African Bank Limited press release

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Are you comparing apples with apples when it comes to interest?

Market-leading interest rates may sound appealing at face value but are you sure you are always comparing apples with apples?

As service providers it is our responsibility to ensure that as far as possible any published information is as clear, fair and reasonable as possible, says Neil Thompson, Head of Product at African Bank.

Generally, providers advertise the Annual Compounding interest rate – that's the interest you earn as a depositor if you leave your deposit with the bank for a full year and only draw the interest at the end of that year.

Unfortunately it is easy to make the common mistake of comparing compounded interest rate, also referred to as an "Expiry Rate", with a simple non-compounding rate if this is not spelt out clearly.

To illustrate the point let's look at the following example, where African Bank currently offers a 10.5% rate for a fixed term deposit of 5 years. That is the Annual Compounding rate that you will earn if you decide to have interest paid out annually. Simply put, if you were to invest R100 000 in this 5-year fixed term product on 1 July 2018, the bank would pay you R10 500 in interest on 30 June 2019, and again on 30 June 2020, 30 June 2021, and 30 June 2022, and return the principle, together with the 5th year's interest on 30 June 2023, paying out a total of R 110 500 on that date. In total you earn and are paid out interest of R52 500 (5 x R10 500).

Let's now look at what is termed the "Expiry Rate". This is a higher rate that is earned by not having your bank pay you the interest on an annual basis, but by having the interest paid out on maturity of the product after 5 years. At first you may think the same R 52 500 as above will be paid out after 5 years, which together with the return of the original principal, would result in a total pay-out of R152 500 on 30 June 2023.

Thompson says this is not however the case. The reason for this is “compounding” or “earning interest on interest”. “When we don’t have our interest paid out by the bank it is effectively re-invested and earns interest again at this Annual Compounding rate. Under this scenario the customer earns an additional amount of over R12 000 resulting in total interest earned of over R64 000 at an “Expiry rate” of 12.95%.” That’s the power of compounding or earning interest on interest.

Expiry rate - how it works	Date	Beginning Period Principal	Annual Rate (%)	Interest	Paid Out	Ending Period Principal
Year 0 : Deposit	01-Jul-18					100 000
Year 1 : Interest	01-Jul-19	100 000	10.50%	10 500	0	110 500
Year 2 : Interest	01-Jul-20	110 500	10.50%	11 603	0	122 103
Year 2 : Interest	01-Jul-21	122 103	10.50%	12 821	0	134 923
Year 2 : Interest	01-Jul-22	134 923	10.50%	14 167	0	149 090
Compound Interest	01-Jul-23	149 090	10.50%	15 654	(164 745)	0
Total		100 000	**12.95%**	64 745	(164 745)	110 500

So to simplify this is what you really need to know:

- You must always compare the annual interest rates amongst service providers, and not the Expiry rate interest rate. If you are not sure, phone and ask them or visit your local branch.
- Also remember a Monthly Compounding rate is less than an Annual Compounding rate. It is always better to leave your interest in the bank and let it accumulate for as long as possible to receive the greatest return.
- You should always invest with a reputable service provider. Remember if the rate is too high, you may not be comparing apples with apples.
- If possible don't withdraw your interest. Reinvest your interest to get the most money back – to earn interest on interest, i.e. “compound interest”
- Always check if you will pay penalties if you withdraw your deposit early and/or what you can withdraw when.
- Invest for as long a period as possible to receive maximum benefit

- If you want the full impact of compounding you need to ensure you are comparing the same Expiry Rates, also sometime referred to as maturity rates, for the same maturities across all banks.

"Remember to shop around and make the necessary comparisons. Don't be afraid to ask questions and make sure you understand what interest you will be earning. You may find at the end of the day you could be comparing apples with oranges, rather compare apples with apples and make an informed decision," concludes Thompson.

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