ACCC
AUSTRALIAN COMPETITION & CONSUMER COMMISSION

Retail deposits inquiry

Final report

December 2023

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Australian Competition and Consumer Commission
Land of the Ngunnawal people
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Executive summary

Retail deposit products are essential to the financial security and wellbeing of all Australians and the economy. Consumers depend on retail deposit products to conduct their everyday banking, to safely store over $1.4 trillion of their savings and, importantly, to earn a decent return on these funds.

Despite the importance of transaction accounts, savings accounts and term deposits, the ongoing challenges consumers face in searching for, comparing, and switching between products means that consumer engagement with the market for retail deposit products is relatively low. This low level of engagement means many consumers miss out on earning more from their savings.

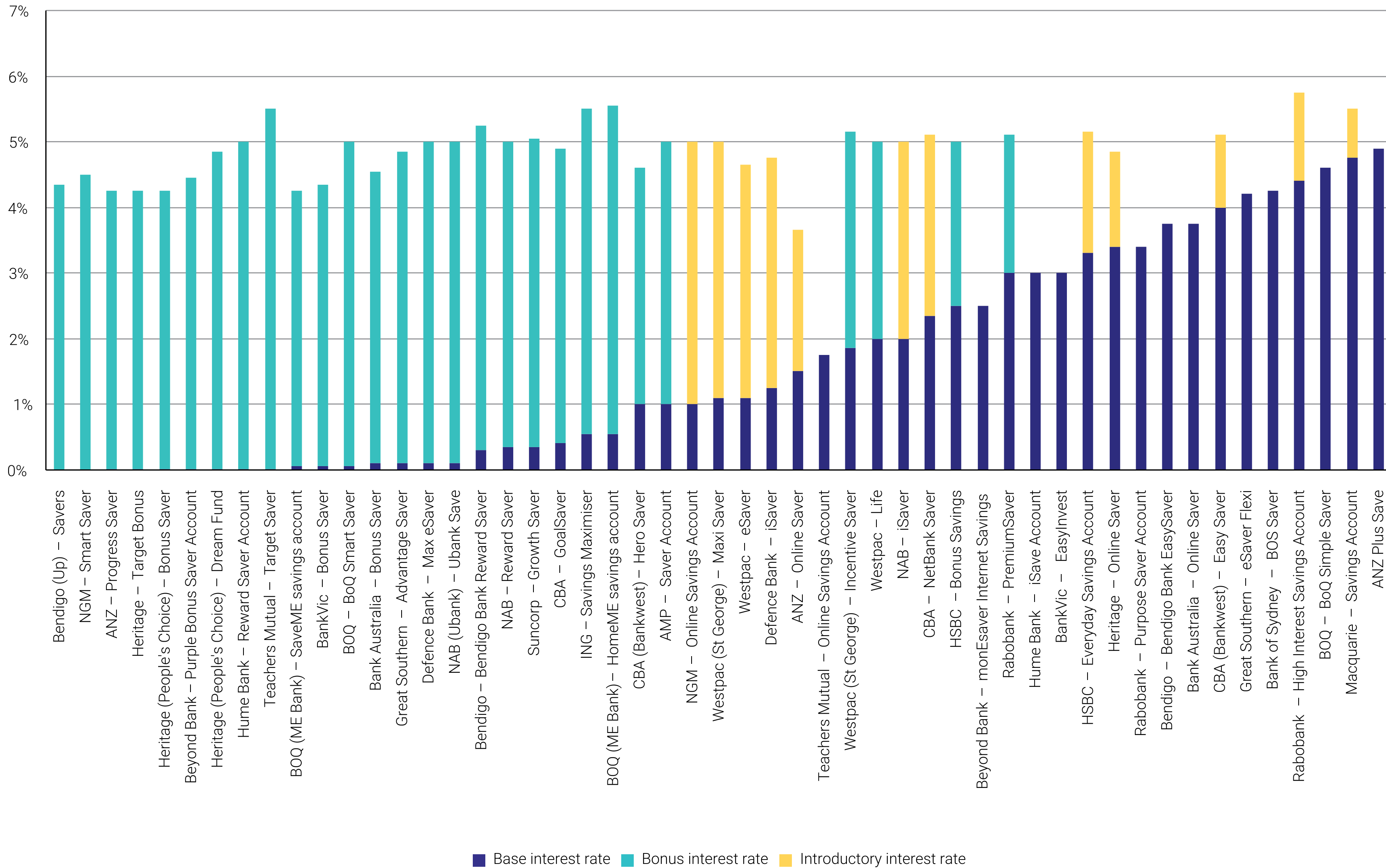
Retail deposits are also essential to banks as a stable and relatively cheap source of funding. Banks on average rely on household deposits for close to 30% of their funding needs, with some banks (especially mutuals) more dependent on retail deposits than others. Banks compete for deposit funding primarily through the interest rates they offer for deposits. A bank's incentive to minimise their retail deposit funding costs through lower interest rates is, in part, constrained by the extent to which consumers can actively switch between products and banks.

This Inquiry examined how banks make their interest rate decisions against the background of their funding requirements and changes in the cash rate target set by the Reserve Bank of Australia (RBA). The cash rate is not paid directly by the RBA to banks, nor is it a regulated rate that banks must receive from borrowers or pay to depositors when setting their retail deposit product interest rates. Banks also consider their broader funding requirements, profitability, economic and regulatory factors, likely customer responses and the competitive landscape when setting their interest rates.

Although we have observed instances of price competition from smaller competitors seeking to grow their market share, there is little evidence of aggressive broad-scale price competition, particularly from larger banks. Instead, banks tend to pursue strategic pricing practices at an individual product or customer level.

We found a range of such practices across banks, designed to attract and retain higher value customers. These pricing strategies take advantage of consumer inertia and other biases to reduce the overall cost of their deposit funding. This includes segmenting their customers through product design and conditional rates, leading to significant differences in rates between products, even within the same bank, as shown in figure S.1.

Figure S.1: Interest rates on select banks' bonus interest accounts, introductory interest accounts and unconditional savings accounts, November 2023

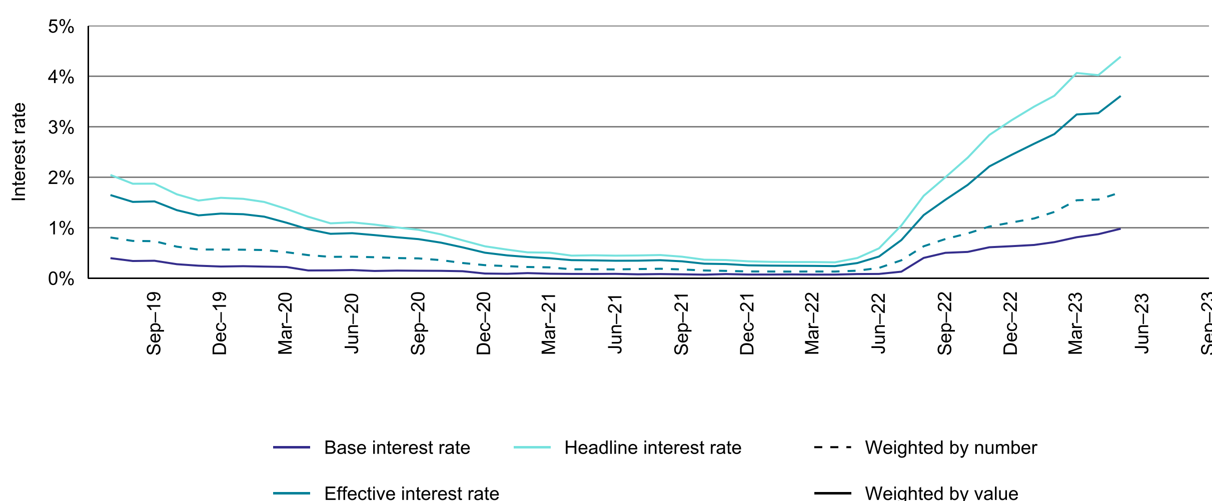


Note: Interest rates are as applicable to a $5,000 deposit balance.
Source: Banks' websites, accessed 20 November 2023.

Banks have relied heavily on conditional and time-limited interest rate offers in recent years. We have observed that increases in headline interest rates for savings products are often driven by increases in a bonus interest rate or introductory interest rate, rather than the base interest rate. The conditional nature of bonus interest rates and introductory interest rates means that the amount of interest actually received by consumers (that is, the effective interest rate) can be considerably lower than the headline interest rates suggest.

We found that 71% of bonus interest accounts did not receive the bonus interest rate on average each month over the first 6 months of 2023. The effective interest rates achieved across bonus interest rate accounts since mid-2019 are shown below in figure S.2. Notably, the effective interest rates received when averaged by the number of accounts are even lower than when averaged by the value of deposits in accounts.

Figure S.2: Estimated average interest rates paid on bonus interest accounts – select banks, July 2019 – May 2023



Note: Excludes offset accounts. Interest rates are based on estimates of interest accrued in a month and the account balance for the same month, and then annualised. Includes inactive (dormant) accounts. The base interest rate is the estimated average for those bonus interest accounts that only received the base interest rate. The headline interest rate is the estimated average for those accounts that received the bonus interest rate (in addition to the base interest rate for those accounts). The effective interest rate is the estimated average across all bonus interest accounts.

Source: ACCC analysis of data obtained from banks.

We also found that banks' pricing strategies include 'below-the-line' pricing – offering targeted specials to particular customer cohorts and negotiating more generous interest rates with individual customers who are of higher value to the bank.

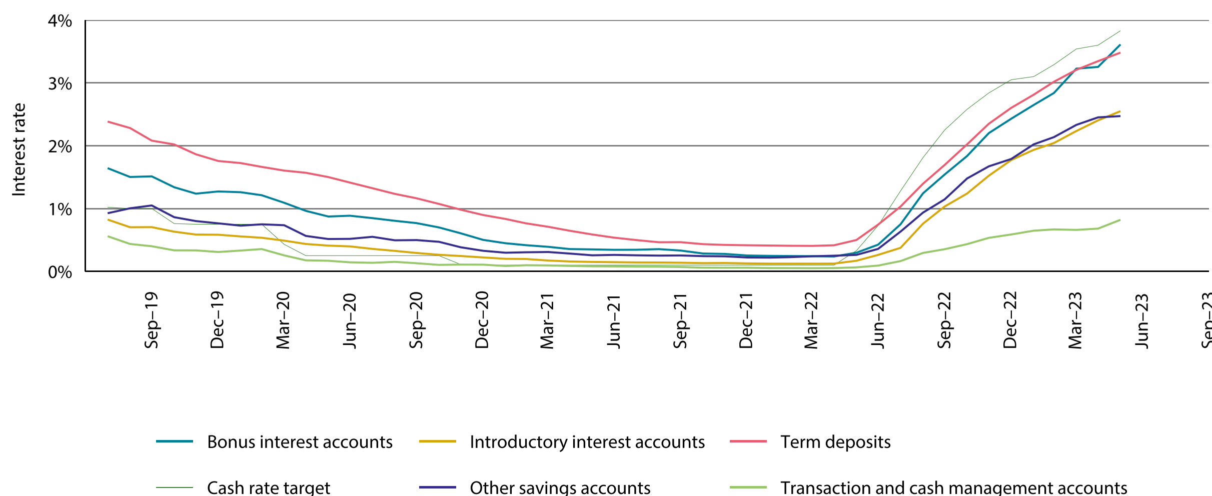
Banks are free to set their own interest rates. Paying different interest rates to different customers with the same product is not inherently anti-competitive. However, in markets with low consumer engagement and high searching and switching costs, the lack of transparency over widespread selective pricing means that any benefits of competition are confined to segmented groups of consumers, rather than consumers more generally.

Widespread strategic and selective pricing also adds difficulty for consumers when seeking to locate key product information and compare market offerings. This lack of transparency may also damage consumer confidence in the market.

Given the range of factors that banks take into account and the strategic pricing approaches they employ when setting their retail deposit rates, the interest rates received by consumers do not automatically follow movements in the cash rate target.

Figure S.3 below shows the effective interest rates across all accounts for different product types. Notably, average effective interest rates for term deposits and bonus interest accounts were above the cash rate target from 2020 until mid-2022, but were both below the cash rate target as of June 2023.

Figure S.3: Estimated average effective interest rates of select banks' retail deposit products, July 2019 – May 2023



Note: Excludes offset accounts. Interest rates for term deposits are as accrued. Interest rates for other retail deposit products are based on estimates of interest accrued in a month (or quarter, where relevant) and the account balance for the same month (or quarter, where relevant), and then annualised. The effective interest rate is the estimated average across all accounts for each retail deposit product type.

Source: RBA, ACCC analysis of APRA data and data obtained from banks.

There are significant differences in the interest rates, terms and conditions across similar products within and between banks. However, consumers often do not consider whether they are getting a good deal unless they are motivated by a specific event or savings goal. Even then, most consumers do not move to products that would provide better outcomes for them, as the steps needed to switch accounts (including changing over their direct debits and other recurring payments) can be convoluted and time consuming.

The ACCC has recommended several measures that have the potential to improve consumer outcomes, in the short and long term.

These measures are designed to provide ongoing transparency and help overcome common consumer biases and inertia, to make it easier for consumers to choose retail deposit products that better meet their needs. Greater transparency is also essential for ensuring that the retail deposits market works in the interests of Australian consumers and the broader economy.

We have also recommended further consideration of bank account portability which has the potential to build on recent reforms and greatly enhance the capacity for consumers to undertake switching between products and banks.

Findings

Chapter 1

Retail deposit products are essential to Australians' everyday lives and their long-term financial security

- Retail deposit products such as transaction accounts, savings accounts and term deposits play an essential role in the Australian economy, providing consumers with a safe place to store their money, pay for goods and services, and earn income through interest.
- They are also essential products for banks, as they help banks fund their lending activities, and contribute to the stability of the banking system.
- Banks offer various types of interest rates on retail deposit products, including base interest rates, introductory and bonus rates, and levy various fees and charges as well.
- Consumer engagement with retail deposit products is complex and often shaped by experiences, preferences, and biases, including towards the banking sector more generally. This can shape how banks try to attract and retain customers.

Chapter 2

Many banks offer retail deposit products, but the sector is concentrated with barriers to entry and expansion

- There are 4 major banks and 6 mid-tier banks which supply 89% of retail deposits, and a long tail of smaller banks supplying the remainder.
- Banks generate their revenue primarily through loans, which are funded by a number of sources including deposits. Retail deposits are considered a stable and accessible source of funding. Smaller banks may be more reliant on retail deposit funding as other forms of funding are more costly or inaccessible for them.
- Banks manage a range of risks associated with deposit taking and lending including in relation to credit and liquidity. Prudential regulation manages these risks by ensuring banks can mitigate risk appropriately and remain solvent during periods of financial adversity, to ensure the stability and resilience of the financial system.
- There are a range of barriers to entry and expansion for retail deposit products including advantages of scale and scope, access to funding, and consumer preferences.

Chapter 3

Competition for retail deposit customers is often selective and opaque

- There has been some limited entry and expansion of banks offering retail deposit products, however the absence of a broader competitive response suggests that this is not a material competition constraint on incumbent banks.
- New entrants and smaller competitors are constrained in how they compete for retail deposits. Their smaller scale means they must compete aggressively to win new customers, often on price, but they must be careful not to significantly increase their funding costs given access to other forms of funding is likely to be more limited. Established mid-tier banks are likely to be less constrained in the same manner.

- In general, incumbent banks have responded to price competition with strategies to retain higher value customers through targeted 'below the line' pricing or seeking to acquire new customers using time limited price competition (such as introductory interest rate offers).
- Banks recognise their customers are 'sticky' and invest in strategies to increase customer stickiness. This enhances banks' ability to respond to price competition selectively rather than through broader pricing changes which may trigger competitor responses that reduce margins.
- There has been a lot of innovation and technological developments over the last decade, both in banking and other sectors, and consumers expect a level of sophistication from product and service providers. Not all examples of innovation are indicators or outcomes of competition and care should be taken not to overstate the extent to which innovation is a result of non-price competition.

