NPA Financial Services

Level 6

PERSONAL FINANCE AWARENESS

Course Notes

Version 1.0

All information contained within these notes was correct at the time of writing.

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Contents

Outcome 1: Income, expenditure and budgeting

1. Income & Expenditure

Your age and stage in life will influence how much money you earn, your financial needs and your sources of income. When preparing your portfolio, you will be asked to consider the sources of income and expenditure for three life stages. The following information is non-exhaustive and has been left deliberately vague to allow you to complete your own research.

Becoming a learner in Further or Higher Education (Summary of student funding)

After leaving school, you may choose to move on to further study, which usually involves attending college or university. The funding available to you will vary depending on your mode of study, your personal background/family income and whether you are living away from home.

In Scotland, student loans and bursaries are administered by the Student Awards Agency for Scotland (SAAS). Tuition fees are fully funded in Scotland. The only reason you would be expected to pay your tuition fees is if you are studying outside of Scotland or are resitting any part of your course.

SAAS also administer all student loans and bursaries. The amount of bursary and student loan you can get will depend on the household income in your permanent home.

Household income	Bursary	Loan	Total
£0 to £20,999	£2,000	£5,750	£7,750
£21,000 to £23,999	£1,125	£5,750	£6,875
£24,000 to £33,999	£500	£5,750	£6,250
£34,000 and above	£0	£4,750	£4,750

Bursaries do not have to be repaid whereas student loans do. The earliest you'll start repaying is the April after you leave your course. You'll only repay 9% of any income over £364 a week or £1,577 a month (correct in October 2019). You will have 30 years to repay your loan before all remaining debt in written off.

Additional funding may be available if you meet one of the following criteria:

- Experienced care
- Estranged from parents
- Lone parent
- Disability/Learning Difficulty
- Studying dentistry

Further information is available at:
https://www.saas.gov.uk/full_time/ug/young/funding_available.htm

While study, you may also receive additional income from parents or a part-time job.

Commencing employment

After leaving education and entering the world of employment, your main source of income will be your wage/salary. Wages/Salaries are usually paid monthly (usually last Friday or last working day) or 4 weekly (13 times per year).

Many people who reach this stage of financial independence will often consider where they would like to spend their hard-earned cash. By having a steady job/income, you are also able to borrow money for some of those more luxurious items or for your own independence (house, car etc.)

Remember, it is also important to consider saving in addition to borrowing and spending!

Your monthly salary will be your main source of income for all remaining life stages until retirement.

Starting your own business

There are any number of reasons that a person may choose to start their own business. While it can be rewarding, it can also involve a lot of hard work and financial insecurity. When starting a business, you will need to have some savings and a sound business plan, which may allow you to borrow additional funds.

Those who are self-employed or own a small business can have irregular income depending on business performance. Many businesses are however successful and can be very profitable.

Those who are self-employed must also complete and annual tax return and good financial understanding is imperative. While you are welcome to consider this life stage when conducting research for your folio, information beyond what has been provided is outside the scope of this unit.

Getting married

Weddings are expensive and other than saving for a house deposit, your wedding is likely to be the most expensive thing you ever pay for. Many people are happy to pay the thousands of pounds required to have the perfect wedding however it is not recommended that any couple starts married life by getting into serious debt (though some do).

In order to meet the costs of a wedding, many people will save for some years in preparation for their big day. More fortunate couples may have the support of their parents/family who will often offer to reduce their financial burden but again, this is done as a result of some dedicated saving.

When preparing for a wedding, the amount of money spent of wants (non-essential reasons) is reduced and more money is set aside. While income can by changed slightly through working overtime, bonuses and commission, it is unlikely that you will see a significant change and as a result it is important to save while living within your means.

There is however the added benefit that you are not alone and your partners income can supplement your own. At this stage in life couples will often consider joint bank accounts for shared expenses.

There are however financial benefits of getting married.

Married couples and those in civil partnerships can transfer up to £1,250 of personal allowance (10% of the £12,500 personal allowance for 2019/20) to their partner for 2019/20 and is sometimes known as the Marriage Tax Allowance.

You might be eligible for this if:

- you're married and are not in receipt of Married Couple's Allowance.
- one of you earns less than the Personal Allowance so is not liable to tax or liable to tax at the higher or additional rates. This means an income of less than £12,500 while your partner is a basic rate taxpayer with income between £12,501 and £50,000

Buying your first house

Before buying your first home, you will be expected to have saved a deposit. The standard deposit that is paid by first-time buyers is usually between 5-10% of the houses value. The remaining is usually paid by taking out a mortgage. Mortgages are usually taken out over term of 25-40 years. Paying for a mortgage will be a monthly expenditure for the remainder of the term. When saving for your deposit, there are a number of government backed help-to-buy schemed that are targeted a first-time buyers.

Further information on savings products and mortgages is provided in chapters 2 and 3 of these notes.

Starting a family

While your income is unlikely to change when you start a family (unless you choose to stop working or reduce your hours), the amount of free cash you have each month will be reduced. With an extra person to provide for, effective budgeting is very important.

Women are entitled to free NHS dental care in the UK while pregnant and for a year after the baby is born.

When a baby is born, mothers are entitled to a year's maternity leave and pay from their employer for up to 39 weeks while on leave. Full pay does not have to be paid and families should budget effectively for the course of the maternity leave.

Statutory Maternity Leave	Statutory Maternity Pay
The first six weeks	90% of your average weekly earnings before tax
The next 33 weeks	£148.68 or 90% of your average weekly earnings - whichever is less
The next 13 weeks (if taken)	Unpaid

Once a child is born, families can also claim child benefit. Child Benefit is a regular payment of money from the government to help with the cost of raising a child. Only one person can claim Child Benefit but they can claim for every child they're responsible for. Anyone responsible for a child under 16 can claim child benefit. The rates for the 2019/20 tax year are £20.70 per week for the eldest or only child plus £13.70 per week for each additional child.

Retirement

When you retire, your main source of income will change from a monthly wage/salary to a pension.

One important note is that most people will aim to have paid off their mortgage before retirement in order to have access to all their pension income.

Most people will have access to a state pension when they retire. For the tax year 2019-20 the full new State Pension is £168.60 per week.

You may also have a workplace or personal pension and the amount this pays out will depend on the type of pension you have and the decisions you made during your life/on retirement. Further information on pensions in provided in the notes for outcome 3.

Portfolio Task Considerations

Further information on the portfolio tasks will be issued in class. It is recommended that you consider the following as your 3 life stages for further investigation.

- Starting further/higher education
- Commencing Employment
- Purchasing a house OR retirement

2. Income Tax & National Insurance

Income Tax

Everyone is allowed to earn some money before they start to pay Income Tax.

This is your Personal Tax Allowance. It is set by the government each year, for example in 2019/20 this is £12,500 per year for most people. The income that you earn above your personal tax allowance is called your taxable income.

Once your income goes above this allowance you will pay Income Tax. The percentage of your taxable income that is deducted from your pay will vary depending on your income. The Scottish income tax bands for the year 2019/20 are as follows:

Band	Taxable income	Scottish tax rate
Personal Allowance	Up to £12,500	0%
Starter rate	£12,501 to £14,549	19%
Basic rate	£14,550 to £24,944	20%
Intermediate rate	£24,945 to £43,430	21%
Higher rate	£43,431 to £150,000	41%
Top rate	over £150,000	46%

This means that for those on the lowest income they pay no Income Tax at all, but the more you earn the higher the amount of Income Tax you pay (although the more you earn the more you take home too!). Charging different rates of tax at different levels of income is known as tax banding.

