Not so simple savings

Disappointed with bank savings rates but wary of investing in an unpredictable stock market? We investigate products that claim to offer a third way

Stock market investment can be a risky business. If things go your way, you can make a much better return than with a bank. But if confidence evaporates, your money can too. But what if there was a way of getting the benefits of any stock market gains without being exposed to the losses if things go wrong?

That's the idea behind 'structured deposits' – often also called stock market-linked savings or capital-protected bonds – that aim to let you have your cake and eat it. If the markets rise while your money is invested, typically over a five or six-year period, you'll reap some, or all, of the benefit. And if stock markets fall, you won't lose any of the investment you started with.

Sound too good to be true? That's because, in many cases, it is. While these products have become all the rage over the past few years, being sold by a number of big-name banks and building societies (such as Royal Bank of Scotland and Santander), few of them stood up to scrutiny when our experts put them to the test.

We looked at a range of recently marketed FTSE 100-linked savings products, to see how they would have performed over the past five and 10 years – and most came up woefully short (see chart, p46). One Santander account would not have paid out the maximum advertised return on a single occasion in the past decade, and would have just paid out the minimum return in 94% of cases.

We found a similar story with Legal & General and Cater Allen. The L&G product wouldn't have paid out the maximum return at all over the past 10 years, while Cater Allen's would have achieved this in only 1% of cases.

Furthermore, none of the products we looked at produced an average annual return above what you could have earned in a fixed-rate savings account over the same period. So while a few lucky investors will have beaten the bank, the vast majority wouldn't have.

WHAT ARE THEY?

Rather than offering a set interest rate on your money, structured deposits pay you a rate of return that is tied to the increase in a particular stock market, such as the FTSE 100, over a set period. They're offered by a variety of providers, from the Credit Suisse products sold by building societies to accounts from banks and specialist providers, such as Investec and Cater Allen (Santander's private banking arm).

Each structured deposit is different, so it can be hard to make like-for-like comparisons. In most cases, if the relevant stock market index rises you'll earn some or all of that growth. But some products apply a cap to the maximum return you can earn, while others pay the full growth. Similarly, some offer you a minimum return if the underlying index falls, while others simply pay you your money back but not a penny more. Santander, for example, pays a minimum 2.06% return, but Cater Allen, Investec and RBS only return your initial deposit with no interest.

If you're thinking of putting money into a structured deposit, either directly or within a cash Isa, you need to decide whether the potential benefits outweigh the risks. Take, for example, the Credit Suisse Super Tracker Bond sold by Skipton BS, offering a maximum return of 40% over six years, equivalent to 5.77% a year. The best five-year fixed-rate savings bond (the nearest equivalent time-wise) currently pays 3.17% a year – so if the Credit Suisse bond delivers its maximum return, you'll do considerably better than you would have done in the bank.

If, however, the stock market performs badly, the structured deposit pays no interest at all. So you have to weigh up whether the possibility of earning an extra 2.6% of interest is worth the risk of losing the 3.17% that you'd receive if you simply put your money in a five-year fixed-rate savings account.

The crucial thing to remember is that even if you get all your initial investment back, you'll have still lost money. Once inflation has eaten away at your cash, £10,000 will be worth much less in six years' time than it is today.

In fact, if inflation averages 3% over the next six years, you'll need almost £12,000 to buy what you could buy for £10,000 today. And if inflation rose significantly more over the next few years, your money would be worth a lot less.

This is the key problem with structured deposits. Although they may give you the impression that you can't lose out, they blur the lines between saving and investing, giving investors the impression that they are a risk-free way of accessing the stock market. In reality, they do present a real risk to your money, and they're also very inflexible.

STRUCTURED CONFUSION

Which? experts found structured deposits complicated products to understand, so it's no surprise that they also baffle potential investors. In October, we showed an online panel of 1,321 Which? members the websites of three structured deposit providers – Cater Allen, Skipton BS and Yorkshire BS. Some 83%, 77% and 63%, respectively, found it either difficult or very difficult to understand how the product works, while almost as many found it difficult to work out the minimum and maximum possible returns.

