Australian Securities & Investments Commission

REPORT 353

Further review of term deposits

July 2013

About this report

This report is a follow up to Report 185 *Review of term deposits* (REP 185), released in February 2010, which set out the findings and recommendations from a marketing and disclosure review of the term deposit market that we conducted in 2009.

This report examines the implementation of our recommendations, and whether any further improvements need to be made.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Contents

Executive summary

About our review

1 In 2009, we conducted a 'health check' of the term deposit market in the form of a marketing and disclosure review, which covered the period from 1 January 2008 to 27 February 2009 (previous review). The results of that review are set out in Report 185 *Review of term deposits* (REP 185), issued in February 2010.[1]

2 This review examined information provided by eight authorised deposit-taking institutions (ADIs) (a mix of large banks and mutuals) on household-sourced term deposits. Three of our key findings were as follows:

- Seven of the eight ADIs we reviewed had dual pricing. That is, they promoted their term deposits by actively advertising the higher interest rates available on selected deposit terms while maintaining lower interest rates for other deposit terms.
- Because term deposits can renew (or 'roll over') on a default basis (unless the investor intervenes), this dual pricing practice could create a risk that a term deposit could roll over automatically from a higher interest rate to a lower interest rate, without the investor being conscious of the change because of absent or limited disclosure in customer communications and disclosure documents.
- There was a high level of default rollovers (a weighted average of 47 % of rollovers) from high interest rates to low interest rates.

3 Based on our findings, we made a number of recommendations for improvements to term deposit advertising, the disclosure of interest rates and the disclosure of the risk of dual pricing and grace periods: see the appendix for a summary of these recommendations. We considered that, when taken together, these recommendations could significantly reduce the incidence of investors rolling over from high to low interest rate term deposits.

4 We worked with the Australian Bankers' Association and Abacus Australian Mutuals to secure broader industry support to adopt these recommendations.

5 Our follow-up review covers the period from 1 January 2011 to 31 July 2011 (current review). It was conducted by assessing further information obtained from the same eight ADIs that were included in the previous review.

[1] A copy of REP 185 is available at www.asic.gov.au/reports.

6 We conducted this review to examine the implementation of the recommendations, and the incidence of investors rolling into and remaining in low interest rate term deposits by default. We also assessed whether improvements to advertising, disclosure and grace periods have been effective in reducing the incidence of these rollovers.

Summary of findings

7 We found that the ADIs we reviewed:

- still use dual pricing models;
- have, however, improved their disclosure of the existence and risk of dual pricing, grace periods, and interest rates;
- have fewer default rollovers from 'high' to 'low' interest rates;
- have a significant number of investors using the grace period to make changes to their term deposit; and
- have made changes to advertising to adopt our previous recommendations.

Table 1: Improvements since 2009 at a glance

Area	2009 review[2]	2011 review[3]
Disclosure of risk of dual pricing	Not specifically disclosed by any of the ADIs in terms and conditions documents and only disclosed by one ADI in investor communications.	All ADIs disclose risk in terms and conditions documents and at least one mode of investor communications (e.g. pre-maturity letter, application form)
Existence of grace periods	Seven of the ADIs had grace periods	All eight ADIs have grace periods
Disclosure of grace periods	Disclosed by three ADIs in pre-maturity and/or post-maturity letters	Disclosed by all ADIs in pre-maturity and/or post-maturity letters (five ADIs in pre-maturity letters only, one ADI in post-maturity letters only, and two ADIs in both pre-maturity and post-maturity letters).
Disclosure of interest rates	Actual or indicative interest rate that will apply to new term deposit after rollover disclosed by two ADIs in pre-maturity letters Interest rate schedule enclosed with pre-maturity or post-maturity letter by three ADIs	Actual or indicative interest rate that will apply to new term deposit after rollover disclosed by five ADIs in pre-maturity letters Interest rate schedule enclosed with pre-maturity or post-maturity letter by three ADIs

[2] In 2009, we reviewed eight ADIs, seven of which had a dual pricing model.
[3] In 2011, we reviewed the same eight ADIs, the same seven of which still have a dual pricing model.

Area	2009 review[2]	2011 review[3]
Proportion of rollovers from 'high' to 'low' interest rate	47%[4]	11%[5]
Number of average rollovers per term deposit	5	3.5

Key findings

ADIs still have dual pricing, with more terms at high rates

8 In our previous review, we found that seven of the eight ADIs we reviewed had dual pricing (i.e. 'high' interest rate and 'low' interest rate term deposits depending on the term). This is still the case with these ADIs.

9 For the seven ADIs with dual pricing, a total of $55.81 billion was lodged in term deposits for the first time during the review period.[6]

10 In REP 185, we noted that for the seven ADIs with dual pricing, 98% of investor funds were initially lodged in term deposits paying a 'high' interest rate. This figure has slightly decreased to 95%.

11 Previously we also found that on most interest rate schedules (typically showing at least 12 terms), between two and four terms would be at high interest rates, with the remaining terms at low interest rates.

