ACCC Retail Deposits Inquiry

Issues Paper

21 April 2023

Acknowledgement of country

The ACCC acknowledges the traditional owners and custodians of Country throughout Australia and recognises their continuing connection to the land, sea and community. We pay our respects to them and their cultures; and to their Elders past, present and future.

Australian Competition and Consumer Commission

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ACCC 04/23

www.accc.gov.au

Contents

1. Background to the Inquiry

On 14 February 2023, the Treasurer, the Hon Jim Chalmers MP, directed the Australian Competition and Consumer Commission (ACCC) to hold an inquiry into the market for the supply of retail deposit products (the Inquiry).[1] The ACCC will submit a report to the Treasurer by 1 December 2023.

In the 10 months from May 2022 to March 2023, the Reserve Bank of Australia (RBA) increased the cash rate target from 0.1% to 3.6% in response to high and rising inflation. The cash rate target is now at its highest level since May 2012.[2] The rising interest rate environment poses a significant challenge for many Australian households with repayments on loans rising sharply, during a period of a broader rise in the cost of living.

While increases in the cash rate have generally been passed through to interest rates on variable rate home loans,[3] the interest rate increases for retail deposit products have often been smaller or conditional.[4] This has impacted the returns Australians receive on their savings. For many Australians, these interest payments are an important source of income.

This inquiry is also occurring during a time of heightened focus on the strength and resilience of the Australian banking system and awareness of the important role deposits play in bank funding.

What we will consider

The ACCC will examine competitive dynamics and consumer outcomes in the supply of retail deposit products by authorised deposit-taking institutions (ADIs). For the purposes of this inquiry, retail deposit products are deposit accounts held by individuals for personal or housing purposes such as savings accounts, term deposits and transaction accounts (including home loan offset accounts) as well as those held by trustees of self-managed superannuation funds.

The ACCC's Inquiry will not consider deposit accounts held for business purposes, redraw facilities linked to home loans, or pre-paid card facilities or similar products.

Competition between ADIs for retail deposits[5] is essential to ensuring that consumers are able to achieve positive outcomes in terms of product quality, choice and value. Competition

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1 See: https://www.accc.gov.au/inquiries-and-consultations/retail-deposits-inquiry-2023/ministerial-direction

2 Box 2 in chapter 6 of this paper explains the cash rate target. The cash rate target has been raised in 10 consecutive monetary policy meetings since May 2022, by either 25 or 50 basis points. RBA, *Cash rate target*, 22 February 2023

3 The RBA noted in its February 2023 Statement on Monetary Policy that *'Housing lenders have passed on cash rate increases up to December in full to their reference rates for variable rate home loans'* and *'most of the largest housing lenders had announced they would also pass through the February increase in the cash rate in full'.*

RBA, *Statement on Monetary Policy*, February 2023, page 47

4 For example, see Dean L, *Banks hit savers to pay for discount mortgages*, *Australian Financial Review*, 3 March 2023, accessed 23 March 2023.

We discuss this further in Chapter 6.

5 For the purposes of this inquiry, the term 'retail deposits' refers to money held in 'retail deposit products' as described in Chapter 2.

is also essential for ensuring the sustainability, strength and resilience of ADIs by further incentivising efficient operations and responsiveness to consumers' needs.

In conducting this Inquiry, the ACCC is directed to consider the following:

- **interest rates paid on retail deposits**, including with reference to differences between consumer segments, and any differences between advertised interest rates and the actual rates paid to consumers
- **other terms and conditions on which retail deposit products are supplied (other than interest rates)**, including fees and charges and restrictions on access to deposited funds
- **supplier approaches to setting interest rates** on retail deposit products, and **supplier decisions following changes to the RBA's cash rate target**, including the timing of announcing interest rate changes and implementing those changes, and any differences in approach between setting interest rates on retail deposit products and lending products (such as home loans)
- **the nature and extent of price and non-price competition** in the supply of retail deposit products, including barriers to entry and expansion, innovation, and factors affecting customer switching (including the extent and existence of supplier practices and strategies that may inhibit switching, consumer behaviour, and the availability of information on products)
- **retail deposit products as a source of funding** for suppliers' provision of credit, including their significance and cost compared to other funding sources, and any differences relating to the size and business model of the supplier.

Consultation

The ACCC invites written submissions on the issues considered in this paper. Further guidance on making a submission, including publication of submissions on the ACCC website and claims for confidentiality, is set out in Chapter 8 of this paper, along with a consolidated list of issues for consultation.

The issues and questions raised are a guide. They are not exhaustive and you do not need to comment on all questions. We would also welcome views on whether there are relevant issues not covered, or to which you consider we should give more emphasis.

Submissions are requested by **19 May 2023** and should be sent to: fscompetition@accc.gov.au.

These submissions will help inform the ACCC's inquiry. The ACCC will also be obtaining documents and information from suppliers of retail deposit products, and undertaking further stakeholder consultation and research as required.

Further information on the timing and progress of the Inquiry can be found on the ACCC's website.

2. Overview

Retail deposit products

Retail deposit products are essential to consumers' participation in the Australian economy.

Retail deposit products enable consumers to safely store their money, receive and make payments (from their own funds) and receive interest on their savings. These interest payments are an important source of income for many Australians, supplementing their income from employment, superannuation and/or the pension.

A defining feature of retail deposit products is that they are protected under the Financial Claims Scheme which was introduced in 2008 to promote stability of the financial system. Under this scheme deposits in ADIs are protected up to a limit of $250,000 per account holder in the event the ADI fails.[6] The Financial Claims Scheme means deposit products are a very low risk up to the $250,000 threshold.

Most Australians have one or more retail deposit products[7] and collectively Australians hold over $1.45 trillion in retail deposits; this includes $1.35 trillion of deposits by households and $136 billion of deposits by self-managed-super funds.[8] Table 1 provides an overview of the main categories of retail deposit products, including interest rates, fees and charges. Fees and charges represent the price consumers pay for holding and using retail deposit products. On the other hand, the interest rates paid by ADIs represent the 'price' to the ADI of sourcing funds from retail deposits.

6 APRA, *Financial Claims Scheme*, APRA website, n.d., accessed 23 March 2023.

7 RBA, Statistical table E5 – Household Financial Assets – Distribution, accessed 22 March 2023.

8 APRA, *Monthly Authorised deposit-taking institution statistics*, 28 February 2023.
ATO, *SMSF quarterly statistical report*, December 2022.

Table 1: Main categories of retail deposit products

Type of retail deposit account	Key features	Interest rates and fees / charges
Transaction accounts	Allow consumers to withdraw money on demand, make payments using deposited funds and receive payments. Transaction accounts are usually linked to a debit card. Often packaged (or bundled) with credit products such as a home loan[9] or credit card.	Usually have low interest rates or pay no interest at all. May include fees such as a monthly account fee, international transaction fees, overdraw fees and certain withdrawal fees.
Savings accounts	Provide consumers with a place to store funds and earn a higher interest rate. Generally not used for day-to-day transactions. Generally do not come with a linked debit card, meaning that consumers will need to transfer money from a savings account into a transaction account to make everyday purchases.	Provide a higher interest rate on deposited funds compared to transaction accounts. Often have an introductory (or promotional) interest rate that applies for several months after the account is opened or a *'bonus interest rate'* that is only received if certain conditions are met, such as depositing a certain amount of money and making a limited number of withdrawals. Generally have few fees attached.
Term deposits	Provide a fixed rate of interest for a specified period, typically ranging from 1 month to up to 3 years.	Generally provide higher interest rates (to compensate borrowers for a lack of access to funds). Funds generally cannot be accessed before the specified period ends without paying a break fee.

