Swallow
Financial Planning

CASH DEPOSIT ACCOUNTS

As with all financial products, the range of options for cash funds is now becoming ever more bewildering. The purpose of these notes is to explain some of the options open to clients with cash funds to invest and to assist you in deciding which type of account is best for your circumstances.

We have access to instant internet and other extensive manuals illustrating pretty well all available deposit accounts available. If you can confirm to us your requirements, we can usually obtain the very best rates for your personal circumstances.

Registered Office:
25 St Helen's St, Ipswich, Suffolk IP4 1HH
Tel: 01473 384858 Fax: 01473 384844

London Office:
4th Floor, 33 Cavendish Square, London, W1G 0PW
Tel: 020 3755 3235

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1. BANKS, BUILDING SOCIETIES OR NATIONAL SAVINGS?

With many building societies having converted to banks the first point to decide is which type of institution is best.

1.1 Banks

Banks are usually public limited companies offering a range of services to their clients. Your security of investment is the financial strength of the institution concerned and the Financial Services Compensation Scheme (FSCS). Frequently banks have different trading names and care needs to be taken to avoid over concentration in the parent company.

1.1.1 Plus Points

- Generally larger and hence possibly more financially secure than building societies.

- As they are in the commercial world and the directors are accountable to shareholders they are arguably more efficient than building societies.

1.1.2 Minus Points

- Substantial sums have to be paid to shareholders by way of dividends.

- The business model developed by banks in the first years of the 21st century is inherently unstable particularly for smaller banks.

1.2 Building Societies

Building societies are usually mutual companies (ie they are owned by their investors) offering a range of services to their clients. Your security of investment is the financial strength of the institution concerned and the FSCS. Frequently building societies have different trading names and care needs to be taken to avoid over concentration in the parent society.

1.2.1 Plus Points

- No need to pay dividends hence a great deal of extra money is available to add interest to your account.

- The building society may demutualise in the future. At this stage, it has to pass on the value of the company to the members, hence producing a large windfall.

- Building societies tend to take in deposits and lend these to borrowers. This is a much more secure approach than the banks borrowing on the money markets.

1.2.2 Minus Points

- Building societies tend to be less efficient than banks. This lack of competitiveness may negate the benefits of not paying out dividend payments.

- Building societies tend to be smaller than banks, hence it could be argued that they are less secure.

Our recent experience of building societies and banks shows no benefit to building societies when it comes to providing good rates of return or the ubiquitous habit of dropping special terms to the detriment of savers.

1.3 National Savings

We mention National Savings because we have had some of the best cash offers from them. The NS&I Direct Savings Account is an excellent account for those who do not want to have to change their deposit fund every time the special offer changes (ie normally every year). It is never the most competitive but it always reasonable.

Likewise previous issues of the guaranteed income bonds have been highly profitable to clients and the NS&I ISA rate is worth taking for those who do not wish to move their cash ISA each year.

2. COMPENSATION SCHEMES

The farcical way the financial authorities and government dealt with the Northern Rock disaster at least illustrates that UK PLC doesn't intend on letting a financial institution fail whatever the circumstances. Nevertheless some prudence does seem advisable.

2.1 UK Deposit Takers

Banks registered in the UK can leave savers very badly off if they fail. With effect from 30th January 2017 the compensation for deposits is 100% of the first £85,000. No compensation is paid for deposits above £85,000.

The compensation applies to each person not each account. So, if the total held in several accounts at the same bank is above £85,000, only compensation to the £85,000 limit will be paid. Joint accounts protect both holders. If all went wrong, up to £170,000 would be returned.

If your bank is part of a conglomerate (for instance Lloyds TSB has 18 brand names) then you will only get compensation for each account which is in a bank or building society which is separately registered with the FSCS. This means that you could hold funds with Halifax and Intelligent Finance and they would be treated as one institution, meaning you would get one set of compensation.

We have a list of FSCS registered companies available on our client website.

If you want to know more about the FSCS or whether your institution is covered, telephone 0800 678 1100 or 020 7741 4100 or visit their website at www.fscs.org.uk.

