RNID - An alternative to fixed deposits

Financial Markets Committee

A new type of deposit product for retail investors was recently introduced for those looking to steadily grow their money over the medium to long term, with potentially higher returns than fixed deposits.

Negotiable instrument of deposits (NIDs), which are essentially deposit certificates that can be traded in the secondary market, have been a staple product in the wholesale money market for years, regularly bought by institutional investors and high-net-worth individuals. To expand the range of deposit products available to retail investors to mobilise their savings, Bank Negara Malaysia in collaboration with the banking industry via the Financial Markets Committee, recently introduced the Retail NID (RNID) Programme, which allows participating banks to issue NIDs to retail investors, defined as individuals and eligible small-and-medium enterprises.

The RNID programme is part of an ongoing effort to enhance financial inclusion and financial literacy of the general public. Prior to the introduction of the programme, retail investments in banking products were generally limited to fixed deposits. By introducing RNIDs as an alternative investment, retail investors would have more choice in making savings and investment decisions in banking products. This would also raise the level of financial awareness among retail investors, empowering them to make decisions on what and where to invest in.

Under the programme, participating banks are allowed to offer RNIDs with maturities of up to five years to retail investors. Among others, the programme lowered the minimum investment amount of RNIDs to RM10,000 from RM60,000 previously, making it easier for retail investors to invest in them. Although the programme did not set any benchmark for interest rates, interest rates offered on RNIDs by participating banks so far have been generally higher than fixed deposits of similar maturity. The programme is also beneficial to the participating banks, as issuances of RNIDs would allow them to diversify their sources of funding and help banks better manage their liquidity profiles. “We think that issuing RNIDs would be helpful to us in managing our liquidity profile. Due to the stable nature of retail investors, we believe that we can capitalise on this new product to further strengthen our liquidity management,” said Mr. Tan Eng Kiang, Head of Group Financial Markets at Alliance Bank.

Flexibility to sell back RNIDs before maturity

A unique feature of RNIDs is the flexibility given to investors to sell back their RNID to the issuing bank before maturity. There would not be a penalty imposed on the accrued interest, unlike fixed deposits, where an early withdrawal before maturity usually results in investors losing at least 50% of the accrued interest. However, investors should be mindful of the level of interest rate and price quoted by the issuing bank when they sell back the RNID, as the deposit value would be affected by the change in the interest rates. For example, if the buyback interest rate quoted by the issuing bank were to be lower than the rate at which investors first bought the RNID, the price would also be higher and there would be a capital gain on the value of the RNID. This gain is in addition to the interest accrued during the period that investors held the RNID. This feature is similar to marketable securities or bonds that institutional and sophisticated investors are able to invest in.

To facilitate investors, Bank Negara Malaysia has made it compulsory for all issuing banks to update and publish their RNID rates daily on either their websites or participating branches. Participating banks have also started educating investors on the difference between investing in RNIDs and fixed deposits, as well as the concept of selling back the product. "Since the concept of selling back the RNIDs before maturity is still new to retail investors, Affin Bank has focused on explaining and training our customers on how to sell the product as well as educating them on the implication to their investment returns when they do it," said Mr. Khairi Nordin, the head of money market at Affin Bank.

There are two different ways for banks to issue RNIDs. Banks could either offer retail investors RNIDs with customisable maturity (similar to fixed deposits), or predetermined maturity (similar to savings bond).

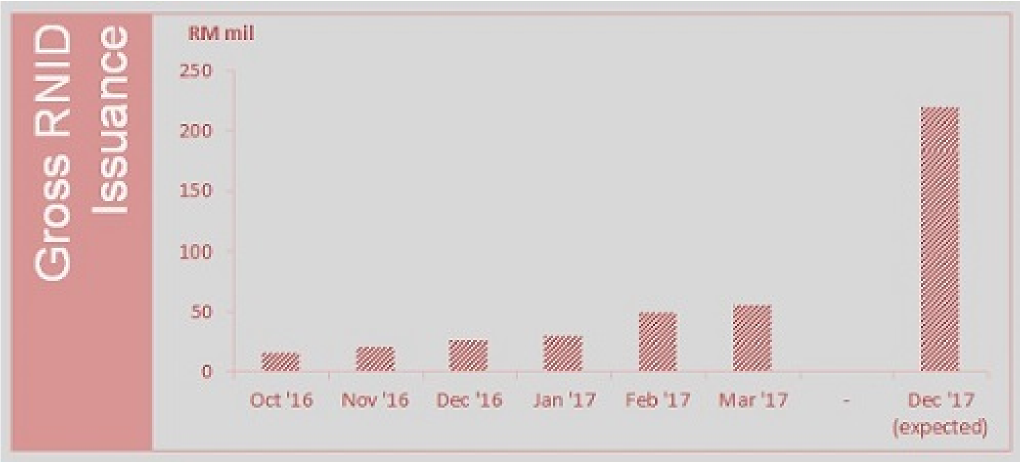
The progress so far

Since the introduction of the programme in October 2016, five banks have started to offer RNIDs. Over a period of six months, total outstanding RNIDs have amounted to RM55.4 million, with maturities of up to 3 years.

