ASIC

Australian Securities & Investments Commission

REPORT 185

Review of term deposits

February 2010

About this report

In May and June 2009, the Australian Securities and Investments Commission (ASIC) conducted a 'health check' of the term deposit market, in the form of a marketing and disclosure review. This report sets out our findings and recommendations.

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.

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Executive summary

About our review

1 On 16 April 2009, ASIC released an investor and consumer guide on term deposits. At the same time, we announced that we would conduct a 'health check' in the form of a marketing and disclosure review of the term deposit market.

2 We decided to conduct this health check for the following reasons:

- With the Australian Government guarantee of deposits and the current state of the financial markets, term deposits have become more attractive to retail investors and consumers.
- While overall we believe that authorised deposit-taking institutions (ADIs) have been, and continue to be, responsible in the marketing and disclosure of term deposits, we considered it timely to do a health check.

3 In relation to the second reason, we became aware that some ADIs promote their term deposits by actively advertising the higher interest rates available on one or two deposit terms while maintaining lower interest rates for all other deposit terms. The terms for which higher interest rates are offered and advertised change on a regular basis.

4 Because term deposits can renew (or 'roll over') on a default basis (unless the investor intervenes), this dual pricing practice would appear to 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.

5 As part of our review, we obtained information on household-sourced deposits from eight ADIs—a mix of large banks and mutuals (credit unions and building societies). This information included:

- marketing and advertising;
- disclosure documents;
- policies and procedures;
- interest rates; and
- rollover patterns.

6 Our review covered the period 1 January 2008 to 27 February 2009 (the review period).

Key findings

Dual pricing of interest rates during the review period

7 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). We 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.

8 On average, for ADIs with dual pricing, low interest rates were 42% lower than high interest rates for banks, and 18% lower for mutuals.

9 On average, low interest rates were also 37% lower than at-call interest rates for banks and 8% lower than at-call interest rates for mutuals (based on the interest rates for the ADIs' most popular at-call accounts).

10 High term deposit interest rates were not significantly higher than at-call interest rates (at most no more than 100 basis points and at times they are lower than at-call interest rates). Thus, even with a high interest rate investors saw only a modest additional return for committing their funds for a fixed term.

11 There was no apparent correlation, based on interest rates during the review period, between movements in the 90-day bank bill swap rate (BBSY) and 90-day term deposit interest rates for four ADIs (with 90-day term deposit interest rates frequently significantly lower than BBSY) and some correlation for the other ADIs.

Default rollovers during the review period

12 For the seven ADIs with dual pricing, a total of $97.34 billion was lodged in term deposits for the first time during the review period. Of this, 98% of investor funds were first lodged in term deposits paying a high interest rate.

13 For the four ADIs able to provide data relating to the date of maturity, a total of $16.63 billion of term deposit funds rolled over for the first time during the review period (two major ADIs are excluded). As at the date of maturity, a weighted average of 47% of these deposits ($7.88 billion) rolled over from high interest rates to low interest rates (with significant variation between ADIs, ranging from 2% of funds to 60% of funds).

14 For the five ADIs able to provide the relevant data, a total of $33.56 billion of term deposit funds that rolled over for the first time during the review period remained deposited (for the same or a different term). A weighted average of 9% of these funds ($2.86 billion) was re-deposited by default at a lower interest rate for the same term (although there was significant variation between ADIs, ranging from 4% of funds to 19% of funds).

15 On average, investors roll over their term deposit five times before withdrawing their money.

Disclosure

16 None of the ADIs we reviewed disclose the existence of dual pricing or the risk of rollover at a lower interest rate.

17 Variations in other disclosure practices, particularly the existence 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) would appear to explain some of the quite significant differences in investor outcomes on rollover between ADIs.

18 Advertising does not mention dual interest rate pricing and in some cases gives the impression that interest rates offered are consistently high or competitive across different terms, when that is not the case.

Recommendations and further work

19 Our review has identified the dual pricing of term deposit interest rates as creating a risk that retail investors could inadvertently rollover into and remain in low interest term deposits. Accordingly, the recommendations outlined below have been developed in order to address this 'dual pricing rollover risk', and are relevant for ADIs that adopt a dual pricing practice.

20 Based on our findings, we consider that our recommendations for improvements to advertising, disclosure of interest rates and grace periods, when taken together, are likely to significantly reduce the incidence of term deposit investors rolling over from high to low interest rates.

21 Importantly, however, we recognise that some ADIs already have practices that address the dual pricing rollover risk, such that the proportion of their retail investors rolling into and remaining in low interest rate term deposits does not differ significantly from the proportion of their retail investors starting in low interest rate term deposits. Our recommendations are not intended to displace practices that are otherwise effective in addressing or eliminating the dual pricing rollover risk.

Advertising and promotion

22 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 returns are available across all deposit terms when this may not be the case.

Disclosure of dual pricing

23 ADIs that have high and low term deposit interest rates should review their disclosure documents to ensure that there is clear and effective disclosure 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.

24 This disclosure should occur in:

(a) term deposit application forms;

(b) Product Disclosure Statements (PDSs) or terms and conditions booklets; and

(c) pre-maturity and post-maturity letters.

Disclosure of interest rates

25 We consider it important that investors are aware of the interest rate that will apply on their new term deposit before it rolls over, so that they have the longest possible period (the pre-maturity period and the grace period) to intervene if they wish. At the same time, we consider it important for investors who would roll over to a low interest rate to know that better interest rates are available from the same ADI for comparable periods.

26 We consider that these disclosures should be made clearly and in the pre-maturity communication with investors. Although enclosing interest rate schedules with pre-maturity letters could potentially achieve this, we consider that investors are more likely to read the actual letter rather than a potentially lengthy and detailed interest rate schedule.

27 Accordingly, ADIs should update their term deposit renewal communication so that they clearly disclose the actual or indicative interest rate that will apply to the new term deposit. Where the interest rate indicated is subject to last minute changes by the ADI, this fact should also be clearly disclosed.

