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HIGHER GROUND

Investors looking for the best interest rates can be smart about where to place their money

RISING RATES MIGHT BE bad news for borrowers but investors looking to boost their savings should be rejoicing. The Reserve Bank has increased rates six times since October from 3% to 4.5% and investors have benefited as a result. Better still, the average interest rate offered on online savings accounts, one- and three-year term deposits is higher than the Reserve Bank cash rate (see table).

And these are just averages. The highest rate on offer on online savings accounts is 6.4%pa from RaboDirect, which includes a bonus 1.4%. And customers can earn more than 7%pa in a term deposit for five years.

With so many great rates on offer there's no excuse to leave your savings languishing in an account paying little or no interest but, surprisingly, many people are doing just that. According to RaboDirect's National Savings Survey, Australians are missing out on \$4.2 billion in potential interest each year by leaving their money in a non-interest bearing account or a transaction account.

RaboDirect conducted an interesting experiment recently. A "money tree", filled with \$5 notes, was placed in the Rocks area in Sydney and was filmed by hidden cameras. At first passers-by ignored the cash or took

COMPARING RATES				
MONTH	RBA RATE	AV ONLINE SA RATE	AV 1YR TD RATE	AV 3YR TD RATE
Sep 2009	3.00%	3.25%	3.73%	4.63%
Oct 2009	3.25%	3.29%	3.82%	4.81%
Nov 2009	3.50%	3.53%	4.74%	5.69%
Dec 2009	3.75%	3.75%	4.87%	6.22%
Jan 2010	3.75%	3.85%	5.66%	6.58%
Feb 2010	3.75%	3.92%	5.64%	6.44%
Mar 2010	4.00%	4.02%	5.65%	6.43%
Apr 2010	4.25%	4.50%	5.85%	6.60%
May 2010	4.50%	4.67%	5.83%	6.48%

Source: RateCity for \$5000 balance SA=savings account; TD=term deposit.

pictures of it but the tree was stripped bare within three hours! RaboDirect says it's interesting to note how Australians react to money they can see and touch, compared with the way they treat their actual savings, which often sit untouched in transaction accounts and low-interest savings accounts.

Given that many financial institutions are losing money on deposits by offering such high rates, it's natural to wonder whether these rates are sustainable over the long term. Probably not, says the managing director of Bank of

Cyprus, George Tacticos. "Competitive rates are here to stay but I don't think they're sustainable at these levels. I think they'll come back a touch," he says, estimating rates will be about 1.8% over the RBA cash rate.

FIIG Securities short-term money markets managing director Bill Keogh shares this view. "Deposit rates will remain competitive, as it's the most effective option for financial institutions to match their asset liability profile. It's simply a question of how much above the benchmark these rates will be," he says. Keogh doesn't think official rates will increase much anyway. "I think the Reserve Bank will pause over the next quarter and reassess. Over the next year we don't see rates going too much higher," he says.

Two popular account options are online savings accounts and term deposits. "Term deposits are a good committed way to save if you don't want the temptation of spending your money," says Tacticos.

Research analyst at Canstar Cannex Peter Arnold says the flexibility of an online savings account can be an advantage because you can pounce on good opportunities as they come up.

RateCity CEO Damian Smith agrees. "You are trading off flexibility with a guaranteed rate," he says, adding that, for shorter terms, online savings accounts are stronger than term deposits. "Make sure you're getting more than the online savings rate if you're locking in a term deposit," says Arnold. If you're willing to lock in your money for a



ONLINE SAVINGS ACCOUNTS, BEST RATES

INSTITUTION	ACCOUNT	ADV RATE	BONUS RATE	RATE W/OUT BONUS	BONUS CONDITION	BONUS EXPIRES
RaboDirect Aust	High Interest Savings	6.40%	1.40%	5.00%	all customers	31-Dec-10
UBank	USaver	6.26%	0.41%	5.85%	monthly sav plan \$200+	N/A
Citibank	Online Saver	6.25%	1.00%	5.25%	new customers	6m
ING Direct	Savings Maximiser	6.25%	1.35%	4.90%	new customers	4m
Bankwest	TeleNet Saver	6.15%	1.65%	4.50%	new customers	12m
Vic Teachers CU	Online Saver	6.15%	1.25%	4.90%	\$200+ dept, no wdl pm	1-Jan-11
Hunter United CU	Premium Online Invr	6.01%	none	6.01%	no wdl in month	N/A
The Rock Bldg Soc	Online Saver	6.00%	1.00%	5.00%	1 dept, no wdl in month	31-Jul-10
CBA	NetBank Saver	6.00%	1.50%	4.50%	new customers	31-Jul-10
Bankwest	Smart eSaver	6.00%	1.50%	4.50%	no wdl in month	N/A
RaboDirect Aust	Premium Saver	6.00%	1.75%	4.25%	bal incr \$200pm	N/A
Westpac	eSaver	6.00%	1.75%	4.25%	new customers	4m
Bank of Qld	WebSavings	6.00%	2.15%	3.85%	new customers	30-Sep-10

