Savings accounts tricks exposed

Banks use clever marketing ploys to entice customers into poor-paying accounts. We help you make the most of your savings

Why is it that, when there are plenty of savings accounts around offering attractive interest rates, so many of us keep our savings in accounts that pay a pittance? For example, Bradford & Bingley currently pays 4.85 per cent on its easy access account, and Halifax pays 7 per cent on its regular saver. Yet some accounts – such as Derbyshire Building Society's cash account – offer as little as 0.50 per cent. The answer lies in a combination of the banks' marketing ploys that attract customers to their accounts and customer inertia about switching.

Of 430 savings accounts we looked at, 103 (24 per cent) pay less than a dismal 2 per cent on balances of £5,000. As the graph ('Best Buy vs Don't Buy') on p30 shows, if you invest a lump sum of £5,000 in a branch-based account that pays 0.50 per cent, you'd be £208 gross a year worse off than if you'd gone for the best branch-based account paying 4.65 per cent.

TRICKS OF THE TRADE

Banks use various tactics to get their hands on our money and then keep hold of it. Many use brazen marketing techniques that help gloss over their poor interest rates or hidden catches.

Deceptive names

Beware of accounts with words like 'gold' in their names. Designed to make you think you'll be watching the pounds stack up, they rarely do in practice.

Cheltenham & Gloucester's Cheltenham Gold account, for example, pays 1.10 per cent interest on deposits up to £9,999. Balances between £10,000 and £24,999 earn a pitiful 1.20 per cent. And

PHOTOGRAPHY SIMON WRIGHT

CAREFUL MONITORING PAYS OFF

Jeff Body *63, retired operations plant manager*

Jeff, from Danbury, regularly monitors his savings rate and switches accounts to ensure he gets the best available deal. 'I look for stability when choosing an account, the track record of the provider and a good rate,' he told us. 'I don't necessarily go for the highest rates, as these accounts often have catches'. Jeff is sceptical about marketing ploys used by account providers. He says: 'Unless you're careful, you can lose out to the hype.'

SAVINGS ACCOUNTS EXPLAINED

Notice, easy access, regular savings, Isas – we help you decide which type of savings account is best for you

Cash Isas You can save up to £3,000 a year, tax-free, at competitive rates. If you pay tax, especially at the higher rate, it's always best to use your Isa allowance before you open a savings account.

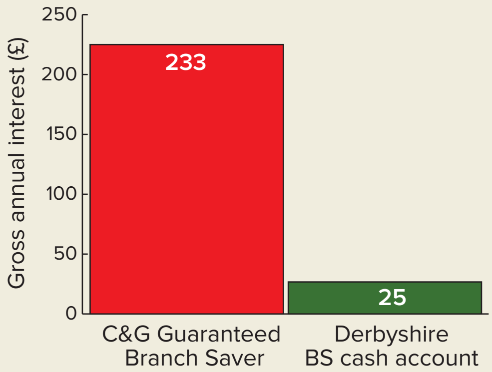
Easy/instant access Most of these accounts let you withdraw your money at any time without penalty. However, a few do impose restrictions on the number of free withdrawals you can make in a year.

Regular savings These are good if you want to make regular, usually monthly, payments into your account. Many have good rates, but they have limits on the amounts you can pay in and withdraw. The high rates usually last for only a year. As the graph on p31 shows, if you have a lump sum to invest, it's better to put all of it in a good Isa or easy access savings account.

Notice With these accounts you have to give notice before you withdraw your money – usually 30, 60 or 90 days – or you lose interest. Traditionally, these accounts had better interest rates than easy access accounts, but this is no longer always the case.

BEST BUY VS DON'T BUY EASY ACCESS ACCOUNT

The graph shows that paying £5,000 into the highest-paying branch-based savings account (C&G Guaranteed, which pays 4.65 per cent interest) leaves you £208 gross a year better off than if you had paid the same amount into the Don't Buy branch-based account (Derbyshire BS cash account, which pays 0.50 per cent).