Disclosure of grace periods

28 We consider it important for investors to have, and be aware of, the grace period that applies when their term deposit rolls over by default. We also consider that the grace period should be of sufficient length to allow the investor to act if they so choose.

29 Based on our review of seven of the eight ADIs that have grace periods, it is industry best practice to:

- tell investors about grace periods at every disclosure point, including PDSs/terms and conditions, pre-maturity and post-maturity letters.
- provide investors with a grace period no shorter than five business days, with industry best practice at 14 days.

30 ADIs should review their policies and disclosure around grace periods in light of current best practice.

Other options

31 Beyond improvements to advertising, disclosure and grace periods, we also considered whether changes to the standard operation of term deposits might also be necessary to reduce the incidence of investors rolling from high to low interest rates by default. In light of the relatively high interest rates on popular at-call accounts, we canvassed with ADIs the possibility of a term deposit rolling over into a high interest at-call account rather than into another term deposit (subject to the interest rate on the at-call account being higher at the time of maturity than the term deposit interest rate, and the investor not instructing otherwise).

32 We considered this proposal to have some merit, because an investor whose funds roll over into a high interest at-call account can withdraw their funds without penalty and receive a higher interest rate in the meantime.

33 However, ADIs expressed some concern with this proposal, primarily on the basis that most high interest at-call accounts were 'online' accounts, and might not be suitable for some term deposit customers. ADIs also suggested that improvements to disclosure, in particular, would be effective in reducing the incidence of investors rolling into low interest rate term deposits.

34 In response to this feedback, we have not recommended that ADIs change the standard operation of term deposits at this stage. We will conduct a further targeted review in the second half of 2011 (see below) and reassess if necessary.

Further work

35 As this review did not include all ADIs, we will work with the Australian Bankers' Association and Abacus – Australian Mutuals to secure broader industry support and adopt these recommendations where necessary.

36 ASIC will also conduct a further targeted review in the second half of 2011 to examine the implementation of our recommendations by ADIs, and the incidence of investors rolling into and remaining in low interest term deposits by default. Our further review will enable us to assess whether improvements to advertising, disclosure and grace periods have been made

and have been effective in reducing the incidence of retail investors rolling and remaining in low interest term deposits by default.

A The term deposit market

Key points

Term deposits increased by 20.4% between June 2008 and June 2009; total deposits increased by 14% over the same period.

44.5% of term deposit accounts belong to investors aged 65 or older.

The mean term deposit is approximately $72,000, the median is approximately $30,000 and the mode is approximately $12,000.

Market share and growth

37 The latest complete public data on term deposits in Australia is for June 2009 for banks and September 2009 for credit unions and building societies. For comparability, we have used June 2009 data for all ADIs. At that date Australian ADIs had a total of $528.9 billion in term deposits: see Table 1.

Table 1: Term deposits at June 2009[1]

	Term deposits ($bn)	Market share (%)
Major banks	425.1	80.4%
Other banks	74.5	14.1%
Sub-total: All banks	*499.6*	*94.5%*
Building societies	9.9	1.9%
Credit unions	19.4	3.5%
Total	**528.9**	**100%**

38 The size of term deposits compared to total deposits is shown in Table 2. While building societies and credit unions have a very small share of total deposits, term deposits make up around half of their deposits, compared with less than one-third for the banks.

[1] Source: APRA, *Quarterly bank performance statistics*, June 2009; *Quarterly credit union and building society performance statistics*, September 2009. Data is as at June 2009.

Table 2: Term deposits compared with total deposits at June 2009[2]

	Total deposits ($bn)	Term deposits as proportion of total deposits (%)
Major banks	1,332.3	31.9%
Other banks	310.1	24%
Sub-total: All banks	*1,616.1*	*30.9%*
Building societies	18.3	54%
Credit unions	40	48.5%
Total	**1,629**	**32.5%**

39 During the financial year of 2008–2009, there was a strong rise in the aggregate size of term deposits. From June 2008 to June 2009, term deposits increased by 20.4% (compared to an increase of 14% for total deposits). Major banks accounted for most of the rise in term deposits, and because other banks and building societies had a fall in their term deposits, the major banks' market share increased from 68.8% to 80.4%: see Table 3.

Table 3: Trend in term deposits—June 2008 to June 2009[3]

	Term deposits—June 2008 ($bn)	Term deposits—Dec 2008 ($bn)	Term deposits—June 2009 ($bn)	Change—June 2008 to June 2009
Major banks	302.4	414.9	425.1	+ 40.1%
Other banks	110.1	75.9	74.5	-32.3%
Sub-total: All banks	*412.5*	*490.8*	*499.6*	*+21.1%*
Building societies	10.5	9.9	9.9	-5.7%
Credit unions	16.2	18.4	19.4	+19.7%
Total	**439.2**	**519.1**	**528.9**	**+20.4%**

[2] Source: APRA, *Quarterly bank performance statistics*, June 2009; *Quarterly credit union and building society performance statistics*, September 2009. Data is as at June 2009.
[3] As above.

Investor profiles

40 The following investor data was provided by the eight ADIs we reviewed and is a snapshot from 27 February 2009:

- Across the seven ADIs where data is available, investors aged 65 or older accounted for between 22% and 53% of term deposit accounts, with an average of 44.5% of term deposit accounts held by investors 65 or older.
- Across the eight ADIs, the mean term deposit ranged from approximately $38,000 to $129,000, with an average of approximately $72,000.
- Across the seven ADIs where data is available, the median term deposit ranged from approximately $14,000 to $50,000, with an average of approximately $30,000.
- Across the seven ADIs where data is available, the most frequently occurring term deposit size (mode) ranged from $5,000 to $20,000, with an average of approximately $12,000.

B The regulatory environment

Key points

Authorised deposit-taking institutions are regulated by both APRA and ASIC.

ASIC regulates the licensing, conduct and disclosure obligations of ADIs under the Corporations Act and the ASIC Act.

Some of the regulatory obligations for ADIs, particularly for disclosure, are less prescriptive for the basic deposit products (including term deposits) available from ADIs.

