



ASIC

Australian Securities & Investments Commission

REGULATION IMPACT STATEMENT

Term deposits that are only breakable on 31 days notice: Proposal for relief

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About this Regulation Impact Statement

This Regulation Impact Statement (RIS) addresses ASIC's proposal for relief, to enable authorised deposit-taking institutions (ADIs) to issue term deposits that can only be broken on 31 days' notice, while being subject to the same concessional regulatory requirements as 'basic deposit products' in the *Corporations Act 2001* (Corporations Act).

What this Regulation Impact Statement is about

- 1 In order to assist ADIs which are affected by APRA's implementation of the Basel III liquidity standards to comply with these requirements, ASIC proposes to provide relief to enable ADIs to issue term deposits with a 31 day notice period, and still be regulated as basic deposit products under the Corporations Act.
- 2 The Basel III liquidity standards have the goal of promoting a more resilient banking sector, including improving the sector's ability to absorb shocks arising from financial and economic stress.
- 3 Traditional term deposits that are breakable without notice would not achieve recognition under the Basel III liquidity standards. This would effectively cause these products to disappear from the market.
- 4 Traditional term deposits are 'basic deposit products', and are a Tier 2 product for the purposes of training requirements under ASIC's Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146) and are subject to lower disclosure requirements. If a 31 day notice was introduced, this would allow such term deposits to be recognised under the liquidity standards, however, they would not meet the definition of basic deposit product in the Corporations Act, and would incur higher compliance costs.
- 5 Relief is required due to potentially significant regulatory uncertainty whether term deposits that are only breakable on 31 days' notice can qualify as basic deposit products under the Corporations Act. The relief that ASIC proposes will enable ADIs to issue term deposits with a 31 day notice period, without requiring them to be issued as Tier 1 products, which means that ADIs will be relieved of the regulatory requirements which apply to Tier 1.
- 6 ASIC published a consultation paper in November 2011, setting out our proposal and supporting rationale for providing conditional relief to allow ADIs to issue 31 day notice term deposits to be issued as basic deposit products: see Consultation Paper 169: *Term deposits that are only breakable on 31 days' notice: Proposals for relief* (CP 169). A summary of the submissions made in response to CP 169 and our consideration of those responses can be found in REP 000 *Response to submissions on CP 169 - Term deposits that are only breakable on 31 days' notice*.
- 7 This Regulation Impact Statement (RIS) addresses ASIC's proposal for relief, so that term deposits of up to five years that are only breakable on 31 days' notice (31-day notice term deposits) are subject to the same

concessional regulatory requirements as basic deposit products under the *Corporations Act 2001* (Corporations Act), in the following manner:

- (a) permanent relief granted to term deposits of up to two years;
- (b) temporary relief for a period of two years granted to term deposits of between two and five years; and
- (c) in providing relief, we propose to impose conditions reflecting relevant consumer protection aspects.

8 In developing our final position, we have considered the regulatory and financial impact of our proposals. We are aiming to strike an appropriate balance between:

- maintaining, facilitating and improving the performance of the financial system and entities in it;
- promoting confident and informed participation by investors and consumers in the financial system; and
- administering the law effectively and with minimal procedural requirements.

9 This RIS sets out our assessment of the regulatory and financial impacts of our proposed policy and our achievement of this balance. It deals with:

- a) the likely compliance costs;
- b) the likely effect on competition; and
- c) other impacts, costs and benefits.

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A Introduction

Background

The regulatory environment

- 10 In Australia, only authorised deposit-taking institutions (ADIs) such as banks, credit unions and building societies can issue term deposits.
- 11 The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry. APRA establishes and enforces prudential standards, which ADIs are required to comply with. APRA is also responsible for authorising ADIs to provide banking services (including taking deposits) under the *Banking Act 1959* (Banking Act).
- 12 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.¹
- 13 As part of ASIC's role as a regulator of the financial services industry, we are responsible for licensing and monitoring 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.
- 14 Only ADIs that are authorised by APRA can carry on 'banking business' (as defined in s5 of the Banking Act), including taking money on deposit.
- 15 'Deposit product' is defined in s764A(1)(i) of the Corporations Act.
- 16 ASIC also has a consumer protection role under the *Australian Securities and Investments Commission Act 2001* (ASIC Act). Part 2, Div 2 of the ASIC Act covers broad standards of conduct, including prohibitions on false or misleading representations (s12DB), unconscionable conduct (s12CB) and misleading or deceptive conduct (s12DA) in relation to financial services.

Basic deposit products

- 17 For a deposit product to meet the definition of 'basic deposit product', it must satisfy a series of conditions set out in s761A of the Corporations Act.

¹ See s764A(1)(i) of the Corporations Act.

- 18 A term deposit of up to five years is a basic deposit product if early withdrawal by the depositor is permitted (i.e. it is breakable). A depositor may make an early withdrawal without prior notice to the ADI, except that:
- (a) an ADI may require prior notice for withdrawal from a term deposit of up to two years in length;
 - (b) for credit unions, credit societies, credit co-operatives and building societies (all referred to as 'mutual ADIs'), a notice requirement of seven days or less may be required for term deposits of between two and five years²; and
 - (c) the ADI may impose a reduction in the return generated for the depositor.
- 19 The definition of basic deposit product makes a distinction between term deposits of up to two years and term deposits of between two and five years, in relation to whether an ADI can impose a notice period requirement for early withdrawal. The distinction is:
- a) term deposits of up to two years may qualify as basic deposit products if early withdrawal by the depositor is permitted subject to a notice period requirement; and
 - b) term deposits of between two and five years may qualify as basic deposit products if funds can be withdrawn without prior notice by the depositor (with the exception of the special provision for mutual ADIs).
- 20 Beyond the special provision for mutual ADIs, the Corporations Act does not specify the period of notice that an ADI may require a depositor to give for an early withdrawal from deposits of up to two years. There has been no judicial consideration of the period of notice that an ADI may require for early withdrawal from these term deposits.
- 21 While it is unclear what notice period for withdrawal could be imposed consistently with the characterisation of a term deposit as a basic deposit product, ASIC's view is that a notice period of 31 days for early withdrawal would not meet the definition of basic deposit product.
- 22 Section 761A of the Corporations Act provides that term deposits of between two and five years must allow an early withdrawal without prior notice in order to meet the basic deposit product definition (subject to the exception referred to in paragraph 18).
- 23 Basic deposit products are given concessional regulatory treatment under the Corporations Act. Basic deposit products are classified as Tier 2 products for training purposes in ASIC's *Regulatory Guide 146 Licensing: Training of*
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financial product advisers (RG 146). Persons providing advice only in relation to basic deposit products can meet the training standards by completing a training course that is not on the ASIC Training Register, but are nevertheless assessed as meeting the training standards by their Australian financial services licensee. By contrast, persons advising on Tier 1 products are required to be trained at a higher knowledge and skill requirement at a diploma education level.

- 24 Since December 2005, basic deposit products have been conditionally excluded from the Product Disclosure Statement (PDS) regime.³ This means that in a recommendation, issue or sale situation, ADIs that issue term deposits as basic deposit products are exempted from the requirement to give a client a PDS.
- 25 Financial advisers are also not required to give clients a Statement of Advice when providing personal advice to clients about term deposits.⁴
- 26 Across the retail banking industry there is a variance in the terms and conditions of term deposits of up to two years, about whether depositors may make an early withdrawal (i.e. some ADIs' terms and conditions provide that early withdrawal is at the ADI's discretion).
- 27 Notwithstanding this variance however, in practice, ADIs generally allow term deposits of up to two years to be readily breakable by the depositor before maturity.

Liquidity coverage ratio (LCR)

- 28 As a member of the Basel Committee on Banking Supervision (BCBS), the Australian Prudential Regulation Authority (APRA) supports the Basel III reforms and the goal of promoting a more resilient global banking system.⁵
- 29 As part of the Basel III requirements, APRA will implement the liquidity coverage ratio (LCR) standard from 1 January 2015.⁶ The LCR requirement aims to ensure that banking institutions have sufficient liquid assets to survive an acute stress scenario lasting 1 month⁷.
- 30 APRA intends to apply the LCR requirement to 40 of the larger and more complex ADIs which includes most of the locally incorporated banks (the four majors as well as regional or mid-tier banks) as well as a number of foreign bank branches. APRA does not currently intend to apply the LCR requirement to mutual ADIs.

³ See reg 7.9.07FA of the Corporations Regulations.

⁴ See s946B(5)(a) of the Corporations Act.

⁵ *Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring*, December 2010.

⁶ APRA, Discussion Paper, Implementing Basel III liquidity reforms in Australia, May 2013, at page 10.

⁷ *Ibid*

31 The LCR aims to ensure that the LCR ADIs maintain an adequate level of unencumbered, high-quality liquid assets (HQLA) that can be readily converted into cash to meet their liquidity needs for 30- calendar days under a significantly severe liquidity stress scenario. Under the LCR requirement, LCR ADIs need to maintain a stock of qualifying HQLA to cover total net cash outflows over the next 30 calendar days.

32 The LCR has two components:

- (a) the value of the stock of HQLA; and
- (b) total net cash outflows,
expressed as:

$$\frac{\text{Stock of HQLA}}{\text{Total net cash outflows over the next calendar days}} \geq 100\%$$

33 The LCR standard requires that, absent a situation of financial stress, the value of the LCR be no lower than 100% (i.e. the stock of HQLA should at least equal total net cash outflows). LCR ADIs must meet this requirement on an ongoing basis, and hold a stock of HQLA as a defence against the potential onset of liquidity stress.

34 For the purpose of calculating total net cash outflows, term deposits will be excluded from an ADI's cash outflow, if the depositor has no legal right to withdraw the deposit within 30 days, or if early withdrawal results in a significant penalty that is materially greater than the loss of interest accrued.

35 If a category of term deposits does not meet the above conditions, that entire category will be treated as equivalent to 'demand deposits' and included in the categories of 'stable', 'less stable' or 'higher run-off less stable' deposits to form part of total net cash outflows. As a consequence, LCR ADIs will be required to hold additional HQLA in proportion with the higher level of assumed outflows.

36 The categories of 'stable', 'less stable' and 'higher run-off less stable' deposit carry different cash outflow assumptions (i.e. assumed cash outflow rates to determine the level of deposit outflows from ADIs caused by early withdrawal of funds during a stress scenario). APRA has set the following run-off rates:

- 5% for stable deposits;
- 10% for less stable deposits; and
- 25% for higher run-off less stable deposits.⁸

⁸ APRA, Discussion Paper, Implementing Basel III liquidity reforms in Australia, May 2013.