12 Our current review indicates that more of the terms on offer have high interest rates. For the interest rate schedules we examined (also typically showing at least 12 terms), between four and seven terms were at high interest rates.

13 While there are now more high interest rate terms, there is still a significant difference between the high and low interest rates, ranging from between 9% and 58%, with a difference of 40% or more for five of the ADIs.

14 We also examined what terms high interest rates were available on. We did not examine this issue in our previous review. However, given the significant difference between high and low interest rates, we considered it was now appropriate to consider it.

[4] This is a weighted average, using data from the four ADIs able to provide data relating to the date of maturity, for the period 1 January 2008 to 27 February 2009.
[5] This is a weighted average, using data from all seven ADIs that have a dual pricing model, for the period 1 January 2011 to 31 July 2011.
[6] In our previous review, which covered a longer period (1 January 2008–27 February 2009), this figure was $97.34 billion.

15 We found that for 68%[7] of terms of between one and 12 months (inclusive) attracting a low interest rate, a high interest rate was available for a term either one month shorter or longer.

Fewer default rollovers from ‘high’ to ‘low’ interest rates

16 As was the case in our previous review, all ADIs we reviewed structure their term deposits so that, unless otherwise instructed by the investor, a maturing term deposit rolls over into a new term deposit for the same term at the prevailing interest rate.

17 We found that there were fewer default rollovers from ‘high’ to ‘low’ interest rates. While this may be largely attributable to the increase in the number of ‘high’ interest rate terms, investor use of the grace period may also be a factor.

18 Our concerns in the previous review stemmed largely from our finding that a weighted average of 47%[8] of term deposits which automatically renewed or rolled over on maturity rolled over from high interest rates to low interest rates.

19 This finding resulted in us making some recommendations, including disclosure of the risk of dual pricing and the indicative or actual interest rate after rollover in the pre-maturity letter. We considered that with this information, investors could make a more informed decision about their term deposit before it rolled over.

20 During the review period, a weighted average of 11% of term deposits which automatically renewed or rolled over on maturity rolled over from high to low interest rates.

21 We also found that the average number of rollovers per customer has decreased since our previous review.

22 In our previous review, we found that term deposits rolled over an average of five times before the funds were withdrawn. The average in our current review is 3.5 times.[9]

Improved disclosure

23 In our previous review, none of the ADIs specifically disclosed, in terms and conditions documents or investor communications, the existence of dual pricing or the risk of rollover into a lower interest rate. We also found variations in other disclosure practices among the ADIs. Examples included

[7] This figure is across all ADIs. The proportion for individual ADIs ranges from 47% to 79%: see Table 6.
[8] This involves significant variation between ADIs, ranging from 2% of funds to 60% of funds.
[9] This figure excludes the one ADI that does not have dual pricing.

variations in the disclosure of 'grace periods' (i.e. a short period of time during which an investor can cancel the new term deposit or change to a different one without charge), and the disclosure of the new interest rate in pre-maturity and post-maturity letters.

24 We made a number of recommendations for ADIs to clearly disclose these matters in application forms, terms and conditions documents, and pre-maturity and post-maturity letters.

25 Most of these recommendations have been implemented by the ADIs we reviewed. The majority of ADIs now:

- disclose the risk of rollover from a 'high' to 'low' interest rate in their terms and conditions documents and pre-maturity letters; and
- provide information about the grace period in terms and conditions documents and pre-maturity letters.[10]

26 In addition, most (but not all) ADIs now disclose the actual or indicative interest rate that will apply to the new term deposit in their pre-maturity letters.

Investor use of the grace period

27 As outlined above, one of the recommendations from our previous review was for ADIs to provide investors with clear disclosure of the grace period at various points including in terms and conditions documents, application forms and pre-maturity and post-maturity letters.

28 We found that investors made a significant number of changes to term deposits during the grace period. Specifically, during the review period, a total of $97 billion of investors' funds were in term deposits which investors re-lodged or cancelled during the grace period.

Changes to advertising

29 We previously recommended that ADIs should review their term deposit advertising to ensure that, where dual pricing practices operate, investors are not given the impression that good or competitive terms are available across all deposit terms when this may not be the case.

30 We are satisfied that this recommendation has been implemented by all the ADIs we reviewed. We did, however, find a number of other issues in term deposit advertising which we discuss in this report together with our recommendations for further improvements in this area: see Section E.

[10] In our previous review, one ADI did not have a grace period but has now introduced one.

Recommendations

31 While our recommendations in REP 185 have been largely implemented, we reiterate our previous recommendations where they have not been fully implemented, and make a number of additional recommendations.

Disclosure of interest rates

32 Five ADIs implemented our recommendation to disclose in their pre-maturity letters the actual or indicative interest rate that will apply to investors’ rolled-over term deposits.