Correct at 7 August 2006

UNDERSTANDING INTEREST RATES

Savings accounts are an easy, low-risk way to build funds, but make sure you know the basics of how interest and inflation work

AER The best way to compare interest rates is to look at the AER, which stands for 'annual equivalent rate'. This takes into account how often interest is added – for example, daily, monthly or yearly – but gives you the rate equivalent to interest being paid annually. This allows you to compare rates directly.

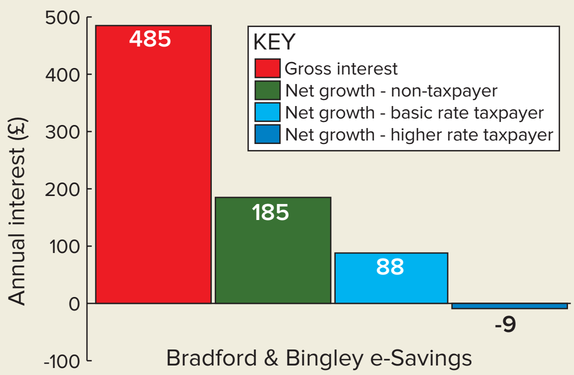
GROSS/NET The interest rates shown in adverts are usually gross – before tax is deducted. If you are a taxpayer, the interest you earn will be taxed and paid net. Basic-rate taxpayers are charged 20 per cent, and higher-rate taxpayers pay 40 per cent.

INFLATION Inflation can have a corrosive effect on your money – another reason to keep an eye on your interest rate. If the rate you're getting after tax is less than inflation, you are effectively losing money. The graph, below, shows the effects of tax and inflation on a Best Buy account.

If inflation remains at 3 per cent, a basic-rate taxpayer needs an interest rate of at least 3.75 per cent to avoid losing out: taking 20 per cent tax off 3.75 per cent leaves you with an effective rate of 3 per cent, the same as inflation. Higher-rate taxpayers would need an interest rate of at least 5 per cent just to stay abreast of inflation.

THE EFFECTS OF TAX AND INFLATION

The graph shows that in a Best Buy savings account paying 4.85 per cent, you would earn £485 gross interest on £10,000 in a year. But inflation at 3 per cent reduces your real return by £300. Then, if you are a basic-rate taxpayer, you are left with £88 after tax. And if you pay tax at the higher rate you will actually be £9 worse off.



Correct at 7 August 2006

Restrictions on regular savings accounts can take the shine off their glowing rates

it's not the only account which you could call 'fool's gold'. Derbyshire Building Society's Triple Gold and Dunfermline Building Society's Gold accounts pay less than 2 per cent on balances up to £10,000. Worst of all is Halifax/Bank of Scotland's Liquid Gold account, which pays a miserly 0.6 per cent interest on balances of £50 and over.

Other accounts with misleading names and shoddy interest rates include NatWest's Reward Reserve, Universal Building Society's Money Master and Co-op's Cash Saver. All pay less than 1 per cent on balances of up to £5,000.

Temporary bonuses

Many banks and building societies use introductory bonus rates to hike up their interest temporarily in a bid to attract new customers. A bonus isn't necessarily a bad thing, as long as you know how long the rate will last for and you switch accounts when it drops.

But bonuses aren't always worthwhile. The Lloyds TSB Reward savings account offers a bonus of 0.5 per cent for six months, bringing the total interest to just 1.35 per cent. That's not much of an incentive, particularly as you're restricted to seven to 12 withdrawals a year.

Regular savings catches

With advertised rates of up to 10 per cent, regular savings accounts are attracting a

steady flow of savers. But beware – restrictions on these accounts can take the shine off their glowing rates.