Source: ASIC MoneySmart website, websites of ANZ Bank, Commonwealth Bank, National Australia Bank, Westpac, ING Bank, HSBC Bank, Suncorp Bank and Bendigo and Adelaide Bank.

While those products described in Table 1 are the most common retail deposit products, there are also other types of products we will consider in the Inquiry. For example, some individuals and self-managed super funds hold cash management accounts which are deposit accounts connected to an investment platform. These accounts allow consumers to invest in a range of managed funds or other investments on the platform.

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[9] For example, under a home loan package a home loan customer also holds a transaction account and credit card, and in return they receive a discounted home loan interest rate (or other benefits) and usually pay an annual fee.

Offset accounts are also often bundled with home loans, which may or may not be part of a package.

An offset accounts is a transaction account that is linked to a loan, where the balance in the offset account reduces the loan balance for the purposes of calculating interest on the loan.

Regulation of retail deposit products

To conduct banking business[10] in Australia, which includes taking deposits and making advances of money, an entity must be licensed as an authorised deposit-taking institution (ADI) by the Australian Prudential Regulation Authority (APRA), and meet ongoing prudential requirements in relation to capital, liquidity, governance, operations and reporting.

In addition to holding an ADI licence, an entity must also hold an Australian Financial Services Licence to offer financial products (such as deposit facilities) and an Australian Credit Licence to offer credit products (such as home loans) to retail consumers. These licences are issued by the Australian Securities and Investments Commission (ASIC) and require entities to meet ongoing conduct, product design and disclosure obligations in relation to financial and credit products.

The requirement for an entity to hold an ADI licence and meet prudential requirements before it can accept deposits from the general public is common around the world, and is an important requirement for stability of the banking system.

While past reviews of the financial system have highlighted that licensing and regulatory frameworks can impose significant barriers to entry for new players in the banking sector,[11] recent changes to the ADI licensing framework have reduced these regulatory barriers to entry.

In 2018, APRA implemented the *'Restricted ADI'* licensing pathway. This pathway provides a way for small entrants to conduct limited banking activities while they are still developing the resources (including capital) and capabilities to become a fully licenced (unrestricted) ADI. Restricted ADIs are limited to accepting individual customer deposits of up to $250,000 and aggregate deposits of up to $2 million. There are currently 5 ADIs operating under a restricted ADI licence[12] and some ADIs have moved from a restricted to full ADI licence.[13]

We discuss barriers to entry and expansion in Chapter 4.

In addition to licensing requirements, deposit product suppliers must also meet a range of prudential liquidity requirements. These liquidity requirements are intended to ensure that ADIs have sufficient liquid assets (assets that can quickly and easily be converted to cash) to pay their depositors, and that ADIs have resilient and stable funding sources.[14] In particular, more complex banks must hold a minimum level of liquid assets to meet their *liquidity coverage ratio (LCR)* and sufficient 'stable' funding to meet the *net stable funding*

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10 Part 5 of the Banking Act 1959 (Cth) defines *'banking business'* as consisting of both taking deposits (other than as part-payment for identified goods or services) and making advances of money, as well as other financial activities prescribed by regulations made under the Banking Act.

APRA, *Licensing guidelines for authorised deposit-taking institutions*, APRA website, n.d., accessed 23 March 2023.

11 For example, see: Australian Treasury, *Financial System Inquiry Final Report*, 2014, p 255.

12 APRA, *Register of authorised deposit-taking institutions*, accessed 24 March 2023.

13 For example, in December 2022, APRA granted Alex Bank Pty Limited a licence to operate without restrictions after initially being licensed as a restricted ADI in July 2021. Prior to the revocation of its license in February 2021, Xinja Bank Limited was licensed by APRA in December 2018 as a restricted ADI before being granted a full licence in September 2019.

APRA, *APRA grants new authorised deposit-taking institution licence to Alex Bank* [media release], APRA, 21 December 2022; APRA, *APRA grants new authorised deposit-taking institution licence to Xinja Bank* [media release], APRA, 9 September 2019.

14 APRA, *Liquidity in Banking*, accessed 24 March 2023, https://www.apra.gov.au/apra-explains-liquidity-banking

ratio requirements.[15] Smaller and less complex ADIs must maintain sufficient minimum liquid holdings.[16]

Suppliers of retail deposit products

As of 31 December 2022 there were over 90 ADIs accepting retail deposits.[17] The big four banks (Commonwealth Bank of Australia, Westpac, NAB and ANZ) are the largest holders of deposits by households.[18] In aggregate, the big four banks hold around 73% percent of all household deposits—nearly $1 trillion.[19]

The next six largest have shares ranging from 1.1% to 4.1%. These ADIs include Macquarie Bank (4.1% share of household deposits), ING Bank (3.4%), Bendigo and Adelaide Bank (3.1%), Bank of Queensland (2.5%), Suncorp Bank (2.4%) and HSBC Bank Australia (1.1%).

These six suppliers are part of either a larger financial service conglomerate (Macquarie Bank), long-standing regional banks that were initially established to service banking needs in a particular region but over time have expanded nationally (Bendigo and Adelaide Bank, Bank of Queensland and Suncorp) or subsidiaries of international banks (ING Bank Australia and HSBC Bank Australia).

Collectively, these ten ADIs hold around 90% of household deposits.

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15 The LCR is a stress test that requires banks to hold at least 100% of their net cash flow requirements in high quality liquid assets for 30 days. High quality liquid assets include cash, high quality sovereign marketable instruments, and certain qualified corporate bonds.

The Net Stable Funding Ratio (NSFR) mandates that available stable funding is always greater than stable funding requirements.

16 RBA, *Submission to the Productivity Commission Inquiry into Competition in the Australian Financial System*, Final Report, p 21.

17 This figure does not include foreign bank branches.

Foreign banks operate in Australia either as subsidiaries or branches of their overseas parent company. The main difference is that ‘foreign bank branches’ are not locally incorporated and can only accept deposits of greater than $250,000 or more from Australian residents or non-corporate institutions.

As of 31 December 2022, there were 49 foreign bank branches operating in Australia.

