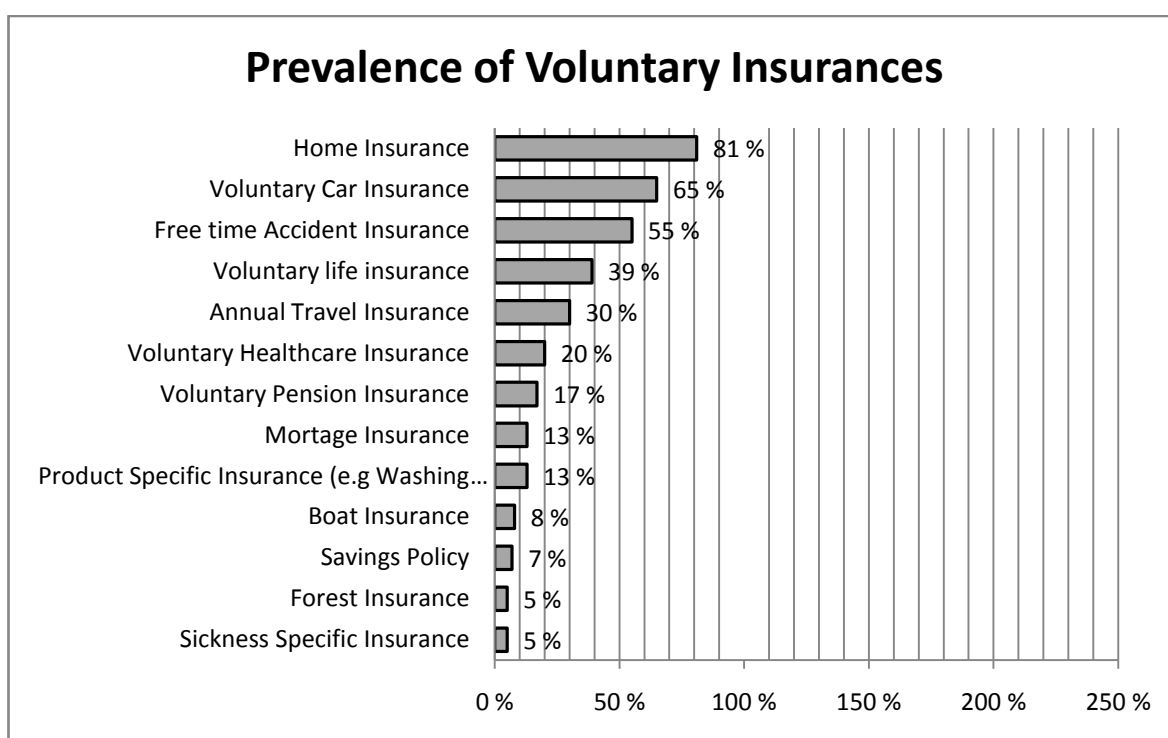


Figure 4. Prevalence of voluntary insurances in Finland year 2009 (Insurance companies in Finland 2009, 3)

What explains the low level of voluntary insurances in Finland is partly the fact that in Finland the state provides the members of the society a quite reasonable compensation already.

To market their products to companies and to private customers, the industry uses different kinds of sales channels. Majority of business related insurances are handled via sales persons specializing to business customers whereas private customers are served by either over the counter sales persons in Insurance compa-

nies' own offices or by independent agents. Private customers also purchase insurances from for example car selling businesses that act as agents to the insurance company, or from the Internet – a trend that is growing (Insurance companies in Finland 2009, 5).

According to the Federation of Finnish Financial Services (Insurances in Finland 2009, 4) there are 65 insurance companies operating in Finland, out of these 65 companies 41 are indigenous. These insurance companies are categorized to indemnity insurance companies, life insurance companies, and employment pension insurance companies and to reinsurance companies due to the requirement of the law that dictates different kind of insurance activities to be separated into independent entities. It is however normal for many of these different companies to cooperate in groups (Insurance companies in Finland 2009, 4). To name some Finnish insurance companies: Fennia, IF and Turva.

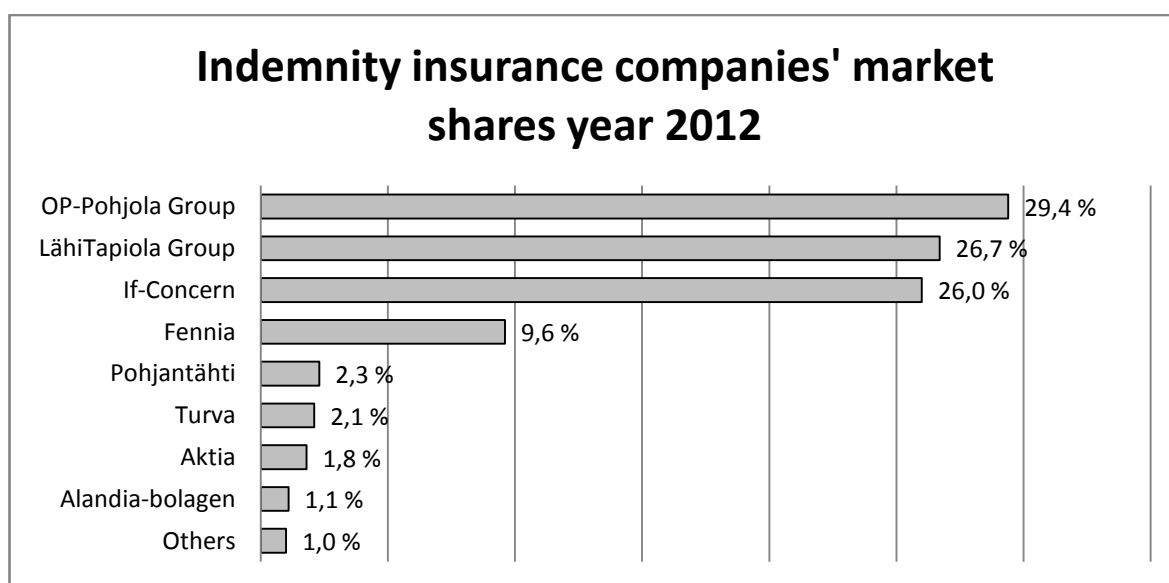


Figure 5. Indemnity insurance companies' market shares year 2012 (Insurance companies in Finland 2012, 9)

