SEC
Office of Investor Education and Advocacy

High-Yield CDs:
Protect Your Money by Checking the Fine Print

When looking for a low-risk investment for their hard-earned cash, many Americans turn to certificates of deposit (CDs). In combination with recent market volatility, advertisements for CDs with attractive yields have generated considerable interest in CDs.

The SEC's Office of Investor Education and Advocacy is issuing this Alert to inform investors about the potential risks of some high-yield CDs. While all CDs feature federal deposit insurance, some CDs are more complex and may carry more risk, especially with respect to getting money back early or locking in an attractive interest rate.

The ABCs of CDs

A CD is a special type of deposit account with a bank or thrift institution that typically offers a higher rate of interest than a regular savings account. Unlike other investments, CDs feature federal deposit insurance up to $250,000.

When you purchase a CD, you invest a fixed sum of money for fixed period of time – six months, one year, five years, or more – and, in exchange, the issuing bank pays you interest, typically at regular intervals. When you cash in or redeem your CD, you receive the money you originally invested plus any accrued interest. If you redeem your CD before it matures, you may have to pay an "early withdrawal" penalty or forfeit a portion of the interest you earned.

Although most individuals purchase CDs directly from banks, many brokerage firms and independent salespeople also offer CDs. These individuals and entities – known as "deposit brokers" – can sometimes negotiate a higher rate of interest for a CD by promising to bring a certain amount of deposits to the institution. The deposit broker can then offer these "brokered CDs" to their customers.

At one time, most CDs paid a fixed interest rate until they reached maturity. But, like many other products in today's markets, CDs have become more complicated. Investors may now choose among variable rate CDs, long-term CDs, and CDs with other special features.

Some long-term, high-yield CDs have "call" features, meaning that the issuing bank may choose to terminate – or call – the CD after only one year or some other fixed period of time. Only the issuing bank may call a CD, not the investor. For example, a bank might decide to call its high-yield CDs if interest rates fall. But if you've invested in a long-term CD and interest rates subsequently rise, you'll be locked in at the lower rate.

Picking a CD

Don't be dazzled by high yields. The right CD for you might have a lower yield, and less risk, than other CDs you are considering. Before you purchase a CD, make sure you fully understand all of its terms and carefully read its disclosure statement. Remember to ask questions and check out the answers with an unbiased source. These basic tips can help you decide if you're picking a CD that's appropriate for you:

Think about Your Financial Goals

Before you make any investing decision, sit down and take an honest look at your entire financial situation, especially if you've never made a financial plan before. The first step to successful investing is figuring out your goals and risk tolerance, either on your own or with the help of a financial professional. CDs and other cash equivalents, such as savings deposits, treasury bills, money market deposit accounts, and money market funds, can be important part of a diversified portfolio. The principal concern for individuals investing in cash equivalents is inflation risk, which is the risk that inflation will outpace and erode returns over time.

Find Out When the CD Matures

As simple as this sounds, many individuals fail to confirm the maturity dates for their CDs and are later shocked to learn that they've tied up their money for five, ten, or even twenty years. Before you purchase a CD, ask to see the maturity date in writing.

As simple as this sounds, many individuals fail to confirm the maturity dates for their CDs and are later shocked that they've tied up their money for five, ten or even twenty years.

Investigate Any Call Features

Your ability to lock in a good interest rate for a long time is restricted with a callable CD. Callable CDs give the issuing bank the right to terminate – or "call" – the CD after a set period of time, but they do not give you that same right. If interest rates fall, the issuing bank might call the CD. In that case, you should receive the full amount of your original deposit plus any unpaid accrued interest. But you'll have to shop for a new one with a lower rate of return

> **Potential Pitfall**
>
> Do you understand the difference between a CD's call period and maturity date? Don't assume that a "federally insured one-year non-callable" CD matures in one year. It doesn't. These words mean the bank cannot redeem the CD during the first year, but they have nothing to do with the CD's maturity date. A "one-year non-callable" CD may still have a maturity date 15 or 20 years in the future.

Confirm the Interest Rate You'll Receive and How You'll Be Paid

You should receive a disclosure document that tells you the interest rate on your CD and whether the rate is fixed or variable. Be sure to ask how often the bank pays interest (for example, monthly or semi-annually) and confirm how you'll be paid (for example, by check or by an electronic transfer of funds).

