Enquiry in the Matter of Advertisements by HBL, MyBank, UBL and Askari in Relation to Deceptive Rates of Profit/Return

1. This Enquiry Report is prepared pursuant to the *suo moto* notice taken by the Competition Commission of Pakistan (hereinafter '**Commission**') against MyBank Limited (hereinafter '**MyBank**'), United Bank Limited (hereinafter '**UBL**'), Askari Bank Limited (hereinafter '**Askari**'), and Habib Bank Limited (hereinafter '**HBL**') for advertising term/time deposits accounts giving exaggerated and incorrect profit rates.

2. The Mutual Funds Association of Pakistan (hereinafter '**Mufap**') had expressed concern to the State Bank of Pakistan that the profit rates being advertised by banks in the print and electronic media were being calculated using a flawed formula which did not reflect the actual returns earned by the depositor. This letter was copied to the Commission and the Commission took cognizance of the matter.

3. On September 2nd, 2008 the Commission wrote to the UBL, Askari, HBL and MyBank (collectively referred to as the '**Undertakings**') seeking clarification and explanation of the method adopted by the Undertakings to calculate the annual return offered to depositors. The Commission was concerned whether or not the formula adopted by the banks to calculate the rate of return was standard practice in the banking industry. The Undertakings sent in replies and justified their profit rates.

Issue

4. This Enquiry Reports addresses, whether the advertised rate of return by the subject undertakings is deceptive and as to whether the advertisements by the Undertakings in this regard appear to be *prima facie* in violation of Section 10 of the Competition Ordinance 2007 (hereinafter '**Ordinance**').

Mufap alleges that the banks use the following flawed formula to calculate the rate of return:

(Investment Value after 10 years *less* Initial Investment value) x (1/No. of years)

5. Based on the foregoing, the Office of Fair Trade is concerned as to whether a violation of Section 10 of the Competition Ordinance 2007 dealing with deceptive market practices has occurred. Section 10 (2) says "*the deceptive marketing practices shall be deemed to have been resorted to or continued if an undertaking resorts to-*

   (a) the distribution of false or misleading information that is capable of harming the business interest of another undertaking:

   (b) the distribution of false or misleading information to consumers, including the distribution of information lacking a reasonable basis, related to the price, character, method, or place of production, suitability for use or quality of goods."

Submissions received from the Undertakings:

6. The submissions made by the undertakings in this connection are summarized below:

HBL

7. HBL has a scheme called the HBL *AdvantageAccount* under which HBL offers profit rates as follows:

HBL AdvantageAccount

Term	Profit
10 year	17%
5 year	14%

3 year	13%
1 year	11%

- Multiple options for tenure and profit payout
- Loan facility upto 90% of deposit
- Minimum required investment as low as Rs. 25,000

8. HBL justified its advertisement by referring to the absence of a directive from regulatory authorities as to the specific manner in which the rate of return is to be calculated. Currently banks are allowed to choose and apply any formula and all methods of calculation of the rate of return are deemed valid. Hence HBL has not deviated from the State Bank of Pakistan (hereinafter '**SBP**') Rules nor is it in violation of any directive of the SBP. HBL also added that their operations are carried out with the approval of the SBP because HBL sends an annual profit rate sheet to the SBP whereby SBP is made aware of the activities of HBL. If this formula is incorrect, then the SBP should have taken action. Furthermore HBL differentiates the scheme offered by them from others (such as the return on mutual funds) on the basis that investments in the banking sector are protected due to the SBP's Capital Adequacy Directives.

9. In its response HBL explained the way that the rate of return is calculated. HBL's profit rate on the *AdvantageAccount* is calculated on the basis of the *profit* given at the end of the specified time period on the deposited amount (Principal). For example, if 100,000 is the amount deposited in the bank (and no interim payments are made by the bank to the depositor) then after ten years the bank will pay the depositor an amount of 2,70,000 in addition to the principal. This means a rate of return of 170% over ten years. The bank then divides this by the time period of ten years and gets an *average* return rate of 17% per annum which they term as the "indicative rate of profit per annum."
10. HBL claim that it is their standard practice to use indicative rate of return rather than the effective rate of return, even when it is to their disadvantage. HBL seem to be

trying to stress that that using an indicative rate of return is their standard policy and not deliberate attempt to mislead in the case of *AdvantageAccounts*.

11. HBL denies misleading consumers. They emphasize that no where in the advertisement is it stated that 17% is the effective rate of return or that there will be a compounding of the profit. Furthermore, they point out that the advertisements specifically clarify that this rate of return of 17% is available only where the profit is disbursed on the maturity of the deposit.