Industry codes of conduct also include standards that subscribers must observe.

Authorisation by APRA

41 In Australia, only ADIs such as banks, credit unions and building societies can issue term deposits.

42 The Australian Prudential Regulation Authority (APRA) authorises ADIs in Australia to provide banking services (including taking money on deposit) under the *Banking Act 1959.* APRA also establishes and enforces prudential standards, which ADIs are required to comply with.

Licensing and disclosure

43 ADIs are also regulated by ASIC. Under the *Corporations Act 2001* (Corporations Act), deposit-taking facilities made available by ADIs are specifically defined as financial products.

44 As the financial services regulator, ASIC licences and monitors financial services businesses (including ADIs) to ensure that they operate efficiently, honestly and fairly, and comply with the obligations prescribed by the Corporations Act, including obligations for conduct and disclosure.

45 Some of these obligations, particularly for disclosure, are less prescriptive for the basic deposit products[4] available from ADIs. Specifically, in December 2005, the Australian Government excluded basic deposit products from the PDS regime, as long as the cost of the product and future payment

[4] Basic deposit products are defined in s761A of the Corporations Act.

requirements are disclosed.[5] Term deposits of no more than five years are generally capable of being basic deposit products.[6]

46 ASIC has also given class order relief simplifying certain disclosure requirements for issuers of deposit products.[7] For example, we have given permanent conditional relief to issuers of deposit products from the requirement to disclose interest rates in PDSs.

47 We have previously stated[8] that despite this relief, we expect issuers of deposit products to:

- adequately disclose information about termination values and interest rates in their offer documents for deposit products (regardless of whether a PDS is required); and
- give more precise information about interest rates and termination values on request.

ASIC's consumer protection role

48 ASIC also has a consumer protection role under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

49 Part 2, Division 2 of the ASIC Act 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.

Industry standards

Code of Banking Practice

50 The Code of Banking Practice (Banking Code) is a voluntary code of conduct that sets out the banking industry's standards of good practice. Relevantly, under cl 10 of the Banking Code, a subscribing bank must:

- on request, provide terms and conditions, details of standard fees and charges, and interest rates (cl 10.1); and
- have terms and conditions that contain prescribed information, including specific information for term deposits about how the principal

[5] The requirements are set out in reg 7.9.07FA of the Corporations Regulations 2001.
[6] A term deposit of more than five years duration cannot qualify as a basic deposit product, unless there is no reduction in the return generated for the investor if they were to withdraw their funds early.
[7] ASIC provided this relief on the basis that 'deposit products are relatively simple and understood', and 'strict compliance with all aspects of the disclosure regime of the Corporations Act does not make sense for all deposit products' (ASIC Information Release IR 06-20).
[8] ASIC Information Release IR 06-20

and interest will be repaid and the consequences of early withdrawals (cl 10.4(f)).

51 Clause 30 of the Banking Code also requires a subscribing bank to ensure its advertising is not deceptive or misleading.

Mutual Banking Code of Practice

52 The Mutual Banking Code of Practice (Mutual Banking Code) is a voluntary code of conduct for credit unions and building societies.

53 As with the Banking Code, the Mutual Banking Code requires subscribers, among other things, to:

- give consumers clear and accessible information about their products and services (including term deposits);
- disclose interest rates, fees and charges in an accessible and clear format; and
- ensure that advertising is not misleading or deceptive.[9]

Australian Government guarantee

54 On 12 October 2008, the Australian Government announced that it would guarantee deposits in eligible ADIs for a period of three years. Generally, this guarantee applies to all term deposits issued by Australian ADIs. For deposits of or under $1 million in each ADI, depositors are protected by the Financial Claims Scheme at no cost. For deposits over $1 million, an eligible institution can obtain a government guarantee under the large deposit guarantee, in return for a fee.[10]

55 While the Australian Government guarantee is administered by the Reserve Bank of Australia (as agent for the Commonwealth), ASIC also has a role in ensuring that appropriate disclosures are made to consumers so that they can determine if their product is covered by the guarantee.

[9] Principle 3, Part C and Sections 1, 2 and 3, Part D of the Mutual Banking Code.
[10] These thresholds apply per depositor, per institution—that is, they apply to the total amount of funds held by a depositor in (separate) deposit accounts with an ADI. On 7 February 2010, the Treasurer announced the withdrawal of the Guarantee Scheme for Large Deposits and Wholesale Funding (see http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/013.htm&pageID=003&min=wms&Year=&DocType=)

C Advertising and promotion

Key points

As part of our review, we asked ADIs for copies of all advertisements (including print, radio, television and internet) for term deposit products from 1 July 2008 to 27 February 2009.

The number of advertisements produced per ADI ranged from eight to 35.

All ADIs used interest rates in at least some of their advertisements.

Given the likelihood of rollovers, some advertisements might give investors an unrealistic expectation about future returns on their term deposits and may contain potentially false or misleading statements (or omissions).

Advertising of interest rates

56 All ADIs displayed interest rates in at least some (or, in some cases, all) of their advertisements. Of the eight ADIs we reviewed:

- three ADIs displayed interest rates in all of their term deposit advertisements;
- two ADIs displayed interest rates in approximately three-quarters of all their term deposit advertisements;
- two ADIs displayed interest rates in approximately half of all their term deposit advertisements; and
- one ADI displayed interest rates in approximately one-third of all its term deposit advertisements.

Representations about interest rates

57 In our review of advertisements, we found that certain representations about term deposit interest rates were made by ADIs that operate dual pricing that could give investors the impression that the interest rate on their investment would always be 'high' or would not change. For example:

> *Consistently high interest rates*
>
> *Completely predictable ending*
>
> *Relax knowing exactly how much your return will be*
>
> *Other great rates available for a variety of terms*
>
> *Competitive rates for other terms of investment*[11]

[11] This representation was made in circumstances where the terms with high rates were already disclosed.

58 Such representations could give investors unrealistic expectations about future returns on their investment. This is because these statements do not take into account that:

- at any one time, good or competitive rates are only available for a small number of terms; and
- there is a risk that returns will decline if the term deposit is automatically rolled over or renewed upon its maturity into a term deposit with a lower interest rate.