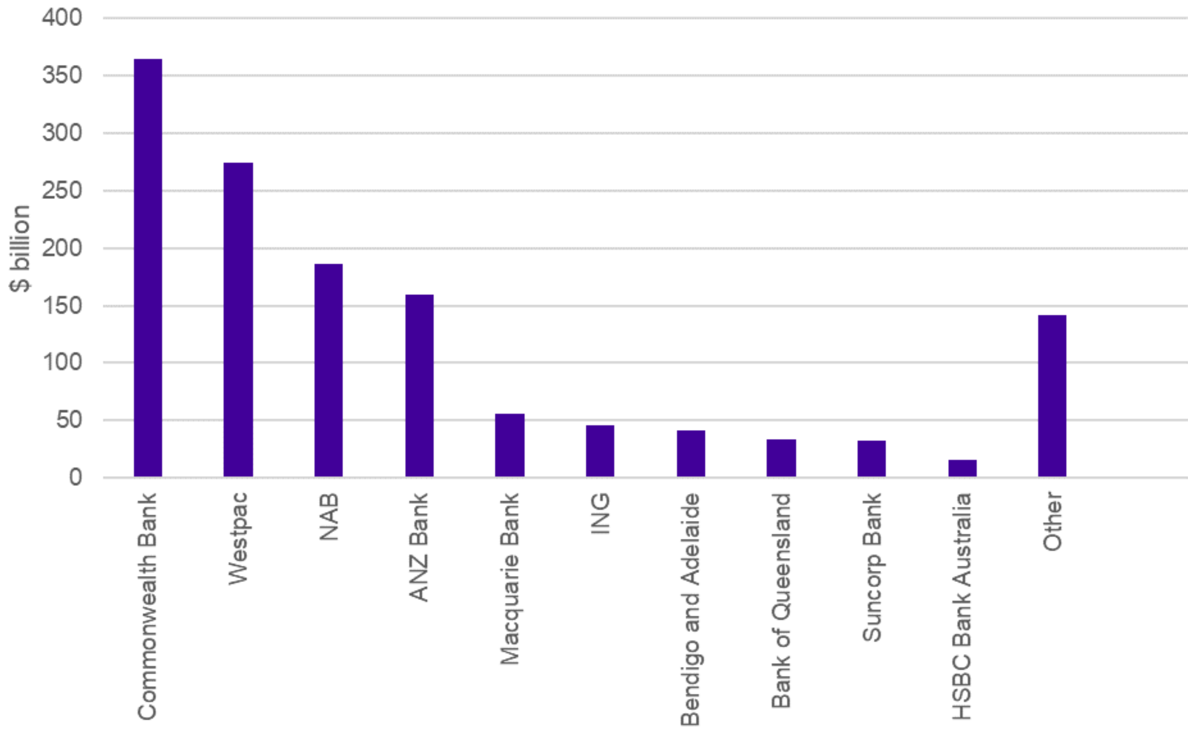
Source: APRA, *Quarterly Authorised Deposit-taking Institution Statistics*, December 2022, released 14 March 2023.

18 As noted earlier, deposits by households make up over 90% of funds in retail deposit products.

19 However, even within the big four banks there is a material size difference. Commonwealth Bank of Australia is the largest holder of household deposits with $363 billion (or a share of 27%), followed by Westpac with $274 billion (a share of 20%), NAB with $186 billion (a share of 14%) and ANZ $160 billion (a share of 12%).

APRA, *Monthly ADI statistics*, January 2023, accessed 24 March 2023.

Figure 1. Household deposits held by ADIs



Source: APRA, *Monthly ADI statistics*, February 2023, accessed 5 April 2023

Similar to other retail banking markets, there is then a long tail of smaller ADIs that provide retail deposit products. These ADIs each have a market share of less than 1% and mainly consist of mutual banks, credit unions and building societies that were originally established to provide banking services to a specific region or occupation.

A mutual bank is a bank that is owned by its customers who are referred to as members. Mutual banks don't pay out profits to shareholders, rather they re-invest profits back into the bank, with the aim to provide better quality or more affordable products. Credit unions and building societies are both types of mutually owned ADIs. As of 31 December 2022, there were 59 mutually owned ADIs operating in Australia with total assets of $164 billion.[20]

ADIs primarily take deposits from retail and institutional customers alongside other funding (such as wholesale debt), which they then lend out to a range of retail and corporate customers.

An ADI's net interest margin (NIM) is a measure of the difference between their interest earnings and interest expenses, expressed as a proportion of their interest-earning assets.[21]

Recent developments

Competitive dynamics change over time, especially as macroeconomic conditions, government policy and technology evolve. In recent years, several developments may have impacted competition in retail deposit products, including the examples below.

20 COBA, How it works, 23 November 2020; APRA, Quarterly authorised deposit taking institution statistics, December 2022, issued March 2023.

21 RBA, *Glossary*, RBA website, n.d., accessed 23 March 2023.

Fintechs and ADI innovation

Productive investment and innovation can result in widespread improvements in consumer outcomes and are both an indicator and desirable outcome of effective competition. As an example of innovation in retail deposit products, mobile banking has significantly reduced the time and cost of making payments and improved the accessibility of banking services, with flow-on efficiency benefits throughout the economy. More recently, several ADIs have developed mobile and online tools that allow users to track income and spending from their saving and transaction accounts, which helps with managing cashflow.

As well as innovation by incumbent ADIs, innovation has also been introduced to the banking sector in recent years through the emergence of so-called 'fintechs'.

Many of the fintechs are small and focus on niche areas of the financial system. This makes it difficult for them to compete against incumbents with full-service offerings. Indeed, the Productivity Commission considered that many are looking to collaborate with incumbent ADIs rather than compete against them.[22] Whether innovation introduced by fintechs is likely to improve consumer outcomes across the sector depends on a range of factors including how incumbents respond. In particular, whether incumbents are actively identifying these innovators and responding with their own innovations on an ongoing basis, or taking steps to hinder competitors from making use of their innovations.

Effects of the COVID-19 pandemic: Term Funding Facility and increased savings

In response to the onset of the COVID-19 pandemic, the RBA introduced the Term Funding Facility (TFF) to provide low-cost fixed-rate funding to ADIs for fixed periods of 3 years.[23] Between April 2020 and June 2021,[24] banks could access new funding at an interest rate substantially below wholesale funding costs.[25]

ADIs' access to low-cost funding through the TFF may have dampened the need to attract funding from retail deposit products. As the TFF expires over 2023 and 2024, we may see an increase in demand for retail deposits.

Between February 2020 and January 2022, the aggregate deposits of Australian households rose over 25% from $988 billion to $1.24 trillion.[26] This increase has been attributed to multiple reasons including government stimulus measures, reduced services spending, early access to superannuation[27] and precautionary saving[28] as a result of the COVID-19 pandemic. The build-up of deposits during the pandemic may have, to some extent, reduced the competitive pressure for banks to raise deposit interest rates.

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22 Productivity Commission, *Competition in the Australian Financial System*, June 2018, p 10.

23 RBA, *Term Funding Facility to Support the Australian Economy*, RBA website, n.d., accessed 22 March 2023.

24 RBA, *Term Funding Facility to Support the Australian Economy*, RBA website, n.d., accessed 22 March 2023.

25 Wholesale funding refers to funding that is raised in domestic and international debt markets. It includes short and long-term bond issuance, and securitisation.