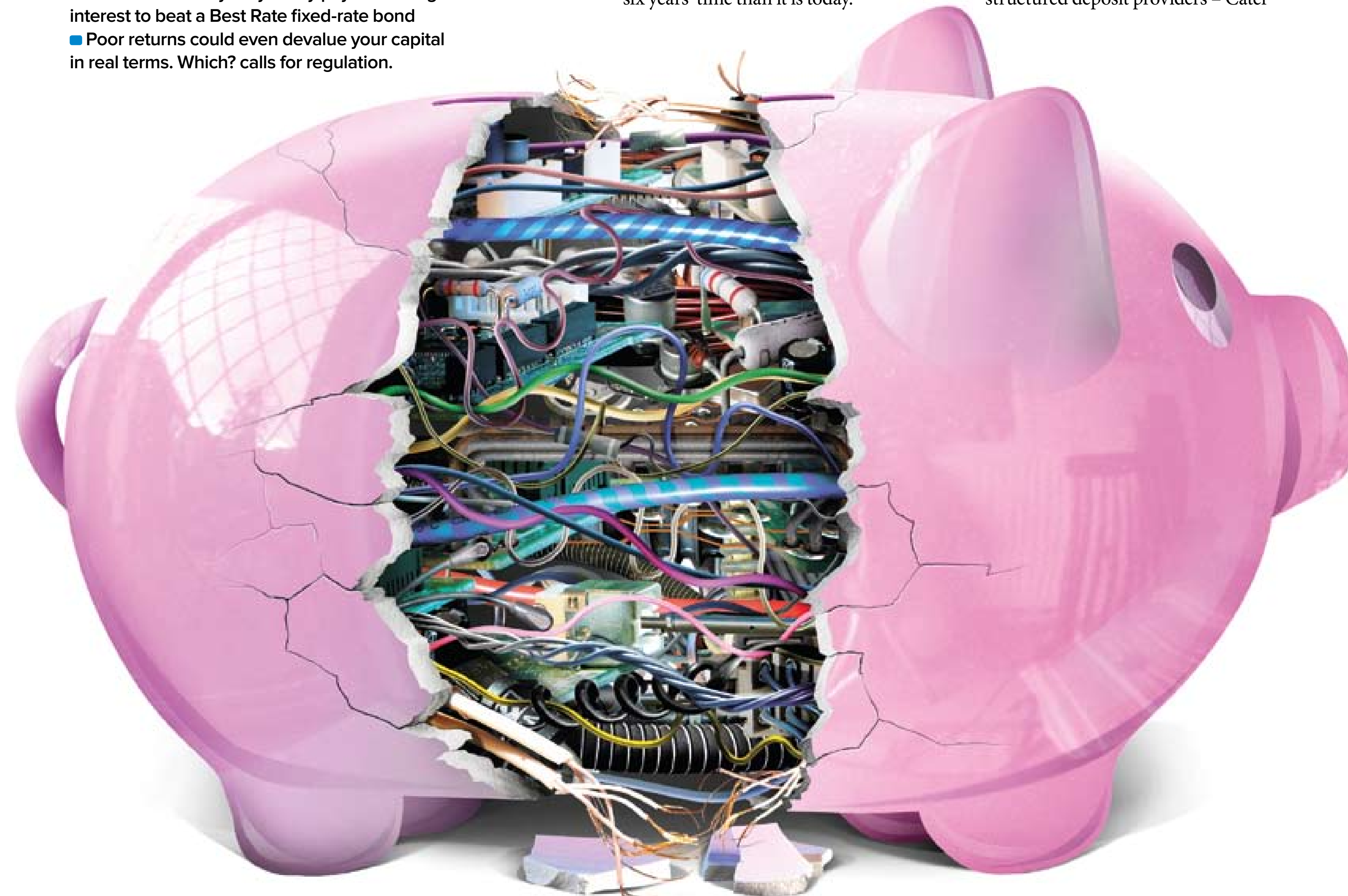
HOW DID THEY PERFORM?