For example, to take advantage of Barclays' highly publicised 10 per cent regular saver deal, you have to open a Barclays current account and pay your salary into it. The credit interest rate on the current account is 0.10 per cent. When you compare this with the 5 per cent rate paid on Alliance & Leicester's Premier Direct current account, it looks positively miserly. Once the 12 months is up, the money in your regular saver account is automatically transferred into the Barclays Easy Saver account, which pays just 3 per cent AER. You can, of course, opt to switch it elsewhere.

It's important to make the required regular payments to these accounts. If you don't, you may lose the bonus or get a lower rate of interest.

If you want to save by paying set amounts into a savings account each month, regular savers are a good bet. However, as the graph, right, shows, they aren't your best option if you have a lump sum to invest.

Not-so-easy access accounts

Some easy access accounts don't let you get your hands on your money as easily as their name suggests.

Many providers restrict the number of free withdrawals – ranging from one a year to one a month. Any extra withdrawals incur a fee, which varies from 50p to £10.

Barclays' highly publicised 10 per cent regular saver has some restrictions – for example, you have to pay your salary into its miserly 0.10 per cent current account to qualify

Some also limit the total number of withdrawals. For example, Leeds Building Society's Premium Access account allows only two withdrawals a year – the account will close if you make a third.

With some providers, you forfeit interest if you withdraw money: several accounts don't pay interest on the balance during any month that you make a withdrawal.

Take no notice

Traditionally, giving 30, 60 or even 90 days' notice to access your savings meant you received a more favourable rate of interest compared with an easy access account. But that is no longer always the case.

Take Universal Building Society's 60-day notice account. It offers just 0.65 per cent on balances between £1,000 and £4,999. Even a deposit of £10,000 in this account earns only 2.20 per cent. Similarly, Lambeth BS's Premium 30-day notice account pays only 1.11 per cent on balances betweeen £500 and £2,499 and 1.86 per cent on balances between £10,000 and £24,999.

The Banking Code and you

Ideally, interest rates of savings accounts should track the Bank of England's base rate. But some don't. To find an account that is competitive, look for one that beats or at least matches the base rate – see www.which.co.uk/money, or check 'Money Monitor', p32.

The Banking Code – a voluntary code that lays down standards of good banking practice – states that your bank or building society is obliged to tell you if the interest rate on your savings account changes by 0.5 per cent or more relative to the base rate over the previous 12 months, if your account contains £250 or more.

From January next year you must be told whenever the interest rate changes by 0.25 per cent or more relative to the base rate. This will apply only if you have £500 or more in your account.

As the base rate increased to 4.75 per cent shortly before we went to press, published interest rates are likely to change.

See bcsb.co.uk for further information on the Banking Code.

Checklist

Here's a summary of our advice on how to make the most of your savings

- **Take advantage of your Isa limits** If you're a taxpayer, use your tax-free Isa limit of £3,000 a year before you open any other type of savings account.
- **Decide how to save** If you want to put aside money each month, go for a regular saver. Traditional accounts are better if you have a lump sum.
- **Don't rely on notice accounts** Tying up your money in a notice account no longer guarantees a better rate of interest.
- **Keep an eye on rates** Regularly check what you are getting on your savings and switch if a better deal becomes available. Check at www.which.co.uk/money or see 'Money Monitor', p32, for our Best Buys.
- **Compare the AER** Use the AER (annual equivalent rate) to compare accounts accurately.
- **Check rates for online accounts** Online savings accounts often beat branch accounts.
- **Beware of bonus rates** Check how long the bonus rate lasts and what the rate drops to when the bonus ends.
- **Check restrictions** Find out how many times you can withdraw your cash in a year for free. Also check whether you'll be charged for specific methods of withdrawal – such as by branch, post, phone or online.

REGULAR SAVER OR EASY ACCESS?

If you have £3,000 to invest, you are better off paying the whole lot into a Best Buy easy access account rather than drip feeding it into a regular saver account at £250 a month. Even though the Halifax account has a higher rate, investing a lump sum gives a higher return.

Correct at 7 August 2006