S Black, B Jackman and C Schwartz, 'An Assessment of the Term Funding Facility', RBA, 16 September 2021, accessed 22 March 2023.

26 APRA, *Monthly authorised deposit-taking institution statistics back-series March 2019 - January 2023* [data set], APRA website, 2023, accessed 22 March 2023.

27 ABS, *Insights into household wealth during COVID-19*, ABS website, 24 September 2020, accessed 22 March 2023.

28 Commonwealth Bank of Australia, *Aussies boosted 'rainy day' funds by almost 50% during COVID in expectation of economic shocks*, CBA website [media release], CBA, 2 June 2022, accessed 22 March 2023.

New Payments Platform

There are a number of developments in payment technologies and account-related services that have been used to attract and retain deposits. For example, the New Payments Platform (NPP), launched in 2018, is an open access infrastructure designed primarily for retail payments that enables users to make secure and fast payments between accounts, at any time.[29] 'Overlay' services sit on top of the NPP and its capabilities in a customised way to define a unique payment service or process.[30] Overlay services can enhance the functionality of ADIs' transactional deposit products and result in product differentiation for consumers to consider when choosing or switching retail deposit products. Osko was the first NPP overlay service introduced, enabling near real-time payments between accounts at participating Australian ADIs.

Consumer Data Right

The Consumer Data Right (CDR) is a data portability reform that is being rolled out in the economy. Data sharing started for banking in 2020, with the original phased rollout by banking data holders completed in 2022. The CDR provides consumers with the ability to efficiently and conveniently access their personal data held by businesses, and to authorise the secure disclosure of that data to trusted third parties. It also requires businesses to share data about the products and services they offer in a standardised way, which increases transparency and can improve the quality of product comparison information. This can empower consumers to more easily identify retail deposit products with higher deposit rates, lower fees and/or better features. This in turn may incentivise banks to compete more vigorously for customers.

29 RBA, *The New Payments Platform*, RBA website, n.d., accessed 22 March 2023.

30 NPP Australia, *New Payments Platform (NPP)*, NPP Australia website, n.d., accessed 22 March 2023.

3. Competition in retail deposits

Competition between ADIs for retail deposits is essential to ensuring that consumers are able to achieve positive outcomes.

In the case of retail deposit products, ADIs can compete on the interest rates they pay to consumers, the products' fees and charges, and other features including the quality of service, accessibility, convenience, and technology.

Consumers play an important role in driving effective competition. Through shopping around for the products that best fit their preferences and switching to better deals, consumers provide suppliers with incentives to continuously improve and innovate their product offerings to both retain their current consumers and win new consumers from competitors. The Inquiry will examine the ability and willingness of consumers to shop around, compare products, and switch products and providers, as discussed in Chapter 7.

The Report for the Productivity Commission's 2018 Inquiry on Competition in the Australian Financial System made the following observation:

> Australia's financial system is dominated by large players — four major banks dominate retail banking...A tail of smaller providers operate alongside these institutions, varying by market in length and market share…[31]

Concentration in retail deposits has reduced somewhat since the Productivity Commission's inquiry, but as of February 2023, the big four banks still accounted for around 73% of household deposits.[32]

Concentration may be a result of weak competition (for example, due to high barriers to entry and expansion), however, this is not necessarily the case. It may also reflect efficiencies in scale or scope, or regulatory settings designed to achieve other outcomes in the interest of consumers.

The Productivity Commission also noted that price [interest rate] rivalry in banking is restrained, and will remain so, due to constraints on the cost of funds for ADIs, finding:

> Banks, and in particular the major banks, exhibit substantial pricing power. The major banks' market power has allowed them to set interest rates to borrowers and depositors that enable them to remain highly profitable — without significant loss of market share.[33]

The Productivity Commission also observed that smaller ADIs generally mirrored the pricing decisions of the big four banks.[34]

The Inquiry will consider the extent to which ADIs compete with each other in relation to retail deposit products in light of more recent developments (including those summarised in Chapter 2). This issues paper seeks views on issues which are relevant to understanding and assessing the nature and extent of this competition.

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31 Productivity Commission, *Competition in the Australian Financial System*, June 2018, p 4

32 APRA, *Monthly authorised deposit-taking institution statistics January 2023* [data set], APRA website, 2023, accessed 22 March 2023.

33 Productivity Commission, *Competition in the Australian Financial System*, June 2018, pp 8–10.

34 Productivity Commission, *Competition in the Australian Financial System*, June 2018, p 8.

As part of this Inquiry, we may also consider profit metrics against relevant benchmarks alongside other competition indicators in forming a view on the nature and extent of competition in retail deposits.

Issues for consultation

1. How, and to what extent, do ADIs compete in providing retail deposit products to consumers, including with respect to setting interest rates and other fees and charges, and non-monetary factors, such as innovative product design?
2. What alternatives do consumers have to retail deposit products for earning a return on their funds? How close are these substitutes? How does this vary with consumers' risk preferences?
3. How effective is competition in the supply of retail deposit products in delivering good outcomes for consumers?

4. Barriers to entry and expansion

The entry or expansion of new firms into retail deposit markets, or the threat of potential entry or expansion, can provide an important source of competitive constraint on ADIs. In particular, it can drive ADIs to continuously improve their product offerings to mitigate against the threat of losing customers to new entrants, or even potential new entrants. In essence, barriers to entry and expansion are costs or other obstacles that make it difficult for a firm to enter a market and grow sufficiently to compete with incumbents.

Barriers to entry and expansion can take many forms and may be classed into 3 broad groups: regulatory, structural/technological, and strategic, although there is not always a clear delineation.[35] In retail banking, barriers may include:

- Regulatory requirements, which may impose costs on new entrants. Regulation is discussed in Chapter 2 above.
- Costs of entry, including the high funding costs new entrants expect to face, infrastructure costs, and the time taken to become profitable. New ADIs are typically heavily dependent on external capital support in meeting their growth targets and absorbing early losses.[36]
- The geographic reach of the major banks, along with their scale and longevity. This contributes to:
  - Their brand recognition and consumers' perception that they may be safer, more stable institutions compared to smaller rivals. Their widespread presence can make it more difficult for small institutions to be seen by consumers as a practicable alternative source of financial services.
  - Their ability to integrate a wide range of products, which gives them the ability to cross subsidise and offer consumers an integrated bundle of services, which may also raise switching costs for consumers.
- Consumer inertia and engagement, which is discussed in Chapter 7 of this paper.

There are some indications that, in the Australian banking sector, new entrants pose only a limited competitive constraint. In their 2018 report, the Productivity Commission observed that, '[f]or now, neither foreign entrants nor fintechs appear to pose a substantial threat to major banks: more entrants alone are not a panacea to drive competition across Australia's financial system'.[37]

This Inquiry will consider the nature and extent of barriers to entry. In recent years, there has been some new entry into the retail banking sector. However, no new entrant has been able

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35 Regulatory barriers to entry include when law or regulatory requirements place restraints on entering the market, such as obtaining a licence or permit. In the retail deposits market, ADIs must be authorised by APRA and be subject to prudential requirements, such as regulatory capital, governance, risk management and compliance.