Note: There are more income tax bands in Scotland than there are in the rest of the UK. This is because income tax rates are devolved to the Scottish Parliament.

Income Tax is collected by HMRC on behalf of the government. It's used to help provide funding for public services such as the NHS, education and the welfare system, as well as investment in public projects, such as roads, rail and housing.

National Insurance

Everyone receives their National Insurance number just before their 16th birthday. It will stay with you for life. Most people who work have to pay National Insurance contributions.

National Insurance is paid at approximately 12% of your income. In 2018/19 there is a lower earnings limit of £8,424, below which you pay no National Insurance at all. There is also an upper threshold of £46,350, above which you only pay 2% of your income.

National Insurance contributions help to build up your entitlement to certain benefits, such as state pension, maternity allowance and financial support if you are unable to work. In addition to employees paying National Insurance, it must also be paid by your employer for every worker they employ.

3. Wages and Salaries

Wage

A wage is a rate of pay that is calculated per hour. e.g. £7.50 per hour.

In the UK there are minimum and living wages.

Minimum Wage

The minimum wage is the least amount per hour that a worker must be paid according to the law.

Living Wage

The living wage is calculated according to the basic cost of living in the UK. Employers choose to pay the living wage on a voluntary basis for anyone under the age of 25. The livening wage and minimum wage for those 25 and over are the same.

Year	25 and over	21 to 24	18 to 20	Under 18	Apprentice
April 2019	£8.21	£7.70	£6.15	£4.35	£3.90

Apprentice rate: Special Note

Apprentices are entitled to the apprentice rate if they're either:

- aged under 19
- aged 19 or over and in the first year of their apprenticeship

Apprentices are entitled to the minimum wage for their age if they both:

- are aged 19 or over
- have completed the first year of their apprenticeship

Salary

A salary is a payment by an employer to an employee for employment that is expressed either monthly or annually. e.g. £24,000 per annum

A salaried employee is paid a fixed amount of money each month. e.g. £24,000 ÷ 12 months = £2,000 (though overtime/additions are still available but far less common)

4. Pay Slips

Basic Pay

This is your pay when you work your normal agreed hours. Basic Pay is the minimum amount of money a person can expect to be paid from their employer.

This is the pay before any additions or deductions.

Additions

An addition is any extra money that is earned on top of your basic pay. The most common examples are overtime, commission or performance bonuses.

Gross Pay

Gross Pay is the amount of money an employee will earn before deductions. (Basic Pay + Additions)

Deductions

A deduction is any money that is taken from your gross pay. e.g. Income Tax, National Insurance Contributions (NIC), Pensions, Student Loans Repayments etc.

Net Pay

Net Pay is the amount of money that will be paid into an employee's bank account. A number of websites will call this the "take home pay". (Basic Pay + Additions - Deductions)

Tax Codes

A tax code is usually made up of several numbers and a letter, for example: 1000L

Residents in Scotland will have an S at the beginning of their tax code (S1000L). This is because income tax is devolved to the Scottish Parliament and the amount of tax Scottish workers pay is different to the rest of the UK.

Multiplying your tax code by ten will provide you with the total amount of income you can earn in a year before paying tax. Therefor, on a tax code of S1250L, the amount you can earn before paying tax is 1250 x 10 = £12,500. This is known as your personal allowance. It is set by the government and may change from year to year.

In the year 2019/2020, the personal allowance is £12,500 (Tax code = S1250L).

Tax Codes Explained

- L - You're entitled to the standard tax-free Personal Allowance.
- M - Marriage Allowance: you've received a transfer of 10% of your partner's Personal Allowance
- N - Marriage Allowance: you've transferred 10% of your Personal Allowance to your partner
- T - Your tax code includes other calculations to work out your Personal Allowance
- 0T - Your Personal Allowance has been used up, or you've started a new job and your employer does not have the details they need to give you a tax code
- BR - All your income from this job or pension is taxed at the basic rate (usually used if you've got more than one job or pension)
- NT - You're not paying any tax on this income

Pay As You Earn (PAYE) Deductions

Most people pay Income Tax and National Insurance Contributions through PAYE. The Pay As You Earn (PAYE) system is a method of paying income tax and national insurance contributions. Your employer deducts tax and national insurance contributions from your wages or occupational pension before paying you your wages or pension. It means you pay tax/NIC over the whole year, each time you are paid, rather than paying tax/NIC in one lump sum.

At the end of the tax year, you will get a form P60 which sets out the total amounts paid to you and deducted from you for the previous tax year. A tax year runs from 6 April one year to 5 April the following year. (P60's will be discussed later in this chapter)

5. Methods of Payment

Cash

Coins were first used in the 7th century BC and notes first appeared in China a thousand years ago. Many people still use cash today as a quick and convenient way to pay for everyday items – though this is now being challenged by a number of electronic methods. Many people like the fact that cash is physical and budgeting is easier when cash is used. Cash is, however, easily lost/stolen, can be counterfeited and can only be used in physical shops up to a limited value.

Cards

Since they first appeared in the 1950s there has been a rapid growth in the number of plastic cards that can be used to access money. When people want cash nowadays they often use a card at an ATM or cash machine to make a withdrawal. Using plastic is also a popular way of spending, though the two most common types of card can easily (but must not) be confused:

Debit card – When you make a payment or withdraw cash with a debit card, the money is taken straight out of your bank account electronically if you have the money available to spend. You cannot borrow money on a debit card. Debit cards usually link to a current account. (Further information in section 7 of this chapter.) Debit cards can be used to pay for goods and services over the phone or online using the information printed on the card. They can also be used to pay for goods and services in store using 'chip and pin'.

Credit card – Available to 18 year olds and older, these allow you to borrow money up to a certain limit. When you buy something with a credit card, the amount you spend is added to the total amount borrowed. (There is much more information on credit cards in the 'Borrowing' chapter.) Interest is charged on credit card purchases if the 'debt' is not repaid within a specified time frame

One of the benefits of using a credit card is that it gives you greater protection if something goes wrong – for example, the business you bought the goods or services from goes bankrupt, or your order is not delivered. If this happens, then you would be entitled to a refund, but only if the item or service you purchased cost between £100 and £30,000. This protection does not apply to debit cards.

	Credit Card	Debit Card
1. Eligibility Criteria	Need to be fulfilled	No criteria
2. Maximum limit	Determined on credit score, credit history, etc	A little less than your savings or current account balance to which the card is linked
3. Interest	Charged or levied on amount utilized	Paid to you on the account balance
4. Utilization summary	Monthly Credit Statement	Monthly Bank Statement
5. Debt Instrument	Yes	No

Contactless

The latest significant development with plastic cards is contactless payments, which speed up any transaction. The contactless symbol identifies that there is a contactless payment option – and is usually found on a card machine. Using a debit card, credit card, smartcard, smartphone or other device, you can make small payments up to a maximum of £30 without having to enter your PIN. Apple Pay & Android Pay are examples of contactless payment methods out with the traditional plastic card and store your cards details securely on a mobile device.