33 The ADIs that do not disclose this information stated that this is not possible, primarily due to technical issues.

34 We consider that it is best practice for investors to receive this information *both before and after* the term deposit rolls over, so that they have ample opportunity to consider whether they wish to keep the term deposit or look for alternatives (which may include investing with the same ADI for a different term or investing in other deposit products).

35 While three ADIs enclose an interest rate schedule with the pre-maturity letter (and one of these ADIs also includes a website link to the latest interest rate schedules), we consider that investors are more likely to read interest rate information in a pre-maturity or post-maturity letter, rather than in a potentially lengthy and complex interest rate schedule enclosed with the letter.

Timing of investor communications

36 We identified that while there is improved disclosure of the risk of dual pricing, interest rates, and grace periods, there may not be adequate time for investors to change their term deposit within the grace period if investor communications, particularly post-maturity letters, are not received by investors in a timely fashion.

37 As outlined above, two ADIs still do not disclose the actual or indicative interest rate in their pre-maturity letter.[11] This means that investors may not be aware of the new interest rate until after the term deposit rolls over and they receive the post-maturity letter.

38 We found that the post-maturity letter is sent out to investors between one and seven days after maturity of the term deposit. Given that ADIs’ grace periods range from five business days to 14 calendar days, we are concerned that investors (particularly those with ADIs that have shorter grace periods)

[11] An additional ADI does not send a pre-maturity letter.

may not have adequate time to actually use the grace period to change their term deposit.

39 Only three ADIs disclose information about the grace period in their post-maturity letters. While this information may be included in pre-maturity letters, we consider that it is best practice to also include it in the post-maturity letter to remind investors that they can make changes.

Advertising and promotion

40 As outlined in Section E, our review highlighted the practice of a number of ADIs that conduct mail out campaigns to existing ‘selected’ customers, where they advertise term deposits at ‘special’ rates or as a ‘special’ or ‘exclusive’ offer. This may be misleading if the offer is available to all customers.

41 We have spoken with the relevant ADIs who have undertaken to amend these practices so that they only make these representations when there is genuinely a ‘special’ or ‘exclusive’ offer.

42 We also recommend that interest rate schedules are attached to such letters so that customers are aware of all other term deposit rates available at the time.

A The term deposit market

Key points

Term deposits increased by 26.8% between June 2009 and June 2011; total deposits increased by 14.4% over the same period.

45.3% of term deposit accounts belong to investors aged 65 or older (a slight increase from our previous review, where this figure was 44.5%).

The mean term deposit is approximately $77,000, the median is approximately $29,000 and the mode ranged from $5,000 to $10,000.

Market share and growth

43 We have updated the data we used in REP 185 (which was from 2009) to give a snapshot of the term deposit market in Australia at time of this review.

44 Table 2 gives a breakdown of term deposit holdings among Australian ADIs as at June 2011.

45 The total amount held in term deposits by ADIs at June 2011 was $700.1 billion (an increase of 26.8% on the June 2009 figure cited in REP 185).

46 Among ADIs, the major banks continue to account for over 80% of the funds held in term deposits. Compared to June 2009, the relative market share among ADI groups has remained largely unchanged.

Table 2: Term deposits at June 2011[12]

	Term deposits ($bn)	Market share (%)
Major banks	565.8	80.8%
Other banks	98.1	14.0%
Sub-total: All banks	*663.9*	*94.8%*
Building societies	24.5	3.5%
Credit unions	11.7	1.7%
Total	**700.1**	**100%**

[12] Source for Table 2–Table 4: APRA, *Quarterly bank performance statistics*, June 2011; *Quarterly credit union and building society performance statistics*, September 2011. Data is as at June 2011.

47 The size of term deposits compared to total deposits is shown in Table 3. Term deposits continued to account for most deposits held at both building societies and credit unions. After accounting for less than a third of total deposits in June 2009 (31.9%), the term deposit bases of the major banks have grown noticeably in the past two years and now account for almost two fifths (38.9%) of total deposits.

48 Term deposits also account for a greater share of the overall deposit base among other banks and credit unions, compared to two years ago.

Table 3: Term deposits compared with total deposits at June 2011

	Total deposits ($bn)	Term deposits as a proportion of total deposits (%)
Major banks	1,453.7	38.9%
Other banks	341.6	28.7%
Sub-total: All banks	*1,795.3*	*37.0%*
Building societies	45.7	53.6%
Credit unions	22.2	52.7%
Total	**1,863.2**	**37.6%**

49 Table 4 shows the evolution in term deposit balances among Australian ADIs between June 2008 (at the beginning of our previous review) and June 2011.