On 2 February 2017, Public Bank launched its inaugural RM18.2 million predetermined maturity 15-month RNID at an interest rate of 4.00%. According to a spokesperson from Public Bank, the bank offered higher interest rate for its RNID as part of its continuing efforts in educating retail investors about alternative investment product which could provide potentially higher returns and flexibility.

The other four banks offer customisable maturity RNIDs with maturities ranging from 1-

month up to 5 years, with interest rates of between 3.00% and 4.10%. As with fixed deposits, the interest rate offered by RNIDs increases as the maturity gets longer. These four banks have issued a total of RM37.2 million of the customisable maturity RNIDs, with the highest take-up in maturities of below 6 months.

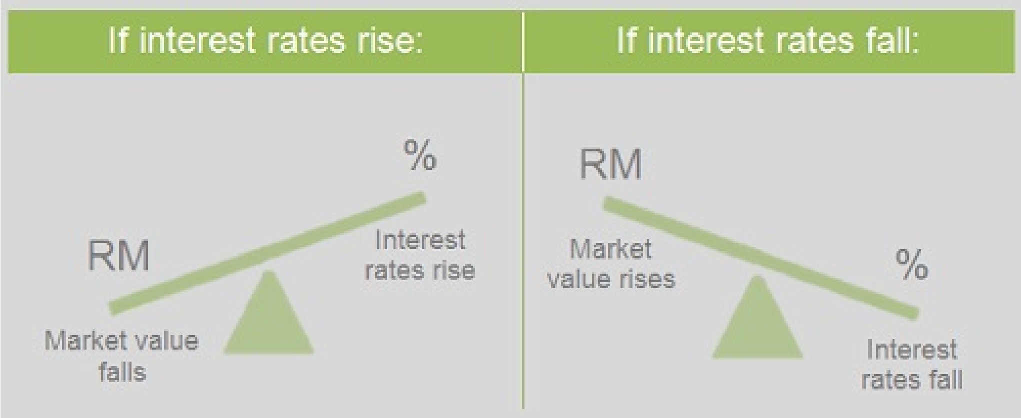


RNID issuances are expected to grow further

Issuances of RNIDs are expected to continue to grow at a reasonable pace, with gross issuance projected to increase by close to four times its current size by year end. Alliance Bank and CIMB Bank are expected announce their RNID programmes in the near future. With the participation of these two banks and the anticipated increase of RNID issuances by existing issuers, total issuance of RNIDs should top RM200 million by year-end. "While we do not expect RNIDs to be a significant part of our funding source in the near-term, we are very likely to issue RNIDs to take advantage of its liquidity management benefits. Apart from that, we are also happy to be involved in this new retail product which we think could grow in popularity among retail investors in coming years," said Mr. Chu Kok Wei, Group Head, Treasury and Markets at CIMB Bank.

Exposure to interest rate and credit risk

In investing in RNIDs, investors take-on two types of risk; interest rate risk (or price risk) and credit risk of the issuing bank. Interest rate risk is the risk that the market value of RNIDs may change as interest rates fluctuate. Just like bonds, the market value of RNIDs increases when interest rate declines, resulting in a capital gain for investors should they decide to sell their RNIDs at that point. Similarly, the market value of RNIDs would also decrease when interest rate rises. Changes in interest rates and prices of RNID may not be too relevant to some investors who plan to hold them to maturity, but investors still need to be aware that selling-back their RNIDs to the issuing banks before maturity in the secondary market could result in a capital gain or loss on their investment. Another important thing to note on interest rate risk is that the market value of longer-tenured RNIDs is more sensitive to changes in interest rates compared to shorter-tenured RNIDs. For example, compared to a 1-year RNID, a 5-year RNID would see a larger gain or loss in market value when interest rates change.



From a credit risk perspective, investors will be taking on the issuing bank's risk. RNIDs are not covered by the Perbadanan Insurans Deposit Malaysia (PIDM) scheme, which insures normal deposits in the event of a bank failure. This means that investors need to be mindful that should the issuing banks run into trouble, the value of their RNIDs may be negatively affected. Since different banks have different levels of credit strength, the returns offered by RNIDs would also differ based on the credit risk of the issuing bank. In general, stronger banks would offer lower rates on their RNID and vice versa. Therefore, it is important that investors look at the credit health and capital strength of issuing banks, focusing on their credit rating, capital ratios, profitability levels and asset quality before choosing which bank's RNID to invest in.

By assessing the interest rates offered and weighing them against the interest rate and credit risks that the RNIDs carry, retail investors would be able to make informed decisions on the suitability of RNIDs as an investment product and on which particular RNID to invest in. All-in-all, the introduction of RNIDs as a new investment product widens investment choices for retail investors and would enhance financial inclusion and literacy in Malaysia.