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How Rock Solid Are Your Life Savings?

The problems faced by Northern Rock have been making the front pages…as the queues stretched round the block, share prices in several other big societies plummeted and people talked about a meltdown. But was there ever really any need to panic? Independent Financial Advisor and Mature Times financial correspondent Chris Budd investigates.

The big news in the world of finance in the past few weeks has, of course, been the crisis at Northern Rock. When it's plastered all over the papers every day it's hard not to worry, not just about the savings and mortgages you may have with Northern Rock themselves, but about the implications for the economy as a whole.

Firstly, just to clarify what would happen in event of Northern Rock becoming insolvent. If you have savings with any UK bank your money is protected by the Financial Services Compensation Scheme (FSCS). The scheme pays a maximum of £31,700 per depositor for the total of their deposits with an organisation, which is made up of 100% of the first £2,000 and 90% of the next £33,000. So your savings couldn't just vanish, and if they amount to under £35,000 the vast majority is covered. However, now Alastair Darling has stepped in and guaranteed 100% of the savings held with Northern Rock, the scheme will not even be required and all your savings are effectively backed by the government.

So how likely are they to go under? The short answer is not very. The reason Northern Rock sought funds from the Bank of England was to cover short term problems funding its lending using loans from other banks. As a result of the fallout from the so-called "credit crunch" in the US all banks have become far more wary of lending funds to each other, pushing up the rate at which they are prepared to extend such loans. This meant Northern Rock, which is more reliant on this type of borrowing to do business than most other lenders, could no longer access the funds to conduct business as usual. This is where the Bank of England agreement came in. It was *not* to bail them out because they were about to go under.

Secondly, banks are always hungry to buy other banks, and it is very likely that before it even got to that stage another bank would have bought them, and simply taken on all their liabilities. This happened with Barings in the 1990s. On

becoming insolvent they were bought out for the nominal sum of £1 by Dutch group ING, on the agreement that they took on their liabilities.

So there was never any need for the panic which lead to the highly publicised bank run. Ironically, though, once people began to withdraw money en masse this in itself threatened the bank's reserves, which mortgages are also loaned against. As all fans of the film It's a Wonderful Life will know, bank runs threaten the whole principle of a bank or building society, that our savings are not kept in a big pile of cash, but are loaned out to other people, usually secured against a property. As Northern Rock boss Adam Applegarth might have said, borrowing from James Stewart: "You're thinking of this place all wrong. As if I had the money back in a safe. The money's not here. Your money's in Joe's house...right next to yours!"

In the case of Northern Rock, then, the Financial Services Compensation Scheme and the guarantee by the Government mean that your savings are secure.

However, this whole episode does highlight a few issues. Firstly the importance of making sure your investments are properly diversified. Bearing in mind the protection is per bank, why not spread your savings across several banks? And for extra comfort, look towards the main four banks if you are saving above £31,700.

This has also highlighted some of the dangers of holding single company shares. Until the current crisis Northern Rock didn't look like an obviously unhealthy pick. It had good earnings growth, having increased its share of a lucrative market very quickly. And its model might even have been sustainable were it not for external factors which froze its access to capital. But as we've seen before any company is potentially at risk of as major fall in its share price often because of factors outside its control. Which again stresses the importance of a well diversified portfolio, ensuring you are not overexposed to any one particular stock.

And, even more importantly, your investments should be monitored over time, to make sure you do not become overweight in a particular stock or sector, ramping up your risk. Your financial adviser should monitor things for you at least annually to make sure you don't end up overexposed in this way.

This article is for general information only and you should seek professional advice in respect of your own circumstances. Please note the value of investments and income from them can fall as well as rise. You may not get back the full amount invested.

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