MyBank

12. My Bank offers Super Saving Certificates which promise a return of 18.50 % p.a. It has been emphasized that the advertisement has only been released once in the newspapers and not in the electronic media and upon receipt of the letter from the Commission it stopped its campaign till clearance is given by the Commission. The certificates have various tenors which alter the rate of return. MyBank said that its scheme was floated on the pattern of the Defense Saving Certificate issued by the Government of Pakistan. MyBank has tried to distinguish themselves from the advertisements of other banks by claiming that their advertisements clearly disclose the tenor of the respective deposits which make their advertisements less ambiguous and confusing. MyBank said that it has already made improvements in its advertisements to make sure that there are no misconceptions and misleading statements about its deposit scheme; it has included the different profit rates for different maturities and clarified in their advertisement that the payment of profit under this scheme will be upon the completion of the prescribed period. They have also specified the amount payable printed upon the completion on the face of the PLS- Fixed Term Deposit receipt so that the customers know the exact amount that they are to receive at the end of the term.

13. MyBank has shown a positive response in that it stopped the impugned media advertisements. However on the website the advertised rate of return of 18.5% for a deposit of 10 years is still displayed. Therefore despite some positive steps, MyBank needs to further clarify its position as it has not yet explained how it calculates the advertised profit/return rates.

Askari Bank

14. Askari Bank replied via letter dated December 05, 2008 in which they stated that the method applied by them for the computation of return on the 'Deposit Multiplier Account' is the "accumulation of return (normally referred to as compounding of profit) over the period of the profit". They stated that the Deposit Multiplier Account operates in such a way that the "returns earned every year are reinvested to earn more profit for the customer in such a way that by maturity the effective return amounts to 16.5 % per annum."

UBL

15. On 29th September 2008, a reply was received from UBL. UBL denied that it had engaged in deceptive marketing practices of any sort. It claims that all its disclosure/ethics requirements are in conformity with the Prudential Regulations for Consumer Financing, framed by the State Bank. In those Regulations the Annualized Percentage Rate means :

    (Markup paid for the period/ outstanding principal) * (360/ Amount of days) * 100

UBL follows the methodology prescribed by the SBP to calculate its advertised rate of return. The Bank is very particular in maintaining uniformity in relation to its rates; hence it uses the same "simple formula" across the board.

16. UBL stressed that their activities are compliant with the SBP's requirements and are consistent with industry practice. Furthermore, they also point out that the main applicable features of their deposit scheme such as the annualized rate of expected return, tenure of the deposit, zakat deductions and applicable taxes are prominently featured in their advertisement.

Analysis and Findings

17. The formula that is used worldwide for investment and deposit products is the Annual Percentage Yield (APY). The annual percentage yield is generally used to refer to the rate paid to a depositor or lender by a financial institutionis calculated as

$$APY = (1 + (i/N)^{N} - 1$$

Where i is the nominal interest rate, and N is number of compoundings per year.

This is the formula that Mufap claims should be used. However in Pakistan the compounding of interest is not permissible hence the subject banks can not apply APY but instead have adopted a formula which is an equivalent of Simple Interest.

The formula for Simple Interest is

Principal x Rate x Time

18. The figures that are being advertised by the subject banks as profit ignore two principles of finance. Firstly, they do not account for the time value of money. In terms of standard practice, when determining the future value of profit or money, an attempt is made to compensate for the depreciation in the value of money over time (the borrowed or lent amount is augmented so that the sum repaid- say ten years hence- has the same buying power or value). Therefore, the advertised profit rate is deceptive in that the deposit/investment is not being cushioned for the decreasing real value of money for the time period of the deposit as is generally done in term deposits.

19. Furthermore in virtually all countries, returns on deposits held for more than a year are calculated on the accumulated value of the deposits i.e. returns are based both on the initial deposit and on any amount earned subsequently. As said earlier, interest earnings can not be compounded in Pakistan. Even so banks have come up with ways to ensure that the value of the customer's investment or deposit in the bank is protected. In Pakistan, when a customer opens a fixed deposit, some banks give him the option of opening a 'link' account/current account where his interest payments on the principal are deposited. The customer then has the option of reinvesting those payments into the principal amount being kept in the fixed deposit, hence increasing his capital and the amount he earns on the fixed deposit. In this way the customer is cushioned for the decreasing real value of his money, especially if the fixed deposit is for long periods of time. Likewise, some banks put the interest that is earned on a fixed deposit into a savings account where a rate of return is payable on the amount. Other banks keep fixed deposits for short periods of time, in some cases only for a month, and then 'roll over' the fixed deposit plus interest for another term. Methods have been devised whereby the consumer's interests are protected and it is possible to cushion him from the effects of inflation when he invests in a time deposit. The investment schemes being currently advertised by banks are similar to term deposit schemes but for longer periods of time. However, the subject banks do not appear to provide customers with the security of investment that is generally offered under regular term deposit schemes. As the situation is at the moment, the consumer can be misled to believe that like all other fixed deposit schemes, the current schemes would also cushion his investment against the decreasing value of money.

