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11 January 2012

Ms Emma Curtis
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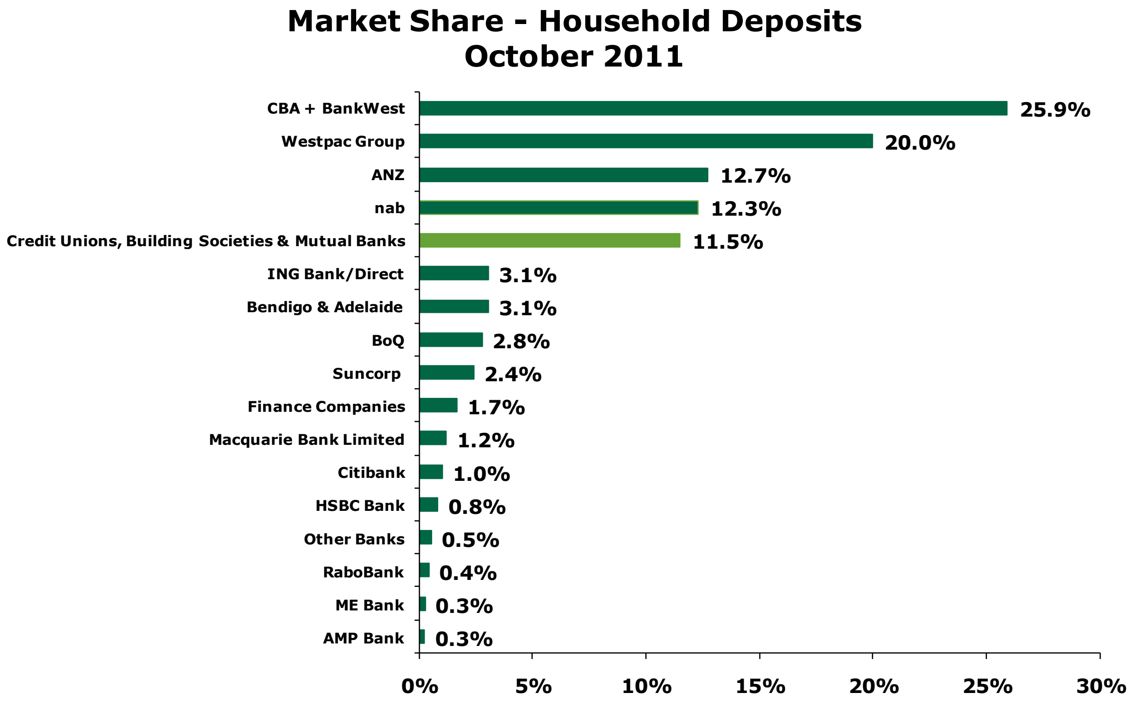
Sydney NSW 2001
By email: emma.curtis@asic.gov.au

Dear Emma,

Consultation Paper 169 *Term deposits that are only breakable on 31 days' notice: Proposals for relief*

Thank you for the opportunity to comment on this Consultation Paper. We appreciate ASIC's concern to deliver regulatory certainty for ADIs about the status of term deposits given the potential implications of proposed new prudential standards on liquidity.

Abacus is the industry body for mutual banking institutions: credit unions, building societies and mutual banks. The mutual banking sector has 4.5 million customers and 11.5 per cent of the household deposits market.



Source: APRA, RBA data

The mutual or customer-owned banking sector provides important competition and choice across all retail banking products and services, including home loans, transaction accounts and deposit products. Our sector has more branches – 1,164 - than any of the major banks. The success of the customer-owned business model is confirmed by the consistently outstanding performance of mutuals in independent customer-satisfaction surveys, where mutuals strongly outperform major banks.

The mutual banking sector relies more heavily on deposits for funding than the major banks, with more than 80 per cent of our sector's funding in the form of deposits compared to 57 per cent for the major banks.

Term deposits comprise half our sector's deposit funding mix and are a critical funding source and core product offering for Australia's credit unions, building societies and customer-owned banks.

Abacus and our member ADIs are vitally interested in proposals to further regulate the term deposits market.

1. Assumptions in CP 169

Abacus does not accept a number of key assumptions made in Consultation Paper 169.

We do not accept that it is a long-standing practice among ADIs to allow term deposits to be breakable at the depositor's discretion.

- Many ADIs allow term deposits to be breakable **only at the ADI's discretion**.