Other issues

59 We identified the following other issues from our review of the advertisements:

- Some ADIs mention the Australian Government Deposit guarantee in their advertisements. However, one of the ADIs failed to mention the maximum term deposit amount eligible for the guarantee at no cost.
- Six ADIs advertised specific interest rates but failed to display or state the applicable minimum or maximum term deposit amounts.
- Three ADIs advertised specific interest rates but failed to display or state the term deposit period.

D Product design and disclosure

Key points

Term deposits are a basic product and generally do not differ greatly between ADIs.

However, differences between ADIs do arise in relation to:

- whether ADIs allow investors to specify what they would like to happen when the term deposit matures;
- the content of letters sent to investors when their term deposit matures (pre-maturity letter), and after rollover into a new deposit (post-maturity letter);
- the disclosure and length of grace periods after rollover.

Product design

Term deposit features

60 All term deposits pay a fixed rate of interest for a fixed period. Term deposits are typically available for between one month and five years, in 30-day increments. ADIs do provide term deposits of a custom length, but this is usually for large amounts and is at the discretion of the ADI.

61 Funds deposited into a term deposit are not available at call, but a term deposit can be broken (break costs usually apply).

62 When the fixed period of a term deposit is due to end (also known as 'maturity'), the investor has a number of options:

- withdraw the deposited funds (and accumulated interest);
- allow the term deposit to automatically roll over into a new term deposit for the same term and for the interest rate applicable for that term on the date of rollover (the prevailing interest rate); or
- re-invest the funds and/or interest into a new term deposit for a different term.

63 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.

64 Term deposits are often for fixed short terms with any rollover resulting in a new contract. However, a significant number of term deposits effectively

span several years in that on average, investors allow (either proactively or by default) their term deposit to roll over approximately five times.

65 Four of the eight ADIs we reviewed allow investors to specify on the term deposit application form what they would like to happen when the term deposit matures. Typically, these options include:

- rollover (part or all funds) at the prevailing interest rate for same the period;
- rollover (part or all funds) at the prevailing interest rate for a different period; and
- return funds to investor by cheque or electronic funds transfer.

66 We do not have sufficient data on the relationship between investors who include instructions on term deposit application forms and actual investor behaviour and outcomes at term deposit maturity.

Dual pricing

67 Seven of the eight ADIs we reviewed use dual pricing. This means that they offer both high and low interest rates on term deposits based on the term of investment, with significant differences between these rates.

68 We 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. These seven ADIs change the terms that attract high interest rates on a regular basis.

69 For more about our findings on interest rates, see Section E of this report.

Disclosure

Form of disclosure

70 As noted earlier, under the basic deposit product exemption, term deposits (and other basic deposit products) are exempted from the disclosure requirements of the Corporations Act. This means that ADIs are not required to give customers a PDS for term deposits, but can choose to do so.

71 In the place of PDSs, ADIs use ‘terms and conditions’ documents to record the contractual terms that apply to the term deposit. Seven of the eight ADIs we reviewed use terms and conditions documents rather than PDSs. Some terms and conditions documents operate as omnibus documents covering a range of retail products issued by the ADI.

Interest rate schedules

72 All ADIs have interest rate schedules that set out the interest rates available for term deposits of different amounts and for different periods. These are available to investors on request, and are also enclosed in the letters sent before or at maturity by four of the eight ADIs we reviewed.

73 These schedules give investors information on every term deposit option offered by the ADI in a table format. Term deposit interest rates vary according to:

- length of investment, with ADIs generally offering periods from one month to five years;
- size of investment (e.g. a number of ADIs show interest rates for deposits up to $5,000, up to $10,000, up to $50,000, up to $100,000 and up to $250,000);
- interest option—that is, some ADIs offer different interest rates depending on the frequency of interest payments (e.g. monthly, quarterly, annually) and whether interest is compounded.

74 For some ADIs, this can mean the schedules are quite long and detailed (e.g. 32 rows and six columns in the case of one ADI). Some ADIs highlight on their interest rate schedules the term deposit periods that are currently paying high rates of interest.

75 For more information about our findings on investors’ responses to interest rate schedules, see Section E of this report.

Pre-maturity contact

76 Seven of the eight ADIs we reviewed send a letter to investors immediately before the term deposit matures (pre-maturity letter) and one ADI sends a letter on the day of maturity (which makes it a post-maturity letter).

77 One of the eight ADIs also telephones all its customers before maturity to discuss what the investor would like to do with their deposit.

78 All pre-maturity letters advise investors that they may withdraw or reinvest the maturing balance. Investors are also told that, if they don’t intervene, the term deposit will roll over for the same term at the prevailing interest rate.

79 Only one of the eight ADIs mentions in the pre-maturity letter the current prevailing interest rate that will be paid if the term deposit is allowed to roll over. Another ADI telephones investors before maturity to discuss the interest rates currently available.

80 Three of the eight ADIs enclose an interest rate schedule with the pre-maturity letter and one ADI encloses an interest rate schedule with the post-maturity letter it sends to investors.

81 One ADI mentions in both the pre-maturity letter and the post-maturity letter that the investor has a grace period after roll over during which they can cancel or change their new term deposit: see 'Grace periods' below.

Post-maturity contact

82 All ADIs we reviewed contact investors by letter after a term deposit has rolled over into a new term deposit (post-maturity letter). This letter sets out the details of the new term deposit, including the interest rate that applies.

83 Three of the seven ADIs that have a grace period mention this grace period in the post-maturity letter.

84 One ADI neither telephones its customers before maturity, nor mentions in its pre-maturity letter the interest rate that will be paid if the term deposit is allowed to rollover. It also does not enclose an interest rate schedule or mention the existence of a grace period in its pre-maturity or post-maturity letters.