Table 4: Trend in term deposits: June 2008 to June 2011

	June 2008 ($bn)	June 2009 ($bn)	June 2010 ($bn)	June 2011 ($bn)	% change from June 2008 to June 2011
Major banks	302.4	428.5	511.9	565.8	+ 87.1%
Other banks	110.1	76.0	85.6	98.1	-10.9%
Sub-total: All banks	*412.5*	*522.4*	*597.5*	*663.9*	*+60.9%*
Building societies	16.2	19.7	22.5	24.5	+51.2%
Credit unions	10.5	9.9	10.8	11.7	+11.4%
Total	**439.2**	**528.9**	**630.8**	**700.0**	**+59.4%**

Investor profiles

50 The following investor data was provided by the eight ADIs we reviewed for the period 1 January 2011 to 31 July 2011:

- Across the seven ADIs where data is available, investors aged 65 or older accounted for between 21% and 54% of term deposit accounts, with an overall mean of 45.3% of term deposits accounts held by investors 65 or older.
- Across the eight ADIs, the mean term deposit ranged from approximately $45,000 to $102,000, with an overall mean of approximately $77,000 (an increase of $5,000 from the overall mean of $72,000 in our previous review).
- Across the seven ADIs where data is available, the median term deposit ranged from approximately $17,000 to $38,000, with an overall median of approximately $29,000.
- Across the seven ADIs where data is available, the most frequently occurring term deposit size (mode) ranged from $5,000 to $10,000.

B The regulatory environment

Key points

Section B of REP 185 contains general information on the regulatory environment, including ASIC's role in relation to licensing, conduct and disclosure.

Since then, there have been some changes in the regulatory environment that may affect the term deposit market.

These changes involve the Basel III reforms developed by the Basel Committee on Banking Supervision, the availability of covered bonds, changes to the Australian Government's deposit guarantee scheme, and the introduction of the Australian consumer law.

Regulation by ASIC and APRA

51 In REP 185, we outlined the regulatory environment applying to ADIs and term deposits. This includes regulation by ASIC for licensing, disclosure and consumer protection, prudential regulation by the Australian Prudential Regulation Authority (APRA), and industry codes of conduct.

52 Overall, the regulatory environment has remained unchanged. However, there are a number of new regulatory reforms which are outlined below. While these reforms are not specific to the term deposit market, they may nonetheless have some impact.

Recent reforms

Basel III reforms

53 The Basel Committee on Banking Supervision (BCBS) released its Basel III reform package in December 2010. The Basel III reforms are a set of reform measures developed by the BCBS to strengthen the regulation, supervision and risk management of the banking sector globally.

54 These measures include new liquidity standards, which require banks to make allowance for a wide range of potential cash outflows, including potential deposit outflows. Deposits that are on demand, or can be withdrawn with little notice, are assumed to have a greater potential for outflow.

Australian Government deposit guarantee

55 In REP 185, we outlined the Australian Government's deposit guarantee scheme, which commenced on 28 November 2008, whereby the Australian Government guaranteed deposits in eligible ADIs.

56 This guarantee generally applied to all term deposits issued by Australian ADIs, with depositors protected by the Financial Claims Scheme (FCS) for deposits of or under $1 million in each ADI, and protection available for a fee for deposits over $1 million. A new permanent cap of $250,000 per person per institution on deposits guaranteed under the financial claims scheme took effect from 1 February 2012.

Australian consumer law: Unfair contract terms

57 REP 185 also briefly outlined our consumer protection role under the *Australian Securities and Investments Commission Act 2001* (ASIC Act), which covers broad standards of conduct, including prohibitions on misleading representations (s12DB), unconscionable conduct (s12CA), and misleading or deceptive conduct (s12DA) in relation to all financial services, including deposit products.

58 Since 1 July 2010, the ASIC Act has been amended to also include provisions which prohibit 'unfair' contract terms[13]. These provisions apply to 'standard form' contracts for banking services (which would include the terms and conditions governing term deposit products).

[13] Under s12BG of the ASIC Act, a term of a consumer contract is defined as being 'unfair' if: (a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and (c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

C Implementation of our recommendations

Key points

On the whole, ADIs have implemented the recommendations in REP 185.

Some ADIs have exceeded our recommendations by making additional improvements to advertising and investor communications.

However, we identified some areas where our recommendations have not been implemented. For example, most of the ADIs we reviewed still do not disclose information about the risk of dual pricing and the grace period in their post-maturity letters. Nor do they advise investors before maturity of the indicative or actual interest rate that will apply to the term deposit after rollover.

We also identified some areas where our recommendations have been partly implemented. For example, revised disclosure by some ADIs on the risk of dual pricing and the availability of grace periods could be improved.

We are working individually with the relevant ADIs to address these issues and encourage full implementation of our recommendations across the term deposit market.

We consider that this will further improve investors' knowledge and understanding of their term deposits and the options available on maturity.

Advertising and promotion

Our previous recommendation

59 We previously recommended that ADIs review their advertising of term deposits to ensure that, where dual pricing practices operate, investors are not given the impression that:

- their future returns will always be at a high interest rate when this may not be the case in the event of a rollover at maturity; and
- competitive interest rates are available for all or most terms.

