

ASIC CLASS ORDER [CO 14/1262]

EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission
Corporations Act 2001

The Australian Securities and Investments Commission (ASIC) makes ASIC Class Order [CO 14/1262] under paragraphs 926A(2)(c), 951B(1)(c) and 1020F(1)(c) of the *Corporations Act 2001* (the *Act*).

Paragraph 926A(2)(c) of the Act provides that ASIC may declare that Part 7.6 (other than Divisions 4 and 8) applies in relation to a person or financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

Paragraph 951B(1)(c) of the Act provides that ASIC may declare that Part 7.7 of the Act applies in relation to a person or a financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

Paragraph 1020F(1)(c) of the Act provides that ASIC may declare that Part 7.9 of the Act applies in relation to a person or a financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

1. Background

Liquidity coverage ratio (LCR)

As part of the Basel III reforms, the Australian Prudential Regulation Authority (APRA) will implement the liquidity coverage ratio (LCR) from 1 January 2015, pursuant to Prudential Standard *APS 210 Liquidity*.

APRA intends to apply the LCR requirement to certain of the larger and more complex ADIs. APRA does not currently intend to apply the LCR requirement to credit unions, credit societies and building societies.

The LCR requirement aims to ensure that banking institutions have sufficient liquid assets to survive an acute stress scenario lasting one month. Under the LCR requirement, banks must maintain a stock of qualifying high-quality liquid assets (HQLA) to cover total net cash outflows over the next 30 calendar days.

For the purpose of calculating total net cash outflows, term deposits will be excluded from a bank'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.

Given that term deposits will be excluded from a bank's cash outflows if the depositor has no legal right to withdraw the deposit within 30 days, a notice period requirement

of 31 days for early withdrawal will enable banks to exclude those term deposits when determining their cash outflows under the LCR.

Basic deposit products

For a deposit product to meet the definition of ‘basic deposit product’ contained in section 761A of the Act, it must satisfy a series of conditions set out in that definition.

A term deposit of up to five years may qualify as 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 authorised deposit-taking institution (ADI), except that:

- a. an ADI may require prior notice for withdrawal from a term deposit of up to two years;
- b. for credit unions, credit societies, credit co-operatives and building societies (*mutual ADIs*), a notice requirement of up to seven days may be required for term deposits of between two and five years; and
- c. the ADI may impose a reduction in the return generated for the depositor.

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).

Beyond the special provision for mutual ADIs, the 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.

While it is unclear what notice period for withdrawal could be imposed consistently with the characterisation of a term deposit of up to two years as basic deposit product, ASIC’s view is that a notice period of 31 days for early withdrawal would be unlikely to meet the definition of basic deposit product.

Section 761A of the 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 noted).

Without relief, term deposits that require a notice period of 31 days for early withdrawal (*31-day notice term deposits*) would not be “basic deposit products” and therefore would be subject to more onerous regulatory requirements under the Act, including:

- a. a higher level of training standards at the Tier 1 level for persons advising on term deposits under ASIC *Regulatory Guide 146: Licensing: Training of financial product advisers*; and
- b. more prescriptive disclosure obligations, including obligations to provide a Product Disclosure statement (PDS) in a recommendation, issue or sale situation and a Statement of Advice (SOA) when advisers provide personal advice to clients about term deposits.

Possible legislative amendment

In order to give Government the opportunity to consider legislative reform to clarify the definition of basic deposit product in section 761A of the Act, as it applies to 31-day notice term deposits, in June 2014, ASIC issued a no-action letter to the ABA for distribution to its members. The no-action position was issued to provide some certainty to industry around the definition, and risk of non-compliance with the Act, whilst enabling ADIs to meet the LCR requirement which take effect on 1 January 2015.

2. Purpose of the class order

The purpose of the class order is to give interim relief for a period of 18 months, by providing conditional relief to enable 31-day notice term deposits of up to five years to be treated as basic deposit products under the Act (by formalising the no-action position).

The temporary 18-month period is intended to give Government the opportunity to consider legislative reform to clarify the meaning of basic deposit product as defined under the Act, as it applies to 31-day notice term deposits.

The relief will assist industry by giving certainty that 31-day notice term deposits of up to five years will be treated as basic deposit products under the Act, subject to meeting the conditions of relief.

The class order seeks to balance the consumer protection objective of confident and informed decision making by consumers of financial products and services with industry concern about compliance costs, by imposing a set of conditions that addresses the greater risks posed by 31-day notice term deposits to retail investors. The risks include:

- a. a risk 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, given the long-standing practice among ADIs to allow term deposits to be readily breakable before maturity; and
- b. the 'dual pricing rollover risk' (i.e. a risk that investors passively allow term deposits to roll over from a high interest rate to a much lower interest rate), in conjunction with the 31-day notice period, poses a greater risks to investors than current term deposits that do not require a notice period, because 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. Further, investors that roll over into and remain in low interest rate term deposits that require a 31-day notice period may be subject to the additional risk of having their interest rate reduced and/or fees imposed, if they wish to make an early withdrawal after the expiry of the 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).

Subsequent to ASIC's provision of the no-action letter, a majority of the affected ADIs (i.e. those who must comply with the LCR) have already largely completed adjusting their practices to comply with the conditions of relief. The conditions of the class order are based on the same set of conditions of the no-action letter. The class order seeks to formalise the position of the no-action letter.

