FD return in savings Account

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Auto-sweep facilities also ensure that your cheques don't bounce but you have to be careful about tax incidence

Parking surplus money in a fixed deposit (FD) and earning a fixed return over a stipulated period of time is one of the favorite investment options for many. But how to proceed if you are not sure how much money you can dispense with for a regular FD? Here comes the second choice, auto-sweep facility -- a hybrid between a savings account and an FD.

Suppose you have Rs 75,000 in your savings bank account and you have to meet some financial goals out of that amount. Your salary is also being credited to this account and your monthly EMI is debited from it. You pay your credit card bills besides meeting monthly household expenses out of the amount. On an average, the total monthly outgo comes at around Rs 50,000 per month which leaves Rs 25,000 lying idle in your account at the end of every month. But if you think in case of emergency you might need that amount and don't want to part with that money in a regular FD but still want to enjoy high returns on this, auto-sweep could be the best option for you.

More liquid than FD

The greatest advantage of auto-sweep facility is that you gain the high interest rates that come with an FD, along with the liquidity of a savings account. This facility allows you to transfer money from your savings account to a fixed deposit account (of varying maturity period) or vice versa. If you have savings bank account and want to get auto-sweep facility, you need to specify the minimum balance or the threshold limit which is always needed to be maintained in your account. However, there's no maximum limit on the FD amount.

Suppose you have quoted Rs 25,000 as the threshold limit, then any amount above that limit deposited in your account would be transferred to an FD account. The interest paid to this swept-in amount depends on the number of days you keep the deposit in the FD. For that you need to check with your bank. Further, the tenure of the FD also varies from one bank to another. While some banks let customers to decide the term of the FD, some others have limited tenure.

Harsh Vardhan Dawar, Director, Wealth Cafe Financial Advisors, Mumbai, says, "In such accounts, money beyond a certain limit, say Rs 25,000, is transferred automatically to an FD account and your money earns a rate higher than the savings account rate of 4 per cent. The benefit here is that you need not to do anything from your end. The surplus money automatically gets transferred to an FD. So, if your account has Rs 60,000, Rs 35,000 will automatically get transferred to an FD and earn you the interest rate on it. In most banks it is booked as a one year FD."

There is flip side of the story as well. If the amount in savings account falls below the threshold limit then the FD will be broken and the short amount is transferred out of FD to the savings account.

Reduced risk of cheque bounce

Another advantage of auto-sweep is that it reduces the possibility of cheque bounce due to shortage of funds in the savings account. The reason is that whenever there are insufficient funds in your account to clear a cheque, the bank breaks the FD to clear the cheque. Here is an example of how it works:

Let's say you have an auto-sweep facility on your savings account. If you have issued a cheque of Rs 4,000 and your savings account balance is Rs 1,000, the bank will break the FD to the extent of Rs 3,000 (4,000 less 1,000) and clear the cheque.

No need to break FD
Unlike FD where a lump sum is parked with the bank which pays interest at fixed/regular intervals, in auto-sweep you need not 'break' the FD to withdraw your money in actual terms. Of course, when you utilize funds over and above the threshold limit of your savings account the auto sweep FD is technically broken, but at the end of the day the break is reversible, meaning if the deposit amount crosses the threshold limit the extra sum is again swept into the FD and your FD continues till it matures after which it is renewed in most cases.

However, there are some banks which impose penalty when the threshold limit is broken. Bank of India for instance, charges Rs 200 per quarter for non-maintenance of minimum balance prescribed in the savings account.

On the other hand, some banks charge penalty if you break auto-sweep FD. For instance, if your auto-sweep FD was earning 9 per cent interest rate for the period of one year and if it is broken before one year tenure, you would earn an interest of 8 per cent only. Even after this deduction the gain is higher than your savings account rate.

You also need to be sure of the tenure of the FD. While the auto-sweep facility is active as long as your savings account is operational (unless you opt to discontinue it), it's the tenure of the FD that could vary. The interest rate on FD maturity for, say, 15 days to 179 days period could differ from one bank to another. So you need to check that before entering into it.

FD or auto-sweep
So the crucial question is: what to opt of a regular FD or auto-sweep?

Jitendra PS Solanki, Certified Financial Planner & Founder, JS Financial Advisors, Delhi, argues, "Bank FD is most beneficial for short-term goals. If you have to create an emergency fund or you make payment for your house/car after six-eight months, a bank FD becomes a viable option which can yield you higher returns. On the other hand, for people who keep large amounts in savings account, a sweep in/out account provides an opportunity to earn higher interest as per their requirement."

He says a sweep account is beneficial when you keep higher amount of funds in your savings account but may need it at different intervals. If the same fund is kept in a bank FD and if you have to withdraw it prematurely, you end up earning less. Thus a sweep in account is beneficial when you do not need the entire funds or are not sure about your short-term requirement.

Tax is another issue that needs to take into account while deciding between the options. Interest earned on both bank FDs and sweep in accounts is added to your income and taxed as per your income tax slab. So if you earn 9 per cent interest and falls in the highest tax slab then your net earnings will be approx 5.5-6 per cent which is not lucrative.

Solanki adds, for people in lower tax slab or who are not taxpayers, the interest being offered in today's scenario is highly attractive. Moreover, senior citizens get slightly higher interest rate which is a positive factor.

Thus, one has to look at one's tax liability and then decide whether FD or auto-sweep are making enough money when you have other tax friendly options like ultra short-term debt mutual funds available.