Cheques

A cheque is a document that orders a bank to pay a specific amount of money from a person's account to the person whose name is on the cheque. Cheques go through a rigorous checking procedure and it can take up to 6 days for funds to be available in the receivers account.

A number of businesses will no longer accept cheques and personal cheques should only be accepted from someone you know and trust.

Banks will usually reject a cheque that is over 6 months old.

Cheques will 'bounce' if the payer does not have the money in their account. There is no way of knowing if they have the money until the cheque is deposited and therefore you could end up out of pocket if you have provided a good/service in advance. Cheques are still widely accepted for postal orders. The other challenge with a cheque is that they are physical pieces of paper than cannot be easily transferred from person to person or place to place.

The cheque clearing process is discussed in the next section of these notes.

Bankers Draft

Bankers drafts are cheques that are written by your bank. They are used for paying large sums of money but are becoming increasingly less common as BACS only payment methods becoming more popular.

The issuing bank will make sure you have the money before writing one and so they offer increased protection for the recipient as they will never bounce.

Standing Orders

A standing order is an instruction you give to your bank to pay a fixed amount of money at regular intervals, whether it's weekly, monthly, quarterly or yearly. The payer sets the terms of the standing order and has full control over payment frequency and value.

Direct Debit

A direct debit is set up when you authorise an organisation to collect money directly from your bank account whenever a payment is due. Direct Debit payments can vary in frequency and amount. By signing up to a direct debit you are allowing a 3rd party to withdraw money from your account on a set day to pay for good/services e.g. phone contract, bills, Netflix, Spotify etc.

If the organisation receiving the money makes a mistake and withdraws too much money, it is the account holders responsibility to reclaim the money. As direct debits can vary in amount, they can make budgeting difficult.

The benefit of direct debits is that they save time as there is no need to visit various companies offices/websites to make payments. They also avoid missing payments as the system is automatic and run by the organisation/person receiving the money.

Digital Payment Methods

Pay a contact — Allows mobile banking customers to set up payments to a friend's or contact's account using their mobile phone number to make payments.

PayPal – an electronic payments system that allows you to make secure payments to an individual, or to purchase items online.

Online Bank Transfer – Allows money to be transferred from on person to another provided their bank account details are known. Transfer are typically completed within 2 hours.

6. Cheque clearing process

The 2-4-6 is a clearing system brought in by the Cheque and Credit Clearing Company who carry out cheque clearing.

2-4-6 indicates the two days until the money is earning interest, the 4 days until you can withdraw, and the 6 days until you can be sure that the cheque funds have been applied to your account.

The full details of the process are as follows:

Day one

- The cheque details are registered with both your bank and the bank it has come from
- You can usually see the funds payable to you as an entry on your statement
- All cheques are rounded up at the end of each working day and sent to a clearing centre

Day two

- The cheque arrives at the clearing centre and waits to be sorted
- The sort code, account number, serial number, and amount are taken from the cheque
- These details are sent electronically to the bank on which the cheque is from
- It goes to an exchange centre where the bank the money is coming from picks it up

Day three

- Most banks will begin to pay interest on your paid-in funds within two working days
- The money taken from the account that is paying shows as an entry on a statement
- It could still bounce, or have a technical error that would require it to be returned

Day four

- You can withdraw the funds
- The cheque could still bounce up until the 6th day

Note: The cheque clearing system was changed under new legislation. The new process is discussed in the following diagram (next page) however many banks still make some use of the old system.

7. Bank Statements

Bank statements display all account transactions within a given period.

Statement period	Account Name	Account Number	Sort code
1 June to 30 June	Miss L Jones	68564539	00-00-00

Date	Payment Type	Details	Paid Out	Paid In	Balance
1 June		BALANCE BROUGHT FORWARD			**£148.85**
5 June	ATM	ATM Hackney	£20.00		£128.85
5 June	DR	Charge	£1.75		£127.10
11 June	POS	Super supermarket	£25.00		£102.10
12 June	DD	N.E. Gas and Heating ltd.	£18.00		£84.10
17 June	CR	Wages		£335.00	£419.10
21 June	SO	DoorSteps loan payment	£95.20		£323.90
24 June	CHQ	000478		£185.00	**£508.90**

Paid in or Credits – The amount of money that has been paid into an account on a single transaction.

Balance Brought Forward – The amount of money you have at the start of the statement period (Same as the closing balance on your previous statement)

Paid Out, Withdrawals or Debits – The amount of money that has been removed from the account.

Balance – A running total of how much you've got in your account. The balance in any given row if the amount of money you now have following the corresponding credit or debit.

Closing Balance – The amount of money in the account at the end of the statement period.

Statement period – The time period covered by the statement (often 1 or 3 months).

Sort Code – A 6 digit code that identifies the bank and branch where the account was opened.

Account Number – A unique number that identifies the individual customer.

Bank Statement Payment Type Abbreviations

BGC - Bank Giro Credit

ATM – Withdrawal from a Cashpoint

CDM - Cash & Deposit Machine

CHQ - Cheque

CPT – Cash Point Transaction

CR - Credit

DD - Direct Debit

DR – Debit Balance

DEB - Debit

FPI – Faster Payment Inwards

FPO – Faster Payment Outwards

INT - Interest

ITL - International

POC - Post Office Counters

POS - Point of Sale/Debit Card Transaction

SO - Standing Order

TFR - Transfer

8. Needs & Wants

While it would be great if every person had an unlimited source of money, in reality people have to make important decisions about where their money should be spent. It is important to consider whether spending is for essential or non-essential reasons and we will do this by categorising spending decisions based on needs and wants.

Needs – These are the absolute necessities; the things you really cannot do without. Some of these are obvious, such as water, food or housing, although you may still need to make choices about them, such as which brands to buy, which will impact on the price.

Needs are what we need to live and survive. Since ancient times the three basic needs are food/water, clothing and shelter but with the passage of time, education and healthcare have also been considered essential, as they improve quality of life. Needs are a person's first priority as they are the things, that keep us healthy and safe. Therefore, if needs are not satisfied in time, it may result in illness, inability in functioning properly or even death.

Wants – These are the items, services or experiences you would like to buy if you have the money to do so. This is where personal choice and preferences really come into focus. It is all a matter of the priority placed on each of these by each individual.

Wants include everything else we might like to have, but do not need in order to survive. Wants may vary from person to person and from time to time. The number of wants a person can have are unlimited while the means to satisfy those wants are limited by a person's income. Hence, all the wants of an individual cannot be met.

9. Other Important Documents

P45

You'll get a P45 from your employer when you stop working for them.

Your P45 shows how much tax you've paid on your salary so far in the tax year (6 April to 5 April).

It allows your new employer to make sure you are on the correct tax code to minimise any inaccuracies.

P60

Your P60 shows the tax you've paid on your salary in the tax year (6 April to 5 April). You get a separate P60 for each of your jobs.

If you're working for an employer on 5 April they must give you a P60. They must provide this by 31st May, on paper or electronically. You can use your P60 to work out if you have overpaid tax in the previous tax year. If you have then you may be due a rebate.

Outcome 2: Borrowing

In this chapter you will explore options about borrowing money.

You will see how borrowing has increasingly become a part of the modern world, and that it requires very careful management.

You will look at the various ways there are to borrow money and what the advantages and disadvantages are of each method. You will also investigate how repayments and interest work.

