MULTIPLE OPTION DEPOSITS

# Deposits that work harder

## Multiple option deposits combine the liquidity of savings accounts with the higher interest rates available on fixed deposits

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OFTEN we have surplus funds lying in our savings or current accounts. A savings account pays an interest rate of only 3-3.5 per cent while a current account pays no interest at all. On the other hand, a fixed deposit pays an interest rate that is at around 6-6.5 per cent for one year. However, banks charge a penalty if you withdraw the money prematurely from a fixed deposit. Multiple option deposits offer you the liquidity advantage of a savings or current account, i.e., you can withdraw the money whenever you need it without having to pay a penalty. At the same time, they offer you the higher interest rate that is available on a fixed deposit.

According to Vishal Dhawan, a Mumbai-based financial planner, "These deposits are quite useful for two types of investors. One is the investor who keeps money in his savings bank account to meet his contingency needs, such as a hospital emergency. The other is the investor who has a tendency to leave his money lying idle in a savings account either because he is too busy or because he doesn't focus on financial matters. For both types of investors, the multiple option deposit is useful as it allows them to earn a higher rate of interest."

### How does it work?

A multiple option deposit works as follows. At the end of each day (or the period specified by the customer), any surplus amount over and above a specified sum gets swept into the fixed deposit. The money gets swept in units. In the case of State Bank of India each unit consists of Rs 1,000.

A default option exists regarding the time period for which fixed deposits are created. In the case of some public sector banks, for instance, the default period is 90 days for a savings account and 15 days for a current account. The fixed deposit is automatically renewed once this period elapses.

Whenever you make a withdrawal from your account, the money lying in the fixed deposit gets swept back into your savings or current account and is paid to you. Banks usually follow the last in first out (LIFO) principle for reverse sweep, i.e., the units that were swept into the fixed account last get swept back first.

The customer can change both the minimum threshold amount (above which the money lying in his account gets swept into the fixed deposit account) and the period for which fixed deposits are created.

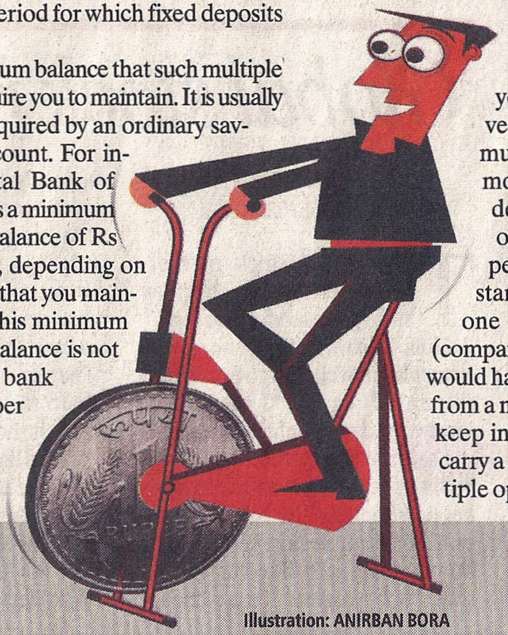
Check the minimum balance that such multiple option deposits require you to maintain. It is usually higher than that required by an ordinary savings or current account. For instance, the Oriental Bank of Commerce requires a minimum average quarterly balance of Rs 5,000 to Rs 10,000, depending on the type of account that you maintain with them. If this minimum average quarterly balance is not maintained, the bank levies a penalty per quarter.

To operate such multiple option deposits, you may either have to open a new account or get your old account re-designated.

One disadvantage of these accounts is that you cannot avail of a loan or an overdraft facility against the money lying in them. Another disadvantage is that the rate of return from these accounts varies depending on how frequently the account is used. For investors it can become quite difficult to calculate exactly what rate of return their deposits have generated.

### Comparable options

Interest earned on multiple option deposits is taxed at your marginal income tax rate. If you belong to a high tax bracket, you could also consider investing in a liquid plus fund of mutual funds as the latter are more tax efficient. The dividend distribution tax levied on liquid plus funds is only 14 per cent, which creates a substantial tax arbitrage for someone in the highest tax bracket (compared to the 30 per cent plus he would have to pay on interest income from a multiple option deposit). But keep in mind that these funds also carry a slightly higher risk than multiple option deposits. ♦



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