Our findings

60 This recommendation has been largely implemented by the ADIs we reviewed.

61 We reviewed copies of all advertisements (including print, radio, television and internet) issued by these ADIs during the period 1 January 2011 to 31 July 2011.

62 While there were some new issues with the advertisements we reviewed (see Section E), we found that ADIs have taken steps to ensure that they do not make representations about future returns on term deposits remaining high or unchanged, particularly where dual pricing exists.

63 These steps include the following:

- Some ADIs have decided to cease advertising headline or special rates.
- Many of the ADIs have implemented or improved their sign-off processes for advertisements.
- One ADI has amended its advertisements that promote 'headline' rates to specifically disclose the risk of dual pricing.

Disclosure of dual pricing

Our previous recommendations

64 Our previous review found that seven of the eight ADIs we reviewed use dual pricing. Our current review found that seven ADIs still use dual pricing.

65 To make investors more aware of dual pricing and a risk of rollover from a high to a low interest rate, we previously recommended that ADIs more clearly disclose that:

- dual pricing exists; and
- because term deposits have the ability to roll over automatically without the investor taking active steps, there is a significant risk of rollover from a high to a low interest rate.

66 We recommended that this disclosure should occur in:

- application forms for term deposits;
- Product Disclosure Statements (PDSs) or terms and conditions documents; and
- pre-maturity and post-maturity letters.

Our findings

67 This recommendation has been implemented, in whole or in part, by all of the ADIs we reviewed.

Term deposit application forms

68 Of the seven ADIs that use term deposit application forms, six have now amended (or undertaken to amend) the wording on their application forms to disclose the risk of dual pricing.

PDSs or terms and conditions documents

69 Of the seven ADIs we reviewed that use dual pricing, all ADIs now provide detailed disclosure of the risk of dual pricing in their terms and conditions documents.[14]

70 We detected some issues with the nature of this disclosure by some ADIs, such as the location of this information and failure to specifically mention that interest rates could be lower as a result of dual pricing.

71 We raised these issues individually with the relevant ADIs, who have undertaken to improve their disclosure further.

Pre-maturity and post-maturity letters

72 Six of the seven ADIs we reviewed that use dual pricing send pre-maturity letters.[15] All six of these ADIs have changed the wording of their pre-maturity letters to disclose the risk of dual pricing. Previously, only one ADI disclosed this risk in its pre-maturity letter.

73 We identified some issues with this disclosure by some ADIs (such as the dual pricing risk only being disclosed in 'fine print' and in somewhat vague terms). The relevant ADIs agreed to amend their letters to address these issues.

74 All of the seven ADIs we reviewed that use dual pricing send post-maturity letters. Three of these ADIs have implemented our recommendation to disclose the risk of dual pricing in these letters.

75 As outlined in REP 185, we consider that it is important for the risk of dual pricing to be disclosed at a number of points, including in post-maturity letters, because investors may not know the actual interest rate of their rolled-over term deposit until they receive this letter.[16]

Disclosure of interest rates

Our previous recommendations

76 Our previous review identified that one ADI told its investors in pre-maturity letters what the interest rate would be if the term deposit rolled over by default.

[14] Previously only one ADI provided detailed disclosure of this information.
[15] One ADI sends only a post-maturity letter, but there is a longer than usual 14-day grace period for investors to change their instructions.
[16] One ADI discloses the actual interest rate before maturity. An additional four ADIs disclose the indicative interest rate.

77 We recommended that all ADIs disclose the actual or indicative interest rate in pre-maturity letters so that investors have the longest possible period (i.e. the pre-maturity period and the grace period) to take action if they wish.

78 We also considered it important for investors (particularly those that will roll over to a low interest rate) to know that better interest rates are available from the same ADI for comparable periods, and stated that interest rate schedules could potentially achieve this. However, we did not specifically recommend that interest rate schedules be enclosed with pre-maturity letters.

Our findings

79 Six of the seven ADIs that send pre-maturity letters now provide some interest rate information in these letters. The level of this information varies between ADIs (e.g. some disclose the indicative interest rate, some provide interest rate schedules or website links to schedules, and some provide all of this information).

80 Five of the seven ADIs who send pre-maturity letters now disclose in these letters the actual or indicative interest rate to be paid on rollover. Two of these ADIs also enclose an interest rate schedule (and another ADI, which does not disclose the actual or indicative interest rate, also encloses an interest rate schedule).

Disclosure of grace periods

Our previous recommendations

81 In our previous review, we looked at the use of the grace period by investors, particularly where the term deposit rolled over from a high to low interest rate by default. We found that (where data was available) the proportion of deposits changed or withdrawn during the grace period ranged from 73% to 91% for accounts which rolled over from high to low interest rates.

82 We also identified that consumers were more likely to use the grace period to cancel or change their term deposit if the grace period was disclosed to them in the post-maturity letter.

83 In REP 185, we recommended that:

- grace periods be disclosed at every disclosure point, including in PDSs and terms and conditions documents, pre-maturity letters and post-maturity letters; and
- investors be provided with a grace period of no shorter than five business days, with industry best practice at 14 days.