Failure to repay and getting into debt can have serious consequences, so you will be looking at how to avoid these situations and what to do if debt does build up.

1. Reasons to Borrow

There are any number of reasons that a person may choose to borrow money but in short, people will borrow money in order to pay for goods/services that they cannot afford to pay in one lump sum and/or at this current moment in time.

This chapter will describe the most common methods of borrowing money. Factors such as the timescale, the cost of borrowing, repayment methods and possible risks will be considered.

Borrowing option/reasons can be categorised as short, medium or long term goals.

Short term – Repaid within 1 year

Medium term – Repaid within 1-5 years

Long term – Repaid in over 5 years

The following table shows a list of reasons that may cause people to borrow money. These are the most common examples and there will be others reasons that a person may choose to save.

Reason	**Term**
Special Events and Occasions	Short
Expensive items e.g. TV, Phone, Laptop etc.	Short
Travel / Holidays	Short
Home Renovation/Repairs	Short/Medium
Buying a car	Medium
Start a business	Medium/Long
Student Loan/Tuition Fees	Long
Buy a house/property - Mortgage	Long

2. Interest Rates

Interest can be both good and bad depending on the context in which it is being discussed.

In the context on savings, interest is money that is being paid to you as a reward for saving money with the particular bank. Interest in relation to savings is discussed in the next chapter.

Interest in relation to borrow is not a positive however. Interest is a fee charged by a lender when money is borrowed. It is expressed as a % of the amount borrowed and it must be repaid in addition to the original loan amount. The higher the interest rate and the longer you borrow for, the more interest you will have to pay.

The interest rate on borrowing products in called the Annual Percentage Rate or APR.

Annual Percentage Rate

Annual Percentage Rate (APR) is a way of measuring the interest rate (and any other charges which are applied) to a number of financial products such as personal loans, credit cards and hire purchase agreements.

APR is the total fee charged by the lender when money is borrowed and includes interest (as above) and other charges such as insurance. APR should be higher than the interest rate and is always expressed as a %. It allows a true comparison of the total cost of borrowing between similar products.

Fixed and Variable Interest Rates

Fixed Interest is....

- Where the interest rate does not change.
- The amount of interest paid each month is the same.
- You always know how much you have to repay.

Variable Interest is....

- Where the interest rate might change from month to month.
- Rates are based on the Bank of England interest rate.
- If the rate goes down, you will repay less.
- If the rate goes up, you will repay more.

3. Secured vs Unsecured Loans

A secured loan is one that is connected to a piece of collateral - something valuable like a car or a home. With a secured loan, the lender can take possession of the collateral if you don't repay the loan as you have agreed. A car loan and mortgage are the most common types of secured loan. Secured loans present less risk to the lender (they are guaranteed to get something back) so they may charge less interest.

An unsecured loan is not protected by any collateral. If you default on the loan, the lender can't automatically take your property. The most common types of unsecured loan are credit cards, student loans, and personal loans. There is more risk to the lender with unsecured loans so they may charge higher interest to make it worthwhile.

4. Credit Rating & Credit Scores

A credit score is what lenders use to check you are able to manage your debt and tells them if you are a risk or not.

What makes a good Credit Score? It's a good question, and one without a single answer because the three main credit referencing agencies (CRAs) in the UK all score consumers differently.

Each CRA states what a good credit score is on their websites:

- A good Experian score starts at 700, with 800 considered excellent.
- With Equifax it is 660 and above.
- And Noddle's best indicator is a 3+ on its 1-5 rating.

If you have a good credit score, you can save yourself a lot of money on hefty interest rates, because your hard-earned credit rating will give you access to the better rates and deals on credit cards, loans, credit agreements and mortgages.

Conversely, if you have a bad credit rating, you are likely to be offered high interest rates and worse deals, or fail to qualify for credit at all.

Credit Checks

Finance companies (Banks, Insurance Companies, etc) collect data on the people who buy their products and these companies then share that data with each other. When someone asks a lender for a new loan, or a mortgage, or some other form of credit, the lender will run a credit check on the person to find out what other companies they may have borrowed from and check how much risk they may be taking by giving that person credit. The lender does this because it needs to know whether you can manage your debts, or whether you are likely to run into financial trouble or even default on the debt. Credit checks are also done by some companies when they set up mobile phone contracts, by some landlords and in some cases by employers when someone applies for a job. The credit check will show a credit score for that person based on their credit history.

Credit reports are likely to be provided by one or more of the UK's three main credit reference agencies for a fee.

This report will tell the bank, loan company or building society whether you have a mortgage, how much you owe on cards, and if you have missed any payments – be they cards, loans or mortgage payments. Therefore, the higher your credit score, the better your chances of being approved for the most attractive credit card deals.

What affects your credit score?

Your credit score is calculated by taking a number of factors into account, including:

- Late payment of existing loan agreements
- Minimum payments: You could also find that your record is tainted if you make only the minimum payments each month.
- Bankruptcy proceedings
- Little or no financial history
- Easy access to available credit: People who borrow relatively small amounts or who prudently pay off their credit card bills in full each month are not profitable for lenders.
- Frequency of credit applications

It’s important to understand that this information doesn’t stay on your report forever. A missed payment on your credit card will usually be wiped off after three years, and details of a CCJ or bankruptcy should remain on your file for six years.

How to improve your credit rating

1. Register on the electoral roll

One of the easiest ways of boosting your score is getting on the electoral roll. It’s free to register on the About My Vote website – if you aren’t on it then you probably won’t get credit.

2. Demonstrate financial stability

Obviously, the best way to improve your credit rating is to manage your debts well. Don’t miss any monthly payments, stick to the payment deadline, and stay within your credit limit.

3. Check your credit report annually

Review your report each year to check all the information held about you is correct. And of course amend any errors if you spot them.

4. Close down old accounts

You might owe nothing on the cards, but the lender will look at all your available credit before it makes a decision on your application.

5. Apply for small amounts of credit at a young age and pay it on time

You will leave school with virtually no credit history and will find it difficult to get large amount of credit. Start by taking out a mobile phone contract in your own name when you turn 18. Then apply for a student credit card with a fairly low amount of credit. Apply for the credit card with the same bank that you have a current account with as other banks are unlikely to give credit to a complete stranger.

5. Borrowing Options

Loans and borrowing are now a part of modern life; they have become almost unavoidable in one form or another. You have to be at least 18 years old to borrow from banks but there are a lot of different forms of borrowing to choose from.

Personal Loans

A personal loan is an agreement between an individual (the borrower) and the financial organisation which is supplying the money (the lender). Personal loans are usually taken out for a term of between 1 and 10 years and are usually unsecured.

You can apply for a personal loan through a bank, building society, credit union or an online financial company. Each will advertise their interest as a "typical" or "representative" APR, but remember, this may not be the rate you actually receive as it will be based on your individual circumstances.

On agreement, you will be provided with a repayment schedule. This shows all the repayments you will need to make over the term of the loan – these are usually monthly but can vary according to the Terms and Conditions of the loan. Once you are happy with the agreement, you will be asked to sign a contract and the money will be transferred to your bank account.

The advantage of a personal loan is that you repay same amount every month, which helps with budgeting. The disadvantage is that is may take a long time to pay off, depending on the amount borrowed and the APR.