1.2.5 Convergence of banking and insurance industry

In the past decade the Finnish insurance and banking market has been converging. This has resulted into the formation of financial conglomerates, entities that have formed in the mergers of banks and insurance companies. One of these examples is LähiTapiola. In 2012 Lähivakuutus and Tapiola groups merged to create a financial conglomerate. (Lähitapiola website [Ref. 30.6.2015]) Fennia and Danske Bank also began a co-operative in 2014. (Danske Bank Website [Ref 30.6.2015])

The reason for these mergers has been the expansion of banks into the territories of insurance companies. Banks have begun to fervently offer life insurances and other saving products to the customers of insurance companies'. This expansion and the knowledge that banks have of their customers finances has driven insurance companies to seek potential acquisitions and partners from the banking sector (Taloussanomat [Ref. 30.6.2015]).

2 SAVINGS AND INVESTMENT POLICIES

Savings and investment policies are agreements made with insurance companies. Through these policies the customer can accumulate savings for future use. Savings policy is a term used for a financial product that refers to a product that is invested into gradually and in small installments – for example every month. Investment policy generally refers to a financial product that is invested into once or more times; the investment will be a larger lump sum instead of small monthly payment. (Finanssivalvonta [Ref. 4.11.2014]) It should be noted that even if the product may contain the word “insurance” the assets and savings within the product are not insured against loss of value.

In savings and investment policies the policyholder has a right to choose a beneficiary for the insurance if the policy has a life insurance attached to it. Should the policyholder die, the beneficiaries will collect the savings. It should be noted that not even a testament will override the beneficiary’s claim and because of that the policy holder should inform the insurance company if he or she wants to change the beneficiary. It is important to understand, that savings and investment policies are “reverse life insurances”, as these policies insure the customer in case he or she is still alive at the time of the policies maturity. If the policy does not have a life insurance attached to the policy and the customer dies, the insurance company will collect the savings for the company. To balance this risk these policies often have a life insurance attached to them and even if the assets are technically lost to the insurance company, the beneficiaries will still receive compensation from the insurance company that often corresponds the policy value. How the compensation is calculated is stipulated in the agreement. The compensation can be, for instance 95% of net payments that have been paid into the policy or of the value of the savings (Guide to choosing a savings policy 2008, 7).

Savings and insurance policies are different from other forms of saving in their taxation. These policies are taxed at the maturity of the policy, unlike normal saving products that are taxed annually, with the exception of funds that do not pay out premiums annually. Also these policies are designed for long term (more than five-year) saving and as such, the insurance companies or entities offering these

policies can set a minimum commitment time for the products. For example an insurance company can demand the customer to keep the assets within the policy for a certain amount of time or may charge extra payments if the assets are withdrawn and realized before the maturity of the policy.

Savings and investment policies, even though they can be marketed by banks that also offer asset management, are not agreements on asset management where the insurance company takes up the task of investing and managing the customer's assets as profitably as possible. (Guide to choosing a savings policy 2008, 5)

2.1 Savings and investment policies and asset management insurances

Both savings and investment policies yield tax advantages and so do asset management insurances, these being contracts between the customer and the insurance company for professional management of customer's assets. It should be noted, however, that even though personal asset management can share the functions of savings and investment policies, there can possibly be significant differences.

Savings and investment policies alone give the customer the tax benefits and means for long-term saving, but they are not as flexible instruments as asset management insurances. For instance Fennia's savings policies that are unit-linked give the investor the possibility of investing into different kinds of pre-selected funds. These funds can be, for instance, Fennica Funds or Fennia's partners' funds. Also, basic savings and investment policies are not managed by anyone else than the customer. (Fennia esite 1.7.2015)

As opposed to basic savings and investment policies, asset management insurances offer the customer much wider spectrum in asset allocation and also provide professional asset management. If the customer has more than €300,000 of assets, a contract can be signed and the customer can then build a portfolio that is more robust than he or she could with just a basic savings or investment policy. (Fennia brochure, 2015)

2.2 Entities offering these policies

Savings and investment policies are being offered by many different banks and asset management businesses. For instance Fennia offers these solutions for saving. Among others are companies like S-Pankki (S-Bank), OP-Ryhmä (OP-Group) and smaller asset management businesses like Alexandria. Outside of Finland some entities are for example SBI Life Insurance and Prudential UK.



Figure 6. Fennia's brochure on savings and investment policies (Fennia, 2013)

2.3 Return on savings and investment policies

The return on savings and investment policies is determined by whether the insurance is a unit-linked policy or a guaranteed-return policy or a combination of the two alternatives.

In *unit-linked policies* the customer himself or herself chooses the investment products that are placed into the insurance. These products often are shares of an investment fund. The customer has the possibility of changing his or her investments within the insurance during its run. The possible profits or losses of the insurance are determined by the value change of the funds or instruments within the insurance. In unit-linked policies the customer bears the risks by himself or by herself: if the value of the investments goes down, the customer loses money, if they gain value, the customer gains money (Finanssivalvonta [Ref 4.11.2014]).