2.1.1 European Union Banks

European Union Banks operating in the UK have their own system. As a minimum, it covers 90% of €100,000 (approximately £85,000) in each account.

2.1.2 Foreign Denominated Accounts

Dollar and other non-EU currencies are not covered by any protection – even if held with a British bank. EU currency accounts are covered by the bank or building society fund.

2.1.3 Offshore Accounts

Offshore accounts do not get any protection from the UK, even if they are with a British bank such as Barclays (Jersey). Compensation depends on local regulations.

In the Isle of Man, compensation is similar to the UK. In the Channel Islands and Gibraltar, however, there is no protection. However, many subsidiaries of UK banks based abroad carry guarantees from the UK parent.

2.2 Which Institution Is Best For Me?

Whilst we accept that some investors will wish to invest in building societies, in the hope that they will demutualise in the future, we will look at the product on offer and the institution regardless of whether they are a bank or building society. Right now, we have no preference as the building societies seem to be as bad as the banks at reducing special offers etc. as soon as they can.

3. ACCOUNT TYPES

3.1 Branch Accounts

A branch account is a deposit where you can call at your local branch to deposit or withdraw funds. These accounts can have reasonable rates for longer term deposits and can be a bolt on option to other account options. Generally speaking branch accounts tend not to be competitive and branches are being closed to recue overheads.

3.2 Postal Accounts

Many institutions are now realising that the days of large branch networks are numbered. The cost of keeping branches open is prohibitive and with the progression of technology it is far cheaper to deal by phone, post or e-mail.

Typically, a postal account is not offered via the branch network. Investors pay in and withdraw funds by post. Our own experience of this is that the average turnaround is 3 days between posting the request and receiving the cheque or confirmation.

Postal accounts are becoming less widely available now at the internet is taking over. In general they offer better rates than their branch equivalents.

3.3 Transfer Accounts

Transfer accounts are a progression from the postal account. These accounts work in a number of differing ways, however, the usual structure is to establish your transfer account with a direct link to your bank current account. This type of account can normally be established by cheque, or by arranging for a transfer from your bank account using the Banking Automated Credit System (BACS). All subsequent transactions are then carried out on the telephone (or internet). If you want to invest money you call the bank/building society and they withdraw the sum from your current account. If you wish to withdraw cash the reverse applies.

These accounts can be appropriate for busy people who prefer to deal with matters via the telephone. On the other hand, if you wish to write cheques to third parties (ie investment cheques) direct from your cash deposits, it can be inconvenient to first telephone your account, wait the 3 days necessary to clear the BACS transfer and then write the cheque out from your main account. Likewise, if your current account is subject to charges (most unusual) these accounts will increase the charges on your current account.

The new fast payment automated BACS system has resolved a lot of these problems however as with everything that costs them money the banks are being dreadfully slow at implementing it.

3.4 Internet Accounts

Electronic banking is now becoming ever more popular. For some years now, business account holders have been able to check balances, pay bills by BACS and more cash from account to account, all by going “on-line” to the bank’s computers.

Egg were the first institution to follow this path when they were owned by the Pru and many others have followed in their path. We generally find that the keenest rates now available are within the internet market.

3.5 Offset Accounts

Although not strictly speaking a deposit account, individuals with both large deposit accounts and sizeable mortgages are best advised to move to an offset mortgage whereby the deposit monies are offset against an equivalent amount of mortgage. In this way individuals obtain an effective net rate or return equivalent to the mortgage rate. A typical mortgage rate might be 3.0%. This is equivalent to a gross return of 3.75% for a 20% tax payer, 5% for a 40% tax payer and 5.45% for a 45% tax payer, better rates than you can possibly get from a deposit taker.

4. NOTICE PERIODS

4.1 Instant Access

Nowadays you can get instant access accounts at the most competitive rates although most of the best rates restrict the number of withdrawals you can take each year.