Chapter 4

Retail deposits are an important funding source for banks

- Banks seek funding to sustain and grow their business. In doing so, they must balance their funding and lending growth, manage key risks and compete in various funding markets.
- Banks obtain funding from a range of sources, including retail deposits, wholesale deposits, short-term and long-term wholesale debt, and equity.
- Retail deposits provide many benefits relative to other funding sources. Retail deposits are generally cheaper, more stable and more diversified than many other funding sources. Retail deposits can also bring additional benefits because retail depositors often become customers for loans and other products with their bank.
- Banks employ funding strategies to ensure they are funded at the lowest cost while remaining consistent with their risk appetite. Funding strategies consider banks' funding needs, costs and risks, and market conditions. As part of their funding strategies, banks set funding targets and limits, and specify approaches to managing various risks, including liquidity risk and interest rate risk.
- Banks have greater discretion on how they set interest rates for retail deposits than they do for other funding sources. Accordingly, interest rate setting is an important part of how banks meet their funding requirements.

Chapter 5

The RBA's recent cash rate target increases have only indirectly affected retail deposit funding costs and rates

- The cash rate (often referred to as the 'official interest rate') is the rate paid on lending between banks in the overnight cash market. The cash rate is not paid directly by the RBA to banks, nor is it a regulated rate that banks must receive or pay.
- Changes to the cash rate target indirectly affect the cost of funding from retail deposits and the interest rates paid on retail deposit products. These effects differ between types of retail deposit products.
- In contrast, changes and expectations of changes to the cash rate target appear to have a more direct effect on a bank's costs of new wholesale debt, which is usually their marginal cost of funding. However, as banks may obtain wholesale funds from a variety of sources and for a range of maturity periods these effects on a bank's wholesale funding costs may not be immediate.
- Recent movements in deposit rates and the cost of funding from deposits have been significantly impacted by the unprecedented impacts of COVID-19, including a combination of the significant

deposit inflows banks received over 2020 and 2021, and banks' access to very low-cost funding from the Term Funding Facility.

- Interest rates on different types of retail deposit products converged from mid-2019 to mid-2022, with greater decreases occurring on term deposits and bonus interest products, given interest rates on other at-call deposit products were already very low.
- As the cash rate target increased, interest rates paid on different retail deposit products have become increasingly distinct, with clear differentials between term deposit products, bonus interest products and other at-call deposit products.

Chapter 6

Banks take a variety of approaches to how they make interest rate decisions, including the factors they take into account

- Banks use a range of processes to make interest rate decisions for retail deposit products and home loans, depending on the financial impact and urgency of the possible rate change.
- Decisions about interest rates can be made in formal forums, such as a bank's pricing committee, or in less formal settings, such as by an exchange of emails among executives and senior managers, where circumstances allow.
- Many banks use a combination of regular and ad hoc decision-making to enable timely decisions based on external changes affecting the market.
- 'Funds transfer pricing' is an integral part of the interest rate decision-making process for many banks. It helps banks allocate costs, measure profitability, incorporate risk considerations, and make informed decisions about interest rates.
- Banks make decisions about interest rates on different products based on a combination of factors, including:
  - profitability objectives
  - the competitive landscape
  - funding requirements
  - economic and regulatory factors
  - customer satisfaction and reputational risk.
- There is significant overlap between the factors considered in interest rate decisions for retail deposit products and home loans.

Chapter 7

Strategic pricing strategies lead to greater complexity for consumers and, for some, poorer outcomes

- Banks typically seek to minimise their retail deposit funding costs but may use short-term and limited time offers such as term deposit specials and introductory offer products, which are relatively more expensive for a bank, to attract customers and their funds.
- Bonus interest rates and introductory interest rates can boost the headline interest rates consumers can receive, however the actual interest rates received by many consumers are lower.
- For savings products, changes in headline interest rates are often driven by changes to a bonus or introductory interest rate rather than the base interest rate.
- Further, the tactics banks use to retain or win higher value customers can be very selective and only a proportion of customers may benefit. Offers can be highly conditional to encourage 'sticky'

behaviour in customers and establish a 'main financial institution' (MFI) relationship. Alternatively, these offers are only available to specific segments of the customer demographic, such as those in early adulthood or those with larger deposit volumes.

- In the first half of 2023, 71% of bonus interest accounts did not receive the bonus interest rate on average each month.
- Banks use fees and charges to recoup operational costs from their customers, including those on retail deposit products. However, the fixed nature of fees means they have a more significant impact on retail deposit accounts with smaller balances.
- Banks' strategic pricing at the product and customer level makes retail deposit rates opaque and adds complexity for consumers engaging in the market.
- Interest rates for the same type of retail deposit product can vary significantly between, and sometimes within, banks. This rate dispersion is most pronounced with savings products.

Chapter 8

Consumer engagement is low and comparing products can be challenging

- There are several barriers for consumers at all stages of consumer engagement and switching.
- While the nature and size of certain barriers may vary for different consumers, there are clear deficiencies throughout the process which may be addressed by a combination of measures.
- Consumer engagement is often influenced by consumer preferences and biases, such as status quo bias and loss aversion, which may lead to prolonged inertia in the absence of triggers to engage.
- Those consumers who are engaged care most about price (including interest rates) but also take other factors into account.
- Key information on retail deposit products is available through bank websites and comparison websites, but can be too complex, not always easy to locate, and is inconsistent between providers.
- It is difficult for consumers to obtain an objective view of the best products due to lack of consistency between banks and conflicted arrangements with comparison websites.

Chapter 9

Consumers find it difficult to switch accounts, so most do not

- Relatively few consumers switch deposit products, despite there often being a range of alternative products offering better interest rates and conditions.
- There are significant impediments to switching which take time and effort to overcome, and which occur at several points in the process. These include changing direct debits and other recurring payments, redirecting incoming payments and proving identity.
- There have been a number of initiatives to date that have so far been ineffective at addressing both barriers to switching, and barriers in consumer engagement more generally.
- Measures that could reduce or remove these barriers have the potential to facilitate more widespread competition between banks and enhance consumer outcomes in the retail deposits market.

Recommendations

The ACCC has made 7 recommendations based on our Inquiry findings. These recommendations are designed to:

- increase transparency to support decision making
- support more effective consumer engagement
- reduce barriers to consumer switching to drive competition.

We consider the measures set out in these recommendations, if adopted, will improve consumer outcomes and the operation of the retail deposits market in Australia.

Increase transparency to support decision making

Recommendation 1

Continued monitoring of prices and competition in the retail deposits market

The retail deposits market requires increased transparency, given its importance to consumers and the economy more broadly. The opacity of retail deposit pricing (rates, fees and charges) and the limited competition observed justify ongoing scrutiny as the sector continues to evolve.

This monitoring should build on existing high-level reporting requirements and mechanisms which would minimise the regulatory burden, particularly on smaller banks. There should also be frequent and timely reporting on the results of the monitoring. This can provide much greater transparency to consumers and evidence to policy-makers on prices and competition in the retail deposits market.

Support more effective consumer engagement

Recommendation 2

Consumers should be provided with an alert if they are about to breach bonus interest rate conditions

Banks choosing to offer conditional bonus interest rates on their retail deposit products should provide real-time alerts to customers at risk of breaching these conditions.

If these measures are not voluntarily taken by banks in a reasonable timeframe, they should be mandated.

Any mandatory requirements should be extensively tested to ensure alerts are presented in an effective manner.

Recommendation 3

Banks should be required to record and report bonus rate achievement for their products

Banks should record, for each bonus interest rate product they offer, the proportion of accounts receiving the bonus interest rate per month. Banks should also record which bonus interest rate criteria are met or not met for each customer.

Banks should use this data to consider the ongoing appropriateness of their bonus interest rate products for their customers.

Banks should also report on the overall proportion of accounts receiving the bonus interest rate for each product alongside their promotional material for the product.

Recommendation 4

Clearer disclosure of introductory interest rates and alternatives

Banks offering an introductory interest rate on a retail deposit product should:

- Prominently disclose the base interest rate applicable at the end of the introductory period.
- If the bank offers a retail deposit product with a better base interest rate (that is, a rate that is not time-limited or conditional), the bank should also disclose this when promoting its introductory interest rate offer. This should include a statement about the length of time it would take before a given deposit amount would return a greater amount of interest if the other product was used for the deposit.

Recommendation 5

Banks should tell consumers directly when they change interest rates, and prompt them to consider switching for a better rate

Banks should be required to directly **notify** transaction and savings account holders of changes to their interest rates, and changes to the eligibility requirements for a bonus interest rate.

As part of these notifications, the bank should **prompt** the account holder to consider whether alternative products may better suit their needs. If the bank offers other transaction or savings products (as relevant) with a higher interest rate that is not conditional or a time-limited offer, the prompt should detail how to obtain more information about those products.

The prompt should be provided to account holders at least annually (in the absence of an interest rate change).

The notification and prompt requirements should be determined following consumer testing and trials.

Recommendation 6

Comparison websites should be more transparent about any commercial arrangement they have with banks

Comparison websites should clearly and prominently display:

- the number and names of the banks they include in their searches
- which of these banks they receive payments from and on what basis (for example, if payment is made per-click or only if an account is opened)
- an explanation of how any product ratings are determined, including what (if any) role the comparison website's commercial arrangements with a bank affect the ratings of that bank's products.

Reduce barriers to consumer switching to drive competition

Recommendation 7

The Australian Government should review the merits of bank account portability

The retail deposits market, and the banking system, has changed considerably over the last decade, however barriers to switching remain very high.

The Australian Government should review the merits of bank account portability.

The review should consider the likely costs, benefits, risks and opportunities that different approaches to bank account portability would present.

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] This is the ACCC's report on matters considered in the Inquiry.

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

- **Interest rates paid on retail deposits**, including with reference to differences between customer segments, and any differences between advertised interest rates and the actual rates paid to customers.
- **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.
- **Bank strategies in relation to retail deposit products, including 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 to alternative retail deposit products (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.

The terms of reference for the Inquiry are at Appendix B.

This report considers the competitive dynamics and consumer outcomes in the supply of retail deposit products by banks. For the purposes of the Inquiry, retail deposit products are deposit accounts held by individuals for personal or housing purposes such as transaction accounts, savings accounts, and term deposits. These accounts may be used for a variety of purposes, including as an offset account for eligible home loans offset accounts or by trustees of self-managed superannuation funds (as described in section 1.2).[2]

Conduct of the Inquiry

The findings set out in this report are based on the ACCC's analysis of information available to it, which was drawn from a range of sources.

As set out below, the Inquiry drew particularly on the data, information and documents in respect of the retail deposit products supplied by 14 of the largest banks in Australia, with a particular focus on the period from mid-2019 to mid-2023.

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

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

As such, observations in this report as to general trends or conduct by banks supplying retail deposit products may not always reflect the behaviour or approach of all banks in the sector but are considered representative of how the market for these products works.

Throughout this report, CBA, Westpac, NAB and ANZ are referred to as the **major banks**. The next 6 largest banks, consisting of Macquarie Bank, ING Bank, Bendigo and Adelaide Bank, Bank of Queensland, Suncorp Bank and HSBC Bank Australia are referred to as the **mid-tier banks**. We focused on the products of 4 mutual banks – Great Southern, Heritage, NGM and Teachers Mutual – and these are referred to as **the mutuals**. All other banks who supply retail deposit products will be referred to as **other smaller banks**.

On 21 April 2023, the ACCC published an issues paper for the Inquiry and invited submissions from interested stakeholders, seeking their views on key issues, including in response to specific questions.

The ACCC received 51 submissions in response to the issues paper, which have been published on the Inquiry website. These comprise submissions from consumers, consumer advocacy groups, banks and bank industry associations, as well as other industry participants. Information from these submissions is referenced throughout this report.

Information requests

Throughout the Inquiry, we have used our compulsory information gathering powers under section 95ZK of the *Competition and Consumer Act 2010* to obtain data, information, and documents on retail deposit products supplied by 14 of the largest banks in Australia.

The Inquiry drew particularly on the data, information and documents in respect of the retail deposit products supplied by the 14 banks noted above. These banks collectively hold more than 90% of household deposits in Australia. This included seeking information directly from these banks as to their retail deposit products and from APRA and RBA, as well as reviewing the information available to the public on the banks' websites.

Consumer research

The ACCC engaged SEC Newgate Research to undertake a consumer survey (ACCC consumer survey),[3] to gain insight into how consumers use and understand their retail deposit products, as well as their general attitudes and preferences in relation to these products.[4]

Publicly available information

The Inquiry has also drawn on publicly available information from Australia and overseas. In particular, we have considered information on products and pricing from a number of bank and comparison websites, along with material from financial services regulators and others.

3 The report summarising the survey findings is available on the ACCC website: SEC Newgate, *Retail deposits research*, 22 June 2023.

4 Of the 1811 respondents, 95% reported having a transaction account, 79% a savings account and 19% had a term deposit. SEC Newgate Research, *Retail deposits research*, 22 June 2023, p 1.

1. How consumers use retail deposit products

Findings

- Retail deposit products such as transaction accounts, savings accounts and term deposits play an essential role in the Australian economy, providing consumers with a safe place to store their money, pay for goods and services, and earn income through interest.
- They are also essential products for banks, as they help banks fund their lending activities, and contribute to the stability of the banking system.
- Banks offer various types of interest rates on retail deposit products, including base interest rates, introductory and bonus rates, and levy various fees and charges as well.
- Consumer engagement with retail deposit products is complex and often shaped by experiences, preferences, and biases, including towards the banking sector more generally. This can shape how banks try to attract and retain customers.

1.1 Retail deposit products are essential

Retail deposit products play a pivotal role in ensuring Australians can confidently engage with the economy. They enable consumers to safely store their money, receive and make payments to and from their accounts, and receive interest on their savings. These products also provide an important entry point to financial services for individuals who are new to Australia's financial system, including young people and newly arrived residents. Retail deposit products are also an important tool for developing financial literacy and participation in the financial system.

Retail deposit products such as transaction accounts, savings accounts, and term deposits are also necessary in providing banks with funding to support new loan creation and undertake other activities from which they profit. The ability of banks to lend money to individuals, businesses and governments is essential for the health of the economy, as it provides the necessary capital for investment, and allows businesses to expand their operations, hire workers and stimulate economic activity.

Retail deposits represent a loan of funds by consumers to the bank and – broadly – the interest rate paid on the deposits is the cost of this funding for the bank. Retail deposits in particular are generally a stable and relatively low-cost source of funding for banks in comparison to many other forms of borrowing. The role of retail deposits as a source of funding is discussed in more detail throughout this report.

The importance of retail deposits to both consumers and banks means that even small changes to how they are supplied and used by consumers can have significant effects on consumers and businesses. A key focus of the Inquiry is to consider how banks set interest rates for deposit products, in particular in light of changes to the cash rate target.

Between 4 May 2022 and 8 November 2023, in response to high and rising inflation the Reserve Bank of Australia (RBA) increased the cash rate target from 0.1% to 4.35%, its highest level since

November 2011.[5] Banks have subsequently increased interest rates for loans, including home loans, personal loans, and business loans, in response. 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.

The implications of the broader economic environment, and the nature of the public discussion, are also considered at relevant points in this report, including with regard to how Australian consumers engage with retail deposit products and their attitudes towards banks in general.

1.2 There are many retail deposit products designed to meet different consumer needs

Retail deposit products broadly serve 3 key purposes for consumers.

- **Storing funds**: deposit accounts provide a safe and accessible way for customers to store their funds, which can be made available on demand or at maturity of the product term, depending on the account type. For many Australian consumers, most or all their savings are held in retail deposit products.
- **Facilitating payments**: transaction accounts in particular provide customers with the ability to make payments from, and receive payments to, their account.
- **Income generation**: interest paid on money in deposit accounts (notably savings or term deposit accounts) can serve as an important source of income for many consumers.

Most Australians have one or more retail deposit product[6] and the collective value of household deposits[7] has grown steadily over time, along with the economy in general, from around $340 billion in 2002 to over $1.4 trillion in 2023 (in $2023, see figure 1.1).[8]

Since March 2020, household deposits have increased by $400 billion in nominal terms. This increase has been attributed to various factors including government stimulus measures, reduced services spending, early access to superannuation[9] and precautionary saving during the COVID-19 pandemic.[10] Research published by the RBA suggests the acceleration in deposit growth may also be attributable to banks' increasing demand for stable deposit funding and the consequential increases in interest rates offered since 2022, making deposits more attractive to consumers.[11]

5 The cash rate target is discussed in detail in chapter 5 of this report. The cash rate target has been raised in 13 of 18 RBA monetary policy meetings since May 2022, by either 25 or 50 basis points, and left unchanged for the remainder of those meetings. RBA, Cash rate target, RBA website, accessed 8 November 2023.