We do not accept that the "*current practice among ADIs is to issue term deposits that are generally breakable by the depositor without notice*" and that the imposition of a notice period would "*result in a departure from the current operation of a basic retail banking product that has been long understood by consumers*."

- We consider that it has been long understood by consumers that term deposits are for **fixed terms** with **fixed returns**.

We do not accept the implication throughout CP 169 that term deposits must be breakable at the depositor's discretion to be 'basic deposit products'.

- We consider that term deposits of up to two years that are breakable only at the ADI's discretion can still be 'basic deposit products'.

2. Response to "significant regulatory uncertainty"

The lack of clarity and significant regulatory uncertainty identified in CP 169 about the scope of the 'basic deposit product' definition is unfortunate and undesirable. The best solution would be a legislative amendment to the definition to deliver the necessary clarity and certainty.

In the meantime, relief provided by ASIC may be of assistance to some stakeholders but care needs to be taken to ensure any conditional relief measure does not have negative consequences for consumers and ADIs in relation to competition, choice, pricing, liquidity management and funding stability.

We note that the proposals in CP 169 are prompted by a proposed change to the prudential regulatory framework. The proposals do not arise from complaints by consumers or any identified consumer protection issue in the term deposits market.

There is no case for extensive regulatory intervention into a term deposits market that is highly competitive, dynamic and diverse. Imposing new prescriptive requirements on term deposit issuers could give rise to a range of forseeable and unforeseeable consequences.

Abacus recommends that the relief proposed in CP 169 should be provided **unconditionally for term deposits of up to two years** and should also apply to term deposits of between two and five years to accommodate the Basel III liquidity reforms.

3. Term deposits market

Deposits have always been the dominant funding source for mutual ADIs but in recent years the share of funding from this source for banks has increased sharply from below 40 per cent to more than 50 per cent, as illustrated below.[1]

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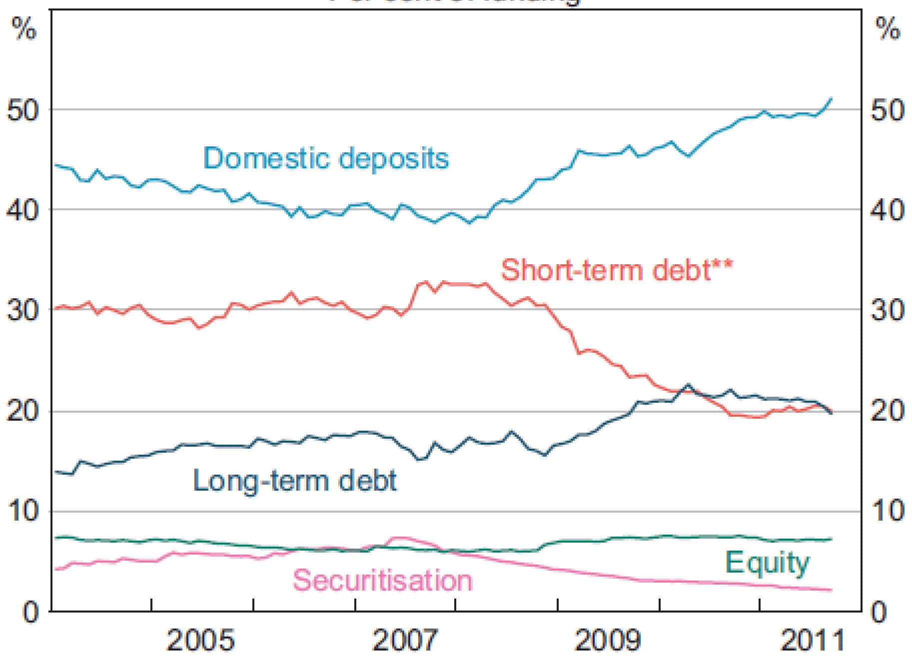
[1] RBA Statement on Monetary Policy, Nov 2011