- 37 Given that term deposits will be excluded from an ADI's cash outflows if the depositor has no legal right to withdraw the deposit within 30 days, a notice requirement of 31 days for early withdrawal will enable LCR ADIs to exclude those term deposits when determining the ADI's cash outflows under the LCR.
- 38 Under the LCR, APRA is able to outline 'exceptional circumstances' under which a term deposit can be withdrawn immediately without changing the treatment of the pool of term deposits. For example, an ADI can allow a depositor experiencing financial hardship to withdraw their term deposit without changing the entire pool of term deposits to demand deposits.⁹
- 39 The assets deemed eligible to be included as HQLA in Australia do not exist in sufficient supply to enable ADIs to comply with the LCR. As a result, APRA and the Reserve Bank of Australia (RBA) have introduced an alternative liquidity approach, the Committed Liquidity Facility (CLF). An LCR ADI is able to establish a CLF with the RBA, sufficient in size to cover any shortfall in Australian dollars between the ADI's holding of HQLA and net cash outflows. Qualifying collateral for the CLF will comprise all assets eligible for repurchase transactions with the RBA under normal market conditions and any other assets nominated by the RBA. The RBA charge a risk margin of 15 basis points for the CLF.¹⁰
- 40 An ADI must apply to APRA for approval before establishing the CLF and the ADI must make every reasonable effort to manage its liquidity risk through its own balance sheet management before applying for the CLF for LCR purposes.¹¹

Size of the term deposit market

- 41 As at December 2013, ADIs (banks and mutual ADIs) held a total of \$847.83 billion in term deposits.¹² Of the total amount of term deposits held by ADIs, banks held \$821.39 billion (representing 96.88% of the total), and mutual ADIs held \$26.44 billion (representing 3.12% of the total).
- 42 Over the past five years, term deposits have grown at a significant rate. From March 2008 to December 2013, term deposits held by ADIs have grown from \$422.25 billion to \$847.83 billion, representing an increase of almost 101%.
- 43 Term deposits also account for a greater share of the overall deposit base held by ADIs. As such, term deposits are an important funding source for ADIs. As at December 2013, term deposits accounted for 37.66% of the total

⁹ See APS 210, at para 42.

¹⁰ See APS 210, Attachment A at para 12.

¹¹ See APS 210, Attachment A at para 16 & 17.

¹² APRA, *Quarterly Authorised Deposit-taking Institution Performance*, December 2013.

deposits held by ADIs. In contrast, as at March 2008, term deposits accounted for 28.81% of the total deposits held by ADIs.

- 44 The strong growth in the term deposit market over the five years has likely been influenced by a number of factors, including:
- (a) a noticeable increase in household savings rates in the aftermath of the global financial crisis (and a corresponding shift in consumer sentiment and attitude to risk);
 - (b) the relative poor performance and/or volatility of other asset classes (including equities and real estate); and
 - (c) increased competition among ADIs in the term deposit market. This was reflected in a noticeable rise in the average spread above market rates of equivalent maturity on banks' term deposit 'specials' (the most relevant rate for term deposit pricing) in the aftermath of the financial crisis.
- 45 In a submission in response to our Consultation Paper 169: *Term deposits that are only breakable on 31 days' notice: Proposals for relief* (CP 169), the Australian Bankers' Association (ABA) noted that around 95% of term deposits held by its member banks had terms of two years or less.¹³

Profile of term deposit retail investors

- 46 We understand that there are around 2 million retail investors aged 14 and over who held a term deposit account in the 12 months to December 2012.¹⁴
- 47 In July 2013, we released *Report 353: Further review of term deposits* (REP 353), which reviewed the practices of eight ADIs relating to the offer of term deposits (discussed in more detail at paragraphs 81-84). In REP 353, we made the following findings:
- (a) across the seven ADIs where data was available, an overall mean of 45.3% of term deposits were held by investors aged 65 or older;
 - (b) across the eight ADIs, the overall mean value of term deposits was approximately \$77,000;
 - (c) across the seven ADIs where data was available, the overall median value of term deposits was approximately \$29,000; and
 - (d) across the seven ADIs where data was available, the mode value of term deposits ranged between \$5,000 and \$10,000.

¹³ The ABA did not specify whether this figure was based on the number or value of term deposits held by member banks.

¹⁴ Roy Morgan Single Source survey database.

Assessing the problem

- 48 As a practical consequence of the introduction of the LCR requirement by APRA, term deposits will be treated as demand deposits and will have to be included in total net cash outflows, unless the LCR ADI imposes a notice requirement of 31 days for early withdrawal. This means that, without a 31-day notice period, LCR ADIs will have significant liquidity management costs for term deposits.
- 49 Term deposits are an important part of the Australian financial market because they are a low risk investment product, with varying investment terms and applicable returns that consumers can select to suit their needs and circumstances. Term deposits help consumers manage basic investment management needs, and can be used for a specific investment term, ranging between one month and up to five years.
- 50 In order to continue offering term deposits to the market, ADIs will only do so where it is cost effective. Term deposits are only cost-effective if compliance costs can be maintained at a reasonable level. If ADIs continue to offer term deposits with no notice period, they will not comply with the LCR requirements, and the ADI will incur liquidity management costs. If a 31 day notice period is imposed, there will be Corporations Act compliance costs (staff training and disclosure documents).
- 51 Under both these scenarios the costs of offering term deposits will rise, which will tend to reduce the returns offered by term deposits, so they will be more like an at call deposit account product. This means that there is a high risk that term deposits will cease to be an attractive or useful investment for consumers. This may mean that term deposits as they are currently structured cease to be offered, which would be a detrimental outcome for consumers and ADIs, for whom they are a legitimate and useful product.
- 52 As stated at paragraph 21, in ASIC's view, term deposits of up to two years that require a notice period of 31 days for early withdrawal will fall outside the definition of basic deposit product.
- 53 Term deposits of between two and five years that require a notice period of 31 days for early withdrawal will not meet the definition of basic deposit product, because those term deposits must allow the depositor to make an early withdrawal without prior notice (except for the special provision for mutual ADIs) in order to qualify as basic deposit products.
- 54 If 31-day notice term deposits are not basic deposit products, they will be subject to regulatory requirements under the Corporations Act similar to more risky investment products, including higher training standards for bank staff who advise on the product, and more prescriptive disclosure obligations (discussed in more detail at paragraphs 60-68).

55 This will result in significant cost implications for LCR ADIs that wish to issue 31-day notice term deposits, because they will incur compliance costs of regulatory requirements under the Corporations Act.

56 We understand that some LCR ADIs will use the CLF offered by the RBA to meet the LCR. The ADI will pay a fee to the RBA of 15 basis points based on the size of the commitment provided by the CLF. We anticipate that ADIs will also want to offer 31-day notice term deposits, as this will reduce the cost of the CLF (discussed in detail at paragraphs 126-131). However, without relief this will mean that the ADI will incur the Corporations Act compliance costs.

57 The introduction of the 31-day notice period for an early withdrawal from term deposits will be a significant change from current practice among ADIs, whereby ADIs allow term deposits to be breakable at the depositor's discretion before maturity without a lengthy notice period.

Compliance costs of regulatory requirements under the Corporations Act

58 31-day notice term deposits are not basic deposit products, so are subject to more onerous regulatory requirements under the Corporations Act, including:

- (a) a higher level of training standards at the Tier 1 level for persons advising on term deposits; and
- (b) more prescriptive disclosure obligations, including obligations to provide PDSs and SOAs.

59 These more onerous requirements recognise that Tier 1 products pose greater risks to consumers than basic deposit products.

Tier 1 training standards under ASIC Regulatory Guide 146: *Licensing: Training of financial product advisers*

60 In RG 146, ASIC has set minimum training standards for financial product advisers. The training standards are sets of knowledge and skill requirements that must be satisfied at a Tier 1 or Tier 2 educational level by advisers. All natural persons who provide financial product advice to retail clients must meet the training standards, subject to certain exemptions.

61 The Tier 1 education level is broadly equivalent to the 'Diploma' level under the Australian Qualifications Framework, and the Tier 2 education level is broadly equivalent to the 'Certificate III' level under the Australian Qualifications Framework.

62 As basic deposit products, term deposits are classified as a Tier 2 product, which means that lighter and more flexible training standards apply to

advisers. Currently, advisers do not need to complete a course that needs to be approved by an authorised assessor and is on the ASIC Training Register. Instead, they can complete a course that is assessed by their Australian financial services licensee as meeting the relevant training standards at the Tier 2 educational level.

- 63 31-day notice term deposits would be classified as Tier 1 products for the purpose of training standards under RG 146. As a result, persons advising on 31-day notice term deposits would be unable to distribute 31-day notice term deposits unless they meet the higher knowledge and skill requirements at the Tier 1 diploma educational level.
- 64 This could have significant implications for ADIs, as it would make it difficult to offer the product to investors. All bank staff, including frontline staff, would be unable to distribute term deposits unless they meet the higher Tier 1 training standards. This will result in significant training costs for ADIs if they had to require all bank staff who distribute 31-day notice term deposits to meet higher training requirements. Ongoing monitoring and competency requirements would also apply.
- 65 Currently, ADIs offer and distribute term deposits based on different business models, including a 'no-advice model' (no financial product advice provided to customers, no training in accordance with RG 146 required), 'general advice' (general financial product advice provided to customers, lower training standard in accordance with RG 146) and /or online model (no advice or general advice only).
- 66 If 31-day notice term deposits require a Tier 1 educational level for advisers, it would have significant cost implications for ADIs, requiring them to make extensive changes to their existing business models, distribution and compliance structures. Some ADIs may not be able to offer and distribute 31-day notice term deposits through bank staff via a no-advice, general advice or online model.

Prescriptive disclosure obligations

- 67 In a recommendation, issue or sale situation, ADIs would be required to give clients a PDS for 31-day notice term deposits, and an SOA when personal advice is provided. These disclosure requirements do not apply to term deposits which are basic deposit products.
- 68 If ADIs are required to provide additional disclosure materials, this will impose a substantial compliance burden with associated operational costs because ADIs will be required to make considerable changes to existing systems and structures to accommodate the provision of PDSs and SOAs.

Significant liquidity management costs under the LCR

- 69 Under the LCR requirement, for the purpose of determining total net cash outflows, term deposits will be excluded from the calculation of an ADI's cash outflows if the depositor has no legal right to withdraw the deposit within 30 days.
- 70 The long-standing practice among ADIs, which allows term deposits to meet the definition of basic deposit product if early withdrawal is permitted, has been to allow term deposits to be readily breakable prior to maturity, whether or not subject to some loss of interest.
- 71 If this practice is maintained, term deposits would be treated as demand deposits under the LCR requirement. Consequently, LCR ADIs would be required to maintain a stock of HQLA to cover term deposits that will form part of total net cash outflows. This will lead to significant liquidity management costs for LCR ADIs, because they will be required to hold a large liquidity buffer.