Ask Whether the Interest Rate Ever Changes

If you're considering investing in a variable-rate CD, make sure you understand when and how the rate can change. Some variable-rate CDs feature a "multi-step" or "bonus rate" structure in which interest rates increase or decrease over time according to a pre-set schedule. Other variable-rate CDs pay interest rates that track the performance of a specified market index, such as the S&P 500 or the Dow Jones Industrial Average. Research Any Penalties for Early Withdrawal – Be sure to find out how much you'll have to pay if you cash in your CD before maturity.

Special Considerations for Brokered CDs

Brokered CDs typically are more complex and may carry more risks than CDs offered directly by banks. For example, if you buy a brokered CD and need to get your money back early, you may lose some of your principal. Be sure to read the fine print about the features of any brokered CD you are considering. In addition, since brokered CDs are sold through an intermediary, you'll need to take extra steps to avoid fraud. These additional tips can help you evaluate a brokered CD:

Thoroughly Check Out the Background of the Deposit Broker

Deposit brokers do not have to go through any licensing or certification procedures, and no state or federal agency licenses, examines, or approves them. Since anyone can claim to be a deposit broker, you should always check whether your deposit broker or the company he or she works for has a history of complaints or fraud. Many deposit brokers are affiliated with investment professionals. You can check out the disciplinary history of investment professionals quickly using the SEC's and FINRA's online databases. Your state securities regulator may have additional information on investment professionals. To research the background of a deposit broker who is not affiliated with an investment firm, start by contacting your state government's consumer protection office. You should continue researching until you are comfortable that the deposit broker is reputable. If you have concerns about a deposit broker, you should consider purchasing a CD through another deposit broker or buying one directly from a bank.

Some variable-rate CDs feature a "multi-step" or "bonus-rate" structure in which interest rates increase or decrease over time according to a pre-set schedule.

Identify the Issuer

Because federal deposit insurance is limited to a total aggregate amount of $250,000 for each depositor in each bank or thrift institution, it is very important that you know which bank or thrift issued your CD. In other words, find out where the deposit broker plans to deposit your money. Your deposit broker may plan to put your money in a bank or thrift where you already have CDs or other deposits. You risk not being fully insured if the brokered CD would push your total deposits over the $250,000 federal deposit insurance limit.

Ask About Your Deposit Broker's Record-Keeping

Good account records by your deposit broker can ensure your CD will have federal deposit insurance and, in the event of a bank closing, you'll be paid quickly. For example, unlike traditional bank CDs, brokered CDs are sometimes held by a group of unrelated investors. Instead of owning the entire CD, each investor owns a piece. Confirm with your broker how your CD is held, and be sure to ask for a copy of the exact title of the CD. If several investors own the CD, the deposit broker will probably not list each person's name in the title. But you should make sure that the account records reflect that the broker is merely acting as an agent for you and the other owners (for example, "XYZ Brokerage as Custodian for Customers"). This will ensure that your portion of the CD qualifies for full federal deposit insurance coverage.

Find Out What Would Happen If You Needed to Withdraw Your Money Early

If you are the sole owner of a brokered CD, you may be able to pay an early withdrawal penalty to the bank that issued the CD to get your money back. But if you share the CD with other customers, your broker will have to find a buyer for your portion. If interest rates have fallen since you purchased your CD and the bank hasn't called it, your deposit broker may be able to sell your portion for a profit. But if interest rates have risen, there may be less demand for your lower-yielding CD. That means you would have to sell the CD at a discount and lose some of your original deposit.

Bottom Line

The bottom-line question you should always ask yourself is: Does the CD make sense for me? A brokered CD with some potential risks and the possibility of a higher yield might be a good fit for your portfolio. On the other hand, you may only be comfortable purchasing a CD directly from a bank. In any case, the safest choice is to educate yourself about your options because the CD with the highest yield may not be the right one for you.

If you have a problem with a certificate of deposit, we would like to hear from you, although we will likely only have jurisdiction to resolve your particular issue if your certificate of deposit is a security. You can send us your complaint using our online complaint form at www.sec.gov/complaint.shtml. You can also reach us by regular mail at:

U.S. Securities and Exchange Commission
Office of Investor Education and Advocacy
100 F Street, N.E.
Washington, D.C. 20549-0213
www.sec.gov

You should also contact the banking regulator that oversees the bank that issued the CD:

The Board of Governors of the Federal Reserve System oversees state-chartered banks and trust companies that belong to the Federal Reserve System.

The Federal Deposit Insurance Corporation regulates state-chartered banks that do not belong to the Federal Reserve System.

The Office of the Controller of the Currency regulates banks that have the word "National" in or the letters "N.A." after their names.

The National Credit Union Administration regulates federally charted credit unions.

The Office of Thrift Supervision oversees federal savings and loans and federal savings banks.

The Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.