Topic 5: Savings Products

Learning outcomes:

- differentiate between different financial services products for savings; and
- begin to evaluate lifelong financial planning, by understanding that people's savings needs change as they pass through the various life stages.

Saving:

- Delayed spending which could be for:
  - needs – such as paying a deposit on a rented flat;
  - wants – items that savers cannot afford on a day-to-day basis, such as computer;
  - aspirations – goods or services that they would like to have or to experience in the future, such as a holiday.

Taxation:

- Since April 2016, providers pay all interest on savings accounts gross (before tax) and savers pay any income tax they owe. Savers have a 'personal savings allowance' for the amount of savings interest they receive before any income tax is charged.
- This allowance is £1,000 for basic-rate taxpayers and £500 for higher-rate taxpayers.
- Additional-rate taxpayers do not receive a personal savings allowance.

Key terms:

AER	Annual equivalent rate is the interest that will be earned on the money in one year and takes into account how often the provider pays the interest (for example, monthly or annually), the effect of compounding the interest and any fees and charges.
Bank rate	The interest rate that the Bank of England uses when it lends money to other banks. Financial services providers take account of the Bank rate when they decide how to set interest rates on their own products.
Child Trust Fund (CTF)	A long-term savings account only available to children born between 1 September 2002 and 2 January 2011. CTFs were set up by the government to encourage people to build up savings for their children.
Consumer Prices Index (CPI)	One of the means the government uses to measure inflation. It is calculated by checking the price of a representative sample of goods on a monthly basis – this enables statisticians to measure how much prices are rising or falling. See also Retail Prices Index (below).
Financial Conduct Authority	One of the two main regulators of financial services in the UK (the other is the Prudential Regulation Authority).
Financial Services Compensation Scheme	A compensation scheme that pays compensation to account holders of up to a certain amount per provider if the provider goes into default (in other words cannot pay account holders the money they have in their accounts).
Help to Buy ISA	First-time buyers can save up to £200 a month towards their first home in a Help to Buy ISA and the government will boost their savings by 25% when the account is closed. That is a £50 bonus for every £200 saved and all interest earned is tax free.
HMRC	Her Majesty's Revenue and Customs – the organisation that collects taxes on behalf of the government.
Income tax	Tax paid on earnings from employment, self-employment and interest on savings.
Individual savings account (ISA)	An account that pays interest tax-free on savings up to a certain level. There are two types of ISA: cash ISAs and stocks and shares ISAs. Junior ISAs are available for people under 18.
Inflation	A rise in prices, which means that the purchasing power of money falls.
Instant access account	An account from which the holder can withdraw their money at any time without losing any interest.
Interest	Money either paid to an account holder by the provider, or charged to the account holder by the provider. Interest is paid on savings accounts and some current accounts and charged on borrowing, eg an overdraft. Each provider decides the rate of interest it will pay or charge, depending on the type of account and, in some cases, the credit history of the individual account holder.
Interest rate	The amount, expressed as percentage, that a financial services provider charges a borrower when it lends money, or pays to a saver.
National Savings and Investment (NS&I)	A provider that is backed by the Treasury (the government department that manages the UK's finances).
Notice account	An account for which the holder has to tell the provider in advance if they want to withdraw their money. If they do not give the provider the required amount of notice, they lose interest on their savings.
Personal allowance	The amount that an individual can earn before they have to pay income tax.
Personal savings allowance	The amount of savings interest that can be earned before the saver pays tax. The amount of the allowance varies according to how much other income the saver has earned in the tax year.
Rate of return	The amount a saver gains in interest on their savings. For instance an account paying 0.2% AER offers a lower rate of return than one paying 0.4%
Retail Prices Index (RPI)	One of the ways the government measures inflation. It is calculated by checking the price of a representative sample of goods on a monthly basis but unlike CPI (see above), it also takes into account mortgage interest payments and other costs associated with home ownership.
Savings bonds	A savings product held for a fixed period, eg two years. The holder can only make a limited number of withdrawals, or none at all, during that period without incurring a penalty.
Starting-rate band	An amount of savings that an individual can earn tax-free if their total income is less than the personal allowance.
Stocks and shares	Stocks, shares and equities are all words used to describe an investment that gives the holder part ownership of a company. If the company's value increases, so does the value of your share; if its value falls, so does the value of your investment. Shares are bought and sold on stock exchanges.
Tax year	Also known as the financial year, the tax year runs from 6 April to 5 April in the following year. The tax people owe is calculated according to how much they have earned April to April rather than January to December.

Criteria for choosing a savings account:

- What is the rate of return (how much interest will I earn?)
- Is the rate of return higher than inflation?
- Will I have to pay tax on the interest my savings earns?
- How often will I be able to withdraw the money?
- How regularly will I want to save?
- How will I operate the account (online, with a passbook, etc)?
- How safe will my savings be?