Mortgages

A mortgage is a long-term loan used to purchase property. On average, a home is the most expensive thing people buy in their lives. It is just not realistic to try and save up the amount of money required, so a mortgage is often used.

The term of a mortgage can vary, but most commonly it is 25 years. The cost of repaying the borrowing is spread over this term. The borrowing is secured against the property you have bought. This means that if you fail to make the repayments your home can be taken back by the lender and sold by them to recover their money – this is called repossession.

The interest rate on a mortgage is generally one of the lowest compared to other forms of borrowing. This is because of the long term and the fact that the loan is secured.

Most people who buy their own home have to take out a mortgage to pay for it. The alternative is to rent property, which is a more flexible arrangement but means that the person paying the rent does not own the property.

Types of mortgage:

- Variable rate mortgage — where the lender can vary the interest rate they charge each month.
- Tracker rate mortgage — this is a form of variable rate mortgage where the interest rate charged goes up or down in line with the Bank of England base rate.
- Fixed rate mortgage — where the interest rate is fixed at a certain level and does not change for a set period (usually two years or more).

Credit Cards

These can be used as a convenient way of paying for things using short-term credit. In other words, when you buy an item using a credit card you are borrowing money from the credit card company to pay for the item and you need to pay the credit card company back. The credit card company will send you a bill at the end of the month and if you don't pay the minimum amount stated then they will add interest to the amount you owe and the amount you owe will, therefore, be higher the next month. The interest applied to credit card debts can be very high, so it is advisable not to build up debt on credit cards and make at least the minimum payments.

Credit cards are available from most banks and allow you to purchase goods and services up to a certain limit. When you buy something with your credit card, the amount you spend is paid for by the credit card provider – it does not come out of your own account. The provider keeps a record of everything you have bought and every month you are sent a statement to show how much you have borrowed.

The credit card provider will set a credit limit for your card (based on your credit score, report and history) – anything from a few hundred to several thousand pounds depending on your personal circumstances.

There are two ways of repaying a credit card. One of them charges you interest, but the other does not:

- Once you receive your monthly statement you repay the balance in full. You will not be charged any interest in this case.
- You pay off some of the statement balance. Credit cards require a minimum payment is made every month. This is around 3% of the balance or £5, whichever is greater. If you choose not to pay the balance in full then you will be charged interest on the remaining balance plus any further spending the following month.

Advantages of a credit card:

- Better consumer protection if something goes wrong
- May get a 0% or low interest card for an introductory period

Store Cards

Store cards are like credit cards but are available from shops rather than banks. They can only be used to buy things at particular shops. Anything you spend on your store card is borrowed money and, as with credit cards, if you do not pay off the full amount each month you will start paying interest on it.

A shopper may be given the incentive of a discount on an opening purchase or similar offer, which can be beneficial but can also lead to increased debt if you have more than one store card. Store cards are usually very expensive if the balance is not repaid in full.

Bank Overdrafts

If you have no money left in your bank account and you carry on spending, you will become 'overdrawn' and you will have an 'overdraft'. Each Bank has its own different rules and conditions concerning overdrafts, so it's important to check the rules relating to your own bank.

In general, banks will charge a high daily rate of interest and/or daily charges for the period you are overdrawn, however, customers who can warn their bank that their account will become overdrawn before it happens can usually get a much better deal. This is known as an 'agreed' or 'arranged' overdraft.

Overdrafts can be requested from the bank or are sometimes automatically offered with current accounts. Arranged overdrafts are set in advance and you can spend money up to the agreed overdraft amount.

The next time the account holder deposits money into the bank account it will automatically be used to repay the overdraft until the entire loan has been repaid.

Payday Loans

A payday lender is the name given to lenders who provide very short-term loans for relatively small amounts of money. As the name suggests, these are intended to cover any unexpected costs you might incur until you are able to repay the loan on your next payday.

Due to the very short-term nature of these types of loan, the interest rates can be very high – 1,500% APR is not unheard of. There are also penalties if the loan is not paid off when expected. Compared to other forms of flexible borrowing, like an arranged overdraft or a credit card, payday loans are very high cost.

One of the most controversial issues around payday loans is known as the "rollover". This is where someone is unable to pay off the loan at the end of the term (which could be as little as a week). In this case, the lender may suggest "rolling over" the loan for another week or more. While this may seem like a reasonable solution, it significantly increases the interest and charges you will pay.

Before applying for a payday loan consider all your other options, as they are likely to be much more costly.

Payday lenders include Wonga, Quick Quid and Swift Money.

You can normally borrow up to £1,000 however there will be set up fees to consider. If payday loans are repaid on time, they are not necessarily any more expensive than a bank overdraft. However charges grow quickly if repayments are missed. There are concern that lenders are targeting the most vulnerable borrowers and are not carrying out checks to ensure that the borrowers can afford repayments. This was resulting in many people having serious debt problems due to payday loans and there are now tighter regulations around pay day loans.

6. Personal Debt

This section investigates personal debt problems. In particular, it will look at the circumstances leading to personal debt problems and the effects of personal debt on individuals.

Is debt and borrowing always bad?

It's a common misconception that all debt is "bad". There are a number of circumstances where borrowing can be used to help us buy things which will have a positive impact on our lives and even improve our financial position over time. For example, borrowing money to buy a home. By taking out a mortgage you are buying your home and it becomes yours to own when the mortgage is paid off – unlike renting, where you may be making a similar payment but never own the property. Over time you would also hope that the value of the home increases, so that when you come to sell the property it would be worth more than you had initially borrowed. However you would need to bear in mind that property values may fall as well as rise.

How to people end up in debt?

There are any number of reasons that a person may end up in debt however the following is a list of the most common reasons. It is important to note that some of the bellow reasons are out of the individuals control whereas some come down to poor life choices. People may end up in debt when they:

- When they spend more than they earn.
- When they don't prioritise their spending. (Poor budgeting)
- When they can't keep up with interest payments on loans.
  (Most common with variable rates)
- When they fail to save for a rainy day. (Poor forward planning)
- When personal circumstances change unexpectedly.
  - Lose their job / Unemployment / Redundancy
  - Accident / ill health of you or a family member
  - Zero hours contracts

Some people may also end up in debt because they borrow more than they can afford to repay from short term and easy access lenders. The most common example is payday loans because of their very high interest rates.

Consequences of personal debt

- Poor Credit Rating (likely to struggle when borrowing money in the future)
- High Interest Payments (unlikely to be offered the best deals – banks want protection!)
- Fuel poverty – Cannot afford to heat your own home.
- Poor diet – Cannot afford regular means.
- Stress and other health related issues – Includes mental health.
- Pressure on family and home
- Repossession of assets – Lenders will want to recoup what they are owed.
- Bankruptcy

Helpful tips to avoid personal debt

- Budget your finances
- Prioritise your spending – consider needs vs wants
- When borrowing, search for competitive rates
- Don't over borrow! Think about what you can afford to repay and not what lenders are prepared to give you!
- Use credit cards responsibly – your credit limit is not a target to reach!
- Repay debts before saving.
- If you are debt free, save for a rainy day!
- Seek advice
- If you cannot pay, contact your lender to discuss a manageable payment plan.
- Don't burry your head in the sand!

