

Keeping cash safe

'I'm not as concerned about the return on my money as I am the return of my money' (Will Rogers)

Small UK Bank goes bust. Not many depositors lose money.

Clients might have missed the news about The Southsea Mortgage and Investment Company. On the 16th June 2011 this small Portsmouth based bank was placed into the Special Resolution Regime (SRR) by the Financial Services Authority (FSA). The SRR legislation, introduced in the wake of Northern Rock's collapse, enables the FSA and the Bank of England to wind up a failing deposit taker.

Southsea, which had deposits of just £7.4m, was the first UK bank failure since the Dunfermline Building Society in March 2009. The new faster compensation payments system worked well for depositors, with the 'vast majority' of payments made on 17th June – a day after the bank was placed in the SRR.

A significant difference with this failure is that compensation has been limited to the maximum of £85,000 for each account holder. According to press reports, the Chancellor took a deliberate decision not to extend the open-ended protection that had applied to the likes of Dunfermline, Icesave and Bradford & Bingley.

At TRH we believe this decision is an important reminder that depositors cannot assume a government bail out if a bank fails. We also have very clear memories of the rescues required in 2008 of Lloyds and RBS in the UK; and one of the world's biggest financial institutions, AIG, in the USA. We believe that uncertainty over the stability of banking institutions is still with us.

Avoiding unnecessary risk

Default risk is a real concern for many clients with cash holdings in excess of the £85,000 compensation limit. Many clients have already taken our advice and reduced their exposure to this risk in the following ways:-

- Only using UK banks that participate in the compensation scheme and protecting cash up to £85,000 in each account.
- Splitting holdings between spouses so both are covered for compensation. (Also often useful for income tax planning).
- Spreading holdings amongst different banks. A convenient way to do this for clients with TRH portfolios on Transact is to use the Transact cash facility. All cash is placed overnight with 4 major UK banks thus achieving 4 amounts of £85,000 compensation. The account is instant access with monies available immediately. Transact currently pay a competitive gross interest rate of 1.04%. This account can also be used for corporate cash; we hold some of TRH's company cash at Transact.
- Being aware of savings institutions that share the same banking licence. Compensation would be limited to £85,000 for all accounts held with the same banking licence holder. For example the Bank of Scotland, Halifax, Birmingham Midshires, Cheltenham and Gloucester,



St James's Place Bank, and Scottish Widows Bank are all covered by the Lloyds Bank banking licence.

- Use National Savings. Sadly the best buy product this year, indexed linked 3 and 5 years certificates, were recently withdrawn but many of our clients managed to invest the maximum and have already built up substantial holdings of inflation protected tax free cash guaranteed by the UK government. As previous issues mature, they can be rolled over into new certificates and unless the cash is required this should be done. As soon as new issues are launched we will be in touch with clients again although we do not anticipate this happening until the 2012/13 tax year.

Summary

The combination of an extended period of negative (after tax and inflation) interest rates and loss of trust in banks can tempt one to consider other alternatives to deposit accounts. It is important to remember that one's cash holdings are generally to cover short to medium term liabilities so should not be subject to unnecessary risk.

This note covers the main risks to cash deposits; the next note will consider alternatives to deposit accounts identifying those to be avoided and some that might be worth considering.

Please do get in touch with TRH if this note gives you any concern about your cash holdings and you would like us to run a safety check for you.

Gareth Marr
The Red House
10th October 2011.

Regulatory notes

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