6 RBA, Statistical table E5 – Household Financial Assets – Distribution, accessed 21 October 2023.

7 Household deposits, as defined by APRA, are deposits by resident households. In turn, 'households' are defined in Reporting Standard ARS 701.0 as persons whose dealings with other sectors are for personal or housing purposes.
In this report we will use the term interchangeably with retail deposits, although there are some differences between the 2. In particular, 'households' excludes self-managed superannuation funds.

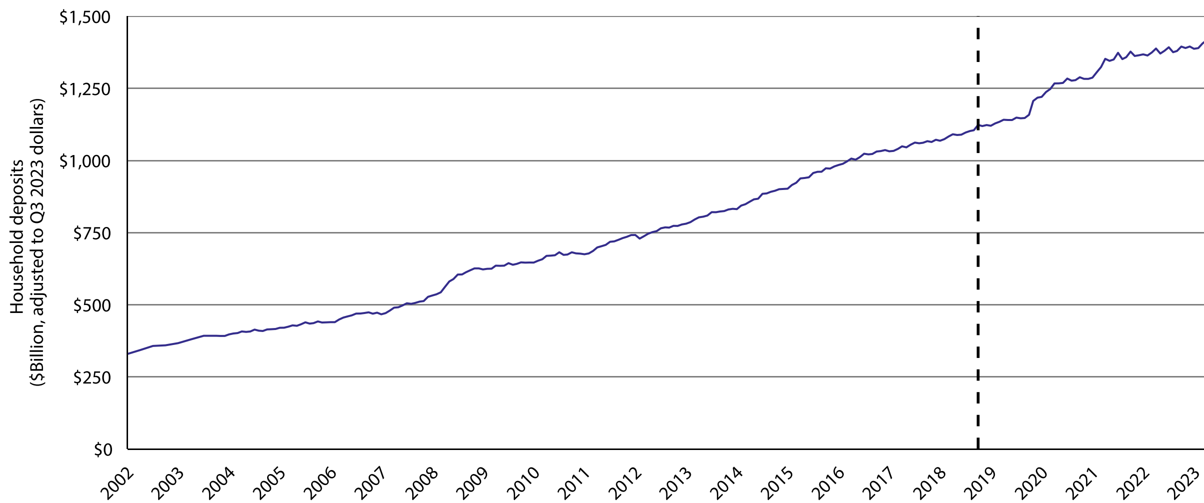
8 Source: ACCC analysis of calculations based on APRA, Monthly Authorised deposit taking institution statistics, June 2023 issued 29 September 2023. Back series data from 2002 to 2019 is also included in our analysis. As of October 2023, Self-managed super funds also hold over $146 billion in cash and term deposits. See: ATO, SMSF quarterly statistical report September 2023, published 27 November 2023, accessed 30 November 2023.

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

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

11 For a detailed discussion of the increase in household liquidity, including deposits, see, Gianni La Cava and Lydia Want, The Rise in Household Liquidity, *RBA*, November 2021.

Figure 1.1: Household deposits, June 2003 – September 2023 ($2023)

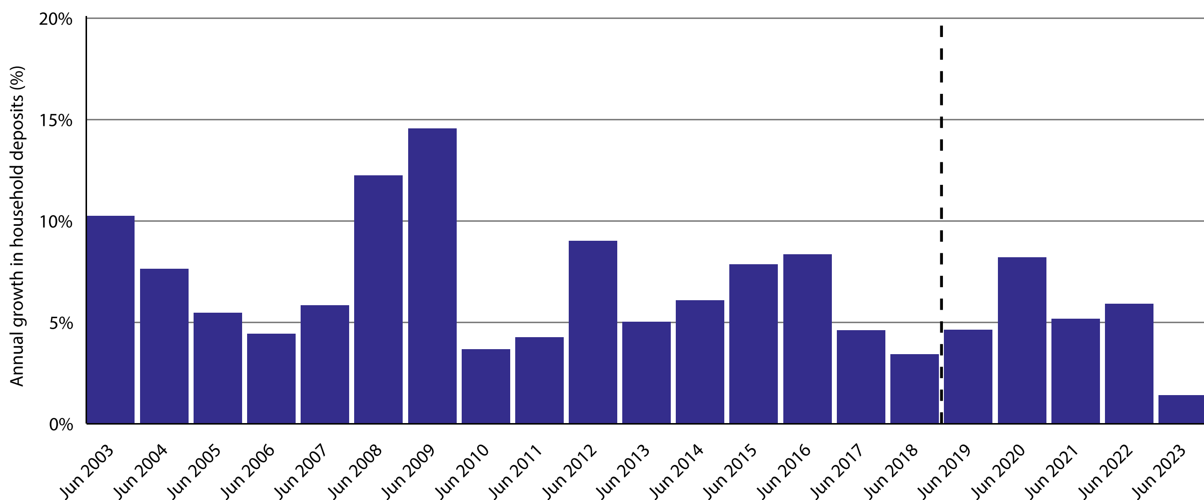


Note: The dashed line represents a series break in March 2019 as a result of APRA's Economic and Financial Statistics (EFS) collection commencing. The old series (Monthly Banking Statistics) included banks only, while the new series (Monthly ADI statistics) includes non-bank ADIs. Discontinuities are attributable to (1) the inclusion of non-bank ADIs, and (2) changes in definition to various data items. CPI adjustment based on ABS 6401.0 Consumer Price Index, All groups CPI, Australia.

Source: ACCC analysis of *APRA Monthly ADI statistics*, September 2023, APRA Monthly banking statistics June 2019 back series.

The increase in saving during the COVID-19 pandemic can be seen in figure 1.2 which shows the growth rate in deposits from 2003 to 2023. While notable, this increase was less than the growth rates of well above 10% observed during the GFC.

Figure 1.2: Annual growth in household deposits, June 2003 – June 2023 (%)



Note: Average population growth rate over the period June 2002 to March 2023 was 1.46% (ABS, 3101.0 National, state and territory population, March 2023 release). The dashed line represents a series break in March 2019 as a result of APRA's Economic and Financial Statistics (EFS) collection commencing, which will also impact the July 2019 annual growth calculation as this is based on July 2018 and July 2019 figures. The old series (Monthly Banking Statistics) included banks only, while the new series (Monthly ADI statistics) includes non-bank ADIs. Discontinuities are attributable to (1) the inclusion of non-bank ADIs, and (2) changes in definition to various data items. CPI adjustment based on ABS 6401.0 Consumer Price Index, All groups CPI, Australia

Source: ACCC analysis of *APRA Monthly ADI statistics*, September 2023, APRA Monthly banking statistics June 2019 back series. .

Retail deposit products have different features and meet different consumer needs

The Australian Banking Association (ABA) noted in its May 2023 submission to the Inquiry that there were over 1,000 retail deposit products available in Australia at that time.[12] At 30 June 2023 there were over 90 banks accepting retail deposits in Australia.[13]

While retail deposit products differ according to specific rates, fees and other terms and conditions offered, they can be broadly divided into 3 distinct categories: transaction accounts, savings accounts, and term deposit accounts. There is no strict distinction between these categories, and they may be interpreted differently by different banks or consumers. We have described them in table 1.1 according to common features and how consumers use these products.

Table 1.1: Main categories of retail deposit products

Key features	Rates, fees, and charges	Consumer use
Transaction accounts		
Enable consumers to withdraw money at any time, make payments using deposited funds and receive payments. Usually linked to a debit card. Often packaged (or bundled) with credit products such as a home loan or credit card.	Usually have low interest rates, or pay no interest at all. May include usage fees such as monthly account fees, international transaction fees, overdraw fees or fees for overdraft facilities, and certain withdrawal fees.	Day-to-day transactions and banking – funds are readily available as needed.
Savings accounts		
Provide consumers with a place to store funds and earn a higher interest rate. Generally do not come with a linked debit card, meaning that money must be transferred from a savings account before it can be used to make purchases.	Generally have a base interest rate that may be paid on funds, subject to terms and conditions (discussed in chapter 7) May also have additional interest rates, such as introductory, bonus, or other conditional rates, which are described below. Generally have few fees or additional charges.	For building up savings and earning interest. Consumers maintain access to their funds at any time, although there may be terms and conditions which place limitations on use of funds, or require a minimum amount to be deposited, for example, to receive higher interest rates (discussed in chapter 7)

12 ABA submission, 29 May 2023, pp 3–5. The ACCC notes that not all products will be available to all consumers.

13 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 30 June 2023, there were 49 foreign bank branches operating in Australia. Source: APRA, Quarterly Authorised Deposit-taking Institution Statistics, June 2023, released 5 September 2023

Term deposit accounts		
Consumer funds are held at the bank for a fixed period, typically ranging from 1 month to up to 3 years. Funds generally cannot be accessed by the consumer without penalty before the end of the term. Some term deposit accounts also require a consumer to provide advance notice before an early withdrawal of funds.	Generally, have higher interest rates than other deposit products, to compensate consumers for the restricted access to funds. Early access to funds may attract both a break fee and impact the amount of interest payable.	For building up savings and earning interest, without needing ready access to the money – this allows consumers to earn a fixed return on their deposit over a fixed term. Provides consumers with the certainty of knowing the interest rate, and when it will be paid.

Additional uses for retail deposit products

These categories of retail deposit accounts noted above are used in several ways to provide additional services to consumers:

- As an **offset account**: A bank may allow its home loan customers to specify certain transaction accounts or savings accounts as an offset account for an eligible home loan. A customer may deposit funds into this account, and the balance is deducted from the outstanding balance of their home loan for the purposes of daily home loan interest calculations. Although offset accounts do not pay interest, consumers are able to save interest they would otherwise pay at their home loan rate on those funds.

  An offset account will frequently have the features of a transaction account, in that it can be used for everyday banking, and linked to a debit card, among other things. Importantly, consumers have immediate access to the funds in an offset account, and may use it for everyday banking, and/or for savings. There will generally be account fees, some accounts may have conditions such as limits on withdrawals, and some mortgages with an offset account feature may have higher loan interest rates.[14]

- As a **cash management account**: These are deposit accounts which enable consumers to keep their funds for everyday banking in the same account as funds for investing but manage them separately. Although product features vary, accounts are often linked to a debit card, and may be connected to an investment platform. Consumers can use these accounts to manage overall cashflow and have a single view of their finances.

- By a **self-managed superannuation fund** (SMSF): A SMSF is a private superannuation fund set up as a trust for the purpose of providing retirement benefits to its members. An SMSF is required to have at least one bank account, into which contributions and rollovers are paid, and from which withdrawals, pension payments, and costs of running the fund are paid.[15] In addition, an SMSF might deposit funds in savings accounts or term deposits as part of their investment strategy, and/or use a cash management account to manage investments.

The analysis in this report generally focuses on the main categories of transaction, savings, and term deposit accounts, which include accounts used for the above purposes. We have only discussed the specific other uses where they are directly relevant.

14 This is in contrast to a redraw facility, which is not a type of deposit account, but enables a consumer to withdraw money paid on a home loan in excess of the minimum amount required.

15 Moneysmart, Self-managed super fund (SMSF), n.d., accessed 4 November 2023; ATO, Set up a bank account, n.d., accessed 4 November 2023.

Alternatives to retail deposit products

For safely **storing money**, retail deposit products have a clear advantage over other investment products. This is due to the regulatory requirements banks must meet to provide deposit products (discussed in chapter 2) and the Australian Government's Financial Claims Scheme (FCS), which provides a Government-backed guarantee for consumers for up to $250,000 per account holder, per bank, in the event that the bank fails. As discussed in section 1.3, safety of funds is a key concern for consumers.

For everyday **transactions**, retail deposit product are the only practical alternative to cash for most consumers. However, cash is not practical for large transactions or storing large amounts of money. Other alternative methods for transactions are available, such as digital wallets and credit cards, but these products do not allow consumers to store savings.

For the ability to **earn interest and grow savings**, other investment products tend to carry higher risks. ANZ, NAB, Westpac and the ABA each submitted that there were other investment products that could serve as alternatives, such as shares, property, or bonds. NAB, Westpac and the ABA each referred to consumers' risk appetite as a factor in choosing alternative investment products.[16]

The difference in risk between retail deposit products and investment products is important, as consumers cannot be assumed to have the knowledge to assess the potential risks and benefits. In 2020, the Australian Securities and Investments Commission (ASIC) warned consumers about the higher risks of investment products following a surge in marketing of fixed-term investment products which were advertised as alternatives to term deposits, but which carried higher risks.[17] Furthermore, alternative investments such as shares, property or bonds are unlikely to be practical for consumers with relatively low savings levels and/or less reliable incomes.

Banks offer several types of interest rates for their deposit products

In general, the interest a bank pays consumers holding a particular retail deposit product broadly represents the direct cost to the bank of sourcing funds from different retail deposit products.[18]

Individual retail deposit products may have different interest rate structures, with the rate a consumer receives depending on the size of their balance, personal characteristics and/or how they use the product. These rate types mainly apply to savings accounts and term deposits, as transaction accounts generally pay no, or negligible, interest, although there are exceptions.[19]

Banks' strategic use of interest rates as a tool for winning or retaining certain customers is discussed further in chapters 3 and 7 of this report.

The main types of interest rates that apply to retail deposit products are set out in table 1.2 below.

16 ANZ submission, 9 June 2023, p 3; NAB submission, 19 May 2023, p 5; Westpac submission, 24 May 2023, p 2; ABA submission, 29 May 2023, pp 2–3.

17 ASIC, ASIC Warns consumers: Investment advertising is not always 'true to label', 7 May 2020.

18 Chapter 4 considers the role of retail deposits as a source of funding for banks, including the various risks the bank must manage in doing so. The cost of managing these risks, including for retail deposit funding, may then be incorporated into the internal price the bank sets for the funds transferred between its business units – see chapter 6 for more detail.

19 Exceptions to this as at November 2023 include Macquarie's transaction account offering 4.5% p.a. (see Macquarie website, accessed 17 November 2023), in1bank offering 3.5% p.a. minimum base rate on its combined transaction and savings account (see in1bank website, accessed 17 November 2023), and retiree focussed accounts with tiered rate offerings.

Table 1.2: Main types of interest rates for retail deposit products

Type of rate	Description
Base interest rate	The interest rate payable to the holder of a Retail Deposit Product excluding any Bonus Interest Rate, Introductory Interest Rate or Negotiated Interest Rate (where applied in addition to the Base Interest Rate). It is the rate available generally to all holders of the Retail Deposit Product.
Introductory interest rate	An interest rate offered generally on a Retail Deposit Product above the Base Interest Rate for a limited period of time following the opening of an account. The base interest rate and introductory interest rate for a product together comprise the headline interest rate for these products. Introductory interest rates generally apply for 3–6 months from when a new account is opened, after which the account reverts to a lower base rate.
Bonus interest rate	A conditional interest rate offered on a Retail Deposit Product in addition to the Base Interest Rate. The base interest rate and bonus interest rate for a product together comprise the headline interest rate for these products Achieving the bonus interest rate (and therefore the full headline interest rate) is contingent on the customer meeting certain conditions. Conditions may include growing the account balance by a certain amount each month, making a minimum number of transactions, or limiting on withdrawals. If these conditions are not met, then only the base interest rate for the product will apply for that month.
Headline interest rate	The total interest rate for a retail deposit product including the base interest rate and any introductory interest rate or bonus interest rates.
Effective interest rate	This is the rate representing the amount of interest consumers actually receive, taking into account whether they achieve a bonus interest rate, are eligible for an introductory interest rate, or receive a targeted or negotiated interest rate.
Negotiated interest rate	An interest rate for a Retail Deposit Product that is agreed with the relevant customer on an individual basis. This will typically differ from the base interest rate, and is not a bonus interest rate or introductory interest rate. Banks may apply the negotiated interest rate in lieu of the base rate or in addition to the base rate.
Fixed term interest rate	A fixed rate of interest paid for a specified term. Term deposits earn interest at rate that is guaranteed not to change for the duration of the fixed term, so long as funds are not withdrawn prior to the maturity of the term deposit.
Tiered interest rate	Where a customer earns a different rate of interest depending on where the size of the deposit is within a balance range determined by the bank. In some cases, the rate applying to the highest balance range will apply to the whole account balance. However in most cases, interest is paid at the rate applicable within each range for the proportion of the deposit balance within that range. Higher value ranges tend to correspond with higher interest rates. However there are exceptions to this, as some banks may offer lower rates for funds held beyond a certain threshold, such as $250,000.