Advice on personal debt is available from:

- The Money Advice Service (https://www.moneyadviceservice.org.uk/en)
- Citizens Advice Bureau (https://www.citizensadvice.org.uk/)
- Money Saving Expert (https://www.moneysavingexpert.com/)

Outcome 3: Savings

1. Reasons to save money

Saving is putting aside money to use in the future. There are a number of reasons that a person may choose to save money and their reasons/motivations for saving will be dependant on an their circumstances, age and stage of life.

People tend to save money for one of 2 reasons:

1. For financial security, protection and comfort.
2. In preparation for a large one-off purchases.

Reasons for saving can be categorised as short, medium or long term goals.

Short term – Within 5 years

Medium term – Within 5 to 10 years

Long term – 10+ years

The following table shows a list of reasons that a person may wish to save money along with the term in which this is likely to take place. These are the most common examples and there will be others reasons that a person may choose to save.

Reason	**Term**
Events, gifts and birthdays	Short
Expensive items e.g. TV, Phone, Laptop etc.	Short
Travel / Holidays	Short
Rainy day fund / Unplanned expenditure	Short
Buying a new car	Short
Education/Qualifications	Short
Your own wedding	Short/Medium
Property	Short/Medium
Your child's wedding	Medium
Emergency fund (poor health or job loss)	Long*
Pension	Long

* Whilst an emergency fund is something that you do not expect to use in the short term, the method of saving should be viewed as a short term goal as you never know when you're going to need to access the funds. It is always recommended to have at least 6 months of living expenses saved in an emergency fund.

2. Savings and Investments – which is best?

Savings – Money you can access fairly easily within a short to medium term. There is minimal risk involved.

With savings, you put the money away in complete safety and get it all back with interest.

For your short-term goals, the general rule is to save into cash deposits, like bank accounts.

The stock market might go up or down in the short-term and if you invest for less than five years you might make a loss.

For the medium-term, cash deposits might sometimes be the best answer, but it depends on how much risk you're willing to take with your money to achieve a greater return on your investment.

For example, if you're planning to buy a property in seven years and you know you'll need all your savings as a deposit and don't want to risk your money, it might be safer to put your money into a savings account.

Short term savings is money put into an account where;

- Interest is earned.
- There is no risk of losing the original amount.
- If the firm gets into serious financial difficulty, providing it is a member of the Financial Services Compensation Scheme (FSCS), compensation may be paid up to a set limit. FSCS
- Banks in the UK must be members of the FSCS before they are allowed to take and hold money for customers.

Investments – Putting money away for a longer term, typically 5 years or longer. There is a risk element involved.

There is more risk involved with investments. For longer-term goals, you may want to consider investing because inflation can seriously affect the value of cash savings over the medium and long-term.

The stock market tends to do better than cash over the long-term providing an opportunity for greater returns on any money invested over time. You can lower the level of risk you take when you invest by spreading your money across different types of investments. This is called diversification.

In the medium term, if your needs are fairly flexible (you do not need a fixed amount), you might consider investing your money if you're prepared to take some risk with your original capital to try and achieve a greater return on your investment than would be possible by saving alone.

Further information on investments will be discussed later in the course.

3. Savings accounts

Choosing between savings options is easier than it looks. There are hundreds of accounts, but only a few types of account – some for easy access to emergency funds, some for saving regularly and some for growing your money.

The difference between a current account and savings account

First, it is important to understand that the account you on a daily basis is known as a current account. There are significant differences between a current account and a savings account:

- A savings account is a deposit account which allows limited transactions, while a Current Account is meant for daily transactions.
- When you withdraw more money from the account, than is actually there, then your account is said to be overdrawn. In the case of a savings account, banks neither offer nor allow overdraft facilities, whereas, this facility is provided with a Current Account.
- Savings accounts earn interest at a rate appropriate to the type of account, while there is no such earning from a Current Account. A Current Account is actually a no interest-bearing deposit account.
- Current accounts also allow you to set up automatic payments like direct debits and standing orders, use a debit card to withdraw cash and pay for items in shop and you also have the option of issuing cheques.

In summary, a current account should not be used as an option for saving money but should instead be used for day to day financial transactions.

Types of savings account

Instant Access Savings Accounts

Also known as easy access savings accounts, these types of account are simple bank accounts that let you earn interest on your balance. You can deposit as much cash as you like into the account - at any time - and withdraw it whenever you want, without having to pay any fees or charges.

You can often open one of these accounts online in under five minutes. And the initial amount you have to pay into the account is usually very minimal. Typically, you can start with as little as £1.

Note: You may have to pay tax on any interest that is earned with this type of account!

Notice Period Savings Account

As the name suggests, notice accounts require you to give advance notice that you intend to make a withdrawal. How much notice is needed will depend on your bank. However, the period usually ranges from between 30 to 120 days. Some banks will also require you to specify the amount you intend to withdraw.

Notice accounts usually earn higher interest rates than easy access accounts. But even then, these rates are usually lower than other types of savings accounts. As a rule of thumb, the more notice you're required to give, the higher you can expect the interest rate to be.

A higher initial deposit is often required for this type of account.

Fixed Term Savings Account & Regular Savings Accounts

Fixed term savings accounts require the account holder to keep their money in for a fixed time period.

With regular saver accounts, you have to commit to paying a specified amount of money into the account each month. Requirements vary from bank to bank, but you'll usually need to pay in at least £25 and not more than £500 per month. This regular payment scheme is often a condition of fixed term accounts.

Fixed term / regular saver accounts tend to attract higher interest rates than instant access or notice savings accounts. Rates can be as high as 3% per year. The trade-off is that they have strict terms and conditions and you may be penalised if you miss a month's deposit. You might not be able to make any withdrawals (or only a limited number of them) until the agreed term expires.

Individual Savings Accounts (ISAs)

Individual savings accounts (ISAs) work in much the same way as any other savings accounts, except that any interest you earn is tax-free. Interest rates can be fixed or variable, meaning they may change over time. ISA interest rates are usually higher than you'd find on other types of savings accounts (though typically they're not as high as the rates offered on regular saver accounts).

On the downside, there's a limit to how much you can deposit into an ISA each tax year. This is known as your ISA allowance. In the current tax year (2019/2020) this amount is set at £20,000.

There are 4 types of ISA's that currently exist. These will be explored in the next section.

Fixed Rate Bonds

Fixed-rate bonds are accounts that allow you to deposit a single lump sum for a set period of time. This can range from a minimum of six months up to five years or even more. You'll be unable to access your money for the duration of the term. However, you'll receive interest every year that you have the bond, and this interest rate is fixed for the duration of the term.

In general, the longer you tie your money up for, the higher the interest rate. Some banks also offer tiered interest rates, which means the rate goes up the larger the sum you deposit into the account.

The minimum deposit amount is usually £1,000.

Account restrictions

Banks may stipulate certain restrictions on how a particular savings account operates or the availability of the account. Examples include:

- Minimum or maximum deposit required to open the account.
- Minimum or maximum regular deposits.
- For Existing or New customers only.

4. Individual Savings Accounts (ISAs) – Further Information

ISAs are savings or investment accounts that you never pay tax on, it's as simple as that. You can save up to a maximum of £20,000 per year (for 2019/20), and this can be in one of 4 types of ISA:

- Cash ISA – including a Help to Buy ISA
- Stocks & Shares ISA
- Innovative finance ISA
- Lifetime ISA

Cash ISAs

Use a standard instant access savings account (not an ISA), and if you've large amounts of savings, you'll have to pay tax on the interest. Basic-rate taxpayers have to give 20% of the interest above their £1,000 personal savings allowance earned straight to the Government.