In *guaranteed-return policies* the insurance company invests the assets collected from the payments. Return is normally made up of the guaranteed interest rate and a bonus as specified in the insurance contract. The guaranteed interest rate can be a fixed interest rate, for example 1.5%, or an interest rate attached to a specific interest rate element, for example a 3-month Euribor. The distribution of bonuses is annually decided by the insurance company (Finanssivalvonta [Ref. 4.11.2014]).

2.4 Entering into a contract

When seeking to enter into a contract with the insurance company and procuring a savings or investment policy the customer can contact the insurance company via phone, email, the Internet or visit the insurance company or insurance agent or a broker. The agreement is however always between the customer and the insurance company and therefore the contract will never be signed between, for instance a bank that is selling these products, and the customer (Finanssivalvonta [Ref. 11.11.14]).

Whomever or whatever the channel might be that is used to make a contract, the insurance company must always provide the customer with adequate information for assessing his or her insurance needs and for choosing the right product. The disclosure requirement also states that the customer must be informed of the investment products in unit-linked products and how they can affect the value of the investment. Customer must also be clearly made aware of the risks concerning his or her capital. Merely providing the customer with the policy terms is not enough

and therefore insurance companies also provide the customer with a product brochure that explains the product in layman's terms. The information that has been handed out to the customer needs to be carefully examined by the policy taker and should he or she not understand something in the terms, ask the insurance company (Finanssivalvonta [Ref. 11.11.14]).

After signing the contract the customer will receive the contract that states the main content of the policy and latest at this point obtain the terms of the policy. Also the insurance company is annually required to inform the customer of the savings accrued, beneficiaries, maturity of the policy, and other important issues that might be of importance to the customer. (Finanssivalvonta [Ref. 11.11.14])

When the person has an intention of entering into a contract that would procure a policy for him or her, discussions will be held between the customer and the fund manager. Certain aspects, like the duration of the policy and its content need to be discussed.

In a situation where the customer has just cash and assets that are liquid it is more easier to move to the phase where the composition of the policy will be discussed, as in, what assets will the policy hold, ETFs, stock or mutual funds or something else, depending whether the product is just a savings policy, or if it is an asset management insurance. If the customer has assets, for example real estate or shares of a company, a more elaborate plan for converting these assets need to be made. These assets need to be converted into cash first and only after that can they be invested into a policy. This is due to the reason that as the assets will be merged with the assets of the company offering these products, the customer cannot directly give any other assets than cash to the company. However plans of this type are usually only addressed when speaking of asset management insurances.

A plan will be crafted for the purpose of liquidating the assets. This plan addresses the sales price of the assets and when to sell them. It should be noted that in some cases the liquidation of some assets might not be beneficial due to taxation.

2.5 Defining, understanding and controlling risk

Investopedia (Ref. 12.4.2015) explains risk as a possible deviation from the expected outcome. The fundamental idea in finance is that there is a relationship between risk and return, as the amount of risk grows, the investor needs to be compensated accordingly: The higher the risk, the greater the reward.

Risk is an important thing for the investor to understand as well as to control. When making investment decisions the person has to understand that as the possible returns increase, the risk of losing the investment also grows. For the common private investor planning to invest his or her money this means that he or she has to be aware of the risk. When the investor is aware of the risks, assets can be invested according to his or her risk carrying capability.

Risk management according to BusinessDictionary (Ref. 12.4.2015) is the act of identifying risk or the analyzing, avoidance, minimization or even elimination of unacceptable risk. To avoid risk, different strategies can be utilized. Among these are asset allocation; the act of investing into different financial instruments, diversification; the strategy of not investing all your assets into one company and analyzing personal risk carrying capability. (SEC [Ref. 12.4.2015])

2.6 Risks of investment and savings policies

As with all investments, savings and investment policies also carry risks. Depending on the composition of the portfolio, as in what kind of mutual funds, securities or bonds are chosen to be included into the policy, the risks might differ. These risks affect either the value of the assets or their liquidity. Following risks might be present in the investment with a different emphasis depending on the composition of the portfolio:

Interest rate risk can be present in a portfolio that has either a portion or a major share of its assets in interest bearing bonds. Such a risk is defined as a possible decline in the value of a fixed-rate debt instrument (Investopedia [Ref. 5.11.2014]).

Business risk refers to the possibility that a company that has issued stock goes bankrupt or ends up being unable to pay the interest or the principal in some situation. (Investopedia [Ref. 5.11.2014]) A typical example of this could be a customer holding shares of a company A in his or her policy and this company ending up going bankrupt consequently making the investment worthless.

Inflationary risk is defined as a chance that the value or yield of the assets become smaller as the cost of living brings down the value of the country's currency. (Investopedia [Ref. 5.11.2014])

Market risk refers to a risk that cannot be controlled through diversification of assets. (Investopedia [Ref. 5.11.2014]) This means that the stock market in its totality will decline because of a war, natural disaster or due to investor panic. Market risk was realized in 2008 as investors and banks were faced with a rapid loss of value of their assets due to the subprime crisis.

Social and political risks come from the ability of the state to administer and change laws related to investments. (Investopedia [Ref. 5.11.2014]) In a case of savings and investment policies this risk could materialize as a loss of the products advantages due to a change in law.

Exchange rate risk might change the profitability of an investment via changes in the value of currency against another currency. (Investopedia [Ref. 5.11.2014]) If large amounts of profit are generated in dollars but need to be converted into Euros, a weak dollar and a strong Euro will bring smaller profits to a person living in the Euro zone and vice versa.