The above types of interest rate are not necessarily mutually exclusive. For example, bonus interest rates may be tiered by balance range similar to tiered interest rates. Banks can also make changes to the structure of their interest rate schedules, for example changes to the size and number of tiers, adding complexity for consumers.

In addition, banks also offer particular transaction and savings accounts targeting specific consumer segments, for example young adults and students, pensioners, or occupations such as healthcare providers. These products can have different features and interest rates from similar products at the same bank. For example, several banks offer a transaction account product for retirees over 55 years of age that pay interest while their main transaction product for other customer types does not.

The variety of interest rate types adds a layer of complexity for consumers. This is especially so for bonus interest rates which depend on the future behaviour of consumers and which mean

that consumers may not receive interest at the headline interest rate if they don't meet relevant conditions. The prevalence of these different types of interest rates, and the complexity that they can present, are considered further in chapters 7 and 8.

Banks continue to levy a range of fees and charges for holding and using retail deposit products

There are a range of fees and charges that may apply to retail deposit products, which may apply under different circumstances. These fees and charges represent the price consumers pay for holding and using these products. Applicable fees, and their terms and conditions vary between banks. The most common types of fees associated with retail deposit products are described below.

- **Monthly account keeping fee**: usually charged as a flat fee of around $5, which may be waived by some banks if certain conditions are met. There are also zero fee accounts on offer.
- **Overdraw fee**: may be a flat fee for a transaction that overdraws an account, and/or be in the form of interest charged on overdrawn amounts.
- **Dishonour fee**: may apply where there are insufficient funds in an account to make a scheduled payment.
- **Transaction fee**: charged for different types of transactions made on an account, such as foreign exchange fees when transacting in another currency, and can vary depending on whether the transactions were made in-branch, through phone banking or online.
- **Early access/withdrawal fee**: charged by some banks for withdrawing funds before the maturity of a term deposit. It may be a fixed amount, or calculated with reference to the interest that would have been earned, and the remaining length of the term.
- **Other fees**: other fees may include administration fees when ending a term deposit prior to maturity, a fee for receiving paper account statements, or account closure and inactive account fees.

Many of the fees and charges banks impose may be reduced or waived in certain circumstances. This can include where a customer holds certain other products or packages with the bank (especially in the case of home loans), where account balances are over a particular figure, or in some cases due to customer hardship.

Banks continue to earn considerable revenue from fees and charges on their retail deposit products as considered in chapter 7.

1.3 Consumer preferences and biases shape their approach to retail deposit products

How consumers choose between retail deposit products, or between banks, is driven by their ongoing experiences with these products, and with the banking sector more broadly. This is apparent from evidence through the ACCC consumer survey, submissions to the Inquiry, information from banks, and public information from a range of organisations.

Consumers value safety of funds and bank reputation very highly

As noted above, one of the key needs that retail deposit products fulfil is to provide a safe storage of funds. All customers value the safety of their funds although there are other factors that individual consumers will take into account when selecting a bank or product. The factors discussed below

contribute to a consumer perception in favour of the major banks, which is discussed further in section 2.4.

The ACCC consumer survey shows that, in addition to general safety of funds, there are other related factors which are important to consumers and may reflect consumers' broader preferences, experiences, or beliefs. When asked to choose the top 3 most important factors when choosing a new transaction, savings or term deposit account, safety of funds was cited by over 40% of customers for each account type. Relatedly, consumers also valued the reputation of the bank, and protections against scams or fraud, as shown in table 1.3.

Table 1.3: Most important safety-related factors when choosing a new account

Factors nominated in the top 3 most important	Transaction account holders	Savings account holders	Term deposit holders
Safety of funds	41%	42%	44%
Protections against scams or fraud	34%	28%	24%
Reputation of bank	28%	21%	24%

Note: Respondents were presented 12 factors for both transaction and savings accounts, and 9 factors for term deposits.
Source: SEC Newgate, *Retail deposits research*, 22 June 2023.

The ACCC considers that consumer attitudes towards safety, protections against scams or fraud, and reputation of the bank may all reflect perceptions of the banking system and its risks based on past and current events. This tends to favour the major banks.

The 2008–09 global financial crisis brought renewed attention to the notion that financial systems can be prone to instability and that the consequences can be significant.[20] Australian consumers' trust in the financial system was widely reported to have dropped[21], even though Australia did not experience financial detriments to the same extent as other countries. Nevertheless, government responses, both in Australia and globally, created or strengthened perceptions that certain institutions, such as major banks, were 'too big to fail' – that is, the government would intervene to ensure their survival. As trust in the financial system declined, it appears that trust in the major banks increased relative to other banks, due to this perception.

The ACCC consumer survey showed that between 34% and 40% of respondents had a preference for a major bank if opening a new account (depending on product type).[22] Among respondents with a preference for a major bank 26%–29% cited a view that major banks were more likely to be bailed out by government.[23] This preference exists despite the fact that the FCS provides a guarantee of up to $250,000 regardless of which bank holds the deposit.

Misconduct towards consumers, as highlighted by the Banking Royal Commission, was also reported to have eroded trust in the banks, particularly the major banks.[24] However, it was reported that a decline in trust regarding the ethics of banks didn't necessarily correspond with a decline in trust regarding the capability of banks.[25] A 2019 report from Deloitte stated that while consumers don't

20 The Treasury, Financial System Inquiry Final Report, November 2014, p 8, accessed 22 November 2023.

21 Guy Debelle, Assistant Governor, RBA speech, Some Effects of the Global Financial Crisis on Australian Financial Markets, RBA website, 31 March 2009.

22 27% to 30% had a preference for another (non-major) bank and the remainder had no preference one way or the other. While major banks and other (non-major) banks had similar reported preference percentages, there is a significant disparity in the number of banks in each grouping.

23 SEC Newgate, *Retail deposits research*, 22 June 2023, p 49.

24 Roy Morgan, NPS rating of big four banks declines during Finance Royal Commission, 1 April 2019, accessed 23 November 2023.

25 Australian Financial Review, Royal Commission erodes trust in banks: new poll, 28 October 2018, accessed 23 November 2023.

trust banks have consumers' best interests at heart, they do trust banks to keep their money safe and to keep their information secure.[26]

The ACCC notes consumers' preference for scam and fraud protection when choosing a new account (as shown in table 1.3 above), but it is not clear how a consumer might easily assess this across various banks.

Consumers value convenient digital and branch access

The ACCC consumer survey also showed that consumers value convenience, although what that means may vary depending on the product, how the consumer is using the product, and preferences of the individual consumer. Online/mobile banking facilities, and convenient bank branch access, both featured prominently when consumers were asked the top 3 most important factors when choosing a new transaction, savings or term deposit account, as shown in table 1.4 below.

Table 1.4: Most important convenience factors when choosing a new account

Factors nominated in the top 3 most important	Transaction account holders	Savings account holders	Term deposit holders
Online/mobile banking facilities	51%	40%	22%
Convenient bank branch access	19%	14%	15%

Note: Respondents were presented 12 factors for both transaction and savings accounts, and 9 factors for term deposits.
Source: SEC Newgate, *Retail deposits research*, 22 June 2023.

The importance of convenient digital access corresponds with how consumers typically use an account. Digital access is most critical to transaction account holders who are regularly interacting with their accounts for a variety of reasons, including making payments and checking balances. The importance of digital access decreases somewhat for savings account holders who still may use their account in a way that relies on regular access, and decreases even further for term deposits where consumers are less likely to regularly interact with their account, given that the funds are not available at call.

These trends with respect to consumer preferences were also reflected in some submissions to the Inquiry. CBA raised that broad accessibility options was a factor relevant to consumer consideration of competing retail deposit products. Westpac stated that making available different channels to manage and access its products ensures Westpac can meet the needs of its diverse customer base.[27] ANZ stated that customers 'increasingly expect that they can conduct their banking and transactions from their phone, instantly and safely. This shift is driving financial institutions to focus on digital technologies and capabilities'.[28]

Within the preference for digital access, there has been a shift away from internet banking, and towards mobile banking. According to research provided by one bank, over the previous 6 years their customers' use of internet banking has reduced by more than visits to a branch while use of their mobile banking app has increased. BOQ also has accounts which are only accessible via their myBOQ mobile app and likewise has products which are only available using BOQ internet banking.[29] ANZ also

26 Deloitte, Open banking: switch or stick?, Deloitte website, October 2019, p 4.

27 CBA submission, 25 May 2023, p 4; Westpac submission, 24 May 2023, p 2; ANZ submission, 9 June 2023, p 6.

28 ANZ submission, 9 June 2023, p 5.

29 Bank Of Queensland, myBOQ App FAQs, BOQ website, n.d., accessed 15 September 2023.

offers ANZ Plus as an app-only offering, which consists of both a transaction account and savings account.[30] Some digital only banks only offer banking through a mobile app.[31]

Convenient bank branch access was cited more consistently across product categories and may reflect that the preference for branch access is, at least in part, related to consumer demographics. The Association of Independent Retirees submitted that the reduction in branches 'considerably disadvantages older customers who have not transitioned to new online service options'[32] and that there is a 'significant group of older customers who still prefer to transact banking in a face-to-face manner'.[33] However, branch access is not just a matter of preference. Despite reported decreasing requirements to physically attend a branch to close an account,[34] many banks still require consumers to attend a branch or call the bank during business hours to close an account.[35]

The ACCC consumer survey found 43% of respondents who preferred a major bank for new transaction accounts cited conveniently located branches as a reason, compared to only 14% for those with a preference for other banks.[36] This difference is consistent with the major banks' larger branch networks and may be one reason why some consumers continue to prefer the major banks above other banks.

The ACCC notes that there has been a 37% reduction in bank branches from June 2017 to June 2023, which includes a 39% reduction in major cities (a net decline of 1,308 branches) and 34% in regional and remote areas (a net decline of 798 branches).[37] The effect this may have on consumer engagement with their products and potential alternatives, and their ability to switch accounts, is discussed in chapters 8 and 9.

Consumers tend to prefer keeping accounts with one bank

The ACCC consumer survey showed that when consumers did not search for a new account or change banks, the preference towards keeping accounts with the same bank was a major reason across product types. Table 1.5 shows how this was predominantly reflected in consumers who chose not to switch to a new product.

Table 1.5: Reasons for not switching accounts in the last 3 years

Reasons	Transaction account holders	Savings account holders	Term deposit holders
Prefer to keep accounts with only one bank	25%	23%	21%
Want to maintain a relationship with current bank	13%	11%	17%
Want to keep account at the same bank as home loan (of those with a mortgage)	20%	18%	14%

Source: SEC Newgate, *Retail deposits research*, 22 June 2023; ACCC analysis of consumer survey results.

This preference is valuable for incumbent banks who may already have a large and relatively 'sticky' customer base, that is, customers who are less likely to shop around and switch to a new

30 ANZ, Welcome to ANZ Plus, ANZ website, n.d., accessed 28 November 2023.

31 For example Up Bank, although a brand of Bendigo and Adelaide Bank, can only be accessed through an app.

32 Association of Independent Retirees submission, May 2023, p 6.

33 Association of Independent Retirees submission, May 2023, p 9.

34 Productivity Commission, Competition in the Australian financial system, 29 June 2018, p 159.

35 Choice submission, May 2023, p 10.

36 SEC Newgate, *Retail deposits research*, 22 June 2023, p 50.

37 APRA, Authorised deposit taking institutions' points of presence statistics, 18 October 2023.

provider, due in part to the preferences outlined above. Banks commonly refer to the bank where a consumer holds their main transaction account as that customer's 'main financial institution' (MFI). These customers represent potential higher value and the opportunity to build a profitable ongoing relationship.

Banks compete to grow their customer MFI base through their retail deposit products, in particular transaction accounts. Transaction accounts are commonly the first product a customer will acquire when they are new to a bank and are considered by consumers as an anchor product.[38] That is, consumers will consider taking out a new product, for example a credit card, with the bank with which they hold their main transaction or saving account before considering other banks.[39]

It its submission to the Inquiry, NAB stated that 'maintaining a deposits offering is important to banks to ensure they are positioned in the market as having a complete offering for customers and are competitive at a whole of bank level'.[40]

Behavioural biases

Consumers make numerous and complex decisions when engaging in the retail deposits market. Consumers must consider ongoing evaluations of costs and benefits in response to certain triggers or events. Because of this complexity, consumer decision making may be more intuitive and informed by individual biases.

Some of the key biases which may affect consumers of retail deposit products are outlined below and are referred to when considering conditional interest rates in chapter 7, and throughout the discussion of searching and switching in chapters 8 and 9 of this report.

- **Status quo bias:** This presents as a preference to stick with a chosen option or default, even if there are superior options available. It can lead to consumers underestimating the value of shopping around and switching, including by overestimating the effort required.[41]
- **Present bias**: This presents as consumers taking short-term actions which may not align with their long-term interests. It can mean that the immediate time and cognitive costs of searching and taking action to switch have an outsized impact compared with the potentially significant longer-term gains.
- **Loss aversion**: This is closely related to status quo bias, and describes a tendency for consumers to prefer avoiding losses over acquiring equivalent gains. This can influence how consumers weigh up expected costs of searching and switching against expected benefits of switching (such as higher interest rates or better product offerings).
- **Overconfidence**: This can arise when consumers overestimate the likelihood that they will experience a better than average outcome. For example, a consumer might overestimate their ability to meet complex requirements to receive conditional bonus interest rates.
- **Information/choice overload**: This can present as decision making paralysis when a consumer is faced with complex products or overwhelming options, such as a range of different interest rates for different investment time horizons and risk levels. It can affect willingness to engage in searching and comparing products.

38 Westpac, SocietyOne on board Westpac's BaaS platform, Westpac website, 23 February 2021, accessed 27 November 2023.

39 Productivity Commission, Competition in the Australian Financial System, 29 June 2018, p 149.

40 NAB submission, 19 May 2023, p 3.

41 The ACCC consumer survey found the top reason consumers did not search for a new account was because they were satisfied with their existing account. SEC Newgate Research, *Retail deposits research*, 22 June 2023, p 29.

2. Suppliers of retail deposit products

Findings

- There are 4 major banks and 6 mid-tier banks which supply 89% of retail deposits, and a long tail of smaller banks supplying the remainder.
- Banks generate their revenue primarily through loans, which are funded by a number of sources including deposits. Retail deposits are considered a stable and accessible source of funding. Smaller banks may be more reliant on retail deposit funding as other forms of funding are more costly or inaccessible for them.
- Banks manage a range of risks associated with deposit taking and lending including in relation to credit and liquidity. Prudential regulation manages these risks by ensuring banks can mitigate risk appropriately and remain solvent during periods of financial adversity, to ensure the stability and resilience of the financial system.
- There are a range of barriers to entry and expansion for retail deposit products including advantages of scale and scope, access to funding, and consumer preferences.

2.1 Most retail deposits are held with a handful of banks

For a business to supply retail deposit products to consumers, it must be licensed as an authorised deposit-taking institution (ADI) by the Australian Prudential Regulation Authority (APRA).[42] The requirements for a licence are discussed below in section 2.3. As noted in chapter 1, at 30 June 2023 there were over 90 banks accepting retail deposits in Australia.[43]

The largest holders of household deposits are the major banks which have around 73%, or nearly $1 trillion, of all household deposits in aggregate. These providers are CBA (26.9%), Westpac (20.5%), NAB (13.8%), and ANZ (11.7%).[44]

The mid-tier banks together hold a further 16.5% of household deposits. In this report, these banks are comprised of Macquarie (4.0%), ING (3.4%), Bendigo and Adelaide (3.1%), BOQ (2.4%), Suncorp (2.4%) and HSBC (1.2%). The mid-tier banks are either part of a larger financial service conglomerate (Macquarie), 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, BOQ and Suncorp) or subsidiaries of international banks (ING and HSBC).