To test how a selection of structured deposits would have performed if they'd been available in previous years, we analysed the performance of the FTSE 100 every day for the past five, 10 and 28 years (which is when the FTSE 100 was launched), calculating how often the structured deposits would have paid the minimum and maximum return, and the average return over each period.

The Santander Stockmarket Linked Savings Bond (Issue 26) offers a maximum return of half the growth in the FTSE 100 index, subject to an

AT A GLANCE

- Structured deposit schemes aim to offer stock market-linked returns without risk to your capital
- Which? finds they very rarely pay out enough interest to beat a Best Rate fixed-rate bond
- Poor returns could even devalue your capital in real terms. Which? calls for regulation.



PHOTOGRAPHY BY: DEREK BACON

Alternatives to structured deposit schemes

If you're looking for a fixed return on your savings and want to beat the 2.4% on offer from an instant-access account, you could consider a fixed-rate bond or cash Isa. The rates paid on these accounts have dropped in recent months, so it may be wise to lock your money in for a shorter period than five years. The best three-year fixed-rate deal, for example, pays 3.3%.

If you want a degree of exposure to stock markets, you could put some of your money into a low-cost tracker fund. While your capital is at risk when investing directly, you can reduce this risk by choosing a fund with a higher proportion of cash- and fixed-interest-based investments. Read 'The best ways to invest £10,000' (Which?, September 2012, p62), visit www.which.co.uk/modelportfolios for more details, or call the Which? Money Helpline on 01992 822848.

overall cap of 50% over six years, or 6.99% a year. But our analysis shows that this product would never have paid out the maximum in any period over the past five or 10 years. Even if you include the performance of the FTSE 100 all the way back to April 1984, including the stock market boom of the early 1990s, you would have had just a one-in-seven chance of earning the maximum. Shockingly, it would have paid out the minimum return of just over 2% a year in almost all cases in the past 10 years, and in 90% of periods during the past five years.

Other products would have paid out the maximum more often. For example, Investec's 3-year Deposit Plan 37 would have paid the maximum 38% of the time over the past decade. However, with this product the bar is set lower – its maximum return of 15% (or 4.77% a year) is more achievable. And despite its apparent superior performance, the average return on the Investec product over the past 10 years would, at 2.02%, have been lower than the average return for those investing in the Santander product due to the zero return paid if the FTSE 100 falls.

But these are not the lowest-paying products. Over the past decade, the structured deposits from Royal Bank of Scotland and Cater Allen would have paid an average annual return of just 1.34%, while products from Skipton BS and Legal & General would each have paid out an average of under 2% a year. These products would have performed slightly better over the past five years. But over the same period you could have earned more on a fixed-rate five-year bond. While today it is 3.17%, in November 2007 Halifax was offering 6.2% AER on its five-year bond, guaranteed for the full term.

Structured deposits: what would they have paid out?

The illustration below shows how often each index-linked savings product would have paid out the advertised maximum and minimum returns for periods ending on each day over the past 10 years to 1 November, as well as the average return you would have earned before tax based on the performance of the FTSE 100 index. Where providers offer more than one structured deposit product, we have selected the product with an upper limit on returns to allow easier comparison within the sector. Where two periods are available, we've then chosen the longer investment period. Annual returns are rounded to two decimal places.

Banks and Products	Desposit term	Maximum annual return	Chance of maximum return	Minimum annual return	Chance of minimum return	Average annual % return
RBS UK Accelerated Growth Deposit Plan 1	5 years 11 months	6.48%	3%	0%	48%	1.34%
Cater Allen Enhanced Growth Plan 12	6 years	6.99%	1%	0%	48%	1.34%
Skipton BS Super Tracker Bond 12	6 years	5.77%	4%	0.82%	57%	1.74%
Legal & General 6 Year Growth Deposit Bond 16	6 years	5.77%	0%	1.21%	61%	1.89%
Investec FTSE 100 3 Year Deposit Plan 37	3 years	4.77%	47%	0%	53%	2.26%
Santander Stockmarket Linked Savings Bond (Issue 26)	6 years	6.99%	0%	2.06%	94%	2.10%
Yorkshire BS Protected Capital Account - Fixed Growth 10	6 years	4.47%	63%	1.00%	37%	3.19%

ILLUSTRATION BY: PAUL BUTT

SAVINGS PROTECTION

Perhaps the one saving grace of structured deposits is that your capital is protected up to £85,000 under the Financial Services Compensation Scheme, so you'd get your money back if your provider went bust.