It should be noted that what distinguishes insurance-based saving from other forms of saving is a risk element indigenous to insurances. When addressing savings and investment policies, this means that if the insured is not alive at the moment of the maturity of the policy, the savings will be left to the possession of the insurance company, which will then distribute the assets among the other policy takers. Therefore it is common to attach a life insurance to the policy, so that the savings will be paid fully in case of the policy holder's death (Finanssivalvonta [Ref. 4.11.2015]).

3 INHERITANCE

Inheritance is defined as the transference of property from the owner to his or her heirs upon the owner's death. (Definition of inheritance, [Ref. 4.11.2015]) The most common situation is the one where children will inherit their parents' property or assets. The concept of inheritance itself is old and some of the best examples are the inheriting of lands and titles that happened during the middle ages.

3.1 Inheritance tax and law in Finland

The first Law to address taxation of gifts and inheritance came to power in 1919 in Finland and it has since been revised multiple times. According to Puronen 2008, there are two purposes for such a tax. The first reason has been to collect taxes for the state and the second, to prevent huge asset accumulation via heritage by taxation of large fortunes – this leading to greater economic equality. Though Puronen does mention that this tax has not been that successful in bringing about economic equality (Puronen 2008, 4-10).

It should be noted, that inheritance tax is not a universally used tax as for instance Sweden, Finland's close neighbor abolished its inheritance tax for both private persons and for companies from January 1st 2005. (KPMG [Ref. 14.10.2015]) Also Norway is abolishing tax on inheritance. (Vero [Ref. 14.10.2015])

After the person who is going to be inherited dies, the process of inheriting starts. Assets gained via inheritance or testaments are subject to tax if the deceased, inheritor or benefactor via testament lived in Finland at the moment of his or her death.

The tax administration will receive information about the person's death via population information system. The system is a "computerized national register that contains basic information about Finnish citizens and foreign citizens residing permanently in Finland." (Population information system [Ref. 6.10.2014]) The persons who have a claim on the inheritance need to hold an inventory conference

within three months of the deceased's death and provide the tax administration with a Deed of Estate Inventory within one month of the inventory conference.

In the Inventory Conference the assets of the deceased will be accounted and a list, the Deed of Estate inventory will be submitted to the local tax authorities.

3.2 Valuing inheritance

The value of inheritance is calculated at the moment of the person's death and the value is the fair value of the assets. Fair value is derived from the likely selling price of the assets at the moment of the person's death. (Vero [Ref. 3.10.2014])

3.3 Order of inheritance

In Finnish inheritance law the right to inherit is based on the closeness of the relative to the one who is passing on his or her property or assets. This means that the closest relative always has the strongest claim on the inheritance. The circle of inheritance is however limited; for example cousins do not inherit. The position in which the inheritor is, is based on his or her relation to the deceased person, whether he was a blood relative, through marriage or an adopted child.

According to the law direct heirs comprise the first tier of inheritors. Direct heirs are children born inside wedlock and children that have been recognized as legal descendants. If there are no direct descendants the spouse will inherit.

The second tier of inheritors is the parents in a situation where the deceased has no descendants of his/her own and has no spouse. In this situation the parents of the deceased will inherit the assets so that the mother and father both receive half of the inheritance. If either of the parents is dead, for instance the mother, the sisters and brothers of the deceased have a claim for the mother's part. If the siblings are deceased also, their children will inherit the mother's share.

The third and final tier of inheritors is the grandparents. If there are no inheritors alive from the first two tiers, the deceased's grandparents will inherit. In situation where they are deceased also, their children, the deceased's sister or brother will inherit. This is where the right to inherit ends; cousins cannot inherit each other. If there are no relatives to that could inherit, the inheritance will be passed on to the state (Puronen 2008, 16-19).

3.4 Spouse and children

To prevent a situation where a legitimate heir would be left without inheritance or the widow or widower would be in a disadvantageous situation after his or her spouse's death certain laws have been enforced. The spouse of the deceased has a right to control and live in the house that the couple inhabited before if the remaining spouse's assets hold within themselves no other house where he or she could continue living. Also the direct descendants of the deceased have a right to inherit fifty percent of the estate. Should there be two children to inherit, both would receive fifty percent of the fifty percent. This is called the *legitime* (Finlex [Ref. 14.10.2014]).

3.5 Taxation of inheritance

How tax is collected on inheritance depends on the inheritors position, whether he or she directly ascends or descends from the deceased or if he or she is a relative of non-direct descendance or ascendance. These two groups have their own class for taxation (Finlex [Ref. 3.3.2015]). The first class, the direct inheritors enjoy a smaller taxation whereas the second class has a higher percentage of tax on the inheritance. (Finlex [Ref. 3.3.2015]) The adjacent spreadsheet shows the taxation percentages.

I Class taxation

Value of inheritance (€)	Lowest tax to be paid (€)	Additional tax for surpassing quantity (%)
20,000€ - 40,000	100	8
40,000 – 60,000	1,700	11
60,000 – 200,000	3,900	14
200,000 – 1,000,000	23,500	17
1,000,000 -	159,500	20

II Class taxation

Value of inheritance (€)	Lowest tax to be paid (€)	Additional tax for surpassing quality (%)
20,000 – 40,000	100	21
40,000 – 60,000	4,300	27
60,000 – 1,000,000	9,700	33
1,000,000 -	319,900	36

Figure 7. Tiers of taxation (Finlex [Ref. 3.3.2015])

3.6 Possible tax deductions

When a person dies, it is possible for the inheritors to deduct some tax if they are the spouse of the deceased or the closest descendant of the deceased. The spouse can deduct up to 60,000€ and the closest descendant 40,000€ if he is a minor, under 18 years of age. However the grandchildren cannot use this deduction (Vero [Ref. 2.10.2014]).