In total, as shown in figure 2.1, the major banks and the mid-tier banks hold around 89% of all household deposits with the mutuals and other smaller banks making up the remainder.

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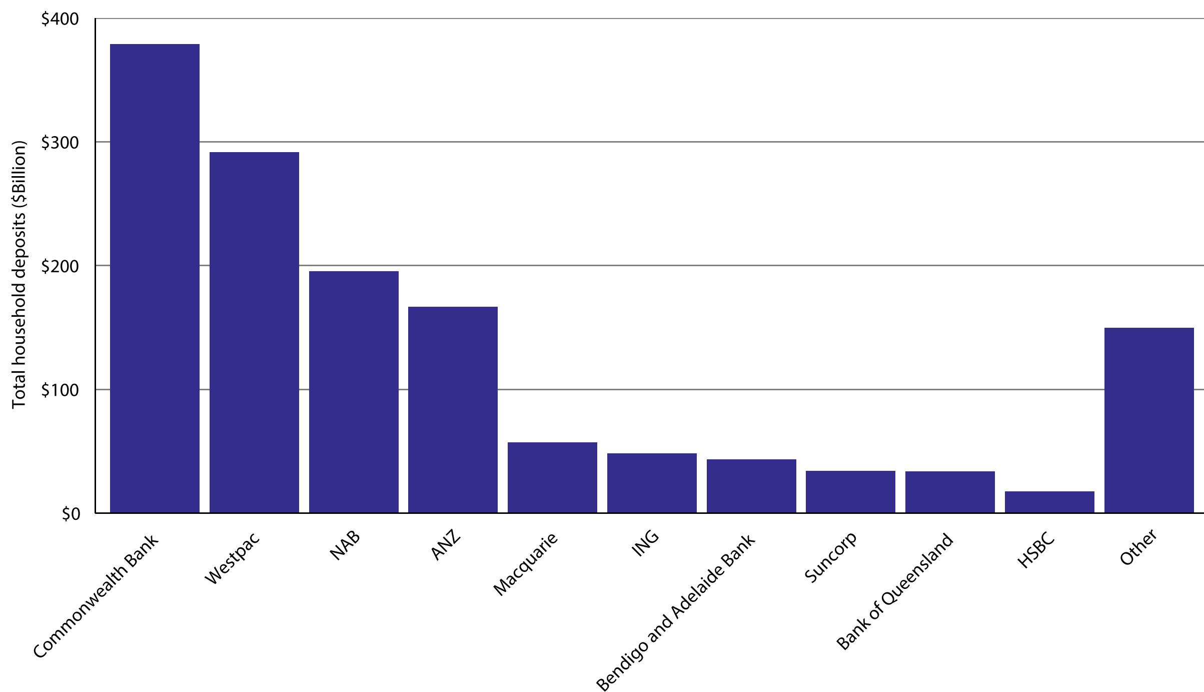
42 APRA, Licensing guidelines for authorised deposit-taking institutions, APRA website, n.d., accessed 23 November 2023.

43 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 30 June 2023, there were 49 foreign bank branches operating in Australia. Source: APRA, Quarterly Authorised Deposit-taking Institution Statistics, APRA website, 5 September 2023.

44 APRA, APRA Monthly ADI statistics, September 2023, accessed 23 November 2023.

Figure 2.1: Household deposits by bank, September 2023



Source: ACCC analysis of *APRA Monthly ADI statistics*, September 2023.

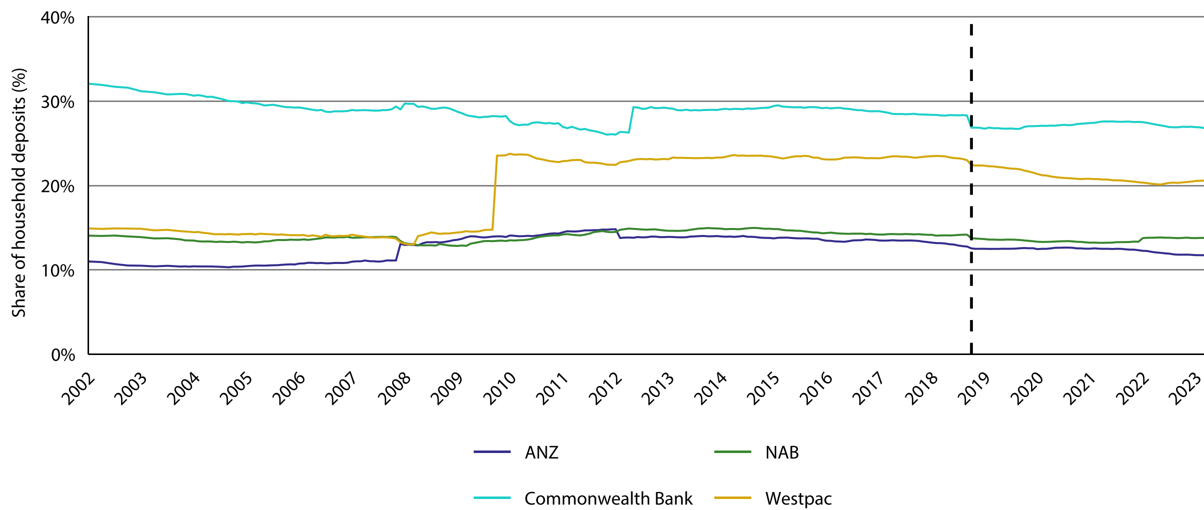
Market shares have remained relatively stable

Figure 2.2 below shows that the major banks have maintained a relatively stable share of retail deposits over the past 2 decades. Their collective share peaked at 81.5% in 2015 and decreased to 73.0% in June 2023.[45] Over this same period, Macquarie increased its share of household deposits from 0.8% to 4.0% (discussed further in chapter 3).[46]

45 APRA 2023, APRA Monthly ADI statistics, September 2023, accessed 23 November 2023.

46 APRA 2023, APRA Monthly ADI statistics, September 2023, accessed 23 November 2023.

Figure 2.2: Share of household deposits at major banks, June 2002 – September 2023



Note: Westpac's large jump in share in 2010 is due to it completing the move to a single ADI after its acquisition of St George in 2008, and CBA's jump in 2012 is due to its acquisition of BankWest in 2008. The dashed line represents a series break in March 2019 as a result of APRA's Economic and Financial Statistics (EFS) collection commencing. The old series (Monthly Banking Statistics) included banks only, while the new series (Monthly ADI statistics) includes non-bank ADIs. Discontinuities are attributable to (1) the inclusion of non-bank ADIs, and (2) changes in definition to various data items.

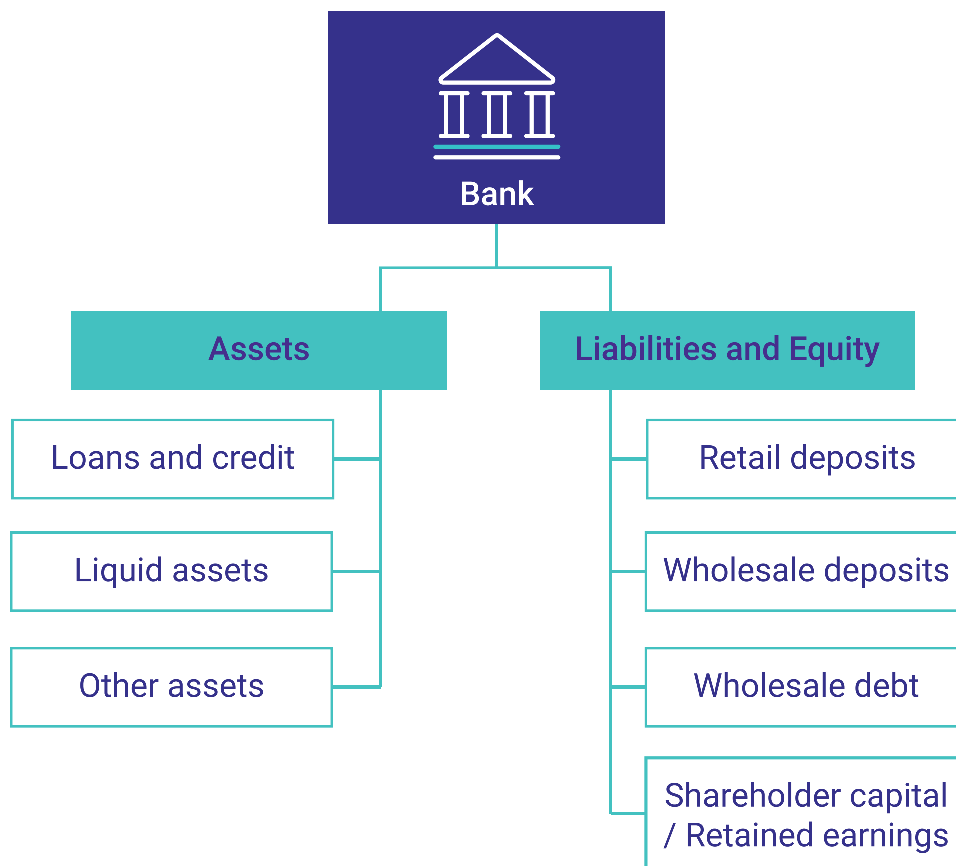
Source: ACCC analysis of APRA Monthly ADI statistics, September 2023, APRA Monthly banking statistics June 2019 back series.

2.2 Banks profit from using deposits and other funds to make loans

Although banks provide a wide range of products and services, their primary 'banking' role can be simply characterised as taking and holding deposits, including from consumers and businesses, and providing loans (such as credit cards, home loans, and a range of personal and business loans).

Loans represent an asset for a bank as the bank has a claim over borrowers for the repayment of the loan and interest. Conversely, deposits represent a liability for banks as the depositor has a claim over the bank for the funds they have deposited. Banks also have other claims over their assets in the form of other wholesale debt, equity, and other sources of funding. This is set out in figure 2.3.

Figure 2.3: A simplified bank balance sheet



Bank funding

Banks fund their businesses through the following main sources, which are described in more detail in chapter 4:

- Retail deposits
- Wholesale deposits
- Wholesale debt (short-term and long-term)
- Shareholder equity and retained earnings.[47]

The balance between the above types of funding (funding composition) will vary depending on the availability and cost of each type of funding, as well as other considerations which are discussed throughout this report. Funding composition, and the importance of retail deposits as a source of funding, are discussed in detail in chapter 4.

In general, banks benefit from having a range of funding sources which can mitigate risks, including that one source of funding may become (relatively) more expensive. In response to the Inquiry issues paper, ANZ, CBA, NAB and Westpac variously referred to deposits as an important source of stable funding and a key part of banks' overall funding mix. They also note deposits are essential

47 For the purposes of this Inquiry, equity here includes funding sources that are considered part of the definition of regulatory capital. Consequently, the main sources of funding noted in this section should be considered representative of the entire balance sheet, and equal to total assets.

for meeting Australia's prudential regulations (discussed below) and underpinning the strength and stability of Australia's banking system.[48]

How the availability and cost of funding sources may vary depending on the size of the bank is discussed in more detail in chapter 4.

Bank revenues and costs

As with any other type of business, banks make profits when their revenues exceed their costs. More specifically, banks profit by earning higher returns on their assets than they pay to their liability holders. In simple terms, banks do this by charging a higher interest rate on loans to borrowers than they pay to depositors, thereby earning a positive 'net interest margin' (NIM).

A primary source of revenue for banks is the interest they earn from loans such as mortgages, personal loans, and business loans. Another key source of revenue is from other assets such as government or corporate bonds, which can also generate interest income for a bank. Other sources of revenue include various fees and charges, such as those outlined in chapter 1, payment fees, fees for additional customer services (such as wealth management services), and trading and investment activities in financial markets.

A significant cost incurred by banks are interest expenses paid to retail deposit holders, especially for savings accounts and term deposits, as deposits comprise the largest share of funding. In addition, banks can have substantial operating expenses, such as employee salaries, technology infrastructure, buildings and rent. Other prominent costs banks face include provision for loan losses, depreciation and amortisation, and taxes such as corporate income tax, GST and payroll tax.[49]

Risk management

One of the key issues for banks is managing risk associated with deposit taking and lending. Table 2.1 sets out some of the key risks relevant to this Inquiry.

Table 2.1: Relevant risks for banks to manage

Risk	Description of risk	Mitigation of risk
Liquidity risk	The risk of a bank not being able to meet financial obligations as they fall due. This may occur when there are unexpected, large withdrawals of deposits by a bank's customers, or where banks are unable to replace short-term wholesale debt.	Banks hold liquid assets to manage this risk. Liquid assets can readily be converted to cash which can be used to meet any demands for deposit withdrawal or short-term wholesale debt repayment. Other key mitigants include diversified, stable funding sources, sound liquidity risk management and governance oversight.
Credit risk	The likelihood that the bank's borrowers are unable to make loan repayments.	Banks have considerable experience in extending loans, which provides insight into the size of the credit risk across a wide range of customers and loan types. Banks can gain additional insight into the credit risk of a particular borrower where borrowers have deposits at the same bank.

48 ANZ submission, 9 June 2023, p 11; CBA submission, 25 May 2023, pp 1–2, 9; NAB submission, 19 May 2023, p 1; Westpac submission, 24 May 2023, p 6.

49 ABA, Taxes and other levies paid to governments in Australia by the banking industry, August 2016.

Interest rate risk	The risk that general interest rate changes, for example when the RBA changes the cash rate target, will affect a bank's revenues differently from their costs and create volatility in net interest margins and profits. There is a risk of higher volatility in a bank's interest rate based revenues and costs arising from differences in maturity between assets and liabilities ('gap risk'), which interest rate indexes are referenced in pricing ('basis risk'), and adverse movements in the level of timing of cash flows ('option risk').[50]	Banks can manage interest rate risk directly by hedging their interest rate exposures in markets, and indirectly through changes to interest rates charged on loans and paid to depositors. Hedging involves banks using commercial financial markets products to reduce changes to NIMs as interest rates move. Hedging products allow a bank to swap any of their payments that move with interest rates, with firms that provide payments that don't move with interest rates. Banks generally pay a charge, often a proportion of the payments, for these products.
Market risk	The risk that adverse movements in financial market prices cause losses for a bank. Market risk can affect bank assets by, for example, reducing the value of assets banks hold on their balance sheets.	Banks can reduce market risk by diversifying their investment portfolio to cover several different asset classes and geographic regions. Banks can also use derivatives and hedging to mitigate their risk exposure and protect themselves against adverse market movements. In addition, strong risk models and monitoring and compliance processes help to reduce a bank's exposure to market risk.
Foreign exchange risk	Foreign exchange risk arises if a bank sources any funding from overseas. Australian banks sourcing funds from another country need to make payments in that country's currency, which will change as the exchange rate changes. Moreover, interest rates in other countries will also move differently from those in Australia.	Banks can use hedging to manage the foreign exchange risk, and often hedge both foreign exchange and interest rate risk simultaneously when sourcing funds from other countries.

2.3 Regulation of retail deposits is important for the stability of the financial system

Banks are subject to a variety of regulation, given the extent to which their activities can impact the economy, businesses, and consumers. This section outlines the key regulators and regulatory requirements (predominantly prudential requirements) which provide context for the analysis in this report.

Financial services regulators

Australia has 3 primary regulators for banking and finance – the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Reserve Bank of Australia (RBA). There are others, including the ACCC, that have broader regulatory roles which include the banking and finance sectors, as set out in table 7.

50 Types of interest rate risk typically faced by banks are set out in Interest rate risk in the banking book, published by the Basel Committee on Banking Supervision in April 2016: https://www.bis.org/bcbs/publ/d368.pdf.