Source: www.canstarcannex.com.au, 10-Jun-10. Based on balance of \$5000, ranked by advertised rate, then revert rate, then alphabetically.

longer period, though, there are better rates on offer from term deposits. "When you get out to beyond three years, rates are north of 7%," says Smith.

Using a combination of both an online savings account and a term deposit can work well, says Arnold.

Online savings accounts

Online savings accounts have now been around for more than 10 years. When ING Direct launched the first online savings account in 1999, it was a pretty straightforward proposition - no fees and a standard variable high rate. Increasingly though, we're seeing "honeymoon" or introductory bonus rates offered to new customers, which ING Direct's executive director savings, Brett Morgan, says has been driven by the new competition in the market.

Make sure you understand the conditions. Questions to ask are: Do you need to make a certain number of deposits? How long does the special rate apply? And, perhaps most importantly, what does the rate revert to? "I think the key is, while the upfront rate might be attractive, make sure you understand what the long-term rate will be," says Morgan.

The bad news is that more often than not existing customers miss out because these rates tend to be available only to new customers. "These rates are so much higher than the cash rate, so offering them to everyone would be a big call," says Canstar Cannex's Arnold.

RaboDirect takes a unique approach so that existing customers don't miss out on the bonus rates entirely says general manager of RaboDirect, Greg McAweeney. Customers who deposit additional funds into their account will get the higher promotional rate on the extra savings. For example let's say a customer had \$15,000 in their account and added an extra \$5000. The original \$15,000 would earn the standard rate of 5% but the extra \$5000 would be earning 6.4%.

UBank is one of the few institutions that doesn't offer introductory rates, paying a flat 5.85%pa. "UBank prefers to offer bonus rates for loyalty and has never offered introductory bonus rates," says executive general manager of direct banking at NAB, Sam Plowman. "USaver account holders who deposit at least

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\$200 per month through the automatic saving plan, receive bonus interest of 0.41%pa.”

“If you are prepared to shift your money around and chase special rates it might be worth it,” says Arnold. Smith says there is no real cost from switching from one online account to another, which makes it easier than chasing a better rate on your home loan for example, where break costs often apply. It’s also a lot easier to open an account and you might be able to do it all online says Arnold.

“Our advice is to shop around. If new customers are getting the lion’s share of the benefit, then become a new customer,” says Smith. McAweeney points out, though, that the benefit will be relative to the amount of money you have. If you have a small balance moving between accounts for a small benefit probably won’t be worth it he says.

Another thing to look out for with online accounts is whether the account needs to be linked to a particular transaction account. “You might be forced to link it with a transaction account, which may come with fees,” says McAweeney.

“There are alternatives to the Big Four banks and they are good ones”

“When it comes to online savings accounts, the three institutions that always seem to be competitive are RaboDirect, UBank and ING Direct,” says Smith. “Others come and go but these three are consistently at or near the top in terms of rates.” Arnold also nominates those three as standouts.

Term deposits

If term deposits appeal to you, one of the decisions you’ll need to make is for how long you are willing to lock away your money. “You need to choose the right term for you and consider liquidity,” says McAweeney. Bank of Cyprus’s Tacticos suggests you find out whether you can get access to your funds in an emergency and, if so, what penalty will apply. If you want to withdraw your money before the term is up you might be charged a fee or have to sacrifice some interest.

It’s important to look beyond the advertised rate says Tacticos. You need to ask how often interest is calculated and paid, which make up the effective rate, he says. In most cases you can choose how often interest is paid – monthly, quarterly, half-yearly, annually or at maturity. The more often interest is paid, the higher the return because of the effect of compounding, if it applies to the product.