Greater risks posed to retail investors

Retail investors' understanding of 31-day notice term deposits

- 72 The current practice by ADIs is to allow term deposits to be readily breakable by the depositor, whether or not subject to an interest rate penalty. A change to the operation of term deposits such that a notice period of 31 days is required for an early withdrawal will result in a departure from the current and well-understood operation of a basic retail banking product.
- 73 If ADIs offer 31-day notice term deposits, there is a risk that investors could be unaware of, or have little understanding of, the new operation of the product. While the training and disclosure requirements of the Corporations Act are supposed to address this, there is a risk that it won't.
- 74 Given the well-understood nature of traditional term deposits which can be broken without notice, this means that investors may acquire a term deposit product without being aware of the 31-day notice period or the practical effect of the notice period, even if the investor receives a PDS. In particular, investors who have long understood that term deposits are readily breakable and have a propensity to seek to withdraw funds before maturity are likely to be at risk.

Dual pricing rollover risk and 31-day notice period

- 75 In 2010, ASIC released *Report 185: Review of term deposits* (REP 185), which reviewed ADI practices relating to the marketing and disclosure of term deposits by eight ADIs, over a period of 14 months. We found that ADIs structure 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 applicable interest rate on the date of rollover.

- 76 In REP 185, we also identified the widespread existence of 'dual pricing' (i.e. ADIs structure and promote term deposits by offering high interest rates on a limited number of term deposit periods, while maintaining lower rates for all other deposit periods, with significant differences between these rates). ADIs change the terms that attract high interest rates on a regular basis.
- 77 Because term deposits can renew or 'roll over' on a default basis (unless the investor intervenes), we found that the dual pricing of term deposits creates a risk that a term deposit could roll over automatically from a high interest rate to a much lower interest rate (dual pricing rollover risk), without the investor being conscious of the change because of absent or limited disclosure in customer communications and disclosure documents. This means that investors could inadvertently roll over into, and remain in low interest rate term deposits.
- 78 We found that there was no apparent correlation 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). For the remaining four ADIs, the interest rates appeared to have some correlation during certain periods.
- 79 In REP 185, we made the following key findings:
- (a) seven of the eight ADIs used dual pricing, but none of the ADIs specifically disclosed this in their terms and conditions and/or investor communications (pre-maturity letter and post-maturity letter);
 - (b) the difference between high and low interest rates ranged from 7% and 48% (or between 47 and 340 basis points);
 - (c) for six ADIs, at all times, the interest rate for their most popular at-call savings account exceeded their low term deposit interest rates (on average, low term deposit interest rates were 37% lower than interest rates offered by at-call savings accounts for banks, and 8% lower for mutual ADIs);
 - (d) 47% of default rollovers rolled over from high interest rates to low interest rates, worth a total of \$7.88 billion of funds;
 - (e) on average, term deposits rolled over 5 times before the funds were withdrawn;
 - (f) seven of the eight ADIs provided investors with a 'grace period' (i.e. a short period of time during which investors can cancel the new term deposit or change to a different term deposit without charge), but only three ADIs disclosed the grace period in investor communications;

- (g) seven of the eight ADIs sent a letter to investors immediately before a term deposit matured (pre-maturity letter); and
- (h) all eight ADIs sent a letter to investors after a term deposit had rolled over into a new term deposit (post-maturity letter).
- 80 Our primary concern related to the significant proportion and amount of funds that rolled over from a high interest rate to a low interest rate (i.e. 47% of default rollovers worth a total of \$7.88 billion). To address the dual pricing rollover risk, we made a number of recommendations for ADIs to improve their advertising, the disclosure about the dual pricing rollover risk, the disclosure of interest rates, and disclosure of grace periods.
- 81 In July 2013, we released REP 353, which was a follow-up report to REP 185. REP 353 examined the implementation of the recommendations made in REP 185 designed to address the dual pricing rollover risk. REP 353 reviewed the same eight ADIs in REP 185, over a period of 7 months.
- 82 Overall, REP 353 highlighted improved industry practice and better outcomes for investors in relation to the automatic rollover of term deposits (see Table 1).

Table 1: Findings of REP 353 compared to findings of REP 185

Area	2009 review (14-month review period)	2011 review (7-month review period)
Dual pricing practice	Seven of the eight ADIs used dual pricing	The same seven ADIs still use dual pricing
Disclosure of dual pricing	Not specifically disclosed by any of the seven ADIs in terms and conditions or investor communications	All seven ADIs that use dual pricing specifically disclose the risk of dual pricing in terms and conditions documents, and at least one mode of investor communications (e.g. pre-maturity letter and post-maturity letter)
Existence of grace periods	Seven of the eight ADIs had grace periods	All eight ADIs have grace periods, ranging from five business to 14 calendar days
Disclosure of grace periods	Disclosed by three ADIs in pre-maturity and/or post-maturity letters	Disclosed by all eight 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)

Area	2009 review (14-month review period)	2011 review (7-month review period)
Disclosure of interest rates	<ul style="list-style-type: none"> One ADI disclosed the actual or indicative interest rate that will apply to new term deposit after rollover in pre-maturity letter Three ADIs enclosed interest rate schedule with pre-maturity letters. 	<ul style="list-style-type: none"> Five ADIs disclose the actual or indicative interest rate that will apply to new term deposit after rollover in pre-maturity letters Three of these ADIs enclose interest rate schedule with pre-maturity letters
Pre-maturity letter	Seven of the eight ADIs sent pre-maturity letters	Seven of the eight ADIs send pre-maturity letters
Post-maturity letter	All eight ADIs sent post-maturity letters	All eight ADIs send post-maturity letters
High interest rates on offer	Between two and four terms were at high interest rates	Between four and seven terms at high interest rates
Difference between high and low interest rates	Ranged from between 7% and 48% (or between 47 and 340 basis points)	Ranged from between 9% and 58% (or between 57 and 339 basis points)
Term deposits lodged during review period	\$97.34 billion	\$55.81 billion
Proportion of rollovers from 'high' to 'low' interest rate	47% (\$7.88 billion)	11% (\$1.9 billion)
Number of average rollovers per term deposit	5	3.5

Source: REP 353

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In REP 353, we found that:

- (a) the same seven ADIs still use dual pricing, but all seven ADIs now specifically disclose the risk of dual pricing in terms and conditions documents, and at least one mode of investor communications;
- (b) the difference between high and low interest rates ranged from between 9% and 58% (or between 57 and 339 basis points);
- (c) for all eight ADIs, the interest rate on the most popular at-call savings account at all times exceeded the low term deposit interest rates;
- (d) 11% of default rollovers rolled over from high interest rates to low interest rates, worth a total of \$1.9 billion of funds;
- (e) on average, term deposits rolled over 3.5 times before the funds were withdrawn;

- (f) all eight ADIs provide investors with a grace period ranging from five business days to 14 calendar days, and disclose the existence of the grace period in investor communications;
- (g) seven of the eight ADIs sent pre-maturity letters, and all eight ADIs sent post-maturity letters to investors; and
- (h) investors made significant use of the grace period, with a total of \$97 billion of investors' funds being re-lodged or cancelled during the grace period.

84 Based on the findings in REP 353, we acknowledge the improvements in industry practice and disclosure, including fewer default rollovers from high to low interest rates. Notwithstanding the improvements, we remain concerned about the considerable amount of investors' funds that continue to rollover from high to low interest rate term deposits on a default basis. In REP 353, we found that over a 7 month period, \$1.9 billion of investors' funds still rolled over from high to low interest rate term deposits.

85 The dual pricing rollover risk, in conjunction with the notice period requirement of 31 days for an early withdrawal, poses a greater risk to investors than current term deposits that do not require a notice period, because investors may roll over into and remain in low interest rate term deposits that require a notice period of 31 days for an early withdrawal. This means that those investors whose funds have rolled over into low interest rate term deposits and who seek to access their funds immediately after a rollover, will be required to give a notice period of 31 days (unless they are facing hardship).

86 Further, investors that roll over into and remain in low interest rate term deposits that require a notice period of 31 days may be subject to the additional risk of having their interest rate reduced and/or fees imposed, if they wished to make an early withdrawal after the expiry of the grace period.

Objectives of government action

- 87 Our aim is to strike an appropriate balance between:
- (a) industry practice that assists retail investors to make confident and informed decisions about investing and re-investing in term deposits;
 - (b) promoting the continued efficient delivery of a traditional banking product by minimising compliance costs for the banking industry; and
 - (c) facilitating ADIs to adopt stronger liquidity risk management practices in a cost-efficient and timely manner, as required by the LCR.

- 88 The need to strike an appropriate balance between protecting investors' interests and allowing markets to operate freely is part of ASIC's mandate under the *Australian Securities and Investments Commission Act 2001*.

B Options and impact analysis

Options

- 89 In considering options available to achieve our desired objectives, ASIC considered the following:
- (a) Option 1: LCR requirements commence as scheduled, with no relief provided by ASIC (status quo)
 - (b) Option 2: Provide conditional and permanent relief, so that 31-day notice term deposits of up to two years are subject to the same regulatory requirements as basic deposit products (not preferred)
 - (c) Option 3: Provide conditional and permanent relief for term deposits of up to two years as per Option 2, and also provide conditional relief for term deposits of between two and five years, for an interim period of two years (preferred).
- 90 Given the greater risks to investors that will arise if 31-day notice term deposits are given concessional regulatory treatment, we do not consider that granting unconditional relief is appropriate. This approach would not address ASIC's concerns because:
- (a) investors have long understood that term deposits are generally readily breakable. Even if these investors receive a terms and conditions disclosure document explaining the 31-day restriction, there is a risk that this disclosure will not provide sufficient salient information to overcome the investor's ingrained understanding of what a term deposit is; and
 - (b) the concurrent operation of dual pricing rollover risk and a 31-day notice period means that those investors whose funds have rolled over into low interest rate term deposits and who seek to access their funds immediately after a rollover, will not be able to do so (unless they face hardship). As discussed at paragraph 84, we remain concerned about the considerable amount of investors' funds that continue to roll over into low interest rate term deposits (as illustrated by REP 353, which found that over a 7 month period, \$1.9 billion of investors' funds rolled over into low interest rate term deposits). We are concerned that a 31-day notice period would further restrict the capacity of investors who seek to withdraw their deposited funds immediately after their funds have rolled over into low interest rate term deposits.
- 91 The difference between Option 2 and Option 3 is because of the different treatment of term deposits of up to 2 years, and between 2 and 5 years in section 761A of the Corporations Act (as set out in paragraph 19).

Option 1 – The LCR requirement commences as scheduled with no relief (maintain the status quo)

92 Under Option 1, we would maintain the status quo. That is, the LCR requirement would commence as scheduled and 31-day notice term deposits would not meet the definition of basic deposit product under the Corporations Act.