Our findings

Existence of grace periods

84 All eight ADIs in our current review provide a grace period to investors immediately after a term deposit has rolled over so that they can either cancel the new term deposit or change to a different term deposit without charge.[17]

85 The length of the grace period ranges from five business to 14 calendar days, which is consistent with our previous recommendation.

Disclosure of grace periods in terms and conditions

86 All ADIs now disclose the existence and details of the grace period in their terms and conditions documents. Previously, this was only disclosed by three ADIs.

87 One ADI's terms and conditions document suggests that the grace period is only available to investors who previously provided instructions (e.g. on the application form) about the rollover of their term deposit. We have liaised with this ADI about this issue.

88 We consider that it is best practice for the grace period to be made available to all term deposit investors, regardless of whether they have previously provided instructions when they opened the term deposit or before its maturity. This is because investors may not be aware of the actual interest rate that applies to their new term deposit until it rolls over, regardless of what their previous instructions were.

89 Best practice in industry is for the grace period to be made available to all term deposit investors, regardless of whether or not their ADI uses dual pricing, because the interest rate for the new term after rollover may not be the same as for the previous term due to other factors such as changes to the official cash rate. This provides investors with an opportunity to change their mind (and therefore change their instructions) after they find out the new interest rate, and particularly after the term deposit rolls over.

Disclosure of grace periods in pre-maturity and post-maturity letters

90 Seven of the ADIs we reviewed send pre-maturity letters to investors before their term deposit matures.[18] All of these ADIs now provide details of the grace period in their standard pre-maturity letters. Previously, this was only disclosed by two ADIs.

[17] One of the ADIs did not have a grace period at the time of our previous review, but has now introduced one.
[18] We also asked these ADIs to confirm the timing of these letters. We found that this varies between ADIs, with the letter being sent from between 13–20 calendar days before the term deposit matures.

91 We identified some issues in the way the grace period is disclosed in some of the pre-maturity letters, with some suggesting that the grace period may only be available to investors who have not previously provided instructions. We have liaised with those ADIs concerned, and they have agreed to consider this issue when they further revise their pre-maturity letters.

92 Three ADIs implemented our recommendation for the grace period to be disclosed in post-maturity letters.

93 It is desirable for information about the grace period to be disclosed in post-maturity letters, given that investors may not be aware of the actual interest rate applying to their new term deposit until this point. We consider it is best practice that investors are given an opportunity to make a decision about their term deposit after they find out the interest rate, and that they are aware that they have this opportunity.

D Changes in the market and investor behaviour

Key points

Interest rates

We analysed the interest rate schedules of seven ADIs over the seven-month review period. While there were fewer low interest rates overall on interest rate schedules (when compared to our previous review), the difference between low and high interest rates is material.

We also found that for 68% of low interest rate terms (across all ADIs), extending or bringing forward the date of maturity by one month would attract a high interest rate instead of a low interest rate.

Rollovers

A total of $55.77 billion was lodged in term deposits for the first time during the review period. Of this, 95% of investor funds were first lodged in term deposits paying a high interest rate.

During the period, a total of $1.9 billion of investors’ funds rolled over from high to low interest rates. This represents 11% of all funds rolled over.

We also found that a total of $97.2 billion of investors’ funds were in term deposits that were either changed or closed during the grace period.

Interest rates

High and low interest rates

94 We analysed the interest rate schedules of the seven relevant ADIs over the review period.

95 In our previous review, we found that the mean difference between high and low term deposit interest rates during the review period ranged from 7% to 48%. In our current review, we found that this difference has widened, with this mean difference now ranging between 9% and 58%: see Table 5.

Table 5: Difference between high and low term deposit interest rates

	ADI A	ADI B	ADI C	ADI E	ADI F	ADI G	ADI H
Mean difference between high and low rates from 1 January 2011 to 31 July 2011	58%	9%	32%	45%	44%	42%	40%

96 We also looked at the ADIs' interest rate schedules to see the terms on which high and low interest rates were offered, for terms of between one and 12 months. We found that where low term deposits were offered in a particular month for a particular term, if investors opened the same deposit for a term one month shorter or one month longer, in the majority of cases, their account would attract a high interest rate instead of a low interest rate: see Table 6.

Table 6: Low interest rate terms where high interest rates were available if the term deposit matured one month earlier and/or later

	ADI A	ADI B	ADI C	ADI E	ADI F	ADI G	ADI H
% of low interest rate terms from 1 January 2011 to 31 July 2011	73%	47%	59%	58%	79%	62%	60%

97 This finding highlights the importance of investors who open a new term deposit or roll over their existing term deposit looking at other terms available, particularly when extending or shortening the maturity of the term deposit by only one month would attract a higher interest rate.