3.7 Traditional process of inheriting

Traditional process of inheriting in this context refers to a process where wealth is passed down to relatives without using any kind of other financial instruments like savings policies or tax planning.

Example 1

In a situation where the deceased person passes on an inheritance of €250,000 and has one direct inheritor (taxed in the first class), the inheritor will pay a tax of €29,700. The formula used to calculate this is below.

$$€21,700 + (€50,000 \times 0,16) = €29,700$$

The €21,700 is the minimum tax paid for an inheritance that is valued between €200,000 and €1,000,000. Everything over the amount of €200,000 will be taxed at 16%.

Example 2

In a situation where the deceased leaves a fortune of €300,000 and has two direct inheritors and the deceased has made a testament that commands that all the assets should be given to a third party and his direct inheritors be left without any inheritance the following will take place:

The direct inheritors will claim their *legitime*, their rightful share, and they will be entitled to 50% of the assets. The third party will receive the other half.

The formula to calculate a child's inheritance tax is:

$$€150,000 / 2 = €75,000$$

$$€3,500 + (€71,500 \times 0,13) = €12,795$$

Both of the direct inheritors will pay €25,590 of tax added together.

The third party will pay a tax of €54,324 as he or she belongs to class II taxation.

$$€9,300 + (€140,700 \times 0,32) = €54,324$$

4 PRO ET CONTRA SAVINGS AND INVESTMENT POLICIES

Investing into savings and investment policies can offer the investor certain advantages that should be taken into consideration when making plans to use these as instruments of saving. These advantages are in asset allocation, in paperwork relating to taxation, in taxation when descendants will inherit the assets and even in anonymity.

4.1 Flexible asset allocation

One of the most convenient aspects of the investment and savings policies are their ability to provide the holder a broad spectrum of different investment products. With certain limitations i.e. if the product is an asset management insurance, some options are included or left out, Fennia's policies can contain the following products:

- Investment fund shares
- ETFs
- Traded stocks
- Mutual funds
- Index loans
- Certificate of deposits, local authority papers and commercial papers
- Real estate funds
- Deposits

(Fennia internal brochure, 2014)

As the investor has the ability to include different kinds of investment products into the portfolio of the policy, he or she can gain the advantages of differentiation through this. Some companies like Fennia for instance, offer investment products from many different companies. Some of these companies include:

- Ice Capital Pankkiiriliike Oy
- Seligson & Co
- Titanium Rahastoyhtiö Oy
- Fennia Varainhoito Oy
- Danske Capital

As can be seen, a multitude of different options for investing is available via many different sources in case of asset management insurances. Depending on the investor's needs, assets and risk carrying capability he or she can benefit from a diverse and proven asset management services that can offer access to a wide variety of markets. And even in just basic savings and investment policies a good variety of options are available.

The only downside for this arrangement is that the assets will be then governed by someone else than the investor, as is normally the case with mutual funds. However this downside is mitigated by the fact that the investor is allowed to make changes into the structure and into the composition of his or her portfolio. How often that is possible depend on the agreement. But for the active investor these policies are most likely going to remain as a supplementary addition.

If the customer is planning to sign an asset management insurance or wants to liquidate assets and reinvest them into a savings or investment policy, before entering into a contract, and before choosing how to allocate assets into the policy, the investor should also ascertain what the composition of his or her current assets is. Some assets like real-estate or shares of a company might be best left untouched. The reason for this is that to invest the value that is in these assets, into a policy, requires them to be converted to cash first. The market situation in that time can be unfavorable or the tax repercussions might be too big in the form of capital gains tax. Taking these things into consideration the preliminary plan can change when calculations are done.

4.2 Advantages in taxation and paperwork

Some of the advantages that savings and investment policies provide are in taxation and paperwork. After the policy is made and the assets within it start to generate income the company that administrates the policy will handle the paperwork and notify the tax authorities of the necessary details, the policy holder does not need to attend these (Fennia internal brochure, 2014).

During the lifetime of the policy, as long as the premiums of the policy are not touched, no taxes need be paid for the accumulation of the savings. This gives the assets inside the policy an advantage over a direct investment. Within the policy:

- Domestic dividends will not be subjected to capital income tax
- Bonds and deposits will not be subjected to capital income tax

Also trades conducted within the policy (sales of shares, swaps of funds) will be tax free. This means that the gross income of the products will increase the value of the capital throughout the lifetime of the policy. Below two investments are compared. The dashed line represents a savings policy and the solid line a direct investment into a fund over the time of ten years. Both of the options have a similar expense structure; the difference between these two options comes from the fact that in the more profitable option, taxes are not paid during the lifetime of the product. The yearly growth of assets in both scenarios is 7% (Fennia internal brochure, 2014).