Option 2 – Provide conditional and permanent relief for term deposits of up to two years

93 Option 2 is to provide relief with conditions, so that 31-day notice term deposits of up to two years could be treated as basic deposit product under the Corporations Act. The relief is not required for and would not apply to traditional term deposits (i.e. the relief will apply only to 31-day notice term deposits that are issued from the commencement date of the relief).

Term deposits of up to two years

94 Under Option 2, the relief would mean that 31-day notice term deposits of up to two years would meet the definition of basic deposit product under the Corporations Act.

95 ADIs would not be required to use the conditional relief to issue 31-day notice term deposits– the decision to rely on the relief would be discretionary for an ADI.

96 The relief would apply only to term deposits of up to two years with a notice period of 31 days. The relief would not apply to term deposits of up to two years with no notice period. Such term deposits would continue to be basic deposit products.

Term deposits of between two and five years

97 Under Option 2, the relief would be limited to 31-day notice term deposits of up to two years, and would not cover term deposits with a term of between two and five years. This means that if LCR ADIs wanted to impose a notice period of 31 days on term deposits of between two and five years they would not be basic deposit products.

The proposed conditions of relief

98 Under Option 2 (and also Option 3), we would impose a set of conditions to address the greater risks posed by 31-day notice term deposits to retail investors. The proposed conditions would set the minimum disclosure and grace period standards, so that the industry appropriately addresses the risks posed to confident and informed decision making by retail investors.

- 99 The proposed conditions of relief seek to address:
- (a) the risk that investors could be unaware of, or have little understanding of the 31-day notice requirement for early withdrawal; and
 - (b) the greater risk posed by the concurrent operation of the 31-day notice period and the dual pricing rollover risk.
- 100 In developing and settling the proposed conditions of relief, we consulted with stakeholders from industry and consumer groups. The proposed conditions of relief provide clear standards such that retail investors are provided with key information in a timely manner in order to make confident and informed decisions about investing and re-investing in term deposits.

Table 2: Proposed conditions of relief

Condition	Requirement
Consumer warning	<p>Before a term deposit is issued, the ADI must disclose the following information to the investor:</p> <ul style="list-style-type: none"> • the ADI has the discretion to delay withdrawal or transfer of the investor's funds for up to 31 days for the life of the term; • if the investor has a need to immediately withdraw or transfer funds, other deposit products may be more suitable; and • if the investor consents to the term deposit rolling over at maturity, it may roll over into a term deposit with a lower interest rate. <p>The information is to be provided to the investor by one or more of the following means:</p> <ul style="list-style-type: none"> • providing the investor with a stand-alone, one page document containing the warning; • providing the warning orally to the investor; or • including the warning in a clear and prominent manner in the terms and conditions of the term deposit, and requiring the investor to specifically acknowledge this warning by an active step (e.g. ticking a box in the application form).
Investor's consent to rollover	<p>At any time before a term deposit is to roll over for the first time, the ADI must obtain the investor's express consent for the term deposit to roll over at maturity.</p> <p>The consent can be provided in writing or orally. The ADI will bear the onus to prove that consent was provided.</p>

Condition	Requirement
Pre-maturity contact	<p>Each time a term deposit is to roll over, the ADI is to make pre-maturity contact at least five business days before maturity, and provide the following information, either orally or in writing:</p> <ul style="list-style-type: none"> • if the funds will or may roll over into a new term deposit with a lower interest rate, a clear and prominent disclosure that: <ul style="list-style-type: none"> – the term deposit [will or may (as the case may be)] roll over into a new term with a lower interest rate; – a higher interest rate may be available from the ADI for another deposit for a comparable period in time; and – if the interest rate is not known, the investor should confirm the interest rate for the new term deposit on the date of the rollover; and • either: <ul style="list-style-type: none"> – the interest rate that will apply to the new term deposit; or – if the interest rate is not known at the time of pre-maturity contact, an indicative interest rate that will apply to the new term deposit, and a warning that the indicative interest rate may be subject to change, together with information on how and when the investor can ascertain the interest rate for the new term deposit; and • that a grace period will apply when the funds are rolled over into the new term deposit, and the date that the grace period ends; and • that if the investor wishes to withdraw their funds after the grace period ends, the ADI has the discretion to delay withdrawal or transfer of the investor's funds for up to 31 days for the life of the term; and • that the investor previously gave consent for the funds in the facility to roll over into the new term deposit.
Grace period on rollover	<p>Each time a term deposit rolls over, the ADI must provide a grace period of at least 7 calendar days from the date of maturity.</p>

Condition	Requirement
Post-maturity contact	<p>Each time a term deposit rolls over, the ADI must make post-maturity contact immediately, but by no later than one business day after the maturity date, and provide the following information, either orally or in writing:</p> <ul style="list-style-type: none"> • that the investor has the benefit of a grace period that started on the day after the maturity date of the facility; • the date the grace period ends; • information about the investor's rights during the grace period; • the interest rate that applies to the new facility; • that a higher interest rate may be available from the ADI for another facility for a comparable investment period in time; • if applicable, that there will be a reduction in the return generated for the investor and fees applicable for withdrawal or transfer of funds from the new facility after the expiration of the grace period; and • that if the investor wishes to withdraw their funds after the grace period, the ADI has the discretion to not permit the withdrawal or transfer of the investor's funds for up to 31 days for the life of the term.

Option 3 – Provide conditional and modified relief for all term deposits of up to five years

- 101 Option 3 is to provide the permanent relief proposed by Option 2, and to also provide interim relief for term deposits of between two and five years, for a period of two years.
- 102 Under Option 3, 31-day notice term deposits of up to five years would be treated as basic deposit products in the following way:
- (a) permanent relief granted to term deposits of up to two years; and
 - (b) temporary relief for a period of two years granted to term deposits of between two and five years.
- 103 As under Option 2, the relief would apply to only to 31-day notice term deposits that are issued from the commencement date of the relief.

Term deposits of up to two years

- 104 Under Option 3, we would provide the conditional and permanent relief for 31-day notice term deposits of up to two years as proposed in Option 2.

Term deposits of between two and five years

105 Under Option 3, we would extend the scope of the conditional relief
proposed in Option 2 to apply to term deposits of between two and five
years, for an interim period of two years after the commencement of the
relief.

106 This means that subject to satisfying the conditions of the relief outlined in
Table 1, 31-day notice term deposits of between two and five years that are
issued within two years after the commencement of the relief would be
treated as basic deposit products, notwithstanding the requirement in the
definition of basic deposit product that term deposits of between two and
five years must not require a notice period for an early withdrawal.

107 The temporary two year relief period is intended to provide time for industry
and Government to engage, and review the legislative intent of the
Corporations Act's distinction between term deposits of up to two years and
term deposits of between two and five years.

108 The relief would apply only to the class of term deposits of between two and
five years that require a notice period of 31 days. This means that the relief
will not apply to term deposits of between two and five years that do not
require a notice period.

The proposed conditions of relief

109 Under Option 3, we would impose the same set of conditions accompanying
the proposed relief as Option 2 (see Table 2). As set out under Option 2, the
proposed conditions seek to address the greater risks posed by 31-day notice
term deposits to retail investors.

110 After the commencement of the conditional relief, if ADIs wish to issue 31-
day notice term deposits as basic deposit products, they would be required to
meet the conditions of relief.

111 For the purpose of rolling over existing term deposits (i.e. term deposits that
do not require a notice period) into 31-day notice term deposits, ADIs would
be required to meet the proposed conditions.

Impact analysis

Option 1 – The LCR requirement commences as scheduled with no relief (maintain the status quo)

Impact on industry

112 There are 40 LCR ADIs that will be subject to APRA's LCR requirement from 1 January 2015. In order to comply with the LCR requirement in a cost-efficient manner by excluding term deposits from forming part of the total net cash outflow, LCR ADIs must impose a notice period of 31 days for an early withdrawal from term deposits.

113 Option 1 would mean that, 31-day notice term deposits would not meet the definition of basic deposit product under the Corporations Act. In submissions received in response to CP 169, ADIs, industry bodies and consumer representative groups strongly supported our proposal to provide relief so that 31-day notice term deposits are able to meet the definition of basic deposit product, rather than maintaining the status quo.

114 Given ASIC's view that 31-day notice term deposits would not meet the definition of basic deposit product, there will be compliance costs relating to additional regulatory requirements under the Corporations Act.

Compliance costs of regulatory requirements under the Corporations Act

115 If LCR ADIs issue 31-day notice term deposits, given ASIC's view that 31-day notice term deposits would not meet the definition of basic deposit products, there will be substantial compliance costs for LCR ADIs. This will mean that 31-day notice term deposits will be treated as Tier 1 products for the purpose of the training requirements under RG 146, and will be subject to more prescriptive disclosure obligations, including the requirements to provide investors with a PDS and a SOA.

116 In terms of the nature and complexity of systems changes that will be required, typical changes will include generating new product labelling data and a transaction monitoring structure, creating testing frameworks, establishing links to other retail banking and enterprise systems, and altering administrative and legal processes and procedures. There will also be additional training requirements for staff who distribute these term deposits, and for managers of these staff.

117 Furthermore, if an ADI has a portfolio of multiple brands that offer term deposits, all brands will separately need to implement systems changes, because generally, these operations are performed by separate IT and distribution platforms. Consequently, ADIs will face additional costs to implement changes across all relevant brands.

- 118 In order to issue 31-day notice term deposits as a Tier 1 Product, LCR ADIs may need to reassess existing business models and make changes to their Australian Financial Services (AFS) licence arrangements.
- 119 Based on the presumption that all of its member-banks would issue 31-day notice term deposits (notwithstanding that such term deposits would not be basic deposit products) and be required to meet the regulatory requirements under the Corporations Act, the Australian Bankers' Association has projected that the estimated aggregate cost incurred by its member banks would be \$151,100,000.
- 120 We note that there are 24 banks that are members of the ABA. Given that there are 40 banks that will be subject to the LCR, the estimated aggregate cost of \$151,000,000 cited above is not an estimated aggregate cost that will be incurred by all of the 40 LCR ADIs.
- 121 During our consultation process for CP 169, we did not receive submissions from banks that are not members of the ABA.
- 122 Given that LCR ADIs will be unable to offer 31-day notice term deposits as basic deposit products without relief, they will be required to consider how viable it is to offer these term deposits. This may diminish the availability of term deposits to investors if LCR ADIs determine that the Corporations Act compliance costs limit their ability to offer term deposits. Significant liquidity management costs
- 123 Alternatively, if LCR ADIs decided to keep their current product offering as a basic deposit product, significant costs would be incurred in terms of the requirement to hold HQLA under the LCR and the direct fee imposed by the CLF in order to meet the LCR requirement
- 124 Consistently with treating term deposits as basic deposit products, the current practice among ADIs is to allow term deposits to be readily breakable. This means that under the LCR requirement, the entire category of term deposits will be treated as equivalent to demand deposits. As a result, LCR ADIs will need to hold a stock of HQLA, or use the CLF to cover term deposits that will form part of total net cash outflows, resulting in significant liquidity management costs.
- 125 On an industry basis, total household Australian dollar term deposits as at 30 June 2013 were \$221.4 billion for LCR ADIs.¹⁵ Without a 31 day notice period, at an average runoff rate of around 9% in the LCR on the retail deposit portfolio, LCR ADIs would be required to hold around \$20 billion of liquid assets (HQLA) against these deposits to meet their LCR requirements.

