23 May 2023

Mr Nick O'Kane
Executive Director
Financial Services Competition
Australian Competition and Consumer Commission

Via email: fscompetition@accc.gov.au

Dear Mr O'Kane

ACCC Retail Deposits Inquiry

Thank you for the opportunity to provide a submission to the ACCC's inquiry into the market for the supply of retail deposit products.

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over $160 billion in assets and is the fifth largest holder of household deposits. Customer owned banks account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market.

Key points

As retail-focused banks, retail deposits are fundamentally important to the customer owned banking model.

Customer owned banks are a strong competitive force in the retail deposits marketplace, collectively being the fifth largest holder of retail deposits.

The expansion of customer owned banks' marketplace deposit share is partly limited by the amount of demand for its lending products.

Retail deposits are the most accessible source of funding for customer owned banks.

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Competition in Retail Deposits

Customer owned banks are very active in the marketplace for retail deposits, offering a wide array of products to meet the needs of the sector's broad customer base. Our sector offers consumers a viable and safe alternative to the larger banks for retail deposits and our 56 members compete strongly in the marketplace. The customer owned banking sector is collectively the fifth largest holder of household deposits in Australia.

The customer owned structure of our members means that we are more community conscious and have less commercial pressure than other banks. In this mutual or co-operative model, customer interests are not in conflict with shareholder interests. The absence of shareholders means profits are used to benefit customers and are delivered back to our customers through more competitive offerings such as better rates, fairer fees, product innovation and outstanding customer service.

Retail deposits are fundamentally important to the customer owned banking model. Customer owned banks primarily serve retail customers, offering savings accounts and term deposits for savers and home loans, personal loans and credit cards for borrowers. Customer owned banks hold over $130 billion in customer deposits, of which over 84 per cent are from households[1] resulting in customer owned banks needing to compete strongly in the marketplace for retail deposits. This can be seen through the wide array of savings products offered by customer owned banks which seek to compete for a broad range of customers – from savings accounts for children and youth, to first home buyers and accounts developed specifically for those in retirement or those tailored to the particular membership base of each institution.

Furthermore, competition is driven through the development of innovative offerings in digital banking, particularly mobile banking apps with extended functionality such as detailed tracking of customer spending and saving habits.

The promotion of the Financial Claims Scheme (FCS) could also help to promote competition in the market for retail deposits by making it clear that there is the same level of safety and stability in eligible deposit products. Although the FCS has been operational for over a decade, greater consumer awareness of the FCS would serve to improve competition in retail deposits as it would highlight to consumers that alternative deposit products from smaller ADIs are a viable and safe alternative to the major banks' products.

Barriers to Entry and Expansion

As previously noted, customer owned banks primarily operate in the retail deposit and lending space. As customer owned banks are smaller than their listed peers, access to wholesale markets and other sources of funding or investment is more limited, meaning that the business model fundamentally relies on matching the demand for retail borrowing with that of retail saving.

This business model means that, in order to remain profitable, the demand for borrowing from customers has a significant impact on a customer owned bank's demand for deposits, and therefore the terms on which it offers deposit products, including price. So the expansion of customer owned banks' marketplace deposit share is partly limited by the amount of demand for its lending products. In the absence of wholesale funding, smaller banks do not have the luxury of dialling up and down specific funding sources to cater for demand. Retail deposit volumes therefore become a factor of lending growth.

New entrants in the supply of retail deposit products are likely to be a digital only offering, given the higher costs and complexity of establishing a physical presence. It is likely however, that new entrants will find it challenging to convince depositors to switch their primary banking relationship to them and rather be an 'add on account' for depositors. This means that the main transactional banking relationship will remain with an existing ADI and the new entrant will only compete for (potentially more

[1] APRA Monthly Authorised Deposit-taking Institution Statistics, March 2023

expensive) savings account deposits. In addition to this, while new entrant banks may manage to attract deposits, they will need to launch asset (lending) products to maintain sustainability.[2]

As noted in the Issues Paper, regulation is a barrier to entry and expansion for retail deposit products in Australia. Although financial sector regulation is necessary to ensure a safe and stable financial system, the sheer scope of regulatory compliance is a challenge for all banking institutions. Smaller banks in particular are subject to relatively higher regulatory costs due to the fixed cost factor which hampers their capacity to grow and expand into new markets. In this case, higher regulatory costs can reduce profits which then lowers the retained earnings that can underpin the capital base for loan growth (and therefore deposit funding demand).