Cash ISAs are simply savings accounts where the interest is NEVER taxed. And any interest you earn doesn't count towards your personal savings allowance, so if you'll earn a lot of interest, you can protect more of it in an ISA.

Just like normal savings accounts, there are a variety of cash ISAs available, including instant access, regular savers and fixed-rate deals. You don't have to pay to open a cash ISA.

Help to Buy ISAs

Help to Buy ISAs were launched in December 2015 for first-time buyers only. You can open one up to 30 November 2019 and save £1,200 in the first month of opening, and then £200 a month after that. When you use the funds to buy your first home, the state adds a 25% bonus (up to a maximum of £3,000) onto your savings, helping you to buy the property.

Help to Buy ISAs are a type of cash ISA, meaning you can't usually hold both in the same tax year.

Innovative finance ISAs

Innovative finance ISAs can be a lot of things, from peer-to-peer lending to lending to businesses, property and crowdfunding. Open an innovative finance ISA and it means any interest you get from lending money to other people (or companies) isn't taxed.

But this is more risky than putting money into a cash ISA. The fact you're lending the money means there's a chance the borrower won't repay. As with any 'investing', the more risk you take, the more reward you could get however.

Lifetime ISAs

Lifetime ISAs were launched on 6 April 2017. You can save up to £4,000 a year into the LISA as a lump sum or by putting in cash when you can. Then the state will add a 25% bonus on top. So if you save £1,000 you'll have £1,250 and if you save the full £4,000 you'll have £5,000. And that's before interest or growth.

Here are the details:

The bonus is paid until you hit age 50, and is paid monthly - once in your account it counts as your money. You'll be paid interest on it too.

The maximum bonus is £33,000 (unless the rules change). To get that you'd need to open one on your 18th birthday and keep contributing the maximum £4,000 each year until you are 50.

Stocks & shares ISAs

You can also use your ISA allowance for investing. This type of account is called a stocks & shares ISA, where you can invest in funds (shares from various companies pooled into one investment), bonds (basically a loan to a company), and shares in individual companies.

Stocks & shares ISAs are typically managed by an online service, fund management group or fund supermarket.

If you wish to open a stocks & shares ISA, you need to be aware that many of these companies charge a fee for you to open and hold a stocks & shares ISA. Some even charge you if you want to change any of your investments, withdraw your money or move it to another company.

The most important factor to consider is that by investing in stocks and shares, you pay capital gains tax on any profits you make unless you open a stocks and shares ISA. There is still the risk that you could lose money because this is based upon investments rather than savings.

5. Other ways of saving/investing

Credit Unions

What is a credit union?

Credit unions are member-run organisations where members pool their savings so they can lend to one another. Members have something in common, such as the same employer, trade union, attending a specific place of worship or living in the same area. Credit unions are not-for-profit organisations and use the money they earn to improve services and reward their members.

There are several ways you can save with a credit union – via local collection points, by direct debit or by having money deducted directly from your wages. Some credit unions offer a fixed rate of interest on savings, but most give you a yearly pay-out called a 'dividend'. The dividend is the way in which the credit union shares its profits with its members and the amount you receive, if any, will vary depending on how much profit the credit union has made in the year.

All credit unions offer basic savings accounts and low interest loans. Credit unions vary greatly in size – some are small community groups while others have thousands of members.

Risk and Return

Credit unions have some restrictions placed on what they can invest in and how much money they can lend out. The more you save, the larger your share of the yearly dividend pay-out will normally be. Dividends can be low, or even zero, if the credit union isn't generating a surplus. Members vote at the credit union's Annual General Meeting on the level of dividend to be paid.

Bonds

Bonds are like a small cash loan from you to a company e.g. £100 each. They are for a specified period of time, usually between 6 months and 5 years. They are issued with a coupon that has a specified interest rate such as 5% per annum.

- So you would get £5 x 5 years = £25
- Plus your £100 back at the end

Bonds are viewed as safe as cash but may generate a better return as the coupon rate is fixed.

6. National Savings and Investments (NS&I)

NS&I is a government agency that offers saving and investment products to the public. They change their products often but they are often innovative and unique. When saving or investing with NS&I, you're lending to the government and your money is totally secure.

Different NS&I products may pay interest, stock market or inflation-linked returns (income) or, in the case of Premium Bonds, tax-free prizes. Some NS&I products may impose early encashment penalties for some investment products, meaning you may get less back than your original investment.

NS&I's most popular products include a range of ISA's, Savings Certificates, Bonds and Premium Bonds.

A Note on Premium Bonds

Premium Bonds are the UK's biggest savings product, with around 22 million people saving almost £82 BILLION in them. NS&I Premium Bonds are a savings account you can put money into (and take out when you want), where the interest paid is decided by a monthly prize draw. You buy £1 bonds and each has an equal chance of winning, so the more you buy, the more your chances improve.

Having a premium bond is like buying a lottery ticket only that lottery ticket never expires. Every month, winners are chosen at random to win between £25 and £1 million. The probability of winning anything is very slim and becomes increasingly less likely as time goes on. The perk of a premium bond is that you can trade it in at any time and withdraw your cash!

7. Gross/Net Interest on savings

The government introduced the Personal Savings Allowance (PSA) at the start of the 2016 tax year (6 April 2016). This was to encourage people to save.

People used to have to pay tax on the interest they received, as it was classed as a form of income, however there is now a tax free part to any interest you earn. The structure is very similar to that used when calculating income tax.

The PSA depends on your Income Tax bracket:

- Basic rate tax (20%) – can earn £1,000 of interest tax free
- Higher rate tax (40%) – can earn £500 of interest tax free
- Additional rate tax (45%) – do not get an allowance

The gross interest is the amount of interest you would receive without tax whereas the Net interest is after tax has been deducted.

7. Interest Rates on savings accounts

APR

APR stands for the Annual Percentage Rate, and it's the official rate used for borrowing. When it's calculated it has to include both the cost of the borrowing and any associated fees that are automatically included. Thus it's meant to give you the overall equivalent cost of a debt.

As this is used in borrowing, it will not be discussed any further in this chapter.

AER

The AER, or Annual Equivalent Rate, is the official rate for savings accounts, and is designed to allow easy comparisons as it's meant to smooth out the variances between accounts (it's the equivalent of the APR for debts).

The idea is it shows what you'd get over a year if you put money in the account and left it there. The alternative is the gross rate, which is the flat rate of interest that's actually paid.

If interest is paid annually then the gross rate and AER should be the same, as there's no interest compounding.

Yet when interest is paid monthly, then the gross rate given is usually around 0.1% less than the AER rate. This is a very complex issue any goes beyond the specifications of this course. When comparing bank accounts, the important thing to note is always compare like with like, thus AER with AER or gross with gross.

Fixed and Variable Rates

Interest rates may be Variable or Fixed.

Variable rates change from time to time over the course of the term in which your money is saved. The benefit is that the rate could always go up as well as down so you could benefit from making more money through interest in the long term. Instant access accounts are most likely to be variable rate savings accounts.