¹⁵ Data sourced from APRA from *ARF 320.0 Statement of Financial Position (Domestic Books)*

This means that under the CLF, an annual fee of \$30m would be incurred to meet the LCR requirement.

126 If a 31 day notice period is imposed, and following a period of transition, then the amount of the portfolio that will be subject to a runoff rate in the LCR (those that have 30 days or less to run or are in a grace period) will fall to around \$30 billion (from \$221.4 billion) At a 9% runoff rate, the LCR liquid asset requirement against these deposits would be less than \$3 billion.

127 This is a difference in the requirement to hold liquid assets against the Australian dollar household term deposit portfolios of LCR ADIs of around \$17 billion. As there are insufficient assets in Australia which are deemed eligible to be included as HQLA to enable ADIs to comply with the LCR, we understand that LCR ADIs will use the CLF to meet the LCR requirement.

128 The RBA will charge ADIs that have a CLF a fee of 15 basis points per year over the size of the facility. If the difference of around \$17 billion of additional liquid assets is met through the holding of assets provided by the CLF, then the permanent annual cost of liquidity management for those ADIs will be around \$25.5 million (\$17 billion at 15 basis points).

129 If ADIs impose a 31 day notice period on term deposits, they will also benefit by reducing the need to purchase additional third party assets to use as CLF collateral.

130 Further information about the CLF is provided in APRA's Regulation Impact Statement - Implementing Basel III liquidity reforms in Australia (OBPR ID: 2012/14531).

131 The following table shows estimated net savings to LCR ADIs from issuing 31 day notice term deposits:

Table 3: Estimated liquidity management costs

Scenario	Value of term deposit portfolio subject to average run-off rate of 9%	Value of HQLA required to be held under the LCR	Cost of annual fee charged by CLF
Traditional term deposits	\$221.4 billion	\$20 billion	\$30 million
Term deposits with 31-day notice period	\$30 billion	\$3 billion	\$4.5 million
Difference in costs	n/a	\$17 billion	\$25.5 million

132 Due to the need to recover the associated costs of maintaining a larger
liquidity buffer under the LCR, LCR ADIs will be required to assess the
commercial viability of offering term deposits in the market. This may result
in a reduction in the availability of term deposits across the market if LCR
ADIs determine that the liquidity management costs limit their ability to
offer term deposits.

Impact on investors

133 We consider that given the long-term costs and potential detriment to
investors, maintaining the status quo will not address the problems discussed
in Section A.

134 Where LCR ADIs impose a notice period of 31 days, LCR ADIs could be
subject to conflicting pressures to either:

- (i) reduce the rate of return offered to investors by 31-day notice term
deposits, in order to recoup the compliance and operational costs
associated with offering 31-day notice term deposits that are not
basic deposit products; or
- (ii) increase the rate of return offered to investors by 31-day notice
term deposits, in order to attract investors who may seek to invest
in other financial products that offer comparable or better interest
rates.

135 In response to CP 169, submissions from industry noted that ADIs may seek
to recoup the compliance and operational costs associated with offering 31-
day term deposits that are not basic deposit products, by reducing the rate of
return offered to investors.

136 Submissions from consumer representative groups also noted concerns about
a potential reduction in the rate of return offered to investors, if ADIs cannot
offer 31-day notice term deposits as basic deposit products.

137 Given the wide variance in the estimated direct and indirect cost impact of
the additional compliance requirements between ADIs, it is not possible to
estimate the possible impact on the rate of return. Whilst we received
feedback during our consultation process that the rate of return offered by
term deposits could be equivalent to or less than 'at-call' saving deposit
products (e.g. online savings accounts), this may be unlikely in practice as
this would remove the incentive for investors to choose a term deposit.

138 As at September 2013, the average 'special' rate across all terms offered by
term deposits was 3.75% p.a.¹⁶ In contrast, the average interest rate offered

¹⁶ The Reserve Bank of Australia, *Retail deposit and investment rates*. This figure is the average rate on \$10,000 term deposits across all terms at the five largest banks, including their advertised 'specials' and regular rates.

by 'online savings accounts' was 2.5% p.a.¹⁷ The difference between the average 'special' rate of term deposits and online savings accounts was 1.25%, or 125 basis points.

139 On the other hand, ADIs could be subject to pressure to increase the rate of return offered to investors by term deposits, in order to attract investors who may seek to invest in other financial products that are at-call and/or offer comparable or better interest rates. For example, investors may prefer to invest in 'bonus savings accounts' that offer a bonus rate of interest if at least one deposit and no withdrawals are made each month. As at September 2013, bonus savings accounts offered an average interest rate of 4.15%¹⁸.

140 However, as 31-day notice term deposits are not basic deposit products, they will be subject to a higher level of regulatory requirements (i.e. higher level of staff training standards and more prescriptive disclosure requirements). As a result, consumers may benefit from the protection afforded by the higher level of regulatory requirements applying to 31-day notice term deposits.

141 During our consultation process, we received feedback from industry that the rate of return offered by term deposits could be repriced as being the same as 'at call' deposit products. As noted at paragraph 138, currently, the difference in the rates offered by term deposits and at-call online savings accounts is 125 basis points.

Option 2 – Grant conditional and permanent relief for term deposits of up to two years

Impact on industry

Cost savings

142 The option to grant conditional and permanent relief so that 31-day notice term deposits of up to two years are included in the definition of basic deposit products will result in cost savings for LCR ADIs, because they will not need to incur the following costs:

- (a) the compliance costs associated with regulatory requirements under the Corporations Act, noted at paragraph
- (b) s 115-122; and

¹⁷ The Reserve Bank of Australia, *Retail deposit and investment rates*. This figure is a trimmed average of the interest rates of online savings accounts offered by prominent providers, including the five largest banks.

¹⁸ The Reserve Bank of Australia, *Retail deposit and investment rates*. This figure is an average of the five largest banks' rates assuming these requirements are met.

- (c) the significant liquidity management costs associated with maintaining a large liquidity buffer, noted at paragraphs 123-132 that they would otherwise have to incur.

143 The actual cost impact of the regulatory requirements if 31-day notice term deposits are not basic deposit products under the Corporations Act will vary from entity to entity, and it is not possible to provide a precise industry cost saving amount.

144 Under Option 2, LCR ADIs will save only part of the compliance costs associated with additional regulatory requirements if 31-day notice term deposits are not basic deposit products, because the scope of the relief will be limited to term deposits of up to two years. However, as noted at paragraph 45, we understand that the vast majority of term deposits issued by ABA member-banks are for term of less than 2 years.

145 Under Option 2, if LCR ADIs opt to impose a notice period of 31 days for term deposits of between two and five years, and are not able to issue these term deposits as basic deposit products, they will incur compliance costs associated with the regulatory requirements for those term deposits (see paragraphs 149-151).

146 As such, the projected estimated aggregate cost of \$151,100,000 that will be incurred by ADIs will not be completely obviated by Option 2. We are not able to provide an estimate that delineates between term deposits of up to two years and term deposits of between two and five years.

147 Similarly, if conditional relief is only provided for 31-day notice term deposits of up to two years, the cost savings associated with not treating term deposits as demand deposits under the LCR will be limited to those for term deposits of up to two years (see paragraph 152). We are unable to provide an estimate of cost savings that delineates between term deposits of up to two years and term deposits of between two and five years.

148 Providing relief should provide other benefits such as reducing the ADIs' reliance on the CLF, which in turn reduces the likelihood of a future call on the RBA's balance sheet, reducing the need to hold eligible securities against the CLF, and reducing the costs of holding these securities.

Costs incurred relating to term deposits of between two and five years

149 If ASIC limits the conditional relief to 31-day notice term deposits of up to two years, it will not be commercially viable for LCR ADIs to offer term deposits of between two and five years.

150 This is because the same issues will arise in relation to these term deposits as apply to term deposits of up to two years, i.e. if a 31-day notice period is

imposed, these term deposits will not meet the definition of basic deposit product under the Corporations Act.

- 151 If term deposits of between two and five years are treated differently to term deposits of up to two years, this would significantly disrupt the existing framework adopted by ADIs to offer term deposits by requiring ADIs to restructure how term deposits of between two and five years are offered. This would involve significant changes to comply with the additional regulatory requirements (classification as a Tier 1 product under RG 146, provision of PDS and SOA). This would trigger significant compliance cost implications for LCR ADIs.
- 152 Alternatively, if LCR ADIs opt not to impose a notice period of 31 days for the purpose of ensuring continuity of treatment of term deposits of between two and five years as basic deposit products under the Corporations Act, the category of term deposits of between two and five years will be treated as demand deposits under the LCR. As a result, LCR ADIs will be required to hold additional HQLA in proportion with the higher level of assumed outflows, triggered by the inclusion of those term deposits. This will cause significant liquidity management costs for LCR ADIs.
- 153 During our consultation, we received feedback from ADIs that if term deposits of between two and five years were not included in the proposed relief, it would not appropriately address concerns about the impact of the LCR requirement on all term deposits of up to five years.
- 154 Further, the feedback expressed concerns that that this approach would cause disparity in the treatment of term deposits of up to two years and term deposits of between two and five years that would result in significant and complex problems for ADIs. The feedback also noted concerns that Option 2 could significantly disrupt the offer of term deposits, because ADIs would be required to assess the viability of offering term deposits of between two and five years because of the associated compliance costs.
- 155 If Option 2 is implemented, and ADIs do not impose a notice period of 31 days, the category of term deposits of between two and five years would be included to form part of the total net cash outflows, and treated as demand deposits under the LCR. Consequently, LCR ADIs would be required to hold additional HQLA in proportion with the higher level of assumed outflows.
- 156 As part of our consultation process, we sought feedback on the quantifiable impact of treating term deposits of between two and five years as demand deposits under the LCR. The feedback we received drew attention to the significant liquidity management costs. A quantifiable cost estimate was not possible because ADIs could not delineate between term deposits of up to two years and term deposits of between two and five years.