Any regulatory changes to the framework around retail deposit taking in Australia which make it more difficult for banks to offer competitive products to consumers could have a disproportionate impact on customer owned banks due to our smaller size and reliance on household deposits. This would be detrimental to the competitive pressure which our members offer in the marketplace.

COBA's view is that diversity of business models is part of achieving more competition and innovation in banking. In this context, the customer owned banking sector and its customer owned ethos is a critical pillar of the Australian banking system and should be supported by government and regulators.

Retail Deposits as a Source of Funding

As aforementioned, household deposits are a critical source of funding for customer owned banks, making up over 84 per cent of all deposits held by the sector.[3] Retail deposits are the most accessible source of funding for customer owned banks, as most of our members do not have access to wholesale funding sources and limited access to other sources.

This deposit reliance ensures that customer owned banks are incentivised to compete strongly in the market for retail deposits when funding is required. For example, when funding received under the Reserve Bank of Australia's (RBA) Term Funding Facility (TFF) expires. The ongoing roll-off of TFF funding would be expected to increase in demand for other funding sources for all banks in the marketplace, including retail deposits.

The current market for retail deposits is highly competitive and has led to some competitors pricing savings account and term deposit products strongly. In considering the setting of interest rates, customer owned banks need to balance a desire for retail deposit growth, considering the constraints imposed by lending growth, while maintaining appropriate margins to ensure the sustainability of the business. Appropriate margins generate profits that underpin investment in new products and services as well as generating capital to underpin loan growth (and therefore deposit funding demand).

Consumer Information and Switching

Customer owned banks offer a number of retail deposit products to suit the needs of their customer base. This includes transaction accounts which offer useful functionality such as easy access to funds or a linked debit card, savings accounts which offer a more competitive interest rate to incentivise customers to retain their funds in the account, and term deposits which offer certainty for both customers (fixed interest rate) and banks (fixed term of deposit).

Consumer switching within financial institutions to find a suitable product for their needs has low impediments, particularly between products at a single bank. During the COVID-19 pandemic, interest rates on deposit products reached record lows and customers faced similar interest rates for money held in transaction accounts (which are typically pay low to no interest) and savings accounts. Both the pandemic conditions and low rate differential have led to a greater proportion of deposits in at-call/ transaction accounts. Between the beginning of the pandemic in the March 2020 quarter and the June

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[2] See APRA's Information Paper on sustainability of new entrants

[3] APRA Monthly Authorised Deposit-taking Institution Statistics, March 2023

2022 quarter when interest rates began to rise, deposits held at customer owned banks in at-call/on demand accounts increased by over 48 per cent while deposits in term deposits fell by over 18 per cent.[4] A similar trend was seen across all financial institutions during the period. This trend is slowly reversing since June 2022, with term deposits at customer owned banks increasing by 17 per cent to December 2022.

As the interest rate environment has changed and rates have risen, the interest rate differential between transaction and savings accounts has risen and therefore also the opportunity cost of leaving funds in a transaction account. We believe there are very limited barriers to consumers switching to a higher interest rate product from a lower interest transaction account; financial institutions often allow customers to open a new account or transfer funds between transaction and savings accounts in minutes. This allows consumers to easily access products which best suit their banking needs, if they choose to do so. As the ACCC paper notes on page 4, certain types of accounts have higher interest rates depending on the features offered.

Consumer switching between financial institutions is generally a more involved process, as banks need to verify the identity of an account holder when opening an account which can take time and effort from a consumer's perspective. Further to this, the consumer will need to transfer direct credits (i.e. payroll) and direct debits/payments. However, these issues are becoming increasingly streamlined especially with new digital offerings from banks which make it easier to transfer banking services to them.

Depositors are beginning to expect an attractive incentive to move their banking relationship, including aggressive deposit pricing and extended digital offerings. Parallels can be drawn with the home mortgage market with high cash back offers along with sharp pricing seeing a strong increase in refinancing in recent months.

Thank you for giving us the opportunity to provide a submission into your Inquiry. Please do not hesitate to contact Alexander Woloszyn (awoloszyn@coba.asn.au) if you have any questions about our submission.

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer

[4] APRA Monthly Authorised Deposit-taking Institution Statistics, March 2023