Disclosure of risks

85 All ADIs disclose that, without further instruction from the investor, a term deposit will roll over at maturity for another term at the prevailing interest rate. However, none of the seven ADIs with dual pricing disclose that:

- dual pricing exists;
- terms attracting high interest rates are moved around on a regular basis; and
- there is a risk of rollover from a high to a low interest rate.

Grace periods

86 In the period immediately after a term deposit has rolled over, seven of the eight ADIs provide investors with a 'grace period' (i.e. a short period of time during which they can cancel the new term deposit or change to a different term deposit without charge). Several ADIs have policies in place to allow investors to change or cancel their term deposits shortly after the grace period has lapsed.

87 Investors who change (rather than cancel) their new term deposit during the grace period do so either because they would like to:

- switch to a term that offers a better interest rate; or
- lengthen or shorten the term of their new term deposit.

88 The one ADI that does not have a grace period telephones all investors before their term deposit matures to discuss what they would like to do with their deposit. This would appear to make a grace period potentially unnecessary, as the risk of an investor rolling over unconsciously is effectively eliminated. However, this type of measure is unlikely to be practical for ADIs with a large number of term deposit customers.

89 For more about our findings on investors' use of grace periods, see Section E of this report.

E The term deposit market

Key points

Interest rates

We analysed the interest rate schedules of seven ADIs over the 14-month review period.

On average, low term deposit interest rates are 42% lower than high term deposit interest rates for banks and 18% lower for mutuals.

On average, low term deposit interest rates are 37% lower than at-call interest rates for banks and 8% lower than at-call interest rates for mutuals.

High term deposit interest rates are not significantly higher than at-call interest rates (at most no more than 100 basis points and at times they are lower than at-call interest rates)

There is no apparent correlation between the 90-day bank bill swap rate (BBSY) and 90-day term deposit interest rates for four major ADIs (with 90-day term deposit interest rates frequently significantly lower than BBSY) and some correlation for the other ADIs.

Rollovers

A total of $97.34 billion was lodged in term deposits for the first time during the review period. Of this, 98% of investor funds were first lodged in term deposits paying a high interest rate.

For the four ADIs able to provide data about the date of maturity, $16.63 billion of term deposit funds rolled over for the first time during the review period (two major ADIs are excluded). As at the date of maturity, 47% of these deposits ($7.88 billion) rolled over from high to low interest rates.

For the five ADIs able to provide data, $33.56 billion of term deposit funds that rolled over during the review period on a default basis remained deposited (for the same or a different term) at the end of any available grace period. 9% of these funds ($2.86 billion) were in low interest rate term deposits at the end of the grace period, having rolled over on a default basis for the same term.

Interest rates

High and low interest rates

90 We asked ADIs for their term deposit interest rates during the review period (i.e. from 1 January 2008 to 27 February 2009). Table 4 shows the mean difference between high and low term deposit interest rates during this period, and as at 27 February 2009 for seven ADIs.[12]

[12] For consistency, our review of high and low interest rates was limited to term deposits of between four and seven months duration.

Table 4: Differences 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 Jan 2008–Feb 2009	40%	28%	42%	48%	7%	34%	45%
Difference between high and low rates at 27 Feb 2009	25%	42%	46%	37%	13%	43%	40%

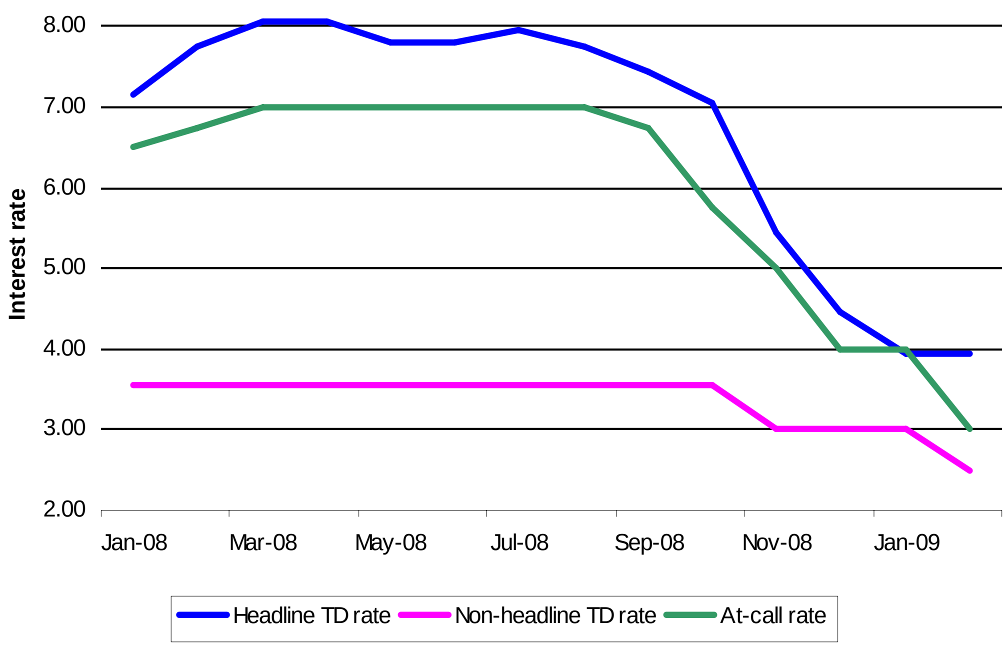
Term deposit interest rates and at-call interest rates

91 During the review period, for six of the seven ADIs, the interest rate on their most popular at-call savings account at all times exceeded their low term deposit interest rates, and was not significantly different to their high term deposit interest rates.

92 Figure 1 compares one ADI’s high and low term deposit interest rates, and the interest rate on this ADI’s most popular at-call account. The low interest rate remains unchanged for most of the 14 months (and is approximately 350 basis points below the at-call interest rate for about nine months).