Funding Composition of Banks in Australia*

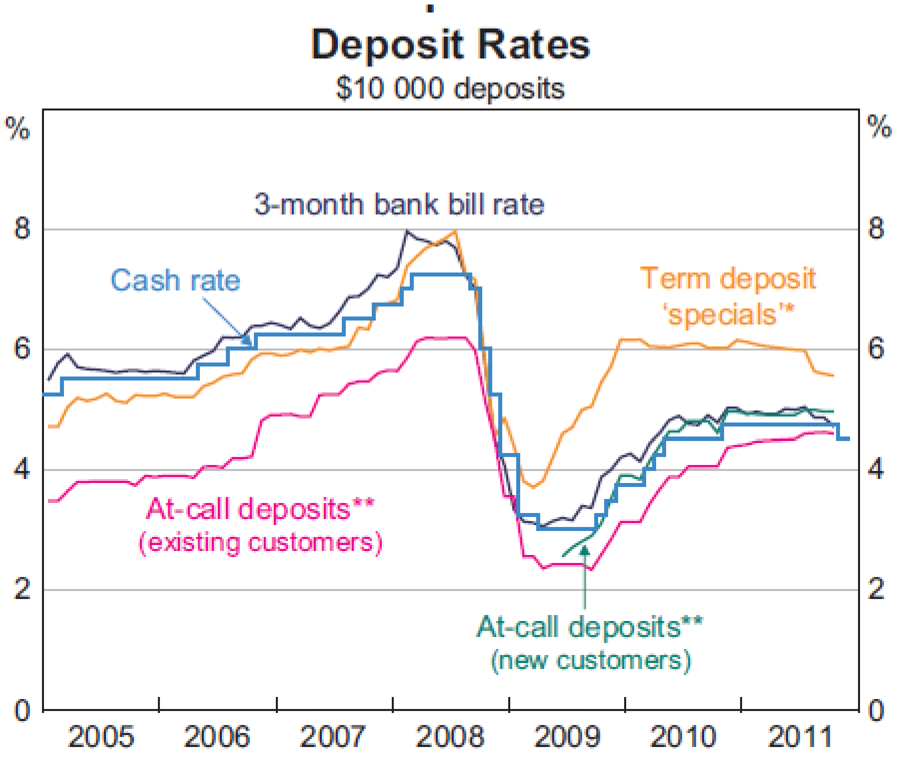
Per cent of funding



* Adjusted for movements in foreign exchange rates
** Includes deposits and intragroup funding from non-residents
Sources: APRA; RBA; Standard & Poor's

Not surprisingly, the increase in demand for deposits has driven up the price. Interest rates on term deposits tended to track below the official cash rate until a decisive upward departure from this trend in 2008-09 and now rates track well above the official rate, as illustrated below.[2]

[2] RBA Statement on Monetary Policy, Nov 2011



* Average of 1–12, 24-, 36- and 60-month terms at the major banks
** Average of online, bonus saver and cash management accounts at the major banks
Source: RBA

As volatility continues to plague equity markets, consumers are benefiting from historically high returns from term deposits - the safest and best understood investment option.

As ASIC's Moneysmart website says, term deposits "are the most familiar type of investments paying interest."

> *"Your money is locked away for a fixed term and you get a fixed rate of interest over that term.*
>
> *"The benefits of term deposits are:*
> - *There's virtually no risk of losing your money.*
> - *You earn a rate of return that's usually higher than a regular transaction account.*
> - *The interest rate will not change over the term you select.*
>
> *"However, term deposits do have their downsides:*
> - *You cannot easily access your money. You may be able to 'break' your term deposit in an emergency, but a penalty is likely to apply.*
> - *May be less flexible and provide a lower income than other comparable products e.g. bank online savings accounts (which are just*

as safe as term deposits) which can offer returns that are higher than those of term deposits.

- *Honeymoon rates can drop when the investment rolls over."*[3]

In a diverse market where 133 ADIs[4] compete for funding and retail customers, there is a range of terms and conditions applying to term deposit products.

As an example, one of the major banks informs consumers that:

> *"A term deposit is an investment where the interest rate is guaranteed not to change for the whole of the nominated term. It provides the security of knowing that interest income is protected from fluctuations in investment markets.*
>
> *"A term deposit may be appropriate for those who do not need immediate access to their money and are looking for a competitive interest rate that is guaranteed not to change for the whole of the nominated term."*

This major bank's policy on withdrawals in advance of maturity for term depositors with a term of two years or less is that such withdrawals are:

> *"at the discretion of the Bank."*

Another major bank informs consumers that:

> *"if you ask the bank to close your account before the end of the term, we will in most instances reduce the interest rate that we will pay…"*

A third major bank says:

> *"You may withdraw amounts from your term deposit at any time."*

This bank says if amounts are withdrawn prior to maturity, the bank may reduce the interest generated on the term deposit by the bank's reasonable estimate of the cost of meeting the prepayment.