Term deposit interest rates and at-call interest rates

98 During the review period, for all of the ADIs with dual pricing, the interest rate on the most popular at-call savings account at all times exceeded the low term deposit interest rates. This is largely unchanged from our previous review.[19]

99 While the interest rates on at-call savings accounts were generally lower than high term deposit interest rates, this difference was far less significant, and in most cases, no more than 100 basis points. At all times, the interest rates on at-call accounts exceeded low term deposit interest rates.

100 We also found that 'introductory' or 'promotional' rates on the at-call savings accounts generally exceeded high term deposit interest rates.

Rollovers

Investor rollover patterns

101 In REP 185, we noted that for the seven ADIs with dual pricing, 98% of investor funds were lodged in term deposits paying a high interest rate. This figure has slightly decreased to 95% as indicated by the current review.

[19] In our previous review, we found that this was the case for six of the seven ADIs with dual pricing.

102 During the review period, a total of $1.9 billion of investors' funds rolled over from high to low interest rates. This represents 11% of all funds rolled over.

103 Table 7 sets out the proportion of deposits that rolled over from high to low interest rates during the review period. The figures in brackets represent the findings in REP 185, indicating a significant decrease in these rollovers.

Table 7: Deposits rolling over from high to low interest rates

	ADI A	ADI B	ADI C	ADI E	ADI F	ADI G	ADI H	Weighted average
Proportion of deposits rolling over from *high to low rates* (as at the date of maturity at end of first term)	7%	39%	39% (60%)	20% (43%)	0.03% (2%)	0.2% (43%)	0.2%	11% (47%)

Use of grace periods

104 Table 8 shows the total amount of funds in term deposits which investors either closed or re-lodged during the grace period. It also shows the proportion of these funds that at the time of re-lodgement were in a low interest rate term deposit, having rolled over from a high interest rate term deposit.

105 We are unable to quantify the amount of funds closed or re-lodged during the grace period as a direct or indirect result of pre-maturity or post-maturity letters. As such, these figures include funds in term deposits where investors have closed or re-lodged their term deposit during the grace period after being prompted to do so by pre-maturity or post-maturity letters, as well as funds in term deposits where investors have decided to close or re-lodge their term deposit for other reasons (with this occurring during the grace period).

Table 8: Use of grace periods

	ADI A	ADI B	ADI C	ADI E	ADI F	ADI G	ADI H
Funds in term deposits closed or re-lodged during the grace period	$41.9 bn	$324.6 mn	$18.4 bn	$4.8 bn	$51.2 mn	$12.1 bn	$19.5 bn
Proportion of these funds in low interest rate term deposits having rolled over from a high interest rate term deposit	8.7%	N/A	2.1%	0.3%	2.1%	16.3%	2.7%

E Advertising and promotion

Key points

We identified some changes in the advertising and promotion of term deposits since our previous review. For example, fewer ADIs now display headline or special interest rates in term deposit advertisements.

While our previous review identified instances of advertising which gave the impression that term deposit interest rates would always be 'high' or would not change, this time the ADIs we reviewed did not include these potentially misleading representations in their advertisements.

While new issues arose in some of the more recent advertisements we reviewed, we are satisfied that the ADIs concerned are taking steps to address the issues and ensure that they do not recur.

Advertising of interest rates

Our previous recommendation

106 In REP 185, we identified a number of concerns with the advertisements for term deposits we reviewed, including representations that term deposits provide consistently high returns when this may not always be the case.

107 We recommended that ADIs review their advertising of term deposits to ensure that, where dual pricing practices operate, investors are not given the impression that:

- future returns will always be at a high interest rate when this may not be the case in the event of a rollover at maturity; and
- competitive interest rates are available for all or most terms.

Our findings

108 We asked the ADIs we reviewed to produce all their term deposit advertisements for the period 1 January 2011–31 July 2011.

109 We found that our previous recommendation had been implemented as follows:

- Two ADIs decided to cease advertising headline or special rates.
- The ADIs that still advertise headline or special rates no longer make specific representations about interest rates being consistently high or competitive.

- One ADI amended its advertisements that promote ‘headline’ rates to specifically disclose the risk of dual pricing.
- Many of the ADIs implemented or improved their sign-off processes for advertisements.

110 However, we identified a number of new issues in the advertisements we reviewed:

- Some ADIs conducted mail out campaigns to existing ‘selected’ customers, advertising term deposits at ‘special’ rates or as a ‘special’ or ‘exclusive’ offer. This may be misleading if the offered rates are generally available. It would also assist consumers if interest rate schedules were enclosed with such letters so that they are aware of all other term deposit rates available at the time.
- One ADI made unqualified representations about ‘guaranteed returns’ which were inconsistent with the Australian Government’s deposit guarantee scheme.
- One ADI published an advertisement which, in our view, gave the overall impression that term deposits are likely to provide consistently higher returns than another savings account product when this was not necessarily the case.

111 We raised these concerns with the individual ADIs, and they have agreed to cease making these representations and ensure that future advertisements do not contain similar representations.