With respect to banking and finance, the Australian Treasury is responsible for providing advice to the Government and implementing policies and programs, among other things, to promote competitive and efficient markets and a secure and resilient financial system.[51]

The Council of Financial Regulators is the coordinating body for Australia's main financial regulators. It is chaired by the RBA and its other members are APRA, ASIC, and the Treasury. It does not have any decision-making powers, but facilitates cooperation and coordination among member agencies, and other relevant agencies when necessary.[52]

Table 2.2: Regulators in financial services

Regulator	Responsibilities relevant to this Inquiry
Reserve Bank of Australia (RBA)	Australia's central bank with oversight of the stability of the financial system, including monetary policy.
Australian Prudential Regulation Authority (APRA)	Develops and enforces prudential regulation of ADIs and is responsible for licensing and regulatory oversight to protect the interests of customers.
Australian Securities and Investments Commission (ASIC)	Monitors, regulates, and enforces corporations and financial services laws, including consumer protection laws in relation to financial products and services.
Australian Transaction Reports and Analysis Centre (AUSTRAC)	Anti-money laundering and counter-terrorism financing, and financial intelligence.
Australian Competition and Consumer Commission (ACCC)	Promoting and enforcing compliance with competition laws across the economy and for consumer protection (excluding in financial services insofar as it falls within ASIC's remit).[53] Competition in the financial services sector has been an ACCC priority since 2021.

Prudential regulation

Prudential regulation is 'a legal framework focused on the financial safety and stability of institutions and the broader financial system'.[54] Australia's prudential regulator, APRA, is 'responsible for ensuring that the entities it regulates can, under all reasonable circumstances, meet the financial commitments they make to a core group of customers'.[55] For banks which supply deposit products, this means ensuring that deposited funds are safe and available to depositors when they need to access their funds, which in turn contributes to the overall stability of the financial system.

The ACCC notes that there can be tension between the objectives of financial stability and competition. However, the *Australian Prudential Regulation Authority Act 1998* sets out APRA's purpose and relevantly states: 'In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia'.[56]

Robust competition in banking – as in other sectors – helps ensure businesses effectively meet the needs of their customers in favourable terms (including on rates, fees and quality of service). In

51 Treasury, Banking and Finance, Treasury website, n.d., accessed 24 November 2023.

52 Council of Financial Regulators, About the CFR, Council of Financial Regulators website, n.d., accessed 24 November 2023.

53 This included dedicated funding, recovered from industry, from May 2017 until June 2023 to examine competition issues in financial services.

54 APRA, What is prudential regulation?, APRA website, n.d., accessed 24 November 2023.

55 APRA, What is prudential regulation?, APRA website, n.d., accessed 24 November 2023.

56 *Australian Prudential Regulation Authority Act 1998*, s 8(2).

the context of retail deposit products, this competition should occur and be encouraged within the regulatory parameters set for the sector.

Consistent with the Inquiry Direction, this report discusses key elements of prudential regulations that apply to banks supplying retail deposit products, only to the extent that it is necessary to consider the matters the ACCC has been directed to consider. This includes where certain regulations may create or raise barriers to entry or expansion, and as context for how different banks choose to compete, including in how they set interest rates.

The key elements of prudential regulation that apply to banks supplying retail deposit products are outlined below.

ADI License

An ADI receives authority from APRA under s9(3) of the *Banking Act 1959* which permits it to carry on banking business.[57]

There are strict regulatory requirements for obtaining and maintaining an ADI licence. Banks must meet ongoing prudential requirements in relation to capital, liquidity, governance, risk management, operations, and reporting (described below). This is important to the stability of the banking system.

In 2018, APRA introduced a 'Restricted ADI' licensing pathway. This sought to reduce barriers for new entrants by enabling them to conduct limited banking activities while they are still developing the resources (including capital) and capabilities to become a fully licenced (unrestricted) ADI.[58] A Restricted ADI is expected to progress to a fully licenced ADI and, therefore, the restricted licence is for a maximum period of 2 years, although this may be extended by APRA in some circumstances.[59]

Capital requirements

Bank capital requirements are particularly important in ensuring ADIs have a financial buffer to absorb unexpected losses, such as borrowers defaulting on their loans. By requiring ADIs to hold a prudent minimum level of capital, APRA ensures banks are more likely to remain solvent during periods of financial adversity.

APRA's bank capital requirements are developed with reference to international standards, taking into account domestic conditions. APRA's prudential framework provides for one of 2 approaches to calculating capital requirements for credit risk:

- **Standardised approach**: banks apply a common set of APRA-prescribed risk weights for different types of lending.[60] The risk weights are simple and conservative enough to apply to a range of banks.[61]
- **Advanced approach**: also known as the internal ratings-based approach, the advanced approach enables banks to use their APRA-approved internal risk models to calculate capital requirements. [62] These banks must have very good historical data, a sophisticated risk measurement framework, develop advanced internal modelling capabilities, and undergo a rigorous accreditation process. Further, banks using the advanced approach are subject to more stringent regulatory requirements and more intensive ongoing supervision than those using the standardised approach.[63]

57 *Banking Act 1959*, s 9.

58 APRA Information Paper March 2021, ADIs: New entrants – a pathway to sustainability, p 10, accessed 24 November 2023.

59 APRA extended the restricted licence period for In1Bank in June 2021 due to the COVID-19 pandemic, and again in September 2022. It also extended Avenue Bank's restricted licence period in August 2023.

60 APRA, Unquestionably Strong Framework for Bank Capital, November 2021, p 12.

61 APRA, Unquestionably Strong Framework for Bank Capital, November 2021, p 12.

62 APRA, APRA Explains: Risk-weighted assets, APRA website, n.d., accessed 18 November 2023.

63 APRA, Is the capital benefit of being an advanced modelling bank justified?, APRA website, 23 May 2023.

APRA has stated that the capital framework has been calibrated such that capital requirements using the advanced approach tend to be lower than standardised capital requirements.[64] At the time of this report, the major banks, Macquarie Bank and ING Bank all use the advanced approach. All other banks use the standardised approach.[65]

The differential between the approaches has been mitigated by the new capital framework implemented by APRA from 1 January 2023. This increased minimum capital requirements for banks using the advanced approach, and required them to hold higher capital buffers and apply multipliers to risk weights for higher risk loan types. It also reduced capital requirements for lower risk mortgages for banks using the standardised approach.[66]

There are additional minimum capital requirements for APRA-designated domestic systemically important banks (D-SIBs), whose distress or failure would cause significant dislocation in the Australian financial system and adverse economic consequences – currently the major banks.[67] Capital requirements are set by reference to 3 tiers of capital. Common Equity Tier 1 (CET1) is the highest quality of capital (and the most expensive) and D-SIBs must hold more CET1 capital, which increases their ability to absorb losses but also increases their cost of capital.[68]

Box 2.1: Major Bank Levy

In 2017, the Major Bank Levy of 0.015%, paid each quarter on the balance of the bank's liabilities (funding sources), was introduced for banks with over $100 billion in total liabilities (currently the major banks and Macquarie). The levy recognises that large leveraged banks are a source of systemic risk in the financial system and the wider economy.

It is also intended to contribute to a more level playing field for smaller ADIs and non-ADI competitors, relative to the major banks.

The levy is based on a bank's qualifying liabilities – non-qualifying liabilities are excluded, including deposits up to $250,000 covered by the Financial Claims Scheme.[69] Exchange settlement account balances are also deducted in calculating the levy.

Liquidity requirements

A significant proportion of bank funding is borrowed from depositors for short terms, with a lot of these funds available to be withdrawn at any time (such as money in a transaction account), but banks may use that funding to support loans that are generally much longer term (such as a home loan). If deposit customers want to withdraw funds, a bank must be able to ensure it can make those funds available – this is critical to the stability and trustworthiness of the financial system. For this reason, banks are required to hold liquid assets, which can be quickly and easily converted to cash to meet these obligations.

Liquidity requirements aim to ensure that banks have sufficient high quality liquid assets[70] on hand to repay obligations as they fall due.

64 APRA, Unquestionably Strong Framework for Bank Capital, November 2021, p 15; APRA, Is the capital benefit of being an advanced modelling bank justified?, APRA website, 23 May 2023.

65 RBA, Macrofinancial Stress Testing on Australian Banks, 2022, p 6.

66 APRA, Unquestionably Strong Framework for Bank Capital, November 2021, p 15.

67 APRA, APRA submission to ACCC regarding ANZ proposed acquisition of Suncorp Bank, 13 July 2023, p 6.

68 RBA, How Have Australian Banks Responded to Tighter Capital and Liquidity Requirements?, RBA Bulletin, June 2017, p 43.

69 P Hawkins, The Major Bank Levy explained, Australian Parliament House, 23 June 2017.

70 APRA defines liquid assets in general as assets that can easily and quickly converted to cash. See: https://www.apra.gov.au/apra-explains-liquidity-banking. APRA sets out the specific definition for high-quality liquid assets in APS 210 Liquidity.

APRA seeks to ensure banks manage their liquidity risk.[71] There are 2 approaches, depending on how APRA determines the bank should be classified:

- **Minimum Liquidity Holdings (MLH) ADI**: smaller and less complex banks must maintain a minimum holding of 9% of its liabilities in specified liquid assets.
- **Liquidity Coverage Ratio (LCR) ADI:** larger and more complex banks must hold an adequate level of unencumbered high-quality liquid assets to meet its liquidity needs for a 30-calendar day period under a severe stress scenario. An LCR ADI must also structure its borrowing and lending to minimise liquidity risk (as measured through the Net Stable Funding Ratio).[72]

2.4 Barriers to entry and expansion are high

The ACCC considers that there are high barriers to sustainable new entry and expansion in the supply of retail deposit products. In particular, the significant scale, scope and longevity of the major banks are key reasons why new entry and expansion for firms has been difficult in both the general banking sector overall and in the supply of retail deposit products.

While the CBA and ANZ pointed to the Restricted ADI license scheme as having lowered barriers to entry,[73] there is currently limited evidence that new entry is sustainable or that new entrants will be able to reach sufficient scale to provide a competitive constraint, at least not in the short term.

In respect of expansion, we note that since 2019 Macquarie has managed to grow its share of retail deposits, alongside expanding its broader retail banking business. This is discussed in chapter 3, along with recent new entrants.

There are significant advantages in having scale and scope

Smaller banks face the challenge of competing with larger banks that benefit from scale and scope advantages. Scale is important in banking generally, due to the significant fixed costs in providing banking services, including operational costs, regulatory requirements, investing in technology to process transactions, serve customers, and ensure data security. Banks that can spread their fixed costs across more customers or products, will have a competitive advantage as they can achieve higher operating profit margins on both their borrowing and lending activities.

Economies of scale

As a basic proposition, and given the importance of stable retail deposits as a funding source, the ACCC considers that banks' focus is on retaining existing customers, and acquiring new higher value customers, as cheaply as possible. In this regard, the major banks have a significant advantage in that it is usually cheaper to retain customers than to acquire them, and they can draw on a wealth of consumer data to do so effectively.

The Customer Owned Banking Association (COBA)[74] stated in its submission to the Inquiry that 'smaller banks in particular are subject to relatively high regulatory costs due to the fixed cost factor which hampers their capacity to grow and expand into new markets'.[75]

71 APRA regulations for ADIs management of liquidity risk are set out in Prudential Standard APS 210 Liquidity.

72 The net stable funding ratio is expressed by the bank's available stable funding over its required stable funding, and must equal or exceed 100%. See Bank of International Settlements 2018, Net Stable Funding Ratio (NSFR) – Executive Summary, p 1, accessed 24 November 2023.

73 ANZ submission, 9 June 2023, p 8; CBA submission, 25 May 2023, p 7.

74 COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies).

75 COBA submission, 23 May 2023, p 3.

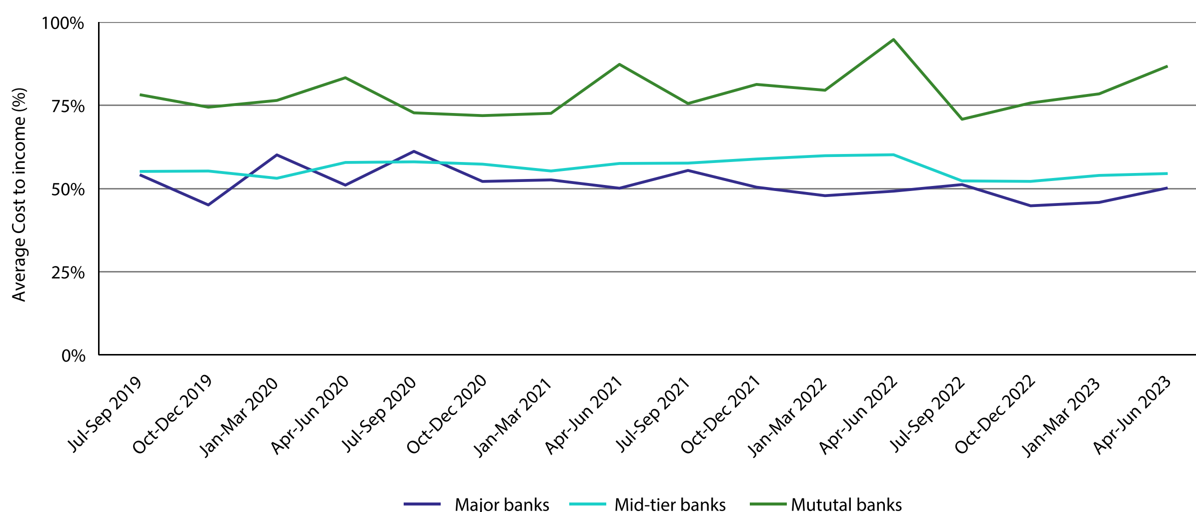
The ACCC notes that some banks have argued that the major banks face larger operating costs, due to factors such as operating branch networks, call centres, and legacy systems.[76] While the costs of providing branches and call centre services can be very high, the ACCC considers that such a presence still provides substantial advantages, beyond enhancing brand awareness and reputation, discussed further below. As discussed in chapter 1, branch access is important to many consumers and essential for some, including those who require additional support or who live in regional or remote areas. Having a dedicated customer call centre is also a significant cost, which incumbent banks can spread across a large customer base.

Submissions from industry note that new entrants, and particularly neobanks have a significant cost advantage as they can enter without the burden of legacy systems and advantages of lower technology costs.[77] However, it is not clear that any such advantage exists to the extent that it can help digital banks overcome other barriers, including other disadvantages due to their smaller scale – it has not been evident in the case of the neobanks who have entered in recent years, as discussed in chapter 3. Further, if banks have more customers, they will generally be more inclined to incur fixed costs (such as investing in technology) to service their customers more efficiently or to provide better-quality services.

Cost to income ratio

Cost to income (CI) ratio is an important metric regarding the operating efficiency of a business. It is defined as the ratio of total operating expenses to total income. Figure 2.4 below shows that the mutual banks have had persistently high CI ratios when compared to other banks – this can have a negative effect on return on equity.

Figure 2.4: Average cost to income ratio by bank type, July 2019 – June 2023



Source: ACCC analysis of bank data obtained via 95ZK notice.

Conversely, the major banks had the lowest average CI ratio of the 3 cohorts, remaining roughly around 50% during the period, with the mid-tier banks slightly higher than the major banks for most of the period. We note that there is more variation in CI ratio within the mid-tier cohort than in other cohorts, due to differences in their cost and organisational structures (e.g. as part of a conglomerate, Australian subsidiary of an international bank, or a standalone regional bank).

76 NAB submission, 19 May 2023, p 7.

77 For example NAB submission, 19 May 2023, p 2, and ANZ submission, 9 June 2023, p 9.

Economies of scope

There are also likely to be some advantages from economies of scope, whereby banks can lower their average costs when offering a suite of banking and finance products, compared to offering only one or a few products. These cost savings could be driven by a bank's ability to spread fixed costs over these different product offerings, the possibility of re-employing clients' information, and risk reduction due to diversification.[78] The ability to provide a range of products also assists banks in being able to attract and retain higher value MFI customers, discussed further below.

Large banks have advantages in access to funding

As outlined in section 2.2, banks fund their businesses through a range of sources. Both access to, and the cost of, funding can vary for banks of different sizes and portfolio mixes, which is discussed in more detail in chapter 4.

While the cost of funding for a bank fluctuates with changes in global and local market conditions, on balance the major banks experience lower funding costs than smaller banks. This funding advantage for the major banks increases in times of instability.[79] On average there remains a considerable funding cost advantage for Australia's major banks over smaller banks.[80]

Larger banks have access to alternative funding sources, which enable them to grow their lending portfolio and fill any lending gaps from a variety of funding sources as required, as discussed in chapter 4. COBA stated in its submission to the Inquiry that due to the smaller size of customer owned banks, 'access to wholesale markets and other sources of funding or investment is more limited.'[81] This increases their reliance on retail deposits and means that they need to closely match growth in lending to growth in deposit funding.