A large credit union says that when a term deposit:

> *"is invested for up two years, the deposit is to remain in place for the full term, but we may consider written requests for an earlier release. Whether or not we agree with your request is at our sole and absolute discretion.."*

Another large credit union says that in:

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[3] https://www.moneysmart.gov.au/investing/investments-paying-interest/term-deposits

[4] APRA website: 15 Australian owned banks, 9 foreign subsidiary banks, 9 building societies, 97 credit unions, Cairns Penny Savings & Loans

> *"exceptional circumstances (to be determined at our absolute discretion) we may allow you to perform an early redemption of all of your funds."*

Below are further examples of ADI policies on early withdrawals from term deposits, as disclosed to consumers in terms and conditions documents from several ADIs:

> *"Deposits cannot generally be withdrawn prior to maturity. However, under special circumstances [we] may agree to a request from a member for the full or partial redemption of their deposit prior to the expiry of the full term."*
>
> *"We may allow early withdrawals in our absolute discretion, eg, in cases of hardship or special need."*
>
> *"Although your investment is for a fixed term we understand that sometimes emergencies do arise. Withdrawals may be allowed…but amounts withdrawn before maturity may incur an interest rate reduction…"*
>
> *"Principle is not available until the date of maturity. Access prior to the maturity date requires our agreement and the agreement may be subject to reducing the interest rate payable on a term deposit."*
>
> *"Full or partial redemption of the term deposit before maturity for terms 1 to 24 months are at [our] discretion."*
>
> *"Withdrawals or early redemptions prior to the maturity date are not encouraged but may be permitted at our discretion, for special circumstances. For example, when not agreeing to a request would result in financial hardship for our client."*
>
> *"We reserve the right to refuse a request for redemption of a term deposit before the agreed maturity date."*

Many other ADIs allow the depositor discretion to break a term deposit, usually with a reduction in the return. This diversity in terms and conditions reflects a competitive and dynamic market.

We do not see a case to require all term deposits to be at-call or subject to a short notice-of-withdrawal period. The notice of withdrawal period for a term deposit of up to two years is the term, unless otherwise stated in the terms and conditions.

We are very concerned that there will be significant negative consequences for consumers and ADIs from a shift in the common perception of a term deposit from being a product where funds are "locked up" for a fixed term to a product where funds are "at-call" with a higher return if the at-call right is not exercised.

All ADIs are encouraged by APRA and by their own risk-management strategies to raise more stable funding. Smaller ADIs have limited options to obtain stable funding other than term deposits. If term deposits are seen by the market as at-call or withdrawable at short notice, ADIs – and particularly smaller ADIs - will have greater liquidity management pressures.

ADIs need to hold liquid assets against liquid liabilities. An increase in more liquid liabilities requires an increase in lower-return liquid assets. This will push down returns for depositors.

An Abacus member mutual ADI provided the following feedback, illustrating the complex range of issues at play and the need to proceed cautiously:

> *"Retaining basic deposit product status for our Term Deposit (TD) is a key to [our business model] from a distribution perspective – our retail network is only trained to Tier 2 level. If TDs required Tier 1 level trained staff our distribution options would be very limited. I suspect our situation is similar to a number of other mutuals and may be compared to the major banks where they are more likely to have Tier 1 staff available in branch to distribute TDs. This is obviously not a good outcome from a market and consumer perspective.*
>
> *"It is very important for us to maintain the maximum liquidity control that we can. If we move to the 31 day notice period ASIC is proposing our control over liquidity using TDs is reduced from up to two years to 31 days. Although the Liquidity Coverage Ratio (LCR) under Basel III may not technically apply to [us] we are likely to apply that standard internally. Assuming that APRA allow at-call with more than 30 days notice to obtain favourable liquidity treatment there should not be an issue with LCR.*
>
> *"However, from a wider business perspective and taking into account the Net Stable Funds Ratio (NSFR) under Basel III if we move to a 31 day notice period for TDs we are losing an important tool in our control over liquidity risk and certainty of funds. To manage liquidity risk and meet NSFR we borrow long but if our certainty of funds is reduced from two years to 31 days this would have a significant impact on the way we manage liquidity risk using TDs. Instead of looking to the terms of TDs up to two years to manage liquidity risk we would only be able to look to a 31 day period.*
>
> *"In turn we believe that pricing may become an issue if a 31 day notice period is introduced for TDs. At the moment an at-call rate is given for an at-call product and a higher rate is given for a TD for the liquidity reasons set out above. If TDs are reduced to 31 days notice then they are moving towards an at-call product and would therefore be priced at a lower at-call rate. Again, this is not a good outcome from a market and consumer perspective.*
>
> *"We haven't to date refused a withdrawal request. This reflects the absence of liquidity issues which are the underlying rationale for the provision."*