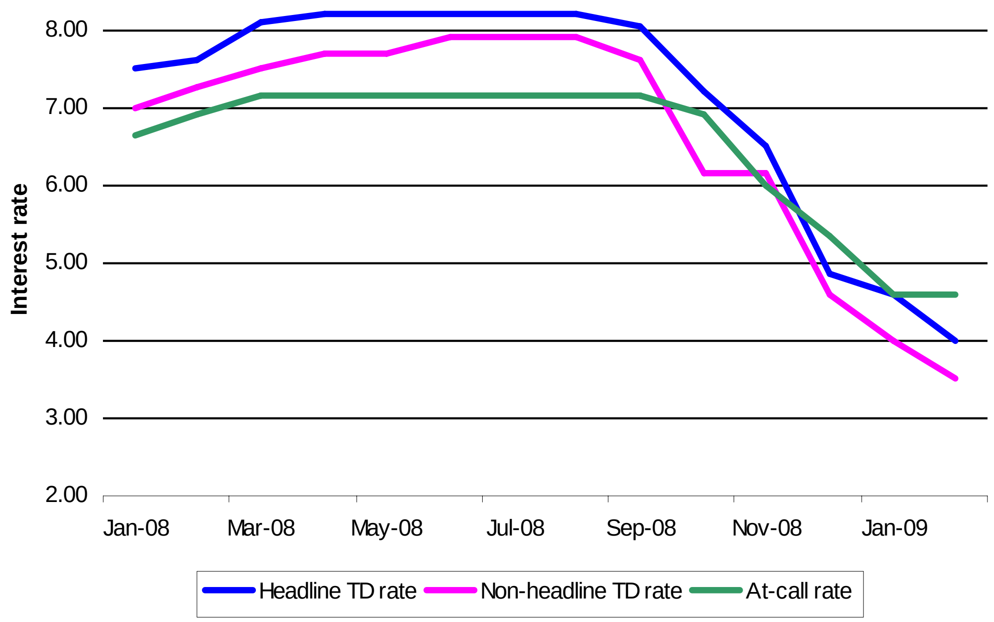
93 Although the gap between the high and low interest rate narrowed (in absolute terms) from November 2008, in relative terms the gap remains large (a difference of 145 basis points, equal to one-third of the high interest rate). All other ADIs except two had a similar pattern.

Figure 1: Comparison of term deposit and at at-call interest rates (Example 1)



94 Figure 2 compares another ADI’s interest rates. This was one of two ADIs where the high and low term deposit interest rates were higher over most of the same period than the interest rate on its most popular at-call account.

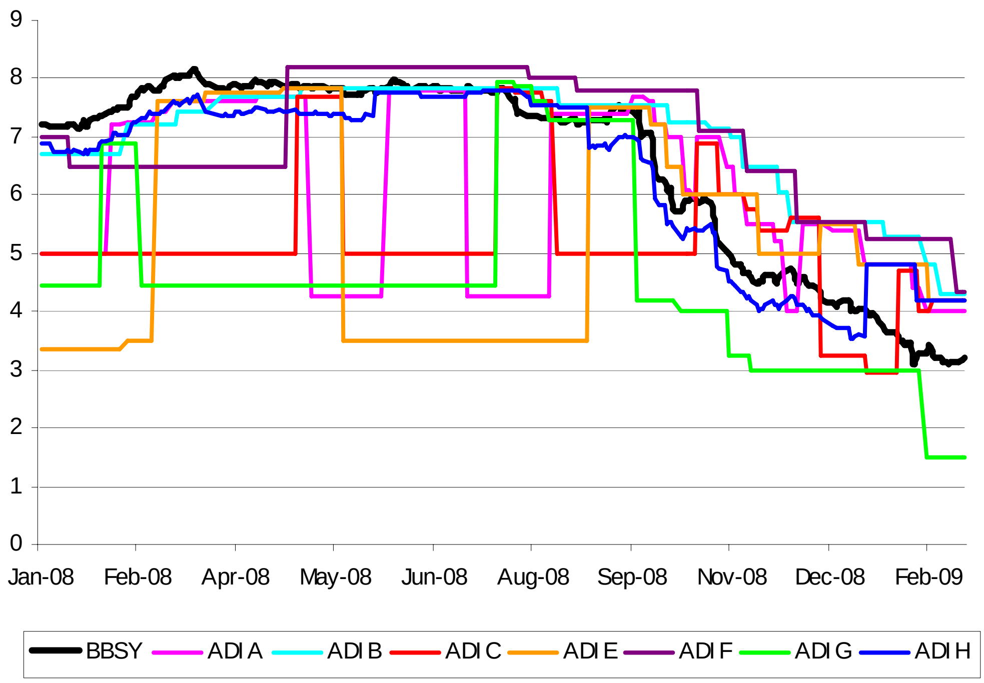
Figure 2: Comparison of term deposit and at-call interest rates (Example 2)



Term deposit interest rates and the 90-day bank bill

95 Figure 3 plots the 90-day bank bill rate (BBSY) against 90-day term deposit interest rates for seven ADIs during the review period. For four ADIs, there is no apparent correlation between movements in these interest rates. For the remaining ADIs, the interest rates appear correlated during certain periods.

Figure 3: Comparison of BBSY and term deposit interest rates



Frequency of interest rate changes

96 During the review period, ADIs issued an average of 43 interest rate schedules (as low as 14 for one ADI and as high as 78 for another ADI), equivalent to a new interest rate schedule approximately every 10 days on average.

97 The terms that attract high interest rates are changed on a regular basis. We examine this issue below in the context of rollovers.

Rollovers—effect of repricing

Repricing patterns and rollover risk

98 We analysed the interest rate schedules of seven ADIs over the 14-month review period, comparing the timing of when high interest rates were available (for term deposits from two to 12 months) and what type of interest rate (high or low) investors would roll over to on a default basis (based on the corresponding interest rates applicable at rollover time). This data is set out in Table 5.

Table 5: ADI repricing and rollover risk

	ADI A	ADI B	ADI C	ADI E	ADI F	ADI G	ADI H
Proportion of deposits that *would* (absent intervention) roll over from high to low rates	57%	8%	64%	65%	55%	83%	79%

99 This data indicates that a significant proportion of investors would, on a default basis, roll over from high to low interest rates based on the timing of interest rate changes by ADIs. For six of the seven ADIs, the proportion of such rollovers ranges from 55% to 83%.