Impact for non-LCR ADIs

157 Under Option 2, non-LCR ADIs may choose to use the conditional relief to offer 31-day notice term deposits of up to two years as basic deposit products, for the purpose of strengthening their liquidity risk management practices. Without ASIC providing relief, non-LCR ADIs would not be able to impose a 31-day notice period and offer the product as a basic deposit product.

Costs associated with the proposed conditions

158 As part of our consultation process, we sought feedback on the quantifiable cost impact of our proposed conditions, and subsequently sought additional feedback on the cost implications of our final proposed conditions.

159 The ABA was able to provide cost estimates relating to the proposed conditions. However, the projected cost estimates are based on the presumption that the conditional relief will apply to all term deposits of up to five years (see paragraph 191).

160 Given that the projected estimate could not delineate between term deposits of up to two years and term deposits of between two and five years, we are unable to provide cost estimates relating to the proposed conditions for Option 2 if the relief is limited to term deposits of up to two years.

Impact for investors

161 The impact for investors if conditional and permanent relief is provided is that term deposits will start to require 31 days' notice in order to break them. This is a departure from current practice. While investors may be more at risk due to the concurrent operation of the dual pricing rollover risk and 31-day notice period, the proposed conditions of relief are designed to alleviate this risk, as well as clearly informing investors about the 31 days notice requirement.

162 Given that term deposits of between two and five years would be excluded from the scope of the proposed relief, LCR ADIs may assess the commercial viability of offering those term deposits to investors because of the associated compliance costs. Consequently, the availability of term deposits of between two and five years to investors could be limited, if LCR ADIs determine that the costs of offering those term deposits are excessive.

163 In response to CP 169, a majority of consumer representative groups expressed support for including term deposits of between two and five years within the scope of the proposed relief. While one submission noted that a term deposit with a term of more than two years should be subject to Tier 1 training standards, the other submissions generally supported the consistent treatment of all term deposits.

Option 3 – Grant conditional and modified relief for term deposits of up to five years

Impact on industry

Cost savings

164 Given that Option 3 will extend the scope of the relief afforded to term deposits of up to two years under Option 2 to also include the category of term deposits of between two and five years for a period of two years from the date of the relief, Option 3 will provide a consistent approach to facilitate the offering of 31-day notice term deposits of up to five years.

165 The conditional relief will apply to the category of term deposits of between two and five years for an interim period of two years after the commencement of the relief. If the relief continues after the two year period, the cost savings will be ongoing (subject to review of this aspect of the relief after the initial two years).

166 This approach will ensure that LCR ADIs obtain cost savings for all term deposits of up to five years, as opposed to Option 2 where LCR ADIs will achieve only partial cost savings and/or will incur additional costs, caused by an inconsistent framework applying to the two categories of term deposits (i.e. relief for term deposits of up two years, and no relief for term deposits of between two and five years).

167 Under Option 3, LCR ADIs will achieve the cost savings associated with issuing 31 day notice term deposits as basic deposit products relating to all term deposits of up to five years.

168 Generally, the direct and indirect cost impact of the compliance requirements will vary from entity to entity having regard to the variance in size, business model and distribution channels between ADIs. During the consultation process, the ABA provided the following estimates relating to one-off system change costs and ongoing compliance costs for its member banks to comply with the Corporations Act if they were to issue 31 day term deposits as Tier 1 products:

- (a) operational costs relating to offering term deposits as Tier 1 products, including:
 - (i) implementation costs relating to changes to IT systems and existing compliance processes could range from \$250,000 to \$3,000,000 per entity;
 - (ii) on-going operational costs could range from \$100,000 to \$2,500,000;
- (b) implementation costs relating to preparation of disclosure documents, including legal and production costs, updating servicing letters and

website disclosure, production of PDS and SOA templates and communications to investors, could range from \$1,875,000 to \$4,875,000 per entity;

- (c) staff training costs relating to distributing term deposits as a Tier 1 product for the purpose of RG 146 compliance, could range from \$500,000 to \$8,000,000 per entity;
- (d) other training costs (non-RG 146 related) including business training requirements and change management costs could range from \$675,000 to \$4,000,000 per entity; and
- (e) additional adviser costs, including preparation and recording of SOA provision could range from \$500,000 to \$5,000,000 per entity.

169 Given the wide variance in the range of costs that are expected to be incurred in order to comply with the regulatory requirements, the actual cost impact will vary from entity to entity. Further, calculation of the precise cost to industry is contingent on the number of ADIs that opt to issue 31-day notice term deposits, notwithstanding that such deposits would not be basic deposit products. Therefore, it is not possible to estimate the exact cost that will be incurred by all ADIs because of these unknown variables.

170 However, based on the projected estimated aggregate costs that will be incurred provided by the ABA member-banks, Option 3 would save 24 of the 40 LCR ADIs a total of \$151,100,000. Given that this figure is limited to ABA member-banks, we estimate that the total aggregate costs that will be saved for all of the 40 LCR ADIs will be significantly larger than \$151,100,000.

Impact on non-LCR ADIs

171 Notwithstanding that the relief is primarily intended to assist LCR ADIs to meet the LCR requirement in a cost-efficient manner, non-LCR ADIs (i.e. ADIs that will not be subject to the LCR requirement) will be able to use the relief if they wish to do so. This means that, if non-LCR ADIs opt to issue 31-day notice term deposits of up to five years as basic deposit products, they will be able to use the relief for this purpose.

172 It is possible that non-LCR ADIs may offer two types of term deposit (31-day notice term deposits and traditional term deposits that do not require a notice period). Given that non-LCR ADIs will not be subject to the LCR requirement, they may have a competitive advantage over LCR ADIs by being able to offer traditional term deposit products without being required to hold HQLA to cover those term deposits. As a result, they may be able to offer a higher rate of return on those term deposits.

173 We anticipate that some non-LCR ADIs will choose to use the proposed conditional relief in order to ensure stable short term funding and to

strengthen their liquidity risk management practices. As non-LCR ADIs will not be subject to APRA's LCR requirement (and therefore not required to maintain a stock of qualifying HQLA to cover total net cash outflows over the next 30 calendar days), we expect there will be different approaches across the market as to whether these ADIs continue to offer the class of term deposits that do not require a notice period, or offer 31-day notice term deposits.

174 Some non-LCR ADIs may choose to offer 31-day notice term deposits if they wish to strengthen their liquidity risk management practices. In a submission to CP 169, the Community Owned Banking Association (COBA), an industry representative group of the mutual ADIs industry, indicated that some of its members may apply the LCR standard internally, notwithstanding that they are not subject to the LCR requirement.

175 All ADIs are encouraged by APRA and by internal risk management strategies to raise more stable funding. Generally, given that ADIs need to hold liquid assets against liquid liabilities (regardless of whether they are subject to the LCR), if term deposits are perceived as being at-call or withdrawable at short notice, ADIs will face greater liquidity management pressures.

Costs associated with the proposed conditions

176 We anticipate that industry will face some compliance costs to meet the proposed conditions. The precise costs will vary from entity to entity, having regard to the variance in size, business model, and distribution channels between ADIs, and the extent of changes required. Some of these costs will be one-off costs, in order to meet the new requirements, and some ongoing.

177 The proposed conditions of relief will require ADIs to change and/or adjust their practices in offering term deposits, because no ADI currently meets all of the proposed conditions. We recognise the potential for an increase in compliance costs for ADIs that opt to use our conditional relief. However, the proposed conditions will not require major structural changes to the operation of term deposits.

178 In terms of new obligations imposed on ADIs by the conditional relief, there will be conditions relating to the consumer warning and obtaining express consent. However, ADIs should be able to adapt existing procedures to incorporate these requirements (e.g. by amending current disclosure documents provided to consumers, and the sales process, to include the consumer warning and obtain the express consent).

179 The other requirements of making pre-maturity contact, post-maturity contact, and the provision of a grace period are existing practices already adopted by ADIs. The proposed conditions relating to these requirements are

largely based on existing industry practice, and will seek to foster the provision of key information in a timely manner to investors.

- 180 In REP 353, we found that seven of the eight ADIs reviewed currently send pre-maturity letters to investors to provide information about their maturing term deposit. Currently, the content of pre-maturity letter varies between ADIs, but ADIs typically provide information about the maturity date, disclosure about dual pricing rollover risk, and applicable indicative interest rate if the term deposit rolls over.
- 181 In REP 353, we found that all eight ADIs reviewed send post-maturity letters to investors after a term deposit has rolled over, to provide information about the new term deposit. Currently, the content of post-maturity letter varies between ADIs, but ADIs typically provide information about the applicable interest rate for the new term deposit, the grace period, and disclosure about dual pricing rollover risk.
- 182 The proposed conditions relating to pre-maturity and post-maturity contact may require LCR ADIs to make adjustments to existing practice:
- (a) ADIs that do not currently make pre-maturity contact will be required to make pre-maturity contact;
 - (b) ADIs that do not currently make post-maturity contact will be required to make post-maturity contact;
 - (c) ADIs that currently do make pre-maturity contact may need to adjust the timing of the contact so that pre-maturity contact is made at least five business days before maturity of a term deposit;
 - (d) ADIs that currently do make post-maturity contact may need to adjust the timing of the contact so that post-maturity contact is made immediately, but by no later than one business day after a term deposit has rolled over;
 - (e) ADIs may need to adjust the content of information provided by pre-maturity and post-maturity contact to provide the required information (see Table 2).
- 183 However, the proposed conditions of pre-maturity and post-maturity contact will provide flexibility for ADIs, in terms of the mode of contact that can be selected. The proposed conditions will allow both pre-maturity and post-maturity contact to be made either orally or in writing. In practice, this means that ADIs will have discretion to choose a mode of contact that is appropriate for their business model, and may choose to make contact by sending a letter, via telephone contact, or by electronic delivery including via email, SMS and online account management portal communication.
- 184 In REP 353, we found that all eight ADIs currently provide a grace period to investors after rollover, which ranges from five business to 14 calendar days,

to allow investors a period of time during which they can cancel the new term deposit or change to a different term deposit without charge.

185 In CP 169, we proposed a grace period of at least 14 calendar days. During our consultation process, industry strongly opposed our approach of mandating a grace period as part of the proposed relief, citing potentially significant liquidity management costs (i.e. holding HQLA to cover higher level of assumed outflows triggered by the inclusion of 31-day notice term deposits that are in a grace period under the LCR). Industry also objected to the proposed grace period on the basis that that the length of the grace period is of direct consequence to the potential liquidity management costs.

186 In response to industry's concerns, and after consulting with industry, we propose to require a grace period of at least 7 calendar days as part of our proposed conditions.