4. Regulation of 'basic deposit products'

Basic deposit products are subject to a lighter-touch regulation than other financial products because they are simple, low-risk products that are well understood by consumers.

Basic deposit products are provided by the most intensively regulated entities in the financial sector – ADIs.

Basic deposit products are the most important source of funding for the most important lenders in the financial sector – ADIs.

If an ADI were to offer 'non-basic' deposit products, it would be required under the Corporations Act to comply with significantly more burdensome disclosure, conduct and licensing requirements.

Our members have advised that in general is not a practical or viable option for ADIs to issue, deal in, and advise on, 'non-basic' deposit products.

Any effective narrowing of the definition of what is 'basic' by regulatory intervention will result in changes to ADI business models, such as a narrowing of product range, adoption of the 'no advice' model, or changes to pricing.

The scope of the definition of a basic deposit product is an important factor in other regulatory frameworks. For example:

- The Future of Financial Advice (FOFA) reforms currently before Parliament propose a number of modifications for advisers on basic deposit products.
- An ASIC class order issued in December 2011 provides a licensing exemption for counsellors in relation to advice about basic deposit products to ensure the continuation of services to consumers, inlcuding Indigenous and other disadvantaged consumers in regional and remote areas.
- An ASIC class order issued in 2004 deems an agent of an ADI as a representative of that ADI when they provide the financial service of arranging for the issue of a basic deposit product.

5. Relief as an interim measure

The fact that ASIC has identified uncertainty about whether commonly available term deposits of up to two years are basic deposit products (unless they are at call) requires a legislative response. The 'basic deposit product' definition should be amended to remove any doubt that term deposits of up to two years are covered.

The amended definition should also cover term deposits of between two and five years that have a notice of withdrawal period of up to 31 days, to accommodate the prudential regulatory change that has prompted CP 169.

In the meantime, Abacus supports the provision of relief by ASIC to enable ADIs to issue term deposits of up to five years than can only be broken on 31 days notice while being subject to the same regulatory requirements as 'basic deposit products' in the *Corporations Act 2001.*

This would facilitate implementation of global prudential reforms for Australian banking institutions as smoothly as possible while minimising the impact on the well-functioning term deposit market.

Should any evidence emerge of problems or consumer risk from any increase in the prevalence of such ‘notice of withdrawal’ term deposit products, ASIC’s response could include some of the conditions canvassed in CP 169. However, any such regulatory intervention should be based on robust research about consumer perceptions and market practices.

I can be contacted on 02 6232 6666 to discuss an aspect of this submission.

Yours sincerely,

LUKE LAWLER
Acting Head of Public Affairs

<u>Detailed responses to CP 169 proposals</u>

Proposal
B1 We propose to give conditional class order relief such that term deposits of up to two years that can only be broken on up to 31 days' notice would be subject to the same regulatory requirements as basic deposit products.

Your feedback
B1Q1 Do you agree with this proposal? Please give reasons for your answer.

We consider that relief is not needed for term deposits of up to two years because ADIs already have discretion about whether or not to impose a notice period for early withdrawal. However, if ASIC's view is that ADIs do not have this discretion the relief may be necessary as an interim measure until the law is clarified and uncertainty removed. The relief should be unconditional for term deposits of up to two years.

B1Q2 Do you think that it would be appropriate to also provide relief so that term deposits of more than two years that can only be broken on up to 31 days' notice would be subject to the same regulatory requirements as basic deposit products?

Yes. The relief should be provided for term deposits of between two years and five years to encourage stable funding for ADIs and better returns for depositors, and to accommodate the Basel III liquidity reforms.

The objective is to implement global reforms to the prudential regulatory framework for banking institutions as smoothly as possible while minimising the impact on well-functioning markets.

B1Q3 What are the consumer risks posed by term deposits that can only be broken on 31 days' notice?

The consumer risks posed by term deposits that can only be broken on 31 days notice are negligible because the notice period will not be enforced for consumers in hardship.