Structural or technological barriers to entry occur outside the control of the market participants and include the substantial economies of scale, sunk costs (costs that cannot be recovered from withdrawing from the market) and high customer switching costs.

Strategic barriers to entry arise because of actions or threatened actions by incumbents to deter new entry into the market, including the creation of strategic customer switching costs and brand proliferation to crowd out the product space.

36 APRA, *ADIs: New Entrants – a pathway to sustainability: Information paper*, 18 March 2021, first accessed 28 February 2023, p 24.

37 Productivity Commission, *Competition in the Australian Financial System*, June 2018, p 10.

to reach sufficient scale or access funds at a cost that would enable them to compete directly with the major banks. We are interested to understand whether the experience of new entrants indicates that barriers to expansion may be preventing new entrants from growing and achieving sufficient scale to compete.

Since 2016, 86 400, Volt Bank, Xinja and Judo Bank have entered the market on either a full or restricted ADI licence. Currently only Judo Bank remains as an ADI, with the others returning deposits or acquired. These firms reportedly encountered several challenges in expanding, particularly, access to operational and regulatory capital.[38] For example, Xinja noted an 'increasingly difficult capital-raising environment' and the COVID-19 pandemic when explaining its decision to exit the market,[39] while Volt was unable to secure capital investment to increase its scale to support mortgage lending.[40]

Issues for consultation

4. What is the potential for new entry in the supply of retail deposit products? What form is new entry likely to take?
5. How significant are barriers to entry and/or expansion in the supply of retail deposit products? How have these changed over time?
6. How has new entry or expansion in the supply of retail deposit products impacted the behaviour of incumbent ADIs?
7. How have ADIs responded following the exit of relative newcomers in the supply of retail deposit products?
8. How are ADIs likely to respond to any new entry, or the threat of new entry, in the foreseeable future?

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38 Melisande Waterford (APRA), '*Regulating challenger banks: balancing objectives and outcomes',* Speech to the Future Banking Forum 2019, 9 October 2019, https://prod.apra.shared.skpr.live/news-and-publications/apra-general-manager-regulatory-affairs-and-licensing-melisande-waterford, viewed 2 February 2022.

39 T Boyd, 'Lessons all round as Xinja Banks shuts', *Australian Financial Review*, 13 January 2021, accessed 22 March 2023.

40 J Eyers and J Shapiro, 'Volt Bank to close, return $100m to customers', *Australian Financial Review*, 29 June 2022, accessed 22 March 2023.

5. Retail deposits as a source of funding

Just as fees and charges represent the price consumers pay for holding and using retail deposit products, the interest rates paid by ADIs represent the 'price' to the ADI of sourcing funds from retail deposits.

ADIs use a range of funding sources to make loans and fund their operations. This includes deposits, short-term wholesale funding, long-term wholesale funding, securitisation, the term funding facility,[41] and equity (Figure 2).

In aggregate, deposits are the largest source of funding for ADIs, accounting for around 60% of total funding.[42] However, it is important to note that there is variation across ADIs in relation to this issue. Mutual banks tend to be more reliant on funding through deposits compared to major banks.

The share of ADI funding from deposits has increased significantly since the onset of the global financial crisis (GFC) due to several factors. Other funding sources (in particular, securitisation) became more difficult to access and expensive during the GFC. Also, changes to prudential liquidity requirements[43] following the GFC led banks to increase their funding from more stable sources including deposits, equity and long-term wholesale debt.[44]

Deposit funding is provided by a range of entities including retail depositors who provide around half of all deposit funding, non-financial businesses (around 30%), and other investors (around 20%) (Figure 3).

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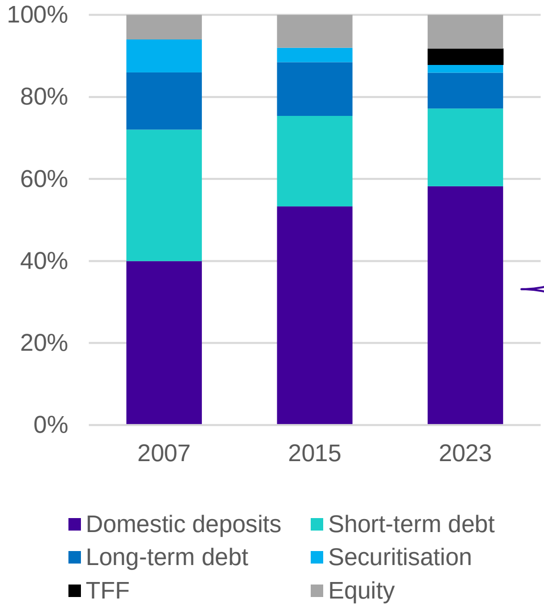
41 V Carse, A Faferko and R Fitzpatrick, 'Developments in Banks' Funding Costs and Lending Rates', RBA March Bulletin, March 2023, p. 66.

42 RBA, *The Australian Economy and Financial Markets Chart Pack*, March 2023, accessed 22 March 2023, p. 31; V Carse, A Faferko and R Fitzpatrick, 'Developments in Banks' Funding Costs and Lending Rates', RBA March Bulletin, March 2023, p 66.

43 In response to learnings from the GFC, APRA introduced Basel III liquidity reforms through revisions to the prudential standard for liquidity. The 2 core measures of reforms, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), became effective from 2015 and 2018 respectively. The LCR is intended to promote short-term resilience of a bank's liquidity profile by ensuring it has sufficient high-quality liquid assets to survive a significant stress event lasting for one month. The NSFR is intended to promote longer term resilience in a bank's funding profile through requiring more stable sources of funding on an ongoing basis. APRA, *Information paper: Post-implementation review of the Basel III liquidity reforms*, June 2022, accessed 22 March 2023, pp 4, 7–8.

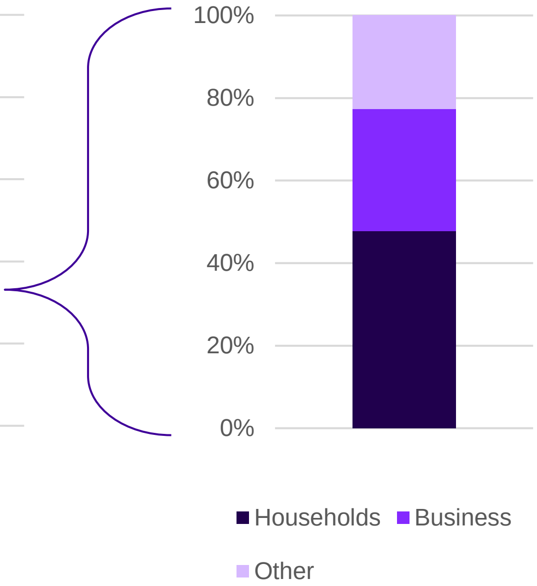
44 T Atkin and B Chung, How have Australian Banks responded to tighter capital and liquidity requirements, Reserve Bank of Australia, June 2017 Bulletin,

Figure 2. Funding composition of banks in Australia



Source: RBA, *Chart Pack*, page 31, accessed 24 March 2023

Figure 3. Domestic deposits by depositor, 2023



Source: APRA, Monthly Authorised deposit-taking institution statistics, accessed 24 March 2023

The different ADIs discussed in chapter 2 rely on retail deposits as a source of funding to different degrees.