4.2 Notice Accounts

These accounts are supposed to offer a higher rate of interest, however, any withdrawals you make are subject to you waiting for the notice period to expire before the funds are issued, or a loss of interest for the same period. If you wish to withdraw cash without any notice these accounts are not competitive. By way of example, the following table indicates the gross rates of return for a deposit account with a £100,000 balance offering 2.0% gross interest where you take two withdrawals of £10,000 in a year and accept the loss of interest rather than waiting for your cash:

Gross Return	2.00%
30 Day Deposit	1.93%
60 Day Deposit	1.87%
90 Day Deposit	1.80%

4.3 Deposit Bonds

These are usually fixed interest deposits over 1 or 2 years. In times of falling interest rates they can represent excellent investments for individuals who can afford to tie their money up for the whole term of the bond. The terms for early encashment generally make these bonds unsuitable for investors who may require access to their savings during the agreed term.

The one exception was the National Savings Guaranteed Bonds which had a 90 day loss of interest but no other penalty.

5. ADMINISTRATION

Money laundering in particular combined with the obsession for passwords and questions can make opening new accounts a nightmare.

Whilst we tend not to recommend accounts where we know clients have had administration problems in the past, a slow turnaround for your required cash can be very irritating. We have experience Abbey National losing a cheque for £1,000,000 then offering £50 compensation!

Many accounts now do not provide paper records instead you can view your records on line and print same out if you wish. Perversely this is now causing problems when other institutions want to see paper money laundering proof.

5.1 Minimum Withdrawals

Many accounts have minimum withdrawals ranging from £100 to £1,000. If you may wish to withdraw smaller sums choose an appropriate account.

5.2 Number Of Withdrawals

Some accounts offering the best rates of return limit the number of withdrawals a year to maintain a high return.

5.3 Minimum Balance

Many accounts have a minimum opening balance of £1,000 or more.

5.4 Money Laundering

Money Laundering alone puts off many clients from opening new accounts. With many accounts now the provider will accept their own electronic checks but some still require the reams of copy statements etc.

5.5 Passwords

The mass hysteria over identity theft and security has led to a situation where anyone with more than one or two accounts has to keep a written record of their pass phrases, user names, passwords, which first school they quoted, which colour their first car was etc. otherwise they cannot get access to their accounts!

This of course makes a nonsense of the security questions in the first place as by writing it all down individuals can have the information stolen.

6. INTEREST TIERS

When investing cash there is always a compromise to be reached between the security of spreading your investment between several institutions and the higher interest available for larger deposits. Many deposit takers tier their investment payments depending upon your balance. A typical spread might be as follows:

Up to £5,000	0.50%
£5,000 to £10,000	0.75%
£10,000 to £25,000	1.00%
£25,000 to £85,000	1.50%
£85,000 plus	2.00%

Whilst the differences are not great, the interest is paid on the whole balance and it does usually make sense to keep the number of deposit accounts to a minimum to obtain the highest rates of return possible.

7. PEER TO PEER (P2P) LENDING

Peer-to-peer and peer-to-business are relatively new concepts in the field of lending and borrowing. Classically individuals (or businesses) would save their money in a bank and the bank would then lend that money to other individuals or businesses. P2P removes the bank from this process. There are a growing number of online companies that can facilitate this process. This process can also be referred to as social lending, or crowd lending.

For the additional risks involved (there is no compensation scheme and borrowers do default) the lender gets a better return than they would do from a bank or building society.

Whilst we cannot recommend any specific product without personal research there is a good P2P website at http://p2pmoney.co.uk/ which seems to have most of the main lenders on board.

For those who want longer term commercial lending options you might do well to try http://relendex.com/home.

From 1st April 2014 the process of peer-to-peer and peer-to business lending will fall under the FCA for regulation (note, FCA do not regulate other forms of crowdfunding such as rewards-based or donation-based crowdfunding).

8. TAX

From 6th April 2016 deposit accounts should be set up to automatically pay interest gross. Any tax due above your annual personal savings allowance will be collected via your tax return.

The simple expedient of transferring an account to the name of a non tax paying or basic rate tax-paying spouse's sole name can increase your net interest return by between 20% and 50% each year.