Proposal
B2 We are considering whether the relief in proposal B1 should be subject to the condition that term deposits with a 31 days' notice requirement for early withdrawal use a new product name that is different to 'term deposit'.

Your feedback
B2Q1 Do you agree with this proposal? Please give reasons for your answer.

No. Introducing a new product name will confuse consumers. There is already a range of term deposit products with varying terms and conditions relating to early withdrawal.

B2Q2 Are there any practical problems with the implementation of this proposal? Please give details.

Yes. There would suddenly be uncertainty about the status of various term deposit products and whether they can be described as term deposits. ADIs wishing to offer the 'new product' mandated by regulatory intervention would have to identify and assess the costs of changes to product disclosure, communications, business policies, procedures and systems, marketing, and staff training.

B2Q3 What are some possible new product names that could be used for term deposits that are only breakable on 31 days' notice?

No suggestions.

B2Q4 Should ASIC prescribe a specific product name for term deposits that are only breakable on 31 days' notice through our relief? If so, what should it be?

No.

Proposal
B3 We are considering whether the relief in proposal B1 should be subject to the condition that, for term deposits with a 31 days' notice requirement for early withdrawal, consumers are given:
(a) a warning about the notice requirement in writing and/or, if practicable, orally, prior to the issue of the product; and
(b) information about other deposit products that permit early withdrawal without prior notice.

Your feedback
B3Q1 Do you agree with this proposal? Please give reasons for your answer.

No. There is no need for additional regulation of term deposit disclosure requirements. All relevant terms and conditions are currently disclosed to consumers and any new conditions, such as a 31 day notice period, would be disclosed adequately under the existing regulatory framework.

A requirement to provide information about other deposit products that permit early withdrawal without prior notice would run counter to efforts to simplify and reduce disclosure documentation.

B3Q2 Would this proposal result in practical problems or additional compliance costs? Please give details, including figures and reasons.

Yes. ADIs already have systems and procedures to meet their disclosure obligations and introducing new obligations would increase costs and complexity.

B3Q3 Do you think there is an alternative approach that would be more appropriate for the protection of investors? Please give details.

There is no evidence that investors need additional protection.

B3Q4 Do you agree that consumers should be provided with information about other deposit products that permit early withdrawal without prior notice? Please give reasons for your answer.

No. Such a requirement creates potential for confusion for consumers, runs counter to efforts to simplify and reduce disclosure documentation, and creates regulatory risk for ADIs.

Proposal
B4 We are considering whether the relief in proposal B1 should be subject to the condition that, for term deposits with a 31 days' notice requirement for early withdrawal, ADIs obtain the investor's express consent to rollover their term deposit at maturity.

Your feedback
B4Q1 Do you agree with this proposal? Please give reasons for your answer.

No. Investor consent is already obtained prior to rollover – at the outset of the original term or in response to contact prior to maturity. If the investor has already provided consent at the outset, it is neither reasonable nor practical to keep requesting consent each time. Investors are likely to object to having to provide consent each time.

B4Q2 Would this proposal result in practical problems or additional compliance costs? Please give details, including figures and reasons.

Yes, the proposal would result in practical problems, as noted above, and additional compliance costs.

The investor could potentially miss out on a higher return if the ADI can't obtain the required additional "express consent" and the funds are therefore transferred to a lower-return at-call account.

For ADIs, the new requirement would entail costs of changes to product disclosure, communications, business policies, procedures and systems, marketing, and staff training.

B4Q3 What would be an appropriate way for ADIs to obtain the express consent of the investor (e.g. by contacting the investor by telephone, by sending a written request form or by electronic means such as online portals or mobile text message)? Please give details.

Investor consent to rollover a term deposit is already obtained by a range of methods, including at the outset of the original term and through contact prior to maturity by letter.

B4Q4 When would be an appropriate time to obtain the express consent of the investor? For example, would within 30 days before the end of the term be an appropriate time to obtain express consent?

There is no problem with current practice and therefore no need for additional regulatory requirements.

B4Q5 What type of disclosure or information should be provided to the investor when a request is made to obtain their express consent (e.g. the indicative or actual interest rate that will apply to a new term deposit after rollover)?

There is no problem with current practice and therefore no need for additional regulatory requirements.