20. HBL is advertising the average rate of return on the AdvantageAccounts as "profit". A footnote at the end of the pamphlets which advertise the *AdvantageAccounts* state that the profit per annum is "the expected rate of return with profit disbursement on maturity." HBL advertises these rates as Indicative Rate of Return per annum, a term which is usually found in Islamic banking. An Indicative Rate of Return is "only analytical and prediction based… Hence, the bank is not obliged to pay out the profit

based on the indicative rate."[1] In its advertisements HBL has added a one line disclaimer on the website which states that the profit rates "are indicative rates and are liable to change".[2] In the response given by HBL they have provided an *Indicative Rate of Profit* and an *Annualized Rate of Expected Return* on HBL *AdvantageAccounts*. The Annualized Rate of Expected Return is "*the projected percentage return on an investment, based on the weighted probability of all possible rates of return.*"[3] This is one of the many standard formulas used for determining the future value of an investment based on a credible calculation of the probable profit that can be earned and this is an established term widely used in the financial sector.

21. A study of the table provided by HBL shows that there are large variations between the Annualized Rate of Expected Return and the Indicative Rate of Profit. Even within the Indicative Rate of Profit if a consumer chooses to have monthly or quarterly payments then the rate of profit varies greatly.

An example is given below:

Period	**Mode of Profit Payment**	**Indicative Rate of Profit P.A. %**	**Annualized Rate of Expected Return P.A. %**
Ten Years	Monthly	11.50	12.13
	Quarterly	11.75	12.28
	Six Monthly	12.0	12.36
	On Maturity	17.00	10.40

22. For a ten year term deposit, depending on the mode of payment i.e. (monthly quarterly and half yearly) the Indicative Rate of Profit can be between 11.50-17 %; this is a huge variation which the advertisement does not disclose. Even more

1 http://www.rhbislamicbank.com.my/index.asp?fuseaction=learning.details&recID=77
2 The HBL website
3 http://dictionary.bnet.com/definition/expected+rate+of+return.html

troubling is the huge difference in the Annualized Rate of Expected Return and the Indicative Profit Rate. For a ten year deposit, even if the payment is taken on maturity, the actual rate that the consumer will get is 10.40 %; about 6 % below the advertised rates of 17%. As said earlier the Annualized Rate of Expected Return is a more credible formula which is used to calculate the value of long term investments. A pertinent question to ask would be why banks are not advertising the Annualized Rate of Expected Return, especially if it would provide the consumer with a more accurate picture of his profits. Advertising an Indicative Profit Rate of 17 %, although more attractive for the purposes of luring in customers, clearly appears to be false and deceptive. It would seem only fair to advertise the more accurate Annualized Rate of Expected Return.

23. HBL denies any contravention of Section of 10 of the Competition Ordinance 2007. HBL claims that it is not harming the '*business interests*' of any undertaking because many other banks are engaged in similar profit rate schemes and so there is no violation of Section 10 (2) (a). And it is true that the main users of this scheme are ordinary consumers and not businesses but this in no way diminishes the culpability of the HBL.

24. HBL (and even UBL) has tried to defend the lack of detail in its advertisement by saying that the *AdvantageAccount* is a service and that before a customer opens such an account managers at the branches are instructed to explain the scheme in detail to the consumer. This does not seem to be a satisfactory precaution. There is no way of ensuring that bank managers have allowed the consumer to make an informed decision. Even if all managers do explain the terms of the Account, the prior distribution of misleading information to consumers, such as the advertisement appears to be a violation under Section 10 (2) (b).

25. By Askari's own declaration in terms of what they stated in Para 11, there appears to be a discrepancy between the rate of return advertised at 16.5 % whereas value of initial investment is to increase from Rs 100,00 to Rs. 265,000 at maturity. If

admittedly the deposit product on which the returns earned each year are reinvested to earn more profit for the customer it remains unclear how the 'effective' return is calculated to be 16.5%. If the effective rate of return is 16.5% then the amount payable on the initial deposit of Rs. 100,000 upon maturity should be approx Rs. 460,537. Either way the advertisement is misleading and deceptive as it is not giving the customers/depositors a fair picture regarding the Askari Deposit Multiplier Account.

26. UBL's justification for using the current formula centers on the claim that it is using the methodology prescribed by the SBP in its Prudential Regulations for Consumer Financing ("**Regulations**"). These Regulations lay down rules and principles that banks should conform to while engaging in consumer financing which is defined in the Regulations as "*any financing allowed to individuals for meeting their personal, family or household needs*". Consumer financing is divided into four categories; credit cards, auto loans, house financing and personal loans. The scope of these Regulations affects credit and leasing - related financial products that banks offer. UBL's attempt to apply these Regulations to the setting up of deposit accounts seems illogical. These Regulations aim to govern and regulate credit-related financial products and are not applicable in the current context.

