

## 2<sup>nd</sup> October 2008 – How Safe is Cash, Really? – David Crozier CFP

It is just over a year since the Northern Rock fiasco surfaced, and recent events at HBOS and several large American banks including Bear Sterns, Lehman Brothers and Merrill Lynch have again raised concern with investors. While it appears that depositors with HBOS have nothing to worry about due to the Lloyds TSB takeover, likewise with Bradford & Bingley and Santander, the current situation has highlighted the risk of having large deposits with a single bank or building society.

In the event of a UK bank going bankrupt, depositors are protected up to a maximum of £50,000 per financial institution, as from 7<sup>th</sup> October, but any investments over this threshold are at risk of 100% loss. Although higher balances do tend to receive higher interest rates (although in some cases, rates remain constant through the range) the uplift in interest does not seem to be sufficient to merit accepting the additional risk in the event of a bank collapse. Therefore, in our opinion, unless there are significant exit penalties, investors should limit deposits with financial institutions to £50,000 each.

This may prove difficult. Individuals with very large balances may struggle to find enough different banks to spread out their £50,000 investments. And be careful – nowadays you need to look at the ownership of the bank, because the £50,000 covers all the members of a group, unless separately registered. For example, although Royal Bank of Scotland owns Nat West, separate registration would mean two lots of compensation; Nationwide has just taken over the Cheshire and Derbyshire building societies, so having £50,000 each in these three institutions is not spreading the risk.

It is worth noting that savings in National Savings & Investments are 100% guaranteed, and are therefore as secure as the UK government, however secure that may be! Any money in Northern Rock is also fully guaranteed, by the government, although they are now cutting their savings rates – an excellent example of risk and reward in action!

To further complicate matters, the Irish government has guaranteed all deposits in six Irish Banks until 2010. At the time of writing it seems that this covers branches in Northern Ireland, however there is some political debate about this and it is not clear if this will end up being the case. Anyway, some commentators, including Irish ones, are casting doubt on what such a guarantee is worth, being issued by a country of only 4.5 million people, with an economy heavily dependent on foreign investment.

One further point to note: not all business bank deposits are protected. Some small businesses will qualify, depending on the turnover, balance sheet

and number of employees, but you should not assume this without checking.

Although it may seem strange, there is an argument that stockmarket investments in a broadly diversified range of asset-class funds is actually less risky now than cash deposits in excess of £50,000. Clearly this is only true where investors can take a long term view as the value of the stock market could fall further in the short term but at current levels the long term prospects appear to offer brave investors excellent potential.

The late Sir James Goldsmith used to say, “when you see a bandwagon, it’s time to get off!” and with everybody currently running to cash and fixed interest investments, equity-based investments don’t look like such a bad idea.

There is one crucial caveat regarding stock market investments. No matter how secure the companies may appear, investments in a limited number of shares always carries significant risk, as even the mighty can fall. However, by investing in a broadly diversified range of index tracking funds that represent the entire market default risk is almost eradicated. The chance of the entire global stock market going bankrupt is so slim as to be inconceivable. Even if the stock market falls further the likelihood, as we know from history, is that it will recover in future; we just don’t know when. However, a deposit with a bank that goes bust will never recover.

What does all this mean?

1. Where it is appropriate to hold cash this should be spread across multiple institutions with an upper limit of £50,000 each.
2. Alternatively, you could consider holding your entire cash deposits in NS&I.
3. Where there is cash available, and your cash flow requirements and risk profile allows, you could consider further investments in the stock market to capitalise on recent events.
4. Investors already in the stock market with no further funds available to invest should maintain their current holdings and sell fixed interest and cash to rebalance back to target weightings rather than withdraw and run for cover.

Obviously, we don’t have a crystal ball, past performance is no guide to the future and the value of investments can fall as well as rise. On the other hand, as we saw on Friday 19<sup>th</sup> September with the biggest ever one-day rise in the FTSE-100, it is also true to say that shares can sometimes soar as well as plummet!

The following is a guide to how various savings institutions are treated. This is an indication only, based on the author's understanding at the time of writing. The situation is changing rapidly and you should check with each individual institution before making a decision on the grounds of security.

#### **Guaranteed 100% by UK government**

National Savings & Investments

Northern Rock

#### **Guaranteed 100% by Irish government until 2010**

Allied Irish

Anglo Irish Bank

Bank of Ireland

Educational Building Society

First Trust Bank

Irish Life & Permanent

Irish Nationwide

#### **Covered by Financial Services Compensation Scheme (FSCS)**

##### **Providers that count as one institution (covered for £50,000 per group)**

Abbey, Cahoot

Bradford & Bingley, Asda

Co-operative Bank, Smile, CIS

Halifax, Bank of Scotland, Birmingham Midshires, Intelligent Finance, The AA, Saga

HSBC, First Direct

Lloyds TSB, Cheltenham & Gloucester

Nationwide, Portman, Cheshire, Derbyshire

Royal Bank of Scotland, Direct Line, Lombard, Ulster Bank

Yorkshire Bank, Clydesdale Bank

##### **Providers registered separately**

Alliance & Leicester

Barclays

Capital One

Cater Allen Private Bank

Citibank

Egg

ICICI Bank

NatWest

Northern Bank

Sainsbury's Bank

Standard Life Bank

Tesco Personal Finance

Virgin Money

Credit unions are also covered by the FSCS.

#### **Navigator Financial Planning**

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