One of the biggest traps of term deposits is letting it automatically rollover when it matures. McAweeney says you might have found a great rate at the time but when it rolls over you will probably be getting a much lower rate. Institutions will probably notify you when your term deposit is about to expire but don’t rely on that. Set yourself a diary note so you can keep your eyes peeled for better deals.

“With high competition come specials. So remain vigilant and keep an eye on the market,” says Keogh. “When looking at term deposits you should also look at different maturities because institutions tend to concentrate on one specific bucket at any one time.” He also adds that you should remain open to odd maturities – for example four or seven months – as opposed to the traditional 90 or 180 days.

Also don’t limit yourself to the majors. “There are alternatives to the Big Four banks and they are good ones,” says Tacticos. “Competitive rates often come from smaller banks or regional institutions.” Arnold and Smith agree. “With term deposits the top performers

can be varied,” says Smith. “It could often be someone you have never heard of or expect to see great rates from.”

McAweeney says investors should consider using a “laddering strategy” to make the most from their savings. “In a three-year ladder strategy, a customer invests \$75,000 in three equal portions into three different term deposits: \$25,000 into a three-year term, \$25,000 into a two-year term, and \$25,000 into a one-year term. After the first year, the first \$25,000 term deposit will mature and the remaining \$50,000 will have a year less on their term to maturity. The investor will place the funds from the first matured term deposit into a new three-year term deposit,” he explains. “In this strategy, a term deposit will mature each year and be reinvested into another three-year term deposit. Investors can often reap the benefit of higher interest rates in the longer-term deposits, but have the benefit of not having to lock their entire investment into one term and one rate.”

The benefits of this strategy include the fact that it reduces the impact of interest rate fluctuations, allows you to invest in more attractive, long-term deposits, creates liquidity and allows you to naturally take advantage of moves in the yield curve. ☺

INSTITUTION	ADV RATE	INTEREST		
		CALCD	PAID	TOTAL
Rural Bank	6.55%	NAP ¹	mat’y	\$655.00
ING Direct	6.50%	NAP ¹	mat’y	\$650.00
Vic Teachers CU	6.50%	NAP ¹	2-wkly	\$650.00
Heritage Bldg Soc	6.25%	daily	mat’y	\$644.89
RaboDirect	6.40%	NAP ¹	mat’y	\$640.00
Bank of Q’land	6.35%	NAP ¹	mat’y	\$635.00
Suncorp Bank	6.35%	NAP ¹	mat’y	\$635.00
ECU Aust	6.20%	quart’ly	mat’y	\$634.56
Rural Bank	6.20%	quart’ly	mat’y	\$634.56
ME Bank	6.30%	NAP ¹	mat’y	\$630.00

Source: www.canstarcannex.com.au, 7 June 2010

¹Interest is not compounded.

TERM DEPOSITS: FIVE YEARS, \$25,000

INSTITUTION	ADV RATE	INTEREST		
		CALCD	PAID	TOTAL
Vic Teachers CU	7.05%	yearly	mat’y	\$10,145.79
Rural Bank	6.40%	quart’ly	mat’y	\$9341.84
RaboDirect	7.30%	NAP ¹	quart’ly	\$9125.00
Citibank	7.25%	NAP ¹	yearly	\$9065.04
Bankwest	7.25%	NAP ¹	yearly	\$9064.68
St George Bank	7.25%	NAP ¹	yearly	\$9063.95
BankSA	7.25%	NAP ¹	yearly	\$9063.59
Bendigo Bank	7.10%	NAP ¹	yearly	\$8878.20
Bankwest	7.02%	NAP ¹	monthly	\$8778.51
Police CU NSW	7.00%	NAP ¹	6-m’tly	\$8754.55

Source: www.canstarcannex.com.au, 7-Jun-10. ¹Interest is not compounded.

END OF THE GUARANTEE

Experts say don’t be concerned

The government guarantee on deposits of up to \$1 million is expected to end in October, 2011. Customers who are locking their money away beyond then may see this as cause for concern. But you may not need to worry. Greg McAweeney from RaboDirect and ING Direct’s Brett Morgan think there is likely to be some guarantee in one form or another, so consumers should still feel confident about their savings.

Sam Plowman from NAB speculates that, if the guarantee ends, it might encourage people to move their savings away from the foreign banks into the Australian banking system.