187 Given the increased risk posed by 31-day notice term deposits, we believe that the provision of a grace period of at least 7 calendar days is important because it will:

- (a) enable investors whose term deposit rolls over by default into a low interest rate term deposit to use the grace period to cancel or change their 31-day notice term deposit. This will help to alleviate the risk posed by the concurrent operation of dual pricing rollover risk and the 31-day notice period (i.e. that investors may roll over into low interest rate term deposits and are subsequently required to wait 31 days to access their funds); and
- (b) provide investors with an opportunity to shop around for better rates after they ascertain the actual interest rate after a rollover, because generally investors are only able to ascertain the actual interest rate after a rollover. A grace period will provide an opportunity for investors to use the actual interest rate to shop around for better rates so that they are able to make an informed decision about whether they could obtain a better interest rate elsewhere.

188 As part of our consultation process, we sought feedback on the quantifiable cost impact of our proposed conditions, and have subsequently sought additional feedback on cost implications of our final proposed conditions. Most submissions drew attention to the additional compliance costs without quantifying the cost estimate.

189 Generally, the direct and indirect cost impact of the compliance requirements associated with the proposed conditions will vary from entity to entity having regard to the variance in size, business model, and distribution channels between ADIs, and the extent of changes required. During our consultation process, the ABA provided the following estimates relating to one-off system change costs and ongoing compliance costs for its member-

banks to meet the proposed conditions. We note that ASIC's REP 185 and REP 353 found that most ADIs reviewed already provide a pre- and post-rollover notification, and a grace period, so the following costs may not accurately reflect the actual costs to ADIs:

- (a) costs in relation to consumer warning and express consent to rollover could range from \$750,000 to \$5,600,000 per entity;
- (b) costs in relation to disclosure and record-keeping for express consent and instruction could range from \$500,000 to \$1,875,000 per entity;
- (c) operational costs, including IT systems and documentation changes could range from \$800,000 to \$5,000,000 per entity;
- (d) disclosure costs, including legal and production costs, update of website disclosures, update of existing documentation, development of communications to investors, could range from \$1,250,000 to \$7,475,000 per entity [we note that the costs set out here may duplicate costs set out at (a) and (b)];
- (e) training costs could range from \$250,000 to \$1,125,000 per entity [we query how realistic this estimate is, as we do not anticipate that the training costs will be as high as this estimate, given the relatively minor impact of the proposed conditions];
- (f) distribution costs could range from \$350,000 to \$950,000 per entity; and
- (g) costs associated with the provision of a grace period of 7 calendar days could range from \$500,000 to \$1,875,000 per entity [note that this will be particularly relevant for ADIs that do not currently offer a grace period of 7 days].

190 Given the wide variance in the range of costs that may be incurred to meet the proposed conditions, and the variance in the extent of changes required to meet the proposed conditions between ADIs, the actual cost impact will vary greatly from entity to entity. Therefore, we are unable to provide the exact costs that will be incurred by the ADIs.

191 However, based on the estimates above, and based on the presumption that all of its member-banks would opt to use the proposed conditional relief, the ABA projected the estimated aggregate cost incurred would be \$127,100,000. Given that this figure is limited to ABA member-banks, we estimate that the total aggregate costs that will be incurred for all of the 40 LCR ADIs will be larger than \$127,100,000.

192 We note the costs associated with meeting the proposed conditions are based on estimates only. In the absence of accurate data based on comprehensive cost analysis, it is not clear whether the estimates noted above reflect the actual costs that will be incurred by ADIs to meet the proposed conditions.

- 193 Given the unknown variables, wide variance across the industry, and uncertainty as to the accuracy in the range of costs, it is not possible to definitively state a net benefit. However, we envisage that the compliance costs associated with meeting the proposed conditions will be absorbed by ADIs, and will not be passed on to investors. This is because there will be significant cost savings relating to:
- (a) not incurring costs required to comply with the regulatory requirements under the Corporations Act associated with 31-day notice term deposits that would be incurred if relief is not provided; and/or
 - (b) not incurring the significant liquidity management costs associated with treating term deposits as demand deposits under the LCR that would be incurred if relief is not provided.
- 194 We expect that these significant cost savings will offset and exceed the costs associated with the proposed conditions (See Table 4 and Appendix A). For the purpose of estimating the costs of the proposed conditions and cost savings resulting from our relief, given the wide variance in the estimates provided by the ABA, the median value has been used as the base figure to determine the average annual cost on a per ADI basis. The estimated costs and cost savings were then used to calculate the estimated costs and cost savings for the 40 LCR ADIs.
- 195 Based on this methodology, the estimated total cost savings arising from relief (of \$361.35 million) outweigh the estimated total costs of the proposed conditions (of \$286.05 million) by \$75.3 million.

Table 4: Summary of estimated costs and cost savings for 40 LCR ADIs

Estimated cost savings		
Cost saving	Type of cost saving	Estimated ongoing or implementation cost saving ¹⁹
Implementation costs for IT systems and compliance processes	Implementation	\$1,62,500 ²⁰
On-going operational costs	Ongoing	\$1,300,000
Implementation costs relating to preparation of disclosure documents	Implementation	\$337,500 ²¹
Staff training costs	Ongoing	\$4,250,000
Other training costs including business training requirements and change management costs	Implementation	\$233,750 ²²
Additional adviser costs, including preparation and recording of SOA provision	Ongoing	\$2,750,000
Estimated total cost saving per ADI	N/A	\$9,033,750
Estimated total cost saving for 40 LCR ADIs	N/A	\$361,350,000
Estimated costs		
Cost	Type of cost	Estimated ongoing or implementation cost ²³

¹⁹ For the purpose of estimating the cost savings achieved by our relief, given the wide variance in the estimated cost savings provided by the ABA, the median value has been used as the base figure to determine the average annual cost savings on a per ADI basis. For example, for 'Ongoing operational costs', given that the cost savings ranged from \$100,000 to \$2.5 million, the median value of \$1.3 million was used as the base figure

²⁰ Given that this is an implementation cost saving, the implementation cost saving has been annualised over a 10 year period. Therefore, this figure (of \$162,500) equates to the median figure of \$1,625,000 divided over a 10 year period.

²¹ Given that this is an implementation cost saving, the implementation cost saving has been annualised over a 10 year period. Therefore, this figure (of \$337,500) equates to the median figure of \$ 3,375,000 divided over a 10 year period.

²² Given that this is an implementation cost saving, the implementation cost saving has been annualised over a 10 year period. Therefore, this figure (of \$233,750) equates to the median figure of \$2,337,500 divided over a 10 year period.

²³ For the purpose of estimating the costs of the proposed conditions, given the wide variance in the estimated costs provided by the ABA, the median value has been used as the base figure to determine the average annual costs on a per ADI basis. For

Consumer warning and express consent	Ongoing	\$3,175,000
Costs re disclosure and record-keeping for express consent and instruction	Ongoing	\$1,187,500
Operational costs, including IT systems and documentation changes	Implementation	\$290,000 ²⁴
Implementation of costs relating to preparation of disclosure documents	Implementation	\$436,250 ²⁵
Training costs	Ongoing	\$687,500
Distribution costs	Ongoing	\$650,000
Grace period costs	Ongoing	\$725,000
Estimated total cost per ADI	N/A	\$7,151,250
Estimated total cost for 40 LCR ADIs	N/A	\$286,050,000
Net cost saving for 40 LCR ADIs (the difference between estimated total cost and estimated total cost savings)	\$75,300,000	

Source: The ABA

Impact on investors

- 196 We understand that there are around 2 million investors who invest in term deposits in Australia. The provision of key information in a timely manner is therefore likely to have a significant benefit for Australian retail investors.
- 197 The proposed conditions are designed to improve the quality and timing of disclosure provided to investors about their term deposit, and other options that they may wish to consider (e.g. whether to keep the term deposit after a

example, for 'Consumer warning and express consent' costs, given that the cost savings ranged from \$750,000 to \$5.6 million, the median value of \$ 3,175,000 was used as the base figure.

²⁴ Given that this is an implementation cost, the implementation cost has been annualised over a 10 year period. Therefore, this figure (of \$290,000) equates to the median figure of \$2,900,000 divided over a 10 year period.

²⁵ Given that this is an implementation cost, the implementation cost has been annualised over a 10 year period. Therefore, this figure (of \$436,250) equates to the median figure of \$4,362,500 divided over a 10 year period.

- rollover or seek an alternative investment that may offer a higher interest rate).
- 198 The proposed conditions intended to reduce the risk posed by the dual pricing rollover risk and 31-day notice period.
- 199 The proposed conditions will assist investors to become more aware of the higher level of risk posed by 31-day notice term deposits. The provision of key information in a timely manner should help to facilitate effective and informed decision making by investors when investing and/or reinvesting in term deposits, and encourage investors to be more proactive with their term deposits (instead of adopting a 'set and forget' approach).
- 200 For example, in REP 353, we found that a term deposit of \$77,000 (the mean deposit value) which opened at a high interest rate of 5.85% p.a. for a term of 4 months generated interest of \$1,502. If the term deposit (a total of \$78,502 including interest generated) rolled over on a default basis upon its expiry, it would have rolled over into a low interest rate term deposit which offered 3.45% p.a. that generated interest of \$903. The difference in interest generated between the 'high' interest rate and 'low' interest rate term deposits equated to \$599 (a decrease of 39.9% in interest generated).
- 201 We note that at the time of rollover, term deposits for terms of 3 months and 6 months offered high interest rates of 5.75% p.a. and 6.15% p.a. respectively.
- 202 In the example above, if the investor was given information about their term deposit (e.g. the grace period and interest rate information) *both before and after* maturity in a timely manner (at least 5 business days before maturity and one business day after maturity), the investor would have had an opportunity to use the grace period to either:
- (a) cancel the term deposit and withdraw their funds without being required to give 31 days' notice; or
 - (b) change their term deposit to one with a higher interest rate, without incurring an interest rate penalty (e.g. change to a term of 3 or 6 months that offered 5.75% p.a. or 6.15% p.a., instead of remaining in a rolled over term deposit offering 3.45% p.a.).
- 203 REP 353 found that \$1.9 billion of funds rolled over from a high to low interest rate, and the interest rate margin ranged from 57 to 339 basis points.²⁶ Therefore, if the risk of rolling over to a low interest rate term deposit is reduced, this will significantly reduce consumer detriment. The

²⁶ We are unable to derive or project a quantifiable dollar benefit for consumers that will result from the proposed conditions by using this figure. Given that the proposed conditions are not directly aimed at eliminating the risk posed by the dual pricing rollover risk and 31-day notice period, we are unable to conduct a valid statistical analysis to calculate quantifiable benefit in terms of additional interest returns that may be generated for investors.

proposed conditions should therefore have a substantial net benefit to consumers which should outweigh the cost to ADIs of the conditions.

204 Overall, our proposal should have a positive impact on investors as they will be able to make better informed decisions about investing and re-investing in term deposits. Further, given that our proposal will facilitate the banking sector to adopt stronger liquidity risk management practices while promoting the continued efficient delivery of a traditional banking product in a cost-efficient manner, investors will benefit from the resulting stability of the banking industry.

