<u>The Next 'Advice Time Bomb?</u>

In April 2016 the new Personal Savings Allowance (PSA) will be introduced to help the majority of savers earn more interest and pay less tax.

From April 2016 the PSA is being introduced for savers who are both basic rate and higher rate tax payers. Basic rate tax payers will be allowed to earn £1,000 per annum interest before paying any tax on their savings. Higher rate tax payers will be allowed to earn £500 per annum interest before paying any tax.

The allowance provides and extra £200 tax benefit for both basic and higher rate tax payers.

So what impact will this have on the financial adviser?

If financial advisers are not careful, this will become another advice time-bomb waiting to go off.

The problem with cash in the financial services industry is that it has always been considered to be a 'necessary evil'. Something that everybody needs to have but not something that can add value to their financial situation. As a result, financial advisers have become accustomed to the idea that the only way to add any value to cash is to invest it.

At a 'certain level' this is accurate.

If nobody helps a client to maximise the value of cash, clients do not appreciate what they are losing. Banks and building societies are motivated to pay their clients the lowest possible rates of interest. This is called, the Dormant Rate of interest, which is currently, at best, 0.10%.

Before understanding what impact this has, let's first of all remind ourselves of the terms of the Personal Savings Allowance:

Basic Rate Tax Payer

The basic rate tax payer will be able to earn up to £1,000 interest per annum before having to pay tax on their savings.

Higher Rate Tax Payer

The higher rate tax payer will be able to earn up to £500 interest per annum before having to pay tax on their savings.

These amounts enable both basic rate and higher rate tax payers to earn an extra **£200.00** interest per annum from their savings held on deposit.

However, to achieve this level of benefit, when earning just 0.10% interest per annum, the following amounts are required to be held on deposit:

	Basic Rate Tax Payer	Higher Rate Tax Payer
0.10% Interest	£1,000,000	£500,000

Given these numbers, it is highly unlikely that any basic rate tax payer, or even for that matter most higher rate tax payers, will ever be able to maximise the value of the PSA.

Surely, this must therefore render it a 'worthless' benefit!

Or does it?

This is the problem that financial advisers will face.

Cash deposits have never fallen into the regulated financial advice space. As a result, most financial advisers have never considered the true value that cash deposits can provide to a client's financial circumstances. This means that they do not know how 'little' a client really needs to maximise the value of their PSA.

If they therefore recommend that a client invest some money, and the investment fails to deliver, the financial adviser will be automatically in breach if it has never been disclosed to a client what they could have earned from a guaranteed tax benefit with a product that guarantees no loss of capital, subject to deposit amounts remaining below the limit of protection offered by the FSCS.

The reality is, that if a client manages their cash effectively, they would actually need as little and the amounts shown in the table to maximise the value of the PSA:

	Basic Rate Tax Payer	Higher Rate Tax Payer
Effectively Managed Cash Portfolio paying 2.12% AER	£48,000	£24,000

(source: Deposit Sense Ltd – 8th March 2016)

Clearly there is a significant difference between the amount an individual requires to maximise the value of the PSA, depending upon whether or not they effectively manage their cash. The unfortunate position for a financial adviser is that their advice will be considered 'unsuitable' if they do not disclose to their clients how they could obtain the maximum value of the PSA.

They therefore have the following options:

1. Continue to ignore cash and use the poor performance of cash as a justifiable reason to invest. Then build a suitable investment portfolio to maximise the value of their longer term cash requirements.

2. Explain the personal savings allowance and explain that the benefit is minimal as the client would need either £500,000 or £1,000,000 on deposit to maximise the value of the benefit. Then build a suitable investment portfolio to maximise the value of their longer term cash requirements.

3. Help clients to maximise the value of their cash. Provide a report to demonstrate that around £47,500 is required to maximise the value of the savings allowance. Then build a suitable investment portfolio to maximise the value of their longer term cash requirements.

To make their best decision, the financial adviser must consider their own processes, their access to appropriate information and their own attitude to risk. If they have a 'high' attitude to risk they will consider the impact of the PSA to be insignificant and will continue to provide investment advice based upon misinformed cash decisions. However, those that wish to preserve their professional pedigree will review their advice processes, or may even already have done so, to ensure their clients are fully informed to ensure they make the right decisions.

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