The big four banks, for example source around 30% of their funding from retail deposits, and their remaining funding from a mixture of business and other deposits, domestic and international debt markets and equity.

In contrast, mutual banks for example (who generally do not have access to wholesale funding markets, or very limited access) source the majority of their funding from retail deposits, with a significantly smaller share from small and medium business deposits and equity.

This inquiry will consider in further detail the issue of retail deposits as a source of funding for ADIs, including their significance and costs compared to other funding sources.

Access to funding is essential for ADIs to grow and the cost of funding is generally their single largest expense.

The significance of retail deposits as a source of funding for ADIs may be affected by a range of factors, including:

- the supply and availability of deposits
- the cash rate target
- the cost and availability of other funding sources
- prudential liquidity requirements, which influence the demand for more stable sources of deposit funding.[45]

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45 T Atkin and B Chung, How have Australian Banks responded to tighter capital and liquidity requirements?, RBA Bulletin, June 2017, pp 45-6.

This Inquiry will investigate different ADIs' access to retail deposits as a source of funding and how this impacts their ability to grow and compete across a range of markets.

These matters also directly influence ADIs' interest rate setting decisions for retail deposit products – this is discussed in the next chapter.

Issues for consultation

9. How do each of the listed factors affect the significance of retail deposits as a source of funding for ADIs? How does this vary between ADIs of different sizes and business models?
10. What other factors affect the role of retail deposits as a source of funding for ADIs? How do these factors vary between ADIs of different sizes and business models?
11. How does the cost of funding from retail deposits compare to the cost of funding from other sources? How has this changed over time?

6. Interest rates for retail deposits

Interest rate practices on retail deposit products

Retail deposit products have different interest rate structures. Some transaction accounts pay no interest at all, or a very low rate.

Savings account have a *'base rate'* that all account holders receive, but many also offer account holders an introductory or 'bonus' interest rate depending on:

- whether they are a new or existing customer – for example, new customers may be eligible for an introductory interest rate for a set period, typically higher than the base rate
- how they use the product – for example, account holders may be able to earn a higher 'bonus' interest rate if they comply with terms and conditions such as restrictions on withdrawals.

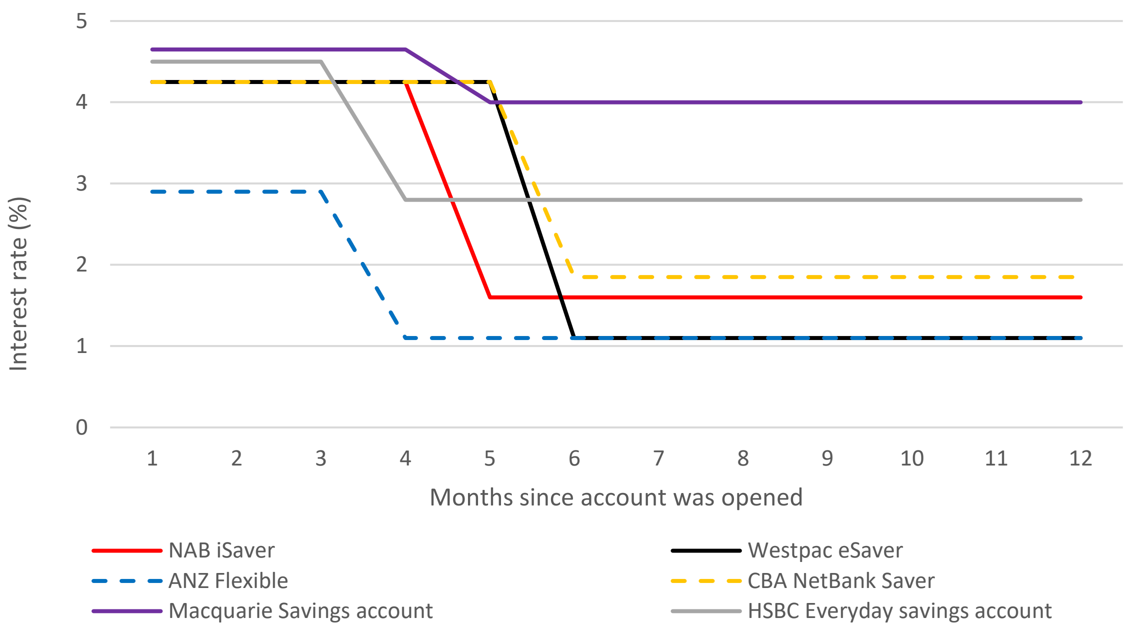
These time-limited and contingent interest rates are common across the market, and they may result in consumers with the same product receiving different interest rates, as shown in Box 1.

Box 1: Introductory interest rates and bonus rates on savings account products

Introductory rates on savings accounts

Many savings account products have a base rate that applies to all customers and higher promotional or introductory interest rate that applies for several months (generally 3 to 6 months) once the account is opened, before reducing to the lower ongoing base rate (see figure 4).

Figure 4: Promotional or introductory interest rates and base rates on select savings accounts



Source: Websites of the banks listed in Figure 4, accessed on 22 March 2023.

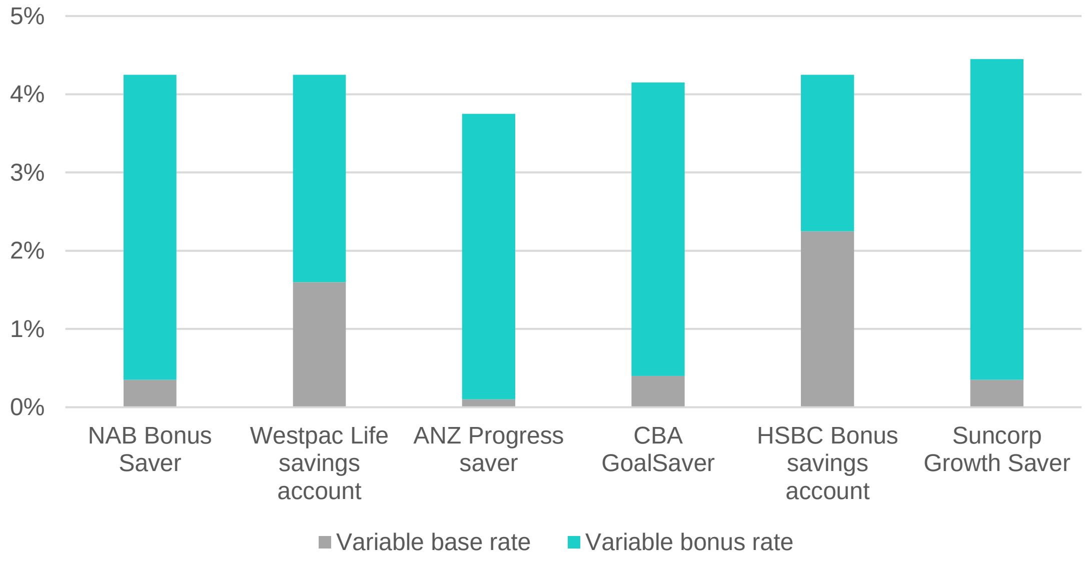
This has been a pricing practice for retail deposit products for several years. More recently, as the cash rate target increased rapidly, suppliers have increased promotion or introductory rates at a similar pace to the cash rate target but have not increased the base rate (or have only increased the base rate by a small amount).

