



Safe bets still need questions

Fixed-interest products are considered safer than most investments, but they still have their risks

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THE truism that there is no such thing as a sure thing also applies to fixed-interest investments, even term deposits.

In the wake of the global financial crisis, investors have flocked to fixed-interest products such as corporate bonds, hybrids and term deposits, dazzled by solid returns of 5 to 7 per cent, but mostly the safe-haven appeal.

The federal government's move in late 2008 to put in place a guarantee on all retail deposits of up to \$1 million just added to their attraction, making them the safest form of investment.

Figures from financial services research and ratings firm Canstar Can-nex show that growth in Australian bank term deposits between September 2008 and May 2010 surged from about \$140 billion to more than \$200bn.

For the most part term deposits have been a good investment, but investors are now being urged to fully understand the pros and cons of locking into a term-deposit contract, as there are traps.

Canstar says there's more to a term deposit than just its rates.

"The interest rate you earn can be eroded by the cost of having the term deposit, so it pays to research and understand the pros and cons of various term deposits before deciding what's right for you," the firm's financial analyst, Adam Beu, says.

One warning fixed-interest investment specialist FIIG Securities calls out is around the government's bank guarantee on retail deposits.

"The big thing to watch there is obviously beware of the government guarantee," says FIIG's director of financial institutions and corporate re-

search, Justin McCarthy. The guarantee is due to expire in October next year, and he says that "while we expect some form of transition arrangements to be announced, there is nothing guaranteed".

McCarthy suggests you make sure you are happy with the credit quality of the bank you are with or "get the maturity before that date".

Canstar also cites three term-deposit traps. Early exit costs are one. The question depositors should ask themselves, it says, is: Are you able to get your hands on the money before the term is up?

Canstar's research shows that some bank early withdrawal fees are as high as 60 per cent of the interest earned.

Even worse, it says, in some cases you simply cannot withdraw any cash before the term is up, even for a fee.

Canstar also warns that fees can be hidden in bank cheques or transfer costs, meaning that it will cost you to withdraw your money, even at the end of the designated term.

"Being aware of what an early exit will cost you, should the unexpected happen and you need access to your money, will help you make a more informed decision," it says.

Another trap is deposit accounts. In some instances, a customer has to open an account with the bank in order to take advantage of the product. The things to look out for there, it says, are what are the costs involved and will the fees eat into your term-deposit money at maturity?

The most common pitfall it comes across is around automatic renewal.

"Don't make the assumption that your money will be rolled over to a similar deal when the term is up," it

says.

To avoid this, Canstar says, be clear on bank rules regarding notifying you when the term is due to expire or, better still, write a diary note on your calendar and get in first.

Experts say caution should also be taken with other fixed-interest investment products such as corporate bonds and hybrids.

The retail bond market is tiny in Australia but after the GFC it has had a stronger following from smaller investors and high-net-worth investors.

The main appeal is the higher yields of 7.5 per cent-plus. Only a handful of retail bonds have been issued over the past 18 months, including Tabcorp, AMP and Sydney Airport.

Experts say the main risk with bonds is a company collapse, which leads to the second risk: where do you sit in the capital structure?

Essentially, if the company collapses, there is a pecking order in terms of who gets what first.

In the event of a liquidation, says McCarthy, "understanding where you actually sit" is important.

For example, he says, Australian banks sit at the top and get paid in full first. "If there is any money left, it goes to ordinary, unsecured bondholders and then if there is any money after that, it goes to subordinated bondholders . . . after that it's tier-one securities and after that it's equity [shareholders]," he says.

With hybrid securities the main risk is also a company collapse.

McCarthy says there is also a risk of coupon deferrals, meaning the interest on that security could be suspended.

"The main protection you have



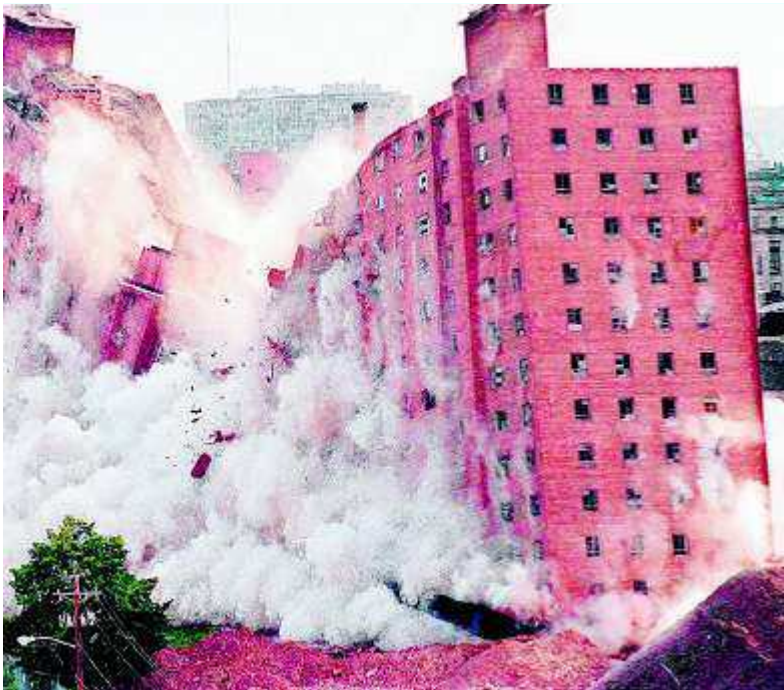
around coupon deferrals is that if you're not getting paid your interest, then no shareholder is going to be paid any dividend," he says.

He says coupon deferrals are less likely for financial companies such as banks and insurance companies be-

cause of the "reputational risk" to them. "We're much more comfortable that financials will pay their . . . coupons or it won't be deferred . . . whereas corporates [hybrids] in the current market are probably more likely not to call." Recent examples of

companies suspending interest payment include Elders and Paperlinx.

While fixed-interest products are considered safer than most investments, as in anything there are pitfalls, so do your research and ask questions about the risks.



The main risk of hybrids is a company collapse

TERM DEPOSIT TRAPS

Early exit costs Are you able to get your hands on the money before the term is up?

Deposit accounts Some term deposits require you to open a deposit account, which adds costs.

Automatic renewal Don't make the assumption that your money will be rolled over to a similar deal when the term is up.