27. Furthermore, the Regulations themselves state that the definition of the Annualized Percentage Rate given is only for the purposes of those Regulations. As stated earlier, these Regulations are not applicable in the current instance, and the formula prescribed by them does not appear justified.

28. UBL has also stated that in order to simplify matters it uses the same formula across the board. However this approach can be problematic. UBL's concern should be to ensure that its methods and practices conform to proper accountancy and banking standards rather than to 'simplify' matters. The current formula is 'simple' but it is harmful for the consumer because it does not provide him with a fair or accurate picture and can, therefore, be regarded as misleading.

29. MyBank states that it finds the advertisements of other banks such as HBL and UBL as misleading, and it distinguishes itself from them because it mentions the "maximum annual profit rate for a particular period and gives other lower rates of shorter maturities." This does not seem to be a satisfactory explanation as the advertisements of MyBank also seem to have similar issues regarding the accuracy of the profit rate and fair and accurate disclosure to the scheme that are found in the advertisements of HBL and UBL.

30. The term 'payment/profit on maturity' has been used by HBL, Askari and UBL in its advertisement, while MyBank states the condition 'profit payable upon completion of each tenor under the scheme'. However none of the advertisements duly disclose the conditions associated with such term. As can be seen from the table submitted by HBL (see Para 21 above) there is a substantial variation in the rate of return if the depositor chooses to have monthly, quarterly or bi-annual payments. Because the other undertakings also use the term 'payment on maturity', it is safe to assume that there will also be such variations on the rate of return if monthly or bi-annual payments are taken under the schemes offered by them. However none of the subject advertisements duly disclose that there might be this substantial variation in the rate of return based on the timing of the profit payments and this condition is relegated to the fine print of the advertisements.

31. The subject advertisements appear to be deceptive and misleading and list exaggerated profit rates without proper disclaimers or due disclosure. In their advertisement literature, the undertakings do not duly disclose and omit to mention that the actual profit rates can be substantially below the advertised rates of profit/return. Furthermore, all disclosures made by the undertakings in the subject advertisements, particularly those pertaining to payment upon maturity are made in fine print and are hardly legible.

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32. Truth in advertisements is gaining increasing importance in the world, particularly in the financial sector. What is important is not only what an advertisement states but also what it omits to state. Standards for advertisements are being discussed and enforced in almost all industries. This is a pervasive trend and even in the absence of guidelines and directives undertakings have to act more responsibly to ensure that advertisements are transparent and are compliant with the law.

Conclusion

In view of the above, position in respect of the subject advertisements can be summarized as follows:

a. The advertised Profit Rate is deceptive in that the deposit/investment is not being cushioned for the decreasing real value of money for the time period of the deposit as is generally done in term deposits;
b. The advertised Profit Rate is deceptive and misleading in that it does not duly disclose that the rate advertised for the term shall further vary depending as to when payments are received by the customer (i.e. on monthly, quarterly or half yearly basis);
c. No due disclosure is made to the depositor that the profit paid annually can not be added to the principal as may be otherwise done in term deposits;
d. That the profit rate is only applicable when there is disbursement on maturity, while the condition is stated on the advertisement in small print it is hardly legible and is likely to mislead the customer as to the true terms and conditions of the scheme.

33. Additionally, Askari's advertisement is deceptive in that the amount payable on a principal of Rs.100,000 with an effective rate of return of 16.5% should be Rs.460,537 and not Rs.265,000 as is stated on the advertisement; which indicates that either the effective rate of return as stated on the advertisement is incorrect or the advertised amount payable on maturity is incorrect. HBL's own response indicates

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that there can be a substantial difference between the advertised Indicative Profit Rate and the actual Annualized Rate of Expected Return depending on the term of maturity which is unclear from the subject advertisements and is misleading.

34. In view of the above it seems that the advertising in question is not only misleading for customers/depositors but also is capable of harming other undertakings who offer similar products by dissuading depositors/customers from making investments elsewhere. In this regard concern has also been expressed by Mufap in the newspapers that such advertisements are "*helping banks to capture the major share of deposits and after advertisements depositors are preferring deposits in the bank over the mutual fund industry, which is directly hurting them*".*

35. In view of the foregoing, it can be concluded that there appears to be a prima facie violation of Section 10 (1) in particular in terms of Section 10 (2) (a) and (b) on part of the concerned banks/undertakings.

Recommendations

36. The deceptive marketing practices have a direct impact on the public at large. It is in the interest of the general public that banks/undertakings should advertise their products with due disclosure in a fair and transparent manner giving consumers/customers true and correct information. Prima facie violations under the Ordinance in terms of the findings of this enquiry report warrant initiation of proceedings under Section 30 of the Ordinance in accordance with law.

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