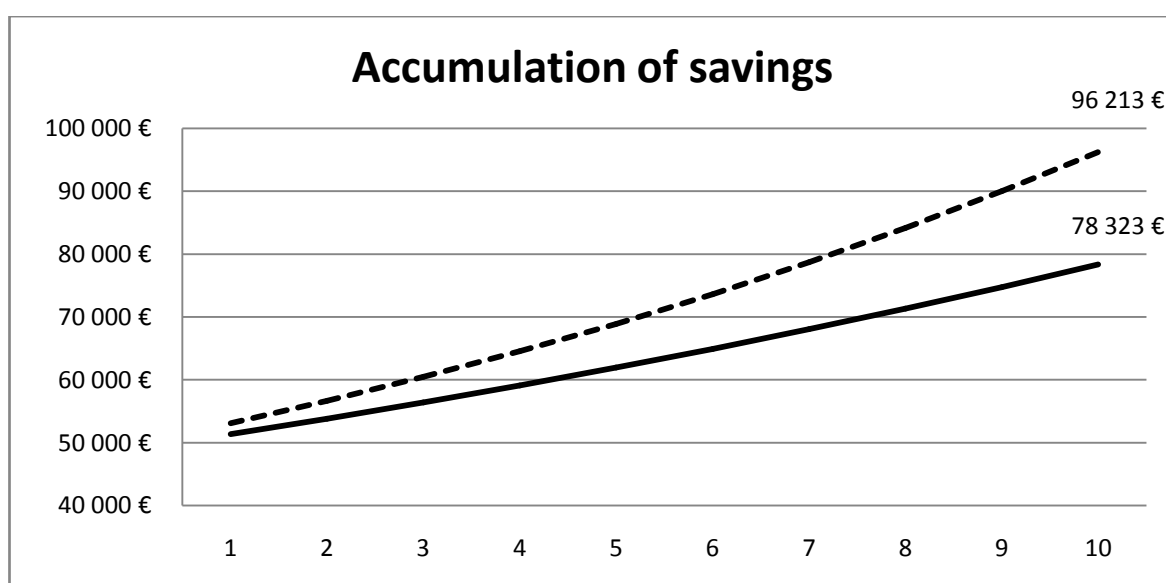


Figure 8. Accumulation of Savings (Fennia internal brochure, 2014)

Savings and investment policies can be used to gain advantages when it comes to inheriting. At the moment the Finnish law gives the possibility for the policy holder to give out savings to his or her closest relatives without tax up to a sum of €35,000 in case of his or her death. The widow of the deceased can receive half of the savings without having to pay inheritance tax (Fennia brochure [Ref, 12.11.2014]).

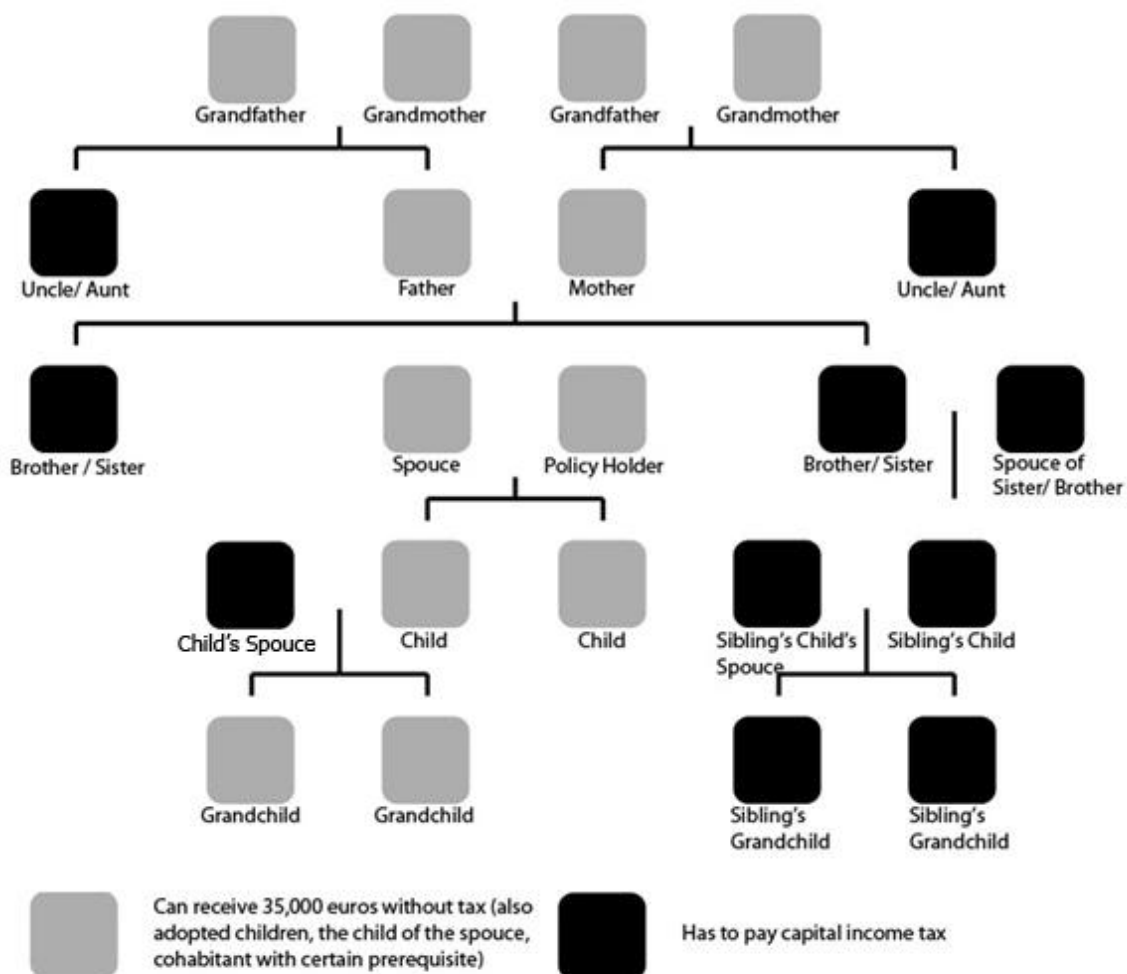


Figure 9. Relatives entitled to benefits (Fennia brochure, 2014)

To see the advantage that savings and investment policies offer in terms of taxation, two examples are used. In this first example the customer has accumulated savings worth of €96,213, as in the *figure 8* and has used a savings policy. To make the scenario more realistic, the inheritor is also going to inherit two pieces of real-estate, each valued at €200,000. In this scenario, the inheritor will inherit a total of €496,213 of estate. In both scenarios the amount of the life insurance coverage that the inheritors receive corresponds to the amount of savings.