Fixed rate accounts will always the same rate for the length of the savings term. These are most common in Fixed Term Savings accounts.

The interest rate in Notice Period Accounts can be either fixed or variable. The conditions of which will be set by the issuing bank.

Other things to watch out for

- Introduction rates – a higher interest rate for an introductory period.
- Interest Tiers – different rates depending on how much money is deposited.
- Payment of interest – How is interest added to the account? Monthly, Quarterly or Yearly.
- Term (or bond) accounts – higher rates can be earned by leaving money tied up for a specific period (1,2,3 years or longer).

8. Savings options by term

Short Term

Examples of short term savings options (Up to 5 years) could include:

- Cash ISAs
- Savings Accounts
- Interest bearing current accounts
- Some bonds

Long Term

Examples of long term savings options (10+ years) could include:

- Stocks and Share ISAs
- Lifetime ISAs
- Pensions
- Life assurance
- Bonds

9. Saving for retirement (Pensions)

The most common way in which people prepare for retirement is by paying into a pension. There are 3 types of pension that a person may pay into during their working life:

- State pension (paid via National Insurance)
- Workplace Pension
- Personal/Private Pension (Not part of this course)

State Pension

State pension is a sum of money that is paid to UK residents who have reached retirement age. The conditions in which you receive state pension are not part of this course but may be discussed in class. Your national insurance payments go towards your state pension. For the current tax year 2019-20 the full new State Pension is £168.60 per week.

Workplace Pension

The law on workplace pensions has changed. Under the Pensions Act 2008, workplace pensions have become 'opt-out' rather than 'opt-in', which means most employees are automatically enrolled into a pension provided by their employer. The law also requires employers to pay into their employees' pension schemes.

If you're a UK-based employee aged between 22 and State Pension age and you earn at least £10,000 per year, you will be automatically enrolled into your workplace pension scheme.

Currently, the minimum employee contribution into an Auto Enrolment pension scheme is 5% of your annual 'qualifying earnings'. The law also requires your employer to pay at least 3%

To be auto enrolled in a workplace pension, you must meet certain criteria. These criteria include:

- You must be at least 22 years of age.
- Earn more than £10,000 per annum.
- Be resident in the UK.

Benefits to contributing to a pension scheme

By contributing to a workplace pension, you are preparing yourself for later life.

Pensions are a method of long term saving and as a result, they generate the required money through investment. It would not be enough to simply save a monthly amount in a savings account as the return may not be enough to make you financially stable for the rest of your life.

Historically, over the long term the stock market out performs cash investments and so it seems reasonable to invest pension savings however there is risk associated with investment. No one would want all their pension cashed in on a trough (they wouldn't want to lose money) and they would far prefer that their pension money is cashed in on a good investment but that is not a certainty.

As a result, pension fund managers gradually will move all your investments from stocks to cash / bonds over the 5 – 10 years before your retirement age in order to ensure there is money available for when you retire. This helps balance your risk.

<u>Remember, all contributions from you are before Income Tax and so it could be a good idea to pay in more than your minimum pension contribution during your working life in order to minimise the amount of tax you pay each month!</u>

Private Pensions

A private pension is a type of pension that you can set up to help you save money for retirement. Its value is usually based on how much money you've paid in and how your investments perform.

A private pension - also called a personal pension - is a product that you can use to save money for retirement. Private pensions are usually defined contribution pensions, which means the money you receive at retirement is based on the money you've paid in and the performance of your investments.

A private pension works similarly to a workplace pension, but it's set up by you rather than your employer. You can set up regular contributions (e.g. monthly) or make one-off payments into your private pension, and your pension provider will add tax relief.

The money you put into your personal pension will usually be invested in a range of assets like shares, bonds, property and cash. When you start your pension, you'll probably get a choice of pension funds to select from, based on how much risk you're willing to take.

When you reach the age of 55, you can take your private pension as a lump sum, use it to buy an annuity (a guaranteed income) or leave it invested and take out cash amounts when you need.

10. Savings Growth

Factors that contribute to savings growth are:

- interest rates — including compound interest
- saving term
- initial investment
- addition of regular funds
- performance of stock market

Interest Rates

Higher interest rates mean that households will gain a higher rate of return on depositing savings in a bank. At interest rates of 1%, a £1,000 bank account, will only get £10 a year interest. If interest rates rise to 6%, then the interest payments will rise to £60 – giving a relatively higher return on savings. Higher interest rates should encourage saving!

Saving Term

The longer you keep your money in, the more money you will make as interest will continue to accrue. Also consider the impact of compound interest (think back to National 5 maths).

Initial Investment

The more money you start with, the more interest you will start to earn from day 1. If you have more to start with then you don't have to worry about topping it up as much each month. If you invest in a company who has continued growth, you will make more on your initial shares than those that you bought later at a higher price.

Addition of regular funds

The more you add, the more you will have available when you need it.

If you buy more shares then you will have more to sell later on (hopefully making more money).

Performance of stock market

If the share price goes up, you will be able to sell your shares for more than the price you paid!

The initial capital investment has grown!

Companies usually share their profits with shareholders by paying out dividends.

Dividends are usually paid out twice a year and are paid at a set amount per share.

The more profit they make, the higher dividend they can pay.

11. Further Pension Information – When you retire…

What is a pension

It is just a pot of cash that you, and your employer, can pay into - and which you get tax relief on - as a way of saving up for your retirement.

Then at retirement, you can draw money from your pension pot or exchange the cash with an insurance company for a regular income until death, called an annuity.

Since the 2014 Budget you've been able to access your pension plan once you turn 55, taking as much or as little as you like, whenever you like.

State Pension

Most people get some State Pension. It's paid by the government and is a secure income for life which increases by at least the rate of inflation each year.

You build up your entitlement to the State Pension by making National Insurance contributions during your working life.

In some cases, you can do this even when you're not working, such as when you're bringing up children or claiming certain benefits.

From April 2016 a new flat-rate State Pension was introduced. For the current tax year 2019-20 the full new State Pension is £168.60 per week.

To be eligible for the full State Pension you will need 35 years NI record.

Defined benefit pension

You're most likely to have a defined benefit (DB) pension if you work in the public sector or for a large company.

This is a salary-related pension which pays out a secure income for life and increases each year. The pension you get is based on how long you've been a part of the scheme and how much you earn.

You might have a final salary scheme where your pension is based on your pay when you retire or leave the scheme, or alternatively a career-average scheme where your pension is based on the average of your pay while you were a member of the scheme.

Most defined benefit pension schemes have a normal retirement age of 65.

Defined contribution pension

With this type of scheme, you build up a pension pot which you can draw an income from when you cut down or stop working. But you must be aged at least 55 before you can start to take money out. With this type of pension scheme, you can usually withdraw at least 25 per cent (a quarter) of your pot tax-free.

The amount that builds up depends on:

- the level of charges you pay
- how well your investment performs, and
- how much you and your employer (if you are employed) pay into the scheme

Defined contribution (DC) pensions include workplace, personal and stakeholder pension schemes.

Useful links/videos

https://www.youtube.com/watch?v=FgPxSTWkAFE

https://quietroom.co.uk/thinking/3pensionoptions/

https://www.pensionbee.com/pensions-explained/pension-types/what-is-a-defined-benefit-pension

https://www.pensionbee.com/pensions-explained/pension-types/what-is-a-private-pension