Costs to raise funds from wholesale debt markets have historically been lower for major banks compared to smaller banks.[82] This is, at least partly, due to credit rating agencies taking into account the perception that major banks have lower risk due to portfolio diversification, scale and the perceived high likelihood of government support.[83] This results in generally higher credit ratings for the major banks compared to smaller banks and better access to wholesale funding markets, both in terms of volume and lower cost.

The larger banks may also access international markets for wholesale funding due to their strong credit ratings, name recognition and larger, more liquid, issuances.

78 See for example Beccalli, E and L. Rossi, "Economies or diseconomies of scope in the EU banking industry?" European Financial Management, 26:5, November 2020, pp 1,261–1,293.

79 Productivity Commission, Competition in the Australian Financial System, June 2018, p 6.

80 See for example: Bendigo and Adelaide Bank Limited, Submission to the ACCC's determination of the application for merger authorisation MA1000023, 3 March 2023, p 21, Judo Bank Pty Ltd, Submission to the ACCC's determination of the application for merger authorisation MA1000023, 18 April 2023, p 3, and Bank of Queensland Limited, Submission to the ACCC's determination of the application for merger authorisation MA1000023, 24 February 2023, p 6. Additionally, in his statement in support of ANZ's application for merger authorisation, the Group Treasurer of ANZ stated that '[i]n periods of financial stress…there is a risk that wholesale investors will withdraw or reduce the funding they provide to financial institutions….the likelihood of this occurring is greater for non-major banks'. See: Statement of Adrian Went (ANZ), 28 November 2022, [33].

81 COBA submission, 23 May 2023, p 2.

82 RBA, Submission to the Productivity Commission Inquiry into Competition in the Australian Financial System, September 2017, p 16, graph 16.

83 RBA, Submission to the Productivity Commission Inquiry into Competition in the Australian Financial System, September 2017, p 13.

Consumer preferences and behaviour favour the major banks

The scale and longevity of the major banks also contributes to brand recognition and the perception that they are safer and more stable institutions, as discussed in chapter 1. This can make it difficult for new entrants and smaller banks to build customer awareness and attract customers.

Banks monitor their consideration rate which is the proportion of consumers shopping for a certain product (e.g. a transaction or savings account) who consider a specific bank in their searches. Larger banks have an advantage here as they tend to have higher consideration rates than smaller banks. For example, research commissioned by one bank indicated the average consideration rate across the major banks for transaction accounts is 27%, compared to the "second tier" banks' average of 11%. Similarly, it indicated the average consideration rate across the major banks for savings accounts is 26%, compared to the "second tier" banks' average of 12%.

One of the critical advantages that established banks gain from this is that, as outlined in chapter 1, banks generally compete to grow their MFI base through retail deposit products. This is assisted by consumer preferences and the ability of incumbent banks to leverage existing customer relationships. in retail deposits.

Further, as explored in chapters 8 and 9, there is a high degree of consumer inertia when it comes to retail deposit products. In general, retail deposits customers are 'sticky', and the more established banks tend to retain a cohort of retail deposits customers who consider their bank to be their 'main financial institution' (MFI), and do not have a high propensity to switch.

Material provided to this Inquiry indicates that banks consider MFI customers valuable for a range of reasons including:

- they provide more stable and lower cost funding since they are less likely to switch to another bank in search of better deposit rates
- they present high lifetime customer value to their MFI given the longer expected time the customers remain with the bank
- they are likely to acquire a range of products from that bank, and the incumbent bank has an advantage when cross-selling, for example, from transaction account products to other savings account and term deposit products, as well as to other retail banking products and small and medium enterprise (SME) banking products.

3. Competition for retail deposits

Findings

- There has been some limited entry and expansion of banks offering retail deposit products, however the absence of a broader competitive response suggests that this is not a material competition constraint on incumbent banks.
- New entrants and smaller competitors are constrained in how they compete for retail deposits. Their smaller scale means they must compete aggressively to win new customers, often on price, but they must be careful not to significantly increase their funding costs given access to other forms of funding is likely to be more limited. Established mid-tier banks are likely to be less constrained in the same manner.
- In general, incumbent banks have responded to price competition with strategies to retain higher value customers through targeted 'below the line' pricing or seeking to acquire new customers using time limited price competition (such as introductory interest rate offers).
- Banks recognise their customers are 'sticky' and invest in strategies to increase customer stickiness. This enhances banks' ability to respond to price competition selectively rather than through broader pricing changes which may trigger competitor responses that reduce margins.
- There has been a lot of innovation and technological developments over the last decade, both in banking and other sectors, and consumers expect a level of sophistication from product and service providers. Not all examples of innovation are indicators or outcomes of competition and care should be taken not to overstate the extent to which innovation is a result of non-price competition.

This chapter considers the state of competition in the retail deposits market.

Competition is the process by which rival businesses strive to maximise their profits by developing and offering desirable goods and services to consumers in most favourable terms.[84]

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 – 4 major banks dominate retail banking...A tail of smaller providers operate alongside these institutions, varying by market in length and market share...[85]

Although concentration in the share of household deposits has reduced somewhat since the Productivity Commission's inquiry, as of June 2023, the major banks still accounted for around 73% of household deposits.[86] CBA, ANZ, and NAB all submitted that the reduction in the major banks' market share is an indicator of strong competition in the supply of retail deposit products.[87] However, as noted in section 2.1, the ACCC considers that shares have remained relatively stable over the past 2 decades, and it is necessary to examine other indicators of competition in the market.

84 Treasury, Competition Policy Review Issues Paper, 14 April 2014, p 1.

85 Productivity Commission, Competition in the Australian Financial System, June 2018, p 4.

86 APRA, APRA Monthly ADI statistics, September 2023, accessed 23 November 2023.

87 ANZ submission, 9 June 2023, p 9; CBA submission, 25 May 2023, p 4, 6–7; NAB submission, 19 May 2023, p 4.

Overall, the ACCC considers that the major banks do not currently face strong competition in the supply of retail deposit products from either existing suppliers or new or potential entrants, due to persistent high barriers to entry and expansion as discussed in section 2.4.

Sections 3.1 and 3.2 discuss how these barriers have influenced emerging competitors, how new entrants and emerging banks compete with incumbent banks for retail deposit products, and which factors have contributed to emerging competitors' exit or ability to remain in the market. Section 3.3 specifically considers the nature and breadth of price (interest rate) competition between banks, while section 3.4 considers the role of non-price competition, with a particular focus on innovation.

3.1 Entry and expansion has been limited

Entry of new firms, or the threat of new entry or expansion by existing firms, into the retail deposits market is an important source of competitive constraint on incumbent banks. While actual entry or expansion need not necessarily occur, the threat must be credible enough to incentivise incumbent banks to act competitively.

We have outlined below the potential competitive threat to incumbent banks posed by new banks, existing banks, and big technology firms.

New entrants

Several new banks have entered the retail deposits market since 2018, some with the assistance of the restricted ADI licensing pathway introduced that year. The restricted pathway was cited as reducing barriers to entry by both CBA and ANZ.[88] Table 3.1 outlines the progression of these new entrants.

Table 3.1: New entrants into the supply of retail deposits since 2018

Bank	ADI licence	Outcome
Volt Bank	Restricted: May 2018 Full: January 2019	Exited the market July 2022
Xinja	Restricted: December 2018 Full: September 2019	Exited the market February 2021
Judo	Full: April 2019	Mostly offering business banking, only retail deposit product is term deposits.
86 400	Full: July 2019	Acquired by NAB January 2021
Alex Bank	Restricted: July 2021 Full: December 2022	Offering personal loans and a retail savings account, as well as a retail term deposit via invite only.
In1bank	Restricted: December 2019 Restricted: extended June 2021 Restricted: extended September 2022 Full: May 2023[89]	Offering personal transaction accounts, term deposits as well as home loans and business banking products.

Source: Volt: APRA media release May 2018, APRA media release January 2019, APRA media release September 2022 Xinja: APRA media release December 2018, APRA media release September 2019, APRA media release February 2021; Judo: APRA media release April 2019; 86 400: APRA media release July 2019; Alex Bank: APRA media release July 2021; APRA media release December 2022; In1bank: APRA media release 2019.

88 ANZ submission, 9 June 2023, pp 8–9; CBA submission, 25 May 2023, p 7.

89 APRA extended the restricted licence period for In1Bank in June 2021 due to the COVID-19 pandemic, and again in September 2022.

CBA submitted to the Inquiry that 'the emergence of new entrants and digital-only banks' was one indicator of strong competition.[90] Likewise, ANZ noted that although some neobanks had exited, that 'other neobanks are continuing to offer deposit products or are taking steps to do so,' and observed that Alex bank had begun offering term deposit products.[91]

The ACCC considers it is premature to conclude that recent new entry is evidence of strong competition in the sector, particularly given that 3 of 6 entrants over the period from 2018 have exited the market or acquired. In its submission to the ACCC's process for considering ANZ's proposed acquisition of Suncorp, BOQ noted that there were barriers to 'meaningful growth and/or expansion' and that 'the recent exit of a number of fin-techs and neo-banks via acquisition by (or partnerships with) larger banks and the seeming difficulties in growing scale and taking market share from the majors casts further doubt on the vigorousness of a broader competitive constraint'.[92] ANZ, in its response to BOQ's submission, noted that smaller scale entrants were a key source of competition and that meaningful entry could involve 'potential new entrants willing to continuously contest the relevant markets and take market share from larger incumbents.[93]

While Neobanks such as Xinja entered the market offering some of the market's highest deposit rates, they had no loan product to earn a sustainable revenue stream.[94] When assessing the level of constraint posed by new entrants in retail deposits, consideration must be given to the circumstances that led to the exit of Xinja, 86400 and Volt, and how the remaining neobanks are choosing to compete in light of the known barriers, including disadvantages in access to funding.

The ACCC considers that, while new entrants may be able to find contestable pockets of the market in which to establish themselves, it is yet to be seen how much they drive competition in retail deposits.

Existing banks

Since around 2002 there have been 2 instances of mid-tier banks significantly expanding their retail deposit business – ING in the mid-2000s and Macquarie from 2019 onwards, as shown in figure 3.1.

90 CBA submission, 25 May 2023, p 4.

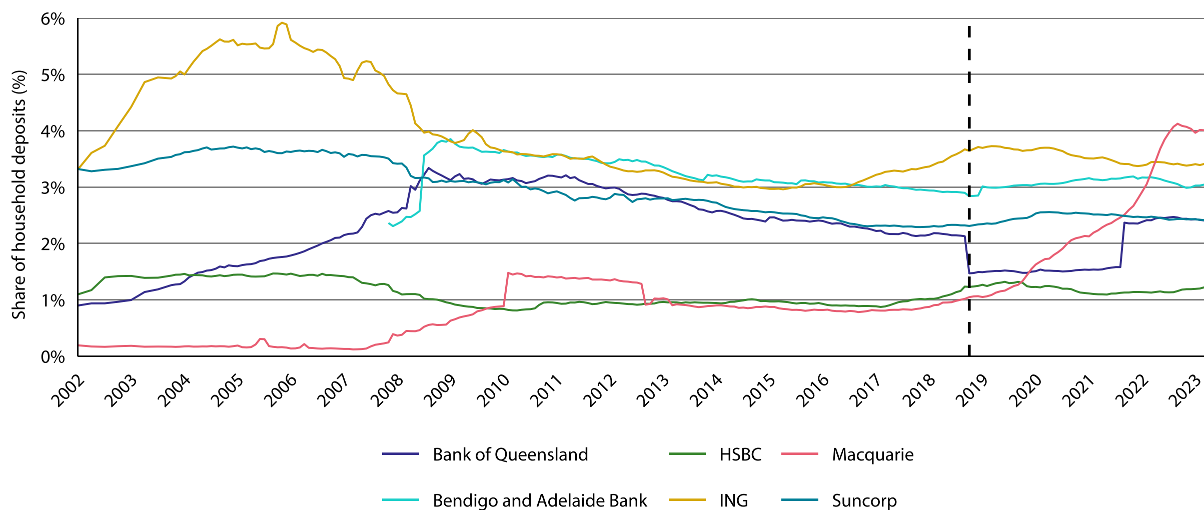
91 ANZ submission, 9 June 2023, p 9.

92 BOQ submission to ACCC consideration of ANZ-Suncorp, 23 February 2023, p 8.

93 ANZ, ANZ proposed acquisition of Suncorp Bank – Further ANZ response to interested party submissions, p 7, 22 March 2023, accessed 25 November 2023.

94 Australian Financial Review, Lessons all round as Xinja Bank shuts, Australian Financial Review website, 13 January 2021, accessed 25 November 2023.

Figure 3.1: Share of household deposits at mid-tier banks, June 2002 – September 2023



Note: BoQ's large jump in share in 2022 is due to it completing the move to a single ADI after its acquisition of ME Bank in 2021. The dashed line represents a series break in March 2019 as a result of APRA's Economic and Financial Statistics (EFS) collection commencing. The old series (Monthly Banking Statistics) included banks only, while the new series (Monthly ADI statistics) includes non-bank ADIs. Discontinuities are attributable to (1) the inclusion of non-bank ADIs, and (2) changes in definition to various data items.

Source: ACCC analysis of APRA Monthly ADI statistics, September 2023, APRA Monthly banking statistics June 2019 back series.

CBA submitted to the Inquiry that competition in the sector could be partially seen by 'the growth in market share of some existing participants offering competitive interest rates and innovative retail deposit products.[95] ANZ submitted that the growing importance of digital channels has allowed banks such as ING and Macquarie to achieve growth in deposits despite limited or no branch networks.[96]

Both ING and then Macquarie were able to achieve this growth in deposit market share by providing a largely online offering with competitive interest rates and backed by a large international banking group. ING's market share has declined since its peak in the mid-2000s, however this is not necessarily indicative that it has not been a competitive constraint to the major groups.

Big technology firms

Submissions to the Inquiry from 3 of the major banks considered the threat of entry from big technology firms as a source of competitive constraint:

- CBA submitted that 'a number of fintech companies have experienced rapid growth in offshore markets and big technology companies are now offering a range of retail financial services including savings accounts' and that it is concentrating on 'strengthening the competitiveness of its retail deposit offering' with a view to such potential developments in Australia.[97]
- NAB stated that 'it is expected that large technology companies will launch retail deposit products in Australia. Many of these companies already offer payment products to customers in Australia and have deep Australian customer bases across their portfolio of products.[98]

95 CBA submission, 25 May 2023, p 4.
96 ANZ submission, 9 June 2023, p 9.
97 CBA submission, 25 May 2023, p 7.
98 NAB submission, 19 May 2023, p 7.

- Both NAB and ANZ noted the 2023 launch of Apple's (white labelled[99]) savings product in the United States. ANZ considered that it 'provides further support for the growing importance of digital channels more generally and the ability of a new entrant to effectively compete for deposits without a physical footprint'.[100] NAB stated that Apple 'could look to launch similar products in Australia in the future'.[101]

While large technology firms, such as Apple, have market power in some digital services, access to a large customer base, and detailed customer data, any such entry into Australian markets remains speculative. Should it occur, or appear to be a real possibility of occurring, it may be a source of competitive constraint, and elicit a competitive response from Australian banks.

3.2 Barriers to entry and expansion influence how banks compete

As noted above, some of the major banks have cited examples of recent new entrants and the increased market share of Macquarie, as evidence of the competitive state of the market. The ACCC considers that closer examination of how these banks compete, and how incumbent banks are responding, is necessary to evaluate competition. The factors that constitute a barrier to entry often remain relevant to ongoing competition after entry has occurred.

Economies of scale and scope

As discussed in 2.4, established banks may benefit from economies of scale and being able to spread some costs over a larger customer base, particularly insofar as scale can improve profitability, access to funding, and costs of funding.

NAB submitted that it 'does not consider that smaller banks or new entrants face cost or scale disadvantages which impact their ability to compete for deposits'[102] In its submission to the Inquiry, ANZ notes that neobanks have launched deposit products 'unencumbered by the legacy platforms of traditional banks'.[103] While new entrants may have lower overall costs than larger incumbent banks, they also have fewer customers to spread costs amongst and costs of attracting new customers are usually higher than retaining them.