The following sums are calculated as follows. In the first example the inheritor receives a €496,213 inheritance. Of this €35,000 is deducted as a policy is in place, leaving €461,213 under tax. The amount of tax that the inheritor has to pay is €23,500 and 17 percent of the amount surpassing that amount as he or she will be taxed in the €200,000 to €1,000,000 range. Below is the formula for *figure 10*.

$$€496,213 - €35,000 = €461,213 \text{ Calculating tax exempted part}$$

$$(€461,213 - €23,500) * 0,17 = €74,411,21 \text{ Calculating tax to be paid}$$

The example where policy is not present is calculated in the same way, but without the tax exemption part.

Results for *figure 11* where there are two inheritors are calculated as follows. As there are two persons inheriting assets worth of €469,213 this sum is divided between those two, each inheriting €248,106.50. As both inherit over €200,000 they are taxed in the €200,000 – €1,000,000 range. Out of this €248,106.50, €35,000 will be deducted leaving €213,106,50 under tax for both persons. Amount of €23,500 will be taxed and 17 percent after that. Below is the formula for *figure 11*.

$$€248,106.50 - €35,000 = €213,106.50 \text{ Calculating tax exempted part}$$

$$(213,106.50 - 23,500) * 0,17 = €32,233,11 \text{ Calculating tax to be paid}$$

The example where policy is not present is calculated in the same way, but without the tax exemption part.

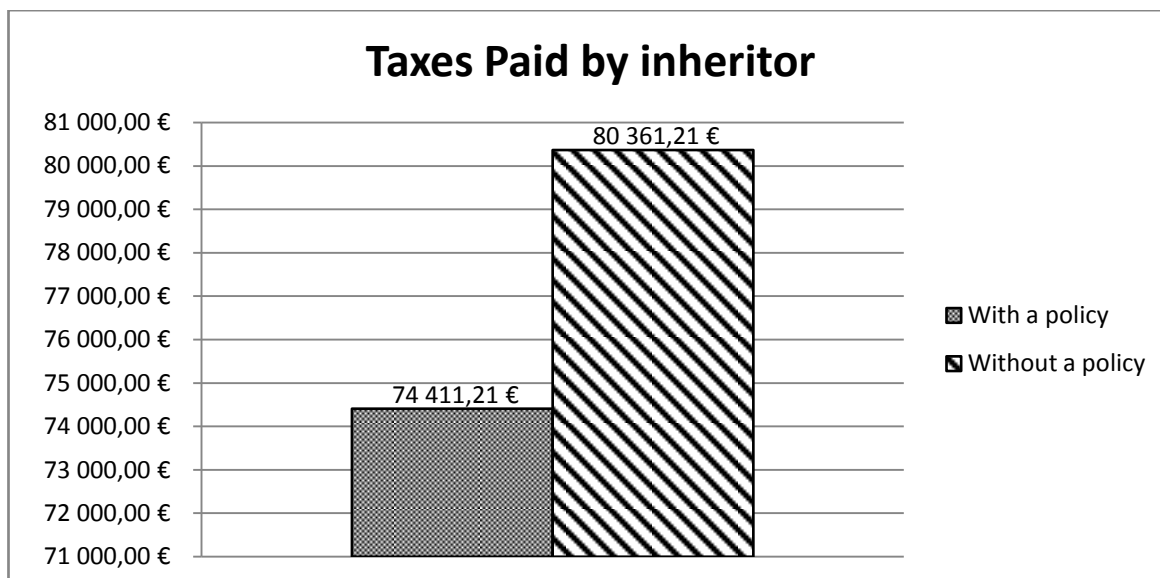


Figure 10. Taxes paid by one inheritor with and without a policy

On the left we can see the amount of taxes that the inheritor must pay with a savings policy in place and on the right the amount of taxes that he or she would pay if the person being inherited did not use a savings policy. The difference is €5,950 in favor of savings policy.

On the second scenario we have two inheritors who are inheriting an estate worth of €496,213. The scenario is exactly the same, but with a difference of having two inheritors.

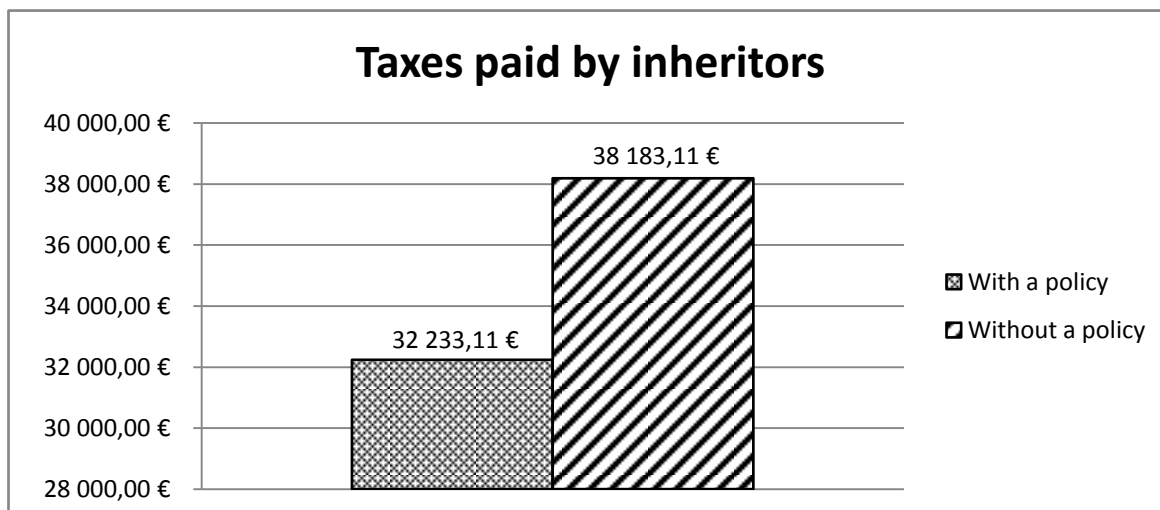


Figure 11. Taxes paid by inheritors with and without a policy

Each of the inheritors will receive an estate worth of €248,106, this is due to the fact that the estate left behind by the one being inherited will be equally split between the two inheritors. The difference is €5,950 in favor of the savings policy.

