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Fixed Rate Bond **Guide**

Fixed rate bonds have been something of a saviour for savers in recent years. With interest rates on savings accounts tending to frustrate rather than elate in recent years, fixed rate bonds have usually offered the best chance of securing a decent return.

Such bonds typically pay higher rates as banks and building societies like the certainty of knowing that funds will be at their disposal for a set length of time. The flip side of the coin is that savers are usually deprived of access to their money during the fixed term, unless they pay a penalty.

This makes it essential that savers work out how long they are willing and able to tie their money up for and choose an appropriate account. Terms typically range from between one and seven years, although there are accounts available over a term as short as one month.

Limited period

If a bond comes to the market paying a rate which is particularly impressive, moving fast is essential. Bonds are usually sold for a limited period of time only, typically for between two and eight weeks.

However, an account with a particularly appealing rate is likely to sell out and be withdrawn before the advertised tranche period reaches an end.

Fixed rate bonds can typically be opened online, by telephone or in branch, although it should be noted that operation of the accounts will not always be possible via all these mediums. Indeed, many bonds cannot be managed online, with access to funds only being available through the use of a passbook in branch.

continued overleaf

Key Facts

- **Fixed rate bonds pay higher rates of interest in return for savers promising to lock their funds away for a set period of time.**
- **The interest rate is fixed for the term, the choice of which tends to range between three months and seven years.**
- **Although funds cannot usually be withdrawn from a bond before maturity, some products do permit early access on payment of a penalty.**
- **At maturity, savers have the option to reinvest their funds or have them paid out.**
- **If no instruction is given at maturity, providers often automatically reinvest the funds, either into another fixed rate bond or a standard savings account, typically paying a low rate of interest.**

Useful Links

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The minimum investment that is required by bonds can vary. Some will accept as little as £1, while others want a minimum of £50K; various bonds are, of course, available which welcome somewhere in between.

Careful thought

An important consideration is that most fixed rate bonds do not allow additional investments to be made once the issue has closed. Given this, and the tendency for funds to be inaccessible during the term without penalty, careful thought is needed to make sure savers do not, a short way into the term, wish they had invested more but, at the same time, do not over-commit.

That money cannot usually be withdrawn from a fixed rate bond means they can be useful vehicles for people who often find the temptation to unnecessarily raid their nest eggs too much. Of course, anyone who opts for a bond but is particularly weak-willed could end up paying a penalty if their spending urges do get the better of them.

An appealing aspect of fixed rate bonds is that savers can enjoy the certainty of knowing precisely the size of the return that they will eventually receive. During the term, the rate will steadfastly remain unchanged, regardless of any movements in the base rate of interest.

At the same time, however, when an interest rate is fixed, there is the chance that the saver could lose out if the base rate starts to rise. In this instance, fixed rate savers might find the interest they are receiving is quickly overtaken by that available elsewhere.

Penalty fee

One potential option in this situation might be to pay a penalty fee in order to extricate the money from the lower paying bond and invest it elsewhere. However, careful calculation will be necessary to make sure this is still financially worthwhile once the penalty has been taken into account.

As funds should typically be left untouched until an account matures, this means bonds are ideal for anyone wanting a hassle-free savings option that does not need constant monitoring. Indeed, once opened, action is only normally required shortly before the account is due to mature.

However, that savers do take note of the maturity date, and take an interest in what happens once the term expires, is essential, yet often overlooked.

Providers will contact an account holder in advance of the term coming to an end to confirm that a bond is about to mature and to outline the options that are available. Some banks and building societies promise to write at least two weeks before the end of the term, while others will give more notice. Whatever the length of the window, it is usually wise to pay the reminder swift attention. Indeed, some providers insist they must receive instructions at least five business days before maturity in order to carry out the customer's wishes.

Maturity options

Although the fundamental choice facing savers at maturity is usually to either take their money back or reinvest it, the finer details can vary between providers. In terms of taking the funds back, payments are usually made either by cheque or by transfer to another account. In respect of the latter, an account is likely to have been nominated by the saver for such a purpose when the bond was opened.

If reinvesting the funds is on the agenda, then it is essential to consider the options available across all of the savings market. Some people might be happy to lock their funds away again and therefore opt for another bond, while others may want the option to access their money in the near future and decide that an instant access account is the way forward.

Whatever the type of account the saver wants, it is imperative not to simply reinvest with their existing provider without checking the alternatives on offer elsewhere.

Not responding

If moving the money is the desired option, then it is important to act sooner rather than later. Indeed, if a provider does not receive a response to their prompt that the bond is about to mature, there are typically two default options to which providers turn, one of which might effectively lock the money away for a further period of time.

For instance, on some accounts, if the provider hears nothing, funds are automatically reinvested into a new fixed term account whose term is closest in length to that of the original product. Therefore, if the original plan was five years in duration, the money is potentially off limits for this length of time again. Of course, the plan might offer the ability to access funds early, but this is likely to involve a penalty having to be paid.

Alternatively, a lack of instruction from the customer might see the provider move the matured monies into a standard savings account. Although in this instance access to the funds is unlikely to be an issue, the interest rate being paid on the funds is almost certain to be negligible.

React to the reminder

Obviously, the key to savers ensuring they have complete control over what happens to their funds at maturity is to react to the reminder that they receive and contact the provider promptly with their preferred course of action.

As to the safety of fixed rate bonds, as long as the provider is regulated by the Financial Services Authority, it is protected under the Financial Services Compensation Scheme. This means savers are guaranteed to receive the first £85,000 of their investment back should the provider fail.