F Recommendations and further work

Key points

We are satisfied that, on the whole, ADIs have implemented the recommendations in REP 185, and that there is a decreased incidence of investors rolling over into 'low' interest rate term deposits. We note, however, that during the review period, $1.9 billion of investors' funds still rolled over into 'low' term deposit rates.

We reiterate our previous recommendations and make a number of further recommendations based on our findings from the current review, which we hope will reduce these incidences even further.

These recommendations are designed to provide increased and timely disclosure to investors about their term deposit and other options that they may wish to consider.

Disclosure of interest rates and schedules

112 Five ADIs implemented our recommendation to disclose in their pre-maturity letters the actual or indicative interest rate that will apply to investors' rolled over term deposits.

113 The ADIs that do not disclose this information stated that this is not possible, primarily due to technical issues.

114 Three ADIs enclose an interest rate schedule with the pre-maturity letter. Two ADIs include a website link to their latest interest rate schedules.

115 As outlined in REP 185, we consider that investors are more likely to read interest rate information in a pre-maturity or post-maturity letter, rather than in a potentially lengthy and complex interest rate schedule enclosed with the letter. However, we also stated that we consider it is important for investors (who will roll over into a low interest rate) to know that better interest rates are available from the same ADI for comparable periods.

116 We reiterate our previous recommendations, as we consider that it is important that investors have sufficient information to make a decision about whether to change their term deposit when it rolls over, particularly about the interest rate they will receive. We consider that it is best practice for investors to receive this information *both before and after* the term deposit rolls over, so that they have ample opportunity to consider whether they wish to keep the term deposit or look for alternatives (which may include investing with the same ADI for a different term).

Timing of investor communications

117 We identified that, while there is improved disclosure of the risk of dual pricing, interest rates, and grace periods, there may not be adequate time for investors to change their term deposit within the grace period if investor communications, particularly post-maturity letters, are not sent to investors in a timely fashion.

118 We found that two ADIs that send pre-maturity letters still do not disclose the actual or indicative interest rate in these letters. This means that investors may not be aware of the new interest rate until after the term deposit rolls over and they receive the post-maturity letter.

119 We found that the post-maturity letter is sent out to investors between one and seven days after maturity of the term deposit. Given that ADIs' grace periods range from five business days to 14 calendar days, we are concerned that investors (particularly those with ADIs that have shorter grace periods) may not have adequate time to actually use the grace period to change their term deposit.

120 Only three ADIs disclose information about the grace period in their post-maturity letters. While this information may be included in pre-maturity letters, we consider that it is best practice to also include it in the post-maturity letter to remind investors that they can make changes.

Advertising and promotion

121 As outlined above, our review highlighted the practice of a number of ADIs that conduct mail out campaigns to existing 'selected' customers, where they advertise term deposits at 'special' rates or as a 'special' or 'exclusive' offer. This may be misleading if these rates are generally available. We recommend that ADIs review these practices to ensure that such representations are only made when there is genuinely a 'special' or 'exclusive' offer.

122 It would assist consumers if interest rate schedules are attached to such letters so that they are aware of all other term deposit rates available at the time.

Appendix: Summary of recommendations from REP 185

Table 9: Summary of recommendations from REP 185

Advertising and promotion	ADIs should review their advertising of term deposits to ensure that, where dual pricing operates, investors are not given the impression that: • their future returns will always be at a high rate when this may not be the case in the event of a rollover at maturity; and • competitive interest rates are available for all or most terms.
Dual pricing	ADIs which have high and low term deposit interest rates should provide clear disclosure that: • dual pricing exists; and • because term deposits have the ability to rollover automatically without the investor taking active steps, there is a significant risk of rollover from a high to a low interest rate. ADIs should make this disclosure in term deposit application forms, PDSs or terms and conditions documents, and pre-maturity and post-maturity letters.
Interest rates	ADIs should provide information in pre-maturity and post-maturity letters about the interest rate that will apply to term deposits when they rollover, and other interest rates that are available for comparable periods.
Grace periods	ADIs should disclose information about grace periods at every disclosure point, including in PDSs or terms and conditions documents, and pre-maturity and post-maturity letters. ADIs should provide investors with a grace period no shorter than five business days, with industry best practice at 14 days.

Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution—has the meaning given in s5 of the *Banking Act 1959*
APRA	Australian Prudential Regulation Authority
ASIC Act	*Australian Securities and Investments Commission Act 2001*
Basel III reforms	A set of reform measures developed by the BCBS to strengthen the regulation, supervision and risk management of the banking sector globally: see www.bis.org/bcbs/basel3.htm
BCBS	Basel Committee on Bank Supervision
FCS	Financial Claims Scheme
grace period	A short period of time during which an investor can cancel the new term deposit or change to a different one without charge
post-maturity letter	A letter to investors after a term deposit has rolled over into a new term deposit
pre-maturity letter	A letter to investors immediately before a term deposit matures
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
REP 185	Report 185 *Review of term deposits*