As the examples show, in both scenarios it is beneficial to have the €96,213 invested into a policy instead of having it and all the other estate inherited “the normal” way. However, the difference is not that large, only around six thousand euros. But as can be seen, the policies become more and more useful when the family is large and when the policy benefits many people. A large family, where children and their children inherit from the policy, can receive notable advantages.

4.3 Liquidity and capital withdrawal

The savings and assets within the policy can be realized whenever partially or completely. The customer can choose to either withdraw the initial capital first or withdraw all invested capital and the premium. In a situation where the policy holder wishes to avoid taxation he or she can withdraw the initial invested capital first as this action is tax free. Only when the customer starts to withdraw the premiums will there be taxable income (Fennia brochure, 2014)

The ability to withdraw the initial invested sum without paying taxes provides the investor an opportunity to use some of the assets should he or she need them due to some unseen and unplanned reason.

4.4 Anonymity of assets

Should the investor choose to invest into a savings policy that has asset management included in it, he or she would gain anonymity for those assets. This is due to the fact that all those assets will be managed by the company offering the policy. Therefore publications stating, for instance, the largest owners of shares of a company, would list the holder company as the owner of the shares instead of the actual owner. In these kinds of arrangements the actual owner is of course given the possibility to use his or her voting rights that the shares grant him or her. This is possible through certain arrangements. This anonymity can be seen as an advantage should the person want to limit others knowledge of his or her assets.

4.5 Professional asset management

If the holder of the policy has a large sum of money (€300,000 minimum in Fennia) to invest the investor can choose to benefit from professional asset management. This provides the customer a good opportunity to invest and then rely on a professional to manage his or her assets. This agreement makes possible tailor-made investing plans and the use of professional knowledge in investing the advantage can be substantial for a person who is not so well read in investing. And, should the customer be dissatisfied his or her asset manager, the customer can ask for another person to do the task. Of course, as with any other service, professional asset management can cost and therefore diminish the gains (Fennia brochure, 2014).

5 CONCLUSION

Savings and investment policies do offer advantages over the traditional way of inheriting as they can be used to reduce the amount of taxes paid by the benefactors. The amount of €35,000 is however not as large as it sounds because, as seen in the examples given, the final difference is only around €6,000 in favor of the policy. However, these policies are not designed to be instruments of tax evasion, but instead products that encourage people to make long-term savings. The ability to accumulate savings by being able benefit from tax exclusion within the policy during its lifetime greatly improves the growth of the invested capital, as seen in *figure 8*. What can also be seen from the calculations is that a larger group of benefactors can better benefit from these products; as the amount of benefactors grows, so does the absolute amount of tax deductions increase. In a situation where a large family has invested in these products under good market conditions, the benefits can be substantial.

But when it comes to savings and investment policies as products of saving, there is no guarantee that they would be always profitable and good investments. In the long run market conditions can be unstable and fluctuations in asset values may occur, bad management of investments can lead to undesired results and some decisions can have opportunity costs that are not seen. Because of different kinds of risks savings and investment policies, like other financial products, need to be managed well for them to be productive. The customer needs to be aware of different kinds of risks and needs to have a plan made. These products can become unproductive if the customer takes too much risk or is not aware of the workings of the economy. Therefore a well balanced portfolio and risk assessment gives security in times of turmoil as well as better profit.

Opportunity costs are also something that the customer should take into consideration. Some assets, for instance real-estate or shares can be hard to liquidate under certain market conditions. Because of this, selling assets that are undervalued might not be a good idea. Instead the customer should consider his or her assets holistically and try to evaluate their future value.

And finally the customer should be aware of the cost structure of the insurances. Comparing different options and offers is recommendable to avoid paying too much administrative costs. Savings and investment policies are after all, products.

5.1 Impact

This thesis is written to research savings and investment policies from the perspective of estate planning. As such it is aimed to provide answers on whether it is a good idea to use these instruments and when it might not be. This thesis provides arguments for, and against these products and ends in a conclusion. Taken into consideration the small amount of information regarding these products, this research adds information that could well be useful for a person considering investment and savings policies. For the reader this study opens these financial products concisely and introduces their possible shortfalls as well. This study should be seen as a participation in the discussion on these products.

5.2 Validity and reliability

Multiple trusted and good information sources were used in the writing of this thesis, therefore the information given can be seen as accurate and non-biased. Sources from both government entities and private business were used. What should be taken into consideration is that this thesis does not give answers to individual situations, but tries to give general answers. Due to the study's general nature, each individual should always consider his or her own position when considering Savings and investment policies.

The reliability of this study is good. Calculations in this study can be repeated and the environment is explained in such accuracy, that others should reach the same conclusion as well. However, due to the study's general nature and somewhat limited scope, results may vary if circumstances are changed.

5.3 Future research

Possible future researches that stem from this subject could be for instance personal experiences from savings and investment policies that study people's willingness to invest into these products, or a study into the marketing of these products. While writing this thesis a lot of information that was available was from the banks and entities that offered these products. Personal experiences would add interesting information and provide the sellers important perspective.

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