100 In practice, however, the proportion of investors who actually roll over from high to low interest rates on a default basis depends on whether they contact their ADI before maturity and intervene before the rollover occurs.

Actual investor rollover patterns

101 For the review period, we asked ADIs for the dollar amount of term deposits starting at a high interest rate. Seven[13] ADIs received $97.34 billion of first-time term deposits during this period, of which 98% ($95.85 billion) started at a high interest rate.

[13] We excluded the one ADI that does not have a dual pricing practice.

102 Unless an investor contacts their ADI before their term deposit matures, or has provided prior instructions, the term deposit will (on the date of maturity) roll over into a new term deposit for the same term at the prevailing interest rate.

103 For the review period, we asked ADIs for the dollar amount of funds rolling over, on a default basis, for the first time from:

- high to high interest rates; and
- high to low interest rates.

104 Table 6 shows, for the four ADIs for which data is available, the proportion of term deposits rolling over from high to low interest rates by default and for the first time, as at the date of maturity.

Table 6: Deposits rolling over from high to low interest rates

	ADI C	ADI E	ADI F	ADI G	Weighted average
Proportion of deposits rolling over from *high to low rates* (as at the date of maturity at end of first term)	60%	43%	2%	43%	47%

Rollover risk and actual investor rollover patterns

105 Table 7 compares the proportion of investors who would, without intervention, be expected to roll over from high to low interest rates with the proportion of investors who actually roll over from high to low interest rates (as at the date of maturity). Where the proportion of investors actually rolling over is lower than the repricing action taken by ADIs might predict, it suggests investors are intervening to prevent their maturing term deposit rolling over from a high to a low interest rate.

Table 7: Rollover risks and actual investor behaviour

	ADI C	ADI E	ADI F	ADI G
Proportion of deposits *that would* (absent intervention) roll over from high to low rates	64%	65%	55%	83%
Proportion of deposits *actually* rolling over from high to low rates (as at the date of maturity at end of first term)	60%	43%	2%	43%
Interest rate schedule enclosed with pre/post-maturity letter	No	Yes	Yes	Yes

106 In the case of ADI F, the fact that only 2% (rather than 55%) of investors actually roll over from high to low interest rates is probably explained by its practice of telephoning every investor immediately before their term deposit matures.

107 In the case of ADI E and ADI G, enclosing an interest rate schedule with the pre-maturity letter might be why in both cases 43% of investors actually roll over from high to low interest rates rather than 65% and 83% respectively. However, other findings show that interest rates schedules do not appear to influence the behaviour of investors during the grace period: see 'Disclosure of interest rates' in Section F.

Rollovers—use of grace periods

Availability of grace periods

108 As noted in Section D, seven of the eight ADIs we reviewed give investors a grace period when a term deposit rolls over automatically into a new term deposit. During the grace period, an investor may withdraw their term deposit, change their term deposit to a different term, or do nothing.

109 Table 8 shows the extent to which investors use the grace period to cancel or change their term deposits. Data is available for three ADIs. The table shows the proportion of term deposits that were cancelled or changed during the applicable grace period out of total funds that rolled over for the first time on a default basis during the review period.

Table 8: Use of grace periods

	ADI C	ADI E	ADI G
Proportion of deposits changed or withdrawn during grace period	61%	48%	70%

Rollover result and use of grace periods

110 Table 9 shows the use of grace periods by investors depending on whether the investor initially rolled over from a high to a low interest rate or from a high to a high interest rate. For the three ADIs where data is available, investors who rolled over from high to low interest rates by default cancelled or changed their term deposit during the ADI's grace period in much greater numbers than investors who rolled over by default from high to high interest rates.

Table 9: Use of grace periods and rollover result

	ADI C	ADI E	ADI G
Proportion of high to low interest rate rollovers changed or withdrawn during grace period	73%	83%	91%
Proportion of high to high interest rate rollovers changed or withdrawn during grace period	44%	22%	55%

Disclosure of grace periods and investor behaviour

111 Table 10 shows the data in Table 6 compared to the proportion of investor deposits that, having rolled over on a default basis from a high to a low interest rate, remained deposited at a low interest rate at the end of the grace period.

112 The percentage expressed in the second row of Table 10 is the amount of funds that rolled over (for the first time) by default from a high to a low interest rate term deposit, as a proportion of the total funds that rolled over for the first time (including funds that rolled by default from a high to a high interest rate, as well as funds that were switched to a different term during the grace period).

Table 10: Deposits at low interest rates at maturity date and at end of grace period

	ADI A	ADI C	ADI E	ADI G	ADI H	Weighted average
Proportion of high to low rollovers as at maturity date	n/a	60%	43%	43%	n/a	47%
Proportion of high to low rollovers still deposited at low rates at end of grace period	7%	19%	9%	4%	6%	9%

113 Table 11 shows the data in Table 10 in conjunction with how the ADIs disclose the existence of the grace period and the length of the grace period. For the five ADIs where data is available, there appears to be a relationship between investors using the grace period to cancel or change their term deposit and whether the grace period has been disclosed to them in the post-maturity letter.

114 In relation to the proportion of investors with funds in low interest rate deposits at the end of the post-maturity grace period:

- the ADI with the lowest proportion of such investors is also the ADI with the longest disclosed grace period;
- the three ADIs with the lowest proportion of such investors are also the only three ADIs that disclose the existence of the grace period in their post-maturity letters, and PDSs/terms and conditions documents; and
- the two ADIs with the highest proportion of such investors are also the only ADIs (with a grace period) that do not disclose the grace period at all.