While promotional or introductory prices exist across many industries and products, consumers appear to switch savings accounts relatively infrequently and often hold these products for long periods of time.

Bonus rates on savings accounts

Further, some savings accounts also have conditional bonus rates. In this case, a higher interest rate is received if certain conditions being met, such as no withdrawals being made from the account or growing the account balance each month, however if these conditions are not met, a much lower base rate generally applies.

Figure 5: Bonus rates on deposit products



Source: Websites of the banks listed in Figure 5, accessed on 22 March 2023.

For some accounts that have a base rate and conditional bonus rate, we have only seen the conditional bonus rates increase with movements in the cash rate. This means there are potentially a large cohort of consumers who have not seen increases in the cash rate target flow through to the interest they receive on their savings.

The Inquiry will examine:

- how interest rates of similar products vary between consumers depending on the amounts deposited, whether they are new or existing customers, whether they hold other products with the ADI (such as a home loan, credit card or insurance products), or they belong to particular customer groupings
- the extent to which customers actually receive conditional 'bonus' interest rates offered on many retail deposit products
- the impact of account fees and charges on the income consumers earn on their savings
- whether consumer engagement is inhibited by approaches to setting interest rates, including whether interest rate setting practices make it more difficult for consumers to compare retail deposit products thereby raising search and switching costs, or by creating complexity and a likelihood of consumer error, confusion, or inertia
- the incentives and constraints that ADIs face when setting interest rates for retail deposit products, including:
  - the cost of other funding sources (as discussed in Chapter 5)
  - consumers' sensitivity to interest rate changes
  - the nature of competition and consumer preferences
  - anticipated and actual competitor responses
  - interest rates on lending products and overall margins
- how ADIs' approaches differ between setting interest rates for retail deposit products and products for the provision of credit.

Issues for consultation

12. What is the relative importance of the various incentives and constraints that influence ADIs in setting retail deposit interest rates and interest rates for lending products?
13. To what extent are ADIs influenced by the interest rate decisions of other ADIs?
14. How do ADIs' approaches to setting retail deposit interest rates impact on competition and consumer outcomes?

ADI responses to changes in the cash rate target

Since May 2022, Australia has experienced the fastest rate of acceleration of the cash rate target in history. In response to the cash rate target increases, ADIs have generally increased their home loan rates by the same or similar amounts. In contrast, interest rate rises for retail deposit products have not kept pace with the cash rate rises.[46] We want to understand why this might be the case.

Box 2: The RBA's cash rate target

In determining monetary policy for Australia, the RBA sets the cash rate target. RBA decisions are announced after each Reserve Bank Board meeting, with any change in the cash rate target taking effect the following day.

The cash rate is the interest rate that banks pay to borrow funds from other banks, or receive when lending money to other banks, in the overnight money market. The RBA keeps the cash rate close to its target through the rates it sets for ADIs' overnight deposits with the RBA. ADIs can deposit funds with the RBA overnight and earn a little below the target cash rate. ADIs can also borrow funds from the RBA at a little above the target cash rate. The cash rate trades inside this corridor, and the RBA can also transact in Australia's money markets to affect the supply and demand for cash to steer the cash rate close to the target.

The cash rate influences (directly or indirectly) most other interest rates in the Australian economy, including home loan and deposit rates.[47]

Recent analysis by the RBA found that over 2022, increases in interest rates paid to households on deposit products trailed increases in interest rates paid to business and institutional investors (Figure 6). This difference in pricing is likely to reflect the fact many wholesale deposit products (particularly deposit products for large businesses and institutional investors) are *'negotiated rate products'* that are priced off a market reference rate (such as the Bank Bill Swap Rate or a longer-term swap rate) which quickly respond to changes in the cash rate target, and that wholesale depositors have a wider range of alternative low-risk market-based alternatives to invest in.

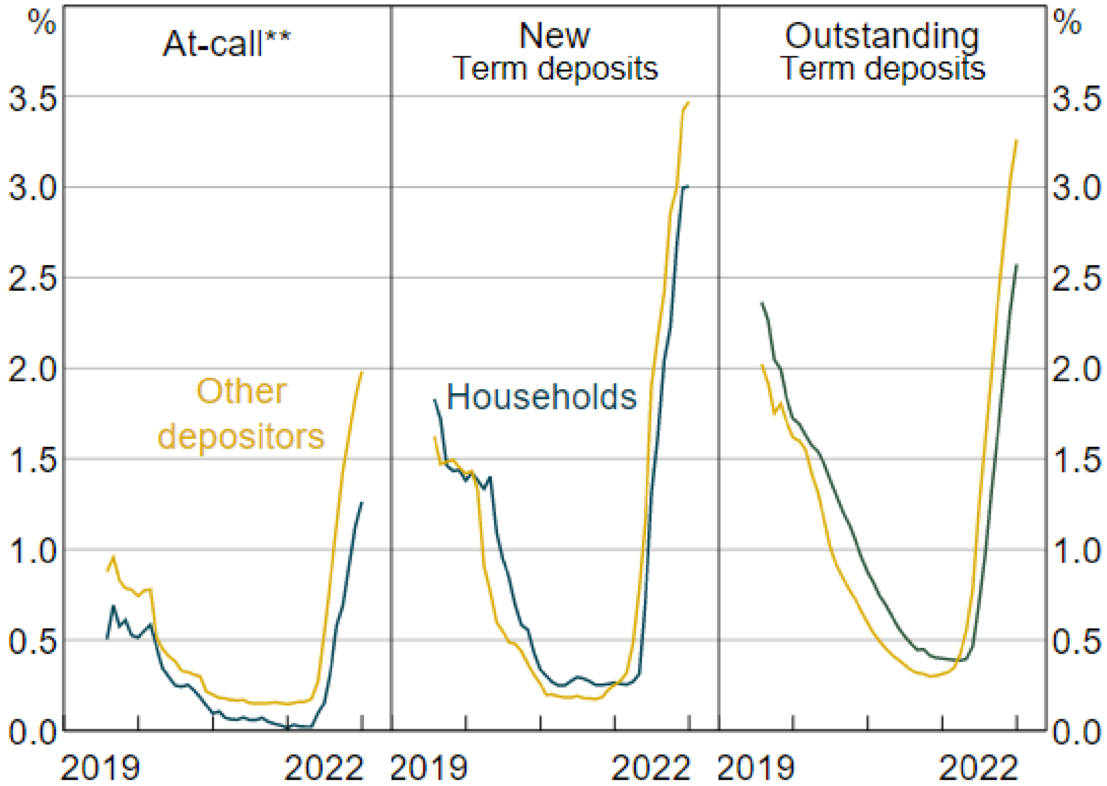
As set out above, we have also seen that ADIs are using rate-setting strategies for retail deposit products such as promotional rates which only apply for a number of months,

46 For example, see: D Hughes, 'Where to find top returns for your bank savings', *Australian Financial Review*, 3 August 2022, accessed 23 March 2023; A Turner-Cohen, 'Australia's big four banks called out for ripping off some customers with savings accounts', *news.com.au*, 13 February 2023, accessed 23 March 2023.