B4Q6 What should the outcome at maturity be if the investor does not respond to a request by the ADI for their express consent prior to maturity? For example, should the term deposit funds be automatically transferred into an at-call account?

There is no problem with current practice and therefore no need for additional regulatory requirements.

B4Q7 Do you think there is an alternative approach that would be more appropriate for the protection of investors? Please give details.

There is no problem with current practice and therefore no need for additional regulatory requirements.

B4Q8 Would this proposal benefit consumers? Please give reasons for your answer.

Any increase in cost on ADIs due to additional regulatory requirements could lead to lower returns and reduced choice for consumers.

Proposal
B5 As an alternative to proposal B4, we are considering whether the relief in proposal B1 should be subject to the condition that, for term deposits with a 31 days' notice requirement for early withdrawal, ADIs send a pre-maturity letter to investors at least 14 days before maturity to disclose:
(a) the actual or indicative interest rate that will apply to a new term deposit if the investor allows the maturing term deposit to automatically roll over into the new term deposit;
(b) a prominent warning that better interest rates may be available from the same ADI for a term deposit of a comparable period;
(c) if the actual interest rate that will apply to the new term deposit at the date of rollover cannot be disclosed:
> *(i) a prominent warning that the investor should confirm the actual interest rate on the date of rollover; and*
> *(ii) information on how the investor may ascertain the actual interest rate on the date of rollover; and*

(d) the grace period that will apply when their term deposit rolls over by default (see proposal B6).

Your feedback
B5Q1 Do you agree with this proposal? Please give reasons for your answer.

No. There is no problem with current practice and therefore no need for additional regulatory requirements.

B5Q2 Would this proposal result in practical problems or additional compliance costs? Please give details, including figures and reasons.

Yes. New and additional disclosure requirements and new procedural requirements will mean additional compliance costs. There is no problem with current practice and therefore no need for additional regulatory requirements.

B5Q3 Would it be appropriate to send a pre-maturity letter at least 14 days before maturity? Please give reasons for your answer.

Not necessarily. There is no problem with current practice and therefore no need for additional regulatory requirements.

B5Q4 Do you think there is an alternative approach that would be more appropriate for the protection of investors? Please give details.

ADIs currently typically send out pre-maturity letters 7 to 21 days from maturity. There is no problem with current practice and therefore no need for additional regulatory requirements.

B5Q5 Would this proposal benefit consumers? Please give reasons for your answer.

Any increase in cost on ADIs due to additional regulatory requirements could lead to lower returns and reduced choice for consumers.

B5Q6 Do you have a preference for the approach in proposal B4 or proposal B5? If so, please give details.

Neither is preferred.

Proposal
B6 We are considering whether the relief in proposal B1 should be subject to the condition that, for term deposits with a 31 days' notice requirement for early withdrawal, ADIs:
(a) provide a grace period to investors of at least 14 days; and
(b) send a post-maturity letter to investors within a maximum of five days after maturity, to disclose:

> *(i) the grace period (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);*
> *(ii) a prominent warning that better interest rates may be available from the same ADI for a term deposit of a comparable period; and*

(iii) a prominent warning about any reduction in the return generated and/or fees applicable for early withdrawal on 31 days' notice, outside the grace period.

B6Q1 Do you agree with this proposal? Please give reasons for your answer.

No. There is no problem with current practice and therefore no need for additional regulatory requirements. Grace periods currently are 7 or 10 days.

B6Q2 Would this proposal result in practical problems or additional compliance costs? Please give details, including figures and reasons.

Yes. New and additional disclosure requirements and new procedural requirements will mean additional compliance costs. There is no problem with current practice and therefore no need for additional regulatory requirements.

B6Q3 Would it be appropriate to prescribe the grace period as a condition of our relief? Please give details.

No. There is no problem with current practice and therefore no need for additional regulatory requirements or prescription.

B6Q4 Would a grace period of at least 14 days be appropriate? If not, what would be an appropriate grace period be? Please give details, including figures and reasons.

There is no need to mandate a grace period. There is no problem with current practice and therefore no need for additional regulatory requirements.

B6Q5 Would it be appropriate to send a post-maturity letter within a maximum of five days after maturity? Please give reasons for your answer.

This is a decision for each ADI. There is no problem with current practice and therefore no need for additional regulatory requirements.

B6Q6 Do you think there is an alternative approach that would be more appropriate for the protection of investors? Please give details.

There is no problem with current practice and therefore no need for additional regulatory requirements.