Table 11: Disclosure of grace periods and investor behaviour

	ADI A	ADI C	ADI E	ADI G	ADI H
Proportion of high to low rollovers as at maturity date	n/a	60%	43%	43%	n/a
Proportion of high to low rollovers still deposited at low rates at end of grace period	7%	19%	9%	4%	6%
Grace period disclosed in pre-maturity letter	Yes	No	No	n/a[14]	No
Interest rate schedule enclosed with pre/post-maturity letter	No	No	Yes	Yes	No
Grace period disclosed in post-maturity letter	Yes	No	No	Yes	Yes
Grace period disclosed in PDS/T&Cs	Yes	No	No	Yes	Yes
Length of grace period	7 days	14 days	6 days*	14 days	5 days

* ADI E provides investors with a further 11 days to change their investment term (but not the balance of the term deposit).

[14] This ADI does not send a pre-maturity letter.

F Recommendations and further work

Key points

We consider that, subject to exceptional circumstances, a fully informed investor would be unlikely to actively seek a low interest rate term deposit. This is because much better interest rates are available on term deposits of different terms or in popular at-call savings accounts offered by the same ADI. Importantly, 98% of investor funds start in high interest rate term deposits.

Despite this, a significant number of investors have their term deposits at low interest rates at the end of the grace period (9% of deposits remaining on deposit after rolling over by default for the same term, amounting to $2.86 billion out of $33.5 billion).

Our review suggests that improved advertising, disclosure and grace periods can significantly reduce the incidence of investors rolling over by default from high to low interest rate term deposits.

Advertising and promotion

115 We consider it important 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.

Disclosure of dual pricing

116 For ADIs that have high and low term deposit interest rates, we consider it important that there is clear disclosure 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.

117 This disclosure should occur in:

- term deposit application forms;
- PDSs or terms and conditions booklets; and
- pre-maturity and post-maturity letters.

Advantages of this approach

- Investors are more likely to be aware of dual pricing and that there is a risk of rollover from a high to a low interest rate.

Disadvantages of this approach

- Slightly longer disclosure documents.

Disclosure of interest rates

118 Currently, only one ADI tells its customers in pre-maturity letters what the interest rate will be if the term deposit is allowed to roll over by default. Four of the eight ADIs we reviewed enclose an interest rate schedule with pre-maturity or post-maturity communications, which sets out all the interest rates available from the ADI for every term deposit provided by the ADI.

119 We consider it important that investors are aware of the interest rate that will apply on their new term deposit before rollover, so that they have the longest possible period (the pre-maturity period and the grace period) to take action if they wish. At the same time, we consider it important for investors (that will roll over to a low interest rate) to know that better interest rates are available from the same ADI for comparable periods.

120 Although interest rate schedules can potentially achieve this, we consider that investors are more likely to read a pre-maturity or post-maturity communication rather than a potentially lengthy and complex interest rate schedule enclosed with the letter. While enclosing interest rate schedules with communications may potentially reduce the proportion of investors rolling over from high to low interest rates (see Table 7), one of the ADIs that only provides such schedules (and does not, for example, disclose the existence of their grace period in pre-maturity or post-maturity letters) has the second highest proportion of investor funds deposited in low interest rate term deposits at the end of the grace period.

Advantages of this approach

- If specifically told in the pre-maturity communication what the indicative interest rate will be on rollover, subject to any intervening change, an investor is able to make an informed decision before their term deposit rolls over.
- Investors are more likely to take action before rollover, rather than during the grace period, which may reduce investor dissatisfaction.
- Adopting this approach would mean that ADIs would be able to move their term deposit book in line with their funding needs (based on term) more efficiently and cost-effectively than is currently the case where investors change their deposit terms during the grace period.

Disadvantages of this approach

- ADIs may need to update their disclosure documents and systems.
- There is a small risk that the interest rate disclosed on the pre-maturity communication may not be the interest rate that applies on the date of rollover, because the ADI has changed its interest rates in the period between the investor being sent the pre-maturity communication and the date of rollover. (We consider that this risk is small, arises in any case where interest rate schedules are enclosed with the pre-maturity communication, and can be addressed by appropriate wording.)

Disclosure of grace periods

121 We consider it important for investors to have, and be aware of, the grace period that applies when their term deposit rolls over by default. We also consider that the grace period should be of sufficient length to allow the investor to act.

122 Based on our review of ADIs that provide grace periods, industry best practice appears to be such that:

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

Advantages of this approach

- Investors are more likely to be aware that there is a grace period and use it.
- Investors are less likely to be rolled over into low interest rate term deposits that attract penalties for withdrawal outside the grace period.

Disadvantages of this approach

- ADIs may need to update their disclosure documents and systems.

Other options for ADIs

123 The recommended changes to disclosure assume that there is a risk of rollover from high to low interest rates. An investor is not exposed to this risk if their ADI does not have a dual pricing practice. The need for improved disclosure might be reduced for ADIs that switch from a dual pricing practice to having interest rates that broadly reflect market rates of interest across all terms.

124 ADIs with a dual pricing practice will continue to expose investors to the risk of rollover from high to low interest rates so long as term deposits rollover on a default basis at maturity. However, an investor is not exposed to any risk at

maturity (regardless of whether a dual pricing practice is in place) if their term deposit does not rollover by default at maturity. Accordingly, changes to the operation of term deposits at maturity can eliminate the risk of an investor rolling over by default from a high to a low interest rate. We consider that ADIs with a dual pricing practice have a number of options in this regard.

125 Given that investors in low interest rate term deposits might receive a higher return in ADIs' popular at-call accounts, and given the ability of the investor to withdraw their funds from an at-call account at any time and without penalty, one option that ADIs could explore is changing the default position on rollover so that investor funds are rolled over into an at-call account where the interest rate available at-call is higher than the low interest rate term deposit.

Further work

126 As this review did not include all ADIs, we will work with the Australian Bankers' Association and Abacus – Australian Mutuals to secure broader industry support and adopt these recommendations where necessary.

127 ASIC will also conduct a further targeted review in the second half of 2011 to examine:

- the implementation of our advertising, disclosure and grace period recommendations by ADIs;
- the incidence of investors rolling into and remaining in low interest term deposits by default.

128 Our further review will enable us to assess whether improvements to advertising, disclosure and grace periods have been made and have been effective in reducing the incidence of retail investors rolling and remaining in low interest term deposits by default.