47 RBA, *Cash rate target – the key monetary policy decision*, n.d., RBA website, accessed 23 March 2023.

without increasing the ongoing base interest rate. These strategies rely on consumer inertia and disengagement to keep deposit funding costs low.

Figure 6. Major bank deposit rates, by deposit type and depositor



** Adjusted to exclude offset accounts; includes non-interest bearing deposits.
Source: Reserve Bank of Australia, *Developments in Banks' Funding Costs and Lending Rates*, March 2023 Bulletin

This Inquiry will examine how ADIs respond to cash rate changes when setting interest rates on retail deposit products, and what this tells us about competition across retail deposit markets. We will:

- Identify whether these changes result in any benefits to ADIs and to what extent these are passed on to deposit holders. These benefits may include, but are not limited to, increased revenues from lending products and/or an increase in the ADIs net interest margin.
- Explore how these changes vary by the type of retail deposit product consumers hold (for example, transaction accounts, term deposit accounts or savings accounts), or for new versus existing customers.

Issues for consultation

15. What factors influence how closely and quickly retail deposit and lending interest rates are adjusted following a change in the cash rate target? How does this vary between different categories of retail deposit products.

7. Consumer information and switching

The ability and willingness of consumers to shop around, compare products, and switch products and providers are important determinants in driving effective competition. To do this effectively, consumers need to be able to:

- access information on product features, rates, fees, charges, and other product terms
- assess the product terms they care about easily
- act on the information, by switching to providers that meet their preferences.

Intermediaries such as price comparison websites can play a role in facilitating this assessment process. The CDR also has the potential to help consumers to navigate the large number of retail deposit products available.

In a competitive market, we would expect interest rates, fees and charges to be transparent and simple to understand, so that consumers are able to make decisions about which product suits them best. The Inquiry will examine the prevalence of consumer switching between retail deposit products and/or suppliers. Many consumers will also maintain multiple retail deposit accounts, including accounts at different ADIs. Any assessment of the level and impact of consumer switching needs to take this account. [48]

The inquiry will also consider whether there are impediments to stronger consumer engagement, including:

- the availability, accessibility and transparency of information that would enable consumers to shop around and compare interest rates, fees, charges and other retail deposit product features
- barriers to consumers' understanding or responding to information, including financial literacy, behavioural biases, or switching costs (including non-financial costs).

Issues for consultation

16. How easy or complex is it for consumers to search for and compare retail deposit products?
17. What are the impediments to consumers finding and understanding relevant information about retail deposit products?
18. How easy or complex it is for consumers to switch from a retail deposit product to an alternative product that better meets their preferences? What impediments do they face?
19. Do different categories of consumers engage with retail deposit products in different ways? If so, how? How do ADIs respond to these differences?
20. How are consumer outcomes in relation to retail deposit products affected by impediments to searching and switching?

[48] Productivity Commission, *Competition in the Australian Financial System*, June 2018, p 166.

8. Making a submission

The ACCC invites your views by way of a written submission to this issues paper. Submissions are requested by **19 May 2023** and should be sent to fscompetition@accc.gov.au.

The issues and questions raised are a guide. They are not exhaustive and you do not need to comment on all questions. We would also welcome views on whether there are relevant issues not covered, or to which you consider we should give more emphasis.

Where possible, please include supporting information and specific examples in your responses.

We would appreciate submissions from suppliers and potential suppliers of retail deposit products, industry associations, consumer groups and users of retail deposit products, including consumers and those with a self-managed super fund.

In addition to submissions, the Inquiry will obtain information, data and other evidence through targeted consultation and information requests.

Treatment of information

The Inquiry is a public process and written submissions will generally be made available on the ACCC website.

The *Competition and Consumer Act 2010* allows parties that provide written submissions to the Inquiry to make claims for confidentiality in certain circumstances. The ACCC invites interested parties, where appropriate, to discuss confidentiality concerns with the ACCC in advance of providing written material.

Where a party claims that disclosure of information in a written submission would damage that party's competitive position, the ACCC can accept a claim of confidentiality from the party if it is satisfied that the claim is justified. If we are satisfied that the confidentiality claim is justified, the ACCC must take all reasonable steps to keep that information confidential unless we consider that disclosure of the information is necessary in the public interest. The ACCC will consult with a party where possible and appropriate prior to publishing any information over which that party has claimed confidentiality.

Making a claim of confidentiality

So that the ACCC can consider whether the confidentiality claim is justified, you must provide reasons why the information is confidential and why disclosure of the information would damage your competitive position.

If you are claiming confidentiality over all of the information in your submission, you must provide reasons why all of the information in your submission is confidential. As the Inquiry is a public process, please consider whether there are any parts of your submission that may be published without damaging your competitive position.

If you are claiming confidentiality over a part of the information in your submission, the information over which you claim confidentiality should be provided in a separate document and should be clearly marked as 'confidential' on every relevant page. Alternatively, you may wish to provide (1) a public version for publication on the ACCC website with the confidential information redacted, and (2) a confidential version with all of the confidential information clearly marked.

Contact us at fscompetition@accc.gov.au if you have any questions regarding making a submission containing confidential information.

Issues for consultation

Chapter 3. Competition in retail deposits

1. How, and to what extent, do ADIs compete in providing retail deposit products to consumers, including with respect to setting interest rates and other fees and charges, and non-monetary factors, such as innovative product design?
2. What alternatives do consumers have to retail deposit products for earning a return on their funds? How close are these substitutes? How does this vary with consumers' risk preferences?
3. How effective is competition in the supply of retail deposit products in delivering good outcomes for consumers?

Chapter 4: Barriers to entry and expansion

4. What is the potential for new entry in the supply of retail deposit products? What form is new entry likely to take?
5. How significant are barriers to entry and/or expansion in the supply of retail deposit products? How have these changed over time?
6. How has new entry or expansion in the supply of retail deposit products impacted the behaviour of incumbent ADIs?
7. How have ADIs responded following the exit of relative newcomers in the supply of retail deposit products?
8. How are ADIs likely to respond to any new entry, or the threat of new entry, in the foreseeable future?

Chapter 5: Retail deposits as a source of funding

9. How do each of the listed factors affect the significance of retail deposits as a source of funding for ADIs? How does this vary between ADIs of different sizes and business models?
10. What other factors affect the role of retail deposits as a source of funding for ADIs? How do these factors vary between ADIs of different sizes and business models?
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Chapter 6: Interest rates for retail deposits

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Chapter 7: Consumer information and switching

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