3. Operation of the class order

The class order operates in relation to “affected term deposits”. “Affected term deposit” is defined in paragraph 6 of the class order in a similar way to “basic deposit product” in section 761A of the Act, except that the definition of affected term deposit:

- will only apply where there is a minimum period (of up to 5 years) before which funds cannot be withdrawn or transferred without a reduction in the return generated for the depositor;
- will only apply to products into which funds were first deposited within 18 months after the class order commences or into which funds were deposited as a result of a rollover from another affected term deposit; and
- will not apply to products where the condition in paragraph (d) of the definition of “basic deposit product” applies and is satisfied.

Paragraph 4 of the class order modifies the definition of “basic term deposit” for the purposes of Parts 7.6 (other than Divisions 4 and 8), 7.7 and 7.9 of the Act. The effect of the modification is that an affected term deposit will be a basic deposit product provided that funds are able to be withdrawn or transferred without a notice period or subject to a prior notice period requirement that does not exceed 31 days from the first business day after the notice is given.

Paragraph 5 of the class order modifies section 1012D of the Act by imposing a requirement in new subsection 1012D(7AB) of the Act that at or before the time an ADI offers to issue a term deposit for which there is a notice period, the ADI discloses the following information to the investor:

- if the depositor requests the funds standing to the credit of the product to be withdrawn or transferred before the last day of the period that the funds are agreed to be deposited - a notice period applies to such requests, the duration of the notice period, and that the ADI has the discretion to delay withdrawal or transfer of the

investor's funds until the end of the notice period (but not beyond the maturity date);

- 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.

Paragraph 5 also inserts a new subsection 1012D(7AC) of the Act, which imposes the following requirements that apply if the ADI has obtained the investor's consent for the term deposit to roll over at maturity:

- each time funds are rolled over in accordance with the consent, give the depositor the benefit of a grace period of at least 7 days, during which the depositor can withdraw or transfer the funds standing to the credit of the new product without incurring a fee or incurring a reduction in the return generated for the depositor, which begins on the day of the maturity date of the product or on the following day;
- before each time a term deposit rolls over, the ADI makes pre-maturity contact at least five business days before maturity, and provide the following information and statement, either orally or in writing:
 - if the funds standing to the credit of the product will roll over into a new product which will or may have a lower interest rate – a statement to that effect;
 - if the interest rate that will apply to the new product is known at the time notice is given – that rate;
 - if the interest rate is not known at the time notice is given – information on how and when the depositor can ascertain the interest rate for the new product;
 - a statement that a higher interest rate may be available from the ADI for another basic deposit product with a comparable term;
 - a statement that there will be a grace period, the days on which the grace period will begin and end, and a description of the depositor's ability to withdraw funds during the grace period;
 - information that if the depositor wishes to withdraw their funds after the grace period, the ADI has the discretion to delay withdrawal or transfer of the funds until the end of a notice period (but not beyond the maturity date for the new product), and that the depositor may incur a fee or a reduction in the return generated for the depositor;
 - a statement that the depositor gave consent for the funds to roll over into the new product; and

- each time a term deposit rolls over the ADI makes post-maturity contact by no later than one business day after the maturity date of the product (or two business days after the maturity date if the maturity date is not a business day) to provide the following information and statements:
 - a statement that the depositor has the benefit of a grace period and details of the days on which the grace period begins and ends;
 - information about the depositor's rights during the grace period;
 - the interest rate that applies to the new product;
 - a statement that a higher interest rate may be available from the ADI for another basic deposit product with a comparable term;
 - information that if the depositor wishes to withdraw their funds after the grace period, the ADI has the discretion to delay withdrawal or transfer of the funds until the end of the a notice period (but not beyond the maturity date for the new product); and that the depositor may incur a fee or a reduction in the return generated for the depositor; and
 - information about any reduction in the return generated for the depositor and any fees applicable for withdrawal or transfer of funds standing to the credit of the new product after the expiration of the grace period.

4. Consultation

ASIC has consulted with the Australian Bankers' Association (ABA), the Customer Owned Banking Association, APRA, individual ADIs, consumer representative groups, and the Treasury.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

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This class order is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the class order

Term deposits that meet the definition of “basic deposit product” under the *Corporations Act 2001* (the Act) are given concessional regulatory treatment (e.g. there is an exemption from the requirement to provide a Product Disclosure Statement).

As part of the Basel III reforms, the Australian Prudential Regulation Authority (APRA) will implement the liquidity coverage ratio (LCR) from 1 January 2015, pursuant to Prudential Standard *APS 210 Liquidity*. Under the LCR requirement, banks must maintain a stock of qualifying high-quality liquid assets (HQLA) to cover total net cash outflows over the next 30 calendar days.

For the purpose of calculating total net cash outflows, term deposits will be excluded from a bank’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. Given that term deposits will be excluded from a bank’s cash outflows if the depositor has no legal right to withdraw the deposit within 30 days, a notice period requirement of 31 days for early withdrawal will enable banks to exclude those term deposits when determining their cash outflows under the LCR.

There is significant doubt whether term deposits that require a notice period of 31 days (31-day notice term deposits) meet the definition of “basic deposit product” under the Act. If they are not basic deposit products, such term deposits will be subject to more rigorous regulatory requirements.

The purpose of the class order is to give interim conditional relief for a period of 18 months to enable 31-day notice term deposits of up to five years to be treated as basic deposit products under the Act. The temporary 18-month period is intended to give Government the opportunity to consider legislative reform to clarify the meaning of basic deposit product as defined under the Act, as it applies to 31-day notice term deposits

Human rights implications

This class order does not engage any of the applicable rights or freedoms.

Conclusion

This class order is compatible with human rights as it does not raise any human rights issues.