But beware of similar-looking products without this protection. The Morgan Stanley FTSE Simple Growth Plan 16, for example, looks like the products in our table: it pays out a return based on the performance of the FTSE 100 and repays your capital in full if the FTSE falls. However, your money is not protected under the FSCS, but rather is invested in a Morgan Stanley corporate bond. If Morgan Stanley fails, you could lose some or all of your money. These products are commonly known as structured investment products.

Santander offers two similar products. Under one, the most you could earn each year is 4.66%, while you could earn as little as 0.06%. In almost two thirds of periods in the past 10 years, you would have earned the minimum. With the product offering no protection under the FSCS, many investors will question why they would invest in this product given the downside risks.

OTHER PROBLEMS WE FOUND

■ **Upper limits** Some structured deposits have an upper cap, which brings with it two dangers. If the stock market does very well over the period, you won't enjoy the full growth. This is particularly true if the product has a relatively low upper limit. Yorkshire BS's Fixed Growth 10, for example, has an upper limit of 30% over six years, equivalent to 4.47% a year. While not a major issue in the current low-growth environment, an upper cap would have come into play in over half of the periods ending between 1990 and 2012.

Conversely, products that advertise a higher upper ceiling risk giving the impression that savers are likely to receive this rate. However, our testing shows that some products would have paid out the maximum return in less than 1% of periods over the past decade.

■ **Fixed end dates** Structured deposits have a fixed end date. Unlike a direct investment in the stock market, you can't hang on and wait for the market to recover if there's a dip in your selected index just before the redemption date. Some providers protect you against stock market fluctuations towards the end of the term by using the FTSE's average closing value over the final six to 12 months. However, you still can't time your exit from the investment without incurring penalties and you could lose out if the stock market rises sharply at the end of the term.

It is sometimes possible to get out earlier, but you will usually lose the return you've earned so far and possibly more. With the Investec, RBS and Yorkshire BS plans, for example, you could get back less than you put in if the stock market has fallen. The Santander product doesn't allow access to your money before the end of the term at all, unless you die.

■ **Loss of extra returns** Unlike direct stock market investments, your capital isn't at risk in a structured deposit. But you won't receive any dividends – a distribution of the profits earned by companies in a stock market index – only the capital growth. On a five-year product, that means you miss out on more than five years' worth of dividends compared with direct investment.

With some providers, there is also no return on the deposit during the 'holding period' – between when you hand over your money and the official launch date of the product. For RBS's recent issue, for example, the plan was open for deposits between 13 August and 12 October 2012, but the opening index value wasn't taken until 26 October, so you could have lost out on over two months' return if you'd invested early.

GO ONLINE If you're ready to start investing in the stock market, our beginners' guide to investment explains the different options, to help you choose the right investment plan for you. Visit **www.which.co.uk/invest**

EXPERT VIEW

Better off in savings

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Structured deposits deliberately blur the lines between saving and investing in our view, often giving customers the impression that they're likely to do better than they actually are.

Although such products are tempting at a time when interest rates on savings accounts continue to plummet, banks, building societies and financial advisers need to help their customers understand what their appetite for risk really is, and how much money they could ultimately afford to lose out on.

For the vast majority of people, a fixed-term savings account will be the best place to put their money. And if they have a good savings buffer built up, and are ready to start investing, the next step should be to consider building a diversified portfolio of stocks and funds (see 'Alternatives', p45).

Structured deposits have crept into the mainstream over the past few years, with banks and building societies presenting them as a mass-market alternative to savings accounts. This positioning is completely wrong, and Which? believes it is time that these products were brought under the same regulations as other investments and sold with regulated financial advice. Banks should also be banned from receiving commission for recommending these products. We want the regulator to take strong and decisive action to stop consumers being misled.

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