205 In response to CP 169, a majority of consumer representative groups expressed support for including term deposits of between two and five years within the scope of the proposed relief to achieve a consistent regulatory treatment of all term deposits.

C Consultation

206 ASIC has prepared a single-stage RIS, and as no decision has been previously announced, an options-stage RIS is not required.

Initial consultation: CP 169

207 In November 2011, we released CP 169 to seek feedback on our proposals to provide relief so that 31-day notice term deposits would be subject to the same regulatory requirements as basic deposit products.

208 We received 16 submissions in response to CP 169 from ADIs, industry bodies and associations, consumer representative groups, a law firm, and an annuities issuer.

209 Generally, there was strong support for the proposal to give relief for 31-day notice term deposits of up to two years. A majority of the respondents agreed that relief is required because there is a need for clarity on the treatment of 31 day notice term deposits of up to two years, due to the regulatory uncertainty about the period of notice that is permitted by the definition of basic deposit product.

210 The primary issues and concerns raised by respondents from industry were:

- (a) the relief should also apply to term deposits of between two and five years;
- (b) the relief should not be subject to a condition requiring a new product name for 31-day notice term deposits, as described in proposal B2 in CP 169;
- (c) the relief should not be subject to the condition requiring a consumer warning to be given to investors, as described in proposal B3 in CP 169;
- (d) the relief should not be subject to the condition requiring the investor's express consent to roll over their term deposit at maturity, as described in proposal B4 in CP 169;
- (e) the relief should not be subject to the condition requiring a pre-maturity letter to be provided to investors, at least 14 days before maturity, to disclose the information described in proposal B5;
- (f) the relief should not be subject to the condition requiring a grace period of at least 14 days, as described in proposal B in CP 169; and
- (g) the relief should not be subject to the condition requiring a post-maturity letter to be provided to investors within five days after maturity, to disclose the information described in proposal B6.

- 211 The responses from consumer representative groups provided the following feedback:
- (a) a mixed view relating to the appropriate scope of relief; one respondent noted that the relief should be extended to term deposits of more than two years, whereas two respondents opposed the idea of extending the relief to term deposits of more than two years;
 - (b) a majority of the responses supported the proposed condition of a new product name;
 - (c) all responses noted that the verbal and/or written warning about the 31-day notice period should be given to consumers at the time of application, because the existing disclosure documents and practices have generally not assisted consumer decision-making, and the risk posed by term deposits that are only breakable on 31 days notice will serve to exacerbate the risk to consumers;
 - (d) all responses noted that ADIs should obtain the express consent of the investor at maturity to ensure that consumers are not disadvantaged by the dual pricing rollover risk;
 - (e) all responses expressed strong support for the condition relating to pre-maturity letter;
 - (f) a majority of responses supported a grace period of 14 days.
- 212 Consumer representative groups expressed mixed views relating to the appropriate scope of relief. One consumer representative group submitted that the relief should be extended to term deposits of more than two years. However, two consumer representative groups were opposed to extending the relief to term deposits of more than two years, because:
- (a) a term deposit of more than two years is a significant period to invest, and it would be appropriate for the consumer to be provided with advice by a suitably qualified adviser before making such an investment; and
 - (b) term deposits of more than two years are likely to comprise a minority of investments, and the existing Corporations Act distinction should be maintained.

Further consultation

- 213 Following the feedback received in relation to CP 169, we engaged with industry to conduct further soft consultation on key issues, primarily relating to the industry's objections to the proposed conditions of relief.
- 214 After an extensive consultation process, the ABA expressed support for our revised proposed conditions of relief, as set out in Table 2. As a result, our

final proposed conditional relief differs from our original proposals in CP 169. The key differences and amendments are as follows:

- (a) the proposed relief will also include term deposits of between two and five years for a period of two years;
- (b) the proposed relief will not require or prescribe a new product name;
- (c) the investor's express consent to roll over their term deposit can be obtained at *any* time before maturity, instead of strictly *immediately before* maturity;
- (d) the pre-maturity contact can be made either orally or in writing, allowing ADIs flexibility to make contact by sending a letter, via telephone contact, or by electronic delivery including via email, SMS and online account management portal communication, rather than only by a pre-maturity letter;
- (e) the pre-maturity contact must be made at least five business days before maturity, instead of 14 calendar days before maturity;
- (f) the post-maturity contact can be made either orally or in writing, and allow ADIs flexibility to make contact by sending a letter, via telephone contact, or by electronic delivery including via email, SMS and online account management portal communication, rather than only by a post-maturity letter;
- (g) the post-maturity contact must be made immediately but by no later than one business day after the maturity date; and
- (h) the relief should be subject to the condition requiring a grace period of at least 7 calendar days, instead of a grace period of at least 14 calendar days.

D Conclusion and recommended option

- 215 We recommend Option 3. By providing both permanent relief for term deposits of up to two years and interim relief for term deposits of between two and five years, this approach provides a pragmatic solution that seeks to address the potential problems that will arise if term deposits of between 2 and 5 years are not covered by the relief at the commencement of the LCR requirements (see paragraphs 149-155), whilst presenting an opportunity for the government and industry to resolve any uncertainty regarding the Corporations Act's treatment of term deposits of between 2 and 5 years.
- 216 We are of the view that Option 3 will ensure that LCR ADIs avoid the significant cost implications, because:
- (a) given that 31-day notice term deposits of up to five years will be treated as basic deposit products, ADIs will not incur the compliance costs associated with the regulatory requirements under the Corporations Act; and
 - (b) given that ADIs will be able to impose a notice period of 31 days for term deposits of up to five years, it will enable ADIs to avoid 31-day notice term deposits of up to five years being treated as demand deposits under the LCR.
- 217 We believe that our proposed conditions of relief will help to address the greater risks posed to retail investors by 31-day notice term deposits discussed in Section A, as follows:
- (a) the consumer warning will help to minimise the risk that investors may acquire 31-day notice term deposits without being aware of the notice period requirement, because investors will be given a clear warning about the 31-day notice requirement at the time of application;
 - (b) the risk posed by the concurrent operation of the dual pricing rollover risk and 31-day notice period will be alleviated, because:
 - (i) the consumer warning and the requirement to obtain the investor's express consent to roll over their term deposit will assist investors to be aware of the risk posed by the dual pricing rollover risk and 31 day notice period, consider their options at maturity, and make an informed decision;
 - (ii) the grace period of 7 calendar days will enable those investors whose funds have rolled over into low interest rate term deposits to cancel or change their term deposit, without being required to give a notice period of 31 days or incurring an interest rate penalty;
 - (iii) the provision of key information (including disclosure about the dual pricing rollover risk, the grace period, and interest rates), both before and after the term deposit rolls over, will enable investors to

have ample opportunity to consider their options and make an informed decision.

- 218 We consider that our proposed conditions should result in a better culture of disclosure and practice among ADIs, by fostering the provision of key information in terms of the content, mode and timing of information provided to investors. This should mean that retail investors will have access to better information in a more timely manner, and help them to make more confident and informed decisions when investing and/or re-investing in term deposits.
- 219 We anticipate that industry will face some compliance costs to meet the proposed conditions. We note that precise costs will vary from entity to entity, having regard to the variance in size, business model, and distribution channels between ADIs, and the extent of changes required. Some of these costs will be one-off costs, in order to meet the new requirements, and some ongoing.
- 220 We envisage that the compliance costs of the proposed conditions will be offset by the significant savings that will be made by ADIs, as ADIs will not be required to incur costs associated with regulatory requirements if 31-day term deposits do not meet the definition of basic deposit products and/or significant liquidity management costs under the LCR.

E Implementation and review

- 221 We propose to implement our proposals by providing relief by way of an ASIC Class Order. This would involve exercise of our modification power to modify the application of the definition of basic deposit product in the Corporations Act subject to compliance with the conditions.
- 222 The relief will apply only to the class of term deposits that require a notice period of 31 days, and will not apply to other classes of term deposits that do not require a notice period of 31 days.
- 223 The conditional relief for term deposits of between two and five years will be effective for term deposits entered into within two years of the commencement of the proposed relief – this two year period will provide industry with time to consult with Government and for Government to assess the legislative intent of the Corporations Act's treatment of term deposits of between two and five years.
- 224 After implementation we may conduct a review of our relief in order to assess its efficacy and whether any changes are appropriate.
- 225 We expect that, once enacted, ADIs will be able to use the relief to start to offer 31-day notice term deposits. We anticipate that existing term deposits will not be affected by the terms of the relief (i.e. the 31-day notice period cannot be imposed retrospectively for existing term deposits that have not yet matured) but that ADIs may wish to offer a 31-day notice term deposit to investors once the ADI is able to start to offer these products in compliance with the terms of the relief.
- 226 For the purpose of rolling over existing term deposits that have matured into 31-day notice term deposits, ADIs would be required to meet the proposed conditions.

Appendix A: Regulatory Burden and Cost Offset Estimate Table

Average Annual Change in Compliance Costs (from BAU)				
Sector/Cost Categories	Business	Not-for-profit	Individuals	Total by cost category
Administrative Costs	\$0	\$0	\$0	\$0
Substantive Compliance Costs	(\$75,300,000) ²⁷	\$0	\$0	(\$75,300,000)
Delay Costs	\$0	\$0	\$0	\$0
Total by Sector	(\$75,300,000)	\$0	\$0	(\$75,300,000)
Annual Cost Offset				
	Agency	Within portfolio	Outside portfolio	Total
Business	\$0	\$0	\$0	\$0
Not-for-profit	\$0	\$0	\$0	\$0
Individuals	\$0	\$0	\$0	\$0
Total	\$0	\$0	\$0	\$0
Proposal is cost neutral? No				
Proposal is deregulatory? Yes				
Balance of cost offsets= (\$75,300,000)				

²⁷ In accordance OBPR methodology, this figure includes both the average annual ongoing costs as well as the one-off implementation costs. For this purpose, the implementation costs and implementation cost savings have been annualised over a 10 year period.

Costs of proposed conditions

For the purpose of estimating the costs of proposed conditions, given the wide variance in the estimated costs provided by the ABA, the median value has been used as the base figure to determine the average annual cost on a per ADI basis. This figure has been used to calculate the estimated costs for the 40 LCR ADIs (of \$286,050,000).

Cost savings

For the purpose of estimating the cost savings achieved by our relief, given the wide variance in the estimated cost savings provided by the ABA, the median value has been used as the base figure to determine the average annual cost savings on a per ADI basis. This figure has been used to calculate the estimated cost savings for the 40 LCR ADIs (of \$361,350,000). As such, the \$75.3m reported in this table is the difference between the cost savings (of \$361.35m) and costs of proposed conditions (of \$286.05m).