Banks which have entered or expanded into the retail deposits market have tended to acquire customers through price competition, although in some cases they have also sought to differentiate themselves or target particular customer segments. However, in most cases this has been alongside offering high interest rates on deposit products.

As discussed in section 3.3, established banks do not tend to respond with broad price competition, partly because their significant customer base gives them cheaper options to retain existing customers, and their diversity of product range (scope) enables them to target higher value customers who are likely to take up other products with that bank.

The ACCC notes NAB's submission that while smaller banks might have some different costs, including in funding, regard should be had to overall costs. NAB submitted that 'for example, the major banks face larger operating costs associated with branch networks and greater overhead

99 Apple's savings product was offered in partnership with a bank, under the Apple brand.

100 ANZ submission, 9 June 2023, p 10.

101 NAB submission, 19 May 2023, p 7.

102 NAB submission, 19 May 2023, p 7.

103 ANZ submission, 9 June 2023, p 9.

costs'.[104] In its submission to the ACCC's consideration of ANZ's proposed acquisition of Suncorp, Judo stated that 'while it is often cited that we have succeeded despite not having a branch network, we do not have a branch network precisely because there are widely acknowledged barriers (e.g. significant set-up and ongoing operational costs) to establishing a new branch network'.[105]

In the same submission, Judo noted that 'regulatory capital requirements and operational costs for new banks are punishing in comparison to established incumbents, who can take advantage of existing economies of scale'.[106]

Access to funding and effect on growth

Scale can also improve access to funding and lower its cost. Access to funding can impact how smaller banks compete in a variety of ways. Retail deposit funding is the most accessible for small banks, but new entrants must be cautious, particularly when on restricted licence and subject to deposit limits, as unexpected withdrawals can cause them to become insolvent.

Access to funding is related to a bank's ability to grow. As discussed in chapter 4, banks which can access wholesale debt can use it to fill short term funding gaps, for instance, to support new short-term lending opportunities that might be missed if relying on organic growth in deposit funding. Banks which are unable to access wholesale debt, or can only access it at a substantially higher cost must be more cautious about their growth, firstly because they have less ability to fill funding gaps with other forms of funding, and secondly because a sudden loss of retail deposits can create a funding gap.

As discussed in chapter 4, retail deposits provide many benefits relative to other funding sources. While smaller banks tend to rely more on deposits for funding due to their more limited access to the wholesale market and have a larger proportion of their funding coming from deposits, they face challenges in attracting more retail deposits compared to larger banks. This is because consumer preferences favour strong brand awareness, and the major banks are the most visible. We discuss implications from consumer preferences below.

Capital funding is critical for smaller banks and new entrants. However, new entrants may be perceived as high risk and face difficulties in raising capital particularly in more uncertain economic conditions, or if they are not backed by a related entity.

With the exception of Judo, the first wave of neobanks (Volt, Xinja, Judo and 86 400), some of which entered via the restricted ADI pathway, had limited success in challenging the incumbent banks. Volt, Xinja and 86 400 experienced significant difficulties raising capital and sustaining an income generating asset product, and Volt and Xinja exited the market, while 86 400 was acquired by NAB (see table 3.1).[107]

Since the exit of Xinja and Volt, APRA changed the requirements for new ADI licensees in 2021 to ensure that:

- a bank on a Restricted licence will need to achieve a limited launch of at least one income-generating asset product and one deposit product before it can progress to a full licence
- a bank applying directly for a full licence will first need to have achieved a limited launch of at least one income-generating asset product and be operationally ready to launch deposit products shortly after being licenced.

104 NAB submission, 19 May 2023, p 7.

105 Judo submission to ACCC re ANZ proposed acquisition of Suncorp Bank, 7 February 2023, p 3.

106 Judo submission to ACCC re ANZ proposed acquisition of Suncorp Bank, 7 February 2023, p 3.

107 Australian Financial Review, The neobank experiment is in tatters, Australian Financial Review website, 29 January 2021, accessed 25 November 2023; SF Koob, Digital bank Volt, which 'wanted to change the world of banking', shuts down, Sydney Morning Herald, 29 June 2022, accessed 25 November 2023.

These new requirements mitigate risks that new entrants will be left with a substantial funding gap due to unbalanced growth between their assets and liabilities. The ACCC considers that the experiences of Xinja and Volt will likely affect how banks compete for deposits.

New entrants have had success attracting deposit customers by offering competitive rates, but this may not offer the level of control required to keep any funding gaps to a minimum. Notably, Judo and Alex bank have taken a more conservative approach and raised capital while growing their loan book and slowly taking deposit customers, starting with term deposits, which are the most stable.[108]

The more cautious approach currently being taken by new entrants shows that, while it is possible to enter and compete on rates only, they should not necessarily be considered as strong price competitors in a way that would constrain incumbents. Similar considerations may apply to other small banks who cannot afford to compete aggressively and broadly on price without the certainty of being able to match potential growth through an income generating product.

More broadly, the competitive advantages from scale/scope and better access to funding mean that smaller banks are likely to face challenges in competing in both price and non-price dimensions across retail deposits and other related banking products.

Consumer preferences

As noted in chapter 1, consumer preferences favour strong brand awareness, and the major banks are the most visible. Publicity around the entry and exit of neobanks in recent years may have further entrenched some of these preferences.

The perception that consumers' funds are safer with the major banks persists despite the existence of the Australian Government's Financial Claims Scheme. In its submission to the Inquiry, the COBA indicated that there is low consumer awareness of this scheme, stating that 'greater consumer awareness of the FCS would…highlight to consumers that alternative deposit products from smaller ADIs are a viable and safe alternative to the major banks' products'.[109]

The recent experiences of neobanks were, however, consistent with other consumer preferences, including an interest in online/mobile access and better interest rates. New entrants may be able to leverage consumer desire for convenience and digital access, particularly for those who highly value a superior digital experience. However, established banks are aware of these consumer preferences and the major banks[110] and Macquarie[111] have been investing significantly in technology upgrades in response.

While it is not necessarily the case that a bank seeking to compete in the supply of retail deposit products needs to provide a full range of products, the major banks retain an advantage in respect of consumer preferences in favour of holding their banking products with the same bank. As discussed in section 3.3 these customers are 'higher value' and banks have strategic incentives to retain them. As stated by BOQ in its submission to the ACCC's consideration of the ANZ proposed acquisition of Suncorp, 'the majors focus on offering the 'whole wallet' and securing a position as a customer's preferred institution across a range of products and services. Smaller players are unable to compete on this scale and as a result, many new entrants are expanding through partnership with the majors, rather than via 'organic' expansion and growth'.[112]

108 S Thompson, Australia gets a new bank, Alex, for Christmas, Startup Daily, 21 December 2022, accessed 25 November 2023.

109 COBA submission, 23 May 2023, p 2.

110 C Yeates, Bank tech war heats up as big four face generational change, accessed 25 November 2023.

111 Sydney Morning Herald 13 December 2021, Macquarie ramps up digital push with rapid bank accounts, Sydney Morning Herald, 13 December 2021, accessed 25 November 2023.

112 Bank of Queensland, Submission to ACCC re ANZ proposed acquisition of Suncorp Bank, 23 February 2023, p 8.

3.3 Banks strategically and selectively compete on interest rates

We consider the dynamics of competition in this sector to be nuanced, in contrast to some banks' submissions that there is vigorous price competition as evidenced by higher deposit rates and lower NIMs for the major banks. We have not seen a broad price response from incumbent banks, even though there have been instances of price competition from challengers seeking to increase their share of retail deposits.

Our review of banks' processes for setting rates has found that banks generally monitor each other's publicly available pricing and take into account their key competitors' movements when deciding on their own interest rates. The subset of competitors that each bank monitors will vary between banks, and will also vary between different types of banks. How banks monitor their competitors is discussed in more detail in chapter 6.

As set out below, in light of the role that retail deposits play in funding, we consider that banks are competing for 'higher value customers'[113] at the lowest cost to them, and using strategies to make these customers stickier, including through opaque negotiated interest rates and targeted offers.

Margin-volume trade-off

A bank's goal of maximising profits, within the constraints of risk management and regulatory requirements, requires a nuanced consideration of the trade-off between product price margins and volumes. In most markets, setting a higher price will result in lower sales. In retail deposits, the 'price' set by banks is essentially the interest rate they pay to depositors. In this context, setting a higher interest rate will attract more deposits and vice versa.

With respect to retail deposits, a bank may enhance its margin by lowering deposit rates or increasing fees and charges. However, this strategy carries the inherent risk of losing more price sensitive deposit customers, and their funds, thereby impacting volume.

In the case of new entry and/or expansion, a bank may choose to sacrifice more of its margin to acquire new customers. However, as noted in section 3.2, high funding volumes from at-call retail deposit products pose risks, particularly for smaller banks with limited diversification capabilities.

However, such risks can transform into future profits if banks successfully secure sticky customers who exhibit loyalty and offer cross-selling opportunities. In this scenario, banks can increase profits through higher volumes in the long term, despite having to increase deposit rates and lower fees in the short term. Striking a balance between maximising volume and minimising margin sacrifice becomes pivotal. The next section looks at strategies we have observed banks use for cost-effective customer acquisition.

Lower cost strategies to acquire customers

Banks adopt a variety of strategies to gain retail deposit customers. However, rather than broad-scale pricing initiatives that may trigger a 'price war', banks generally appear to compete by focusing on acquiring customers at the lowest possible cost.

Banks may seek to attract higher value customers (while managing funding costs) through marketing to strengthen brand and establish differentiation (including consumer perceptions of the major

113 As discussed in chapter 1, higher value customers refers to MFI customers and/or customer with large deposit balances.

banks). For example, this could focus on younger customers just entering the market[114] who have the potential to be ‘sticky’ customers, as discussed in chapter 1.

Banks also engage in strategic pricing at the product and customer level which enables banks to retain and acquire customers without significantly impacting their margins. This can include different strategies depending on whether the customer is new or existing, and qualities such as price sensitivity or stickiness:

- Introductory interest rates designed to target only specific customer segments.
- Bonus interest rate products with conditions designed specifically to target desirable customer segments. Banks choose to offer higher interest rates to customers who exhibit or develop ‘sticky’ behaviour and/or accumulate large deposit balances. These behaviours could be an indication of their higher customer lifetime value, especially since retail deposit products play an important “anchoring” role in whether a consumer considers a bank to be their MFI.
- Targeted offers and negotiated pricing, aimed at retaining existing customers based on how price sensitive and how valuable different customer segments or individual customers are. Banks may prefer this type of ‘below the line’ competition because it avoids broad scale (and expensive) interest rate changes that may prompt a response from competitors.

These approaches, discussed in detail in chapter 7, generally depend not only on consumer preferences and behaviours but also on low consumer engagement and switching and a lack of transparent information (explored in chapters 8 and 9). In some cases, they can represent a form of price discrimination by banks (see box 3.1).

114 For example CBA’s Youthsaver account, Westpac’s Bump Savings account, Suncorp’s Kids Savings Account, Great Southern Bank’s Youth eSaver account, and Australian Mutual Bank’s Young Saver Account.

Box 3.1 Price discrimination

Price discrimination is a practice where firms charge customers different prices for the same product or service. In more common forms of price discrimination, firms segment their customer base based on certain attributes and charge each customer segment a different price.[115] In a more extreme form of price discrimination, firms can vary their pricing for individual customers precisely based on each customer's attributes.[116]

This pricing practice is one of the strategies firms could employ to maximise profits, if they are able to segment their customers into groups.[117] In some cases, price discrimination may even result in more efficient market outcomes than otherwise. For example, firms may choose to serve a new customer segment at a reduced price, rather than forgoing this group of customers completely to avoid charging lower price to everyone.

Banks are well placed to be able to segment customers into groups and utilise these price discrimination strategies due to the amount of data that they collect to monitor customers' behaviours.

In the retail deposits market, higher deposit rates lead to higher costs to banks and higher income to customers. Price discrimination here may manifest in banks choosing to offer higher interest rates through negotiated and targeted pricing to specific groups of customers, likely those with an MFI relationship and/or large deposit balances.

While pricing may not be based directly on a customer's price sensitivity for each specific retail deposit product, it is likely to be based on a bank's estimate of a customer's value for a full suite of product offerings throughout their length of relationship with the bank, i.e. customer lifetime value. That means the higher the estimated customer lifetime value (because a customer is expected to stay with the bank for a long time and/or hold multiple products with the same bank), the more likely the bank will agree to a negotiated interest rate or make a targeted offer to them. These higher value customers are highly desirable to banks and thus they have better competition alternatives, compared to other customers.

In contrast to other banks, smaller banks tend to be more inclined to provide introductory offers which do not revert to a minimal base rate at the end of the introductory period, to attract and retain price-sensitive customers who are most likely to switch.

While smaller banks may at times offer more attractive rates on specific products, or under specific time-limited conditions (such as an introductory offer), they generally refrain from leading on price due to higher funding costs and the need to grow incrementally and attract more stable, long-term customers (as discussed in section 3.2).

Competition and bank NIMs

In recent years, some major banks have argued that declining net interest margins (NIMs) of the past 25 years are an indicator of strong competition in the market. However, as discussed below, there are many factors that can impact NIM and their relationship with competition is not clear. A declining NIM is not in itself evidence of strong competition in the retail deposits market, or even across deposit and lending markets. The ACCC also notes that only one bank, NAB, submitted to this Inquiry on this point.[118]

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115 This is called "third-degree price discrimination".

116 This is called "first-degree price discrimination".

117 Firms also need to be able to prevent resale to avoid arbitrage.

118 NAB submission, 19 May 2023.

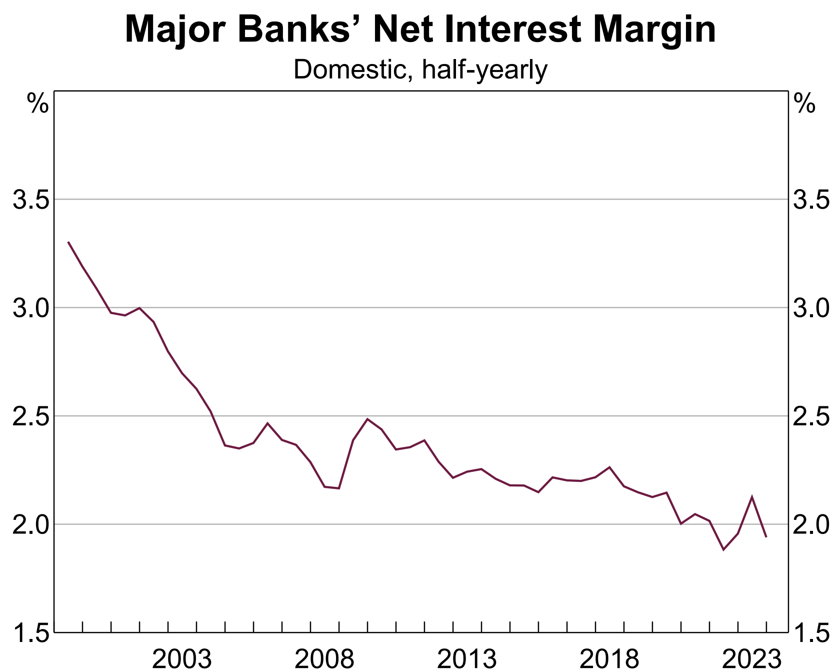
As discussed in chapter 2, banks make profits from their lending activities by lending at interest rates that are higher than the interest rates they pay for their funding. NIM is the ratio of net interest income of the bank as a proportion of its average interest earning assets (for example, various types of loans) and represents the profitability of lending.[119]

NIM = (Interest Income – Interest Expense) / Interest Earning Assets

It is also useful to note that this measure relates to performance at an entity level, rather than a specific product segment, such as retail deposit products. It has the benefit of accounting for profitability in both lending and deposit businesses of a bank, so comparisons can be made regardless of how a bank sets its funds transfer prices, or whether it uses that process at all.

Figure 3.2 below shows the NIM of the major banks over the past 25 years which has seen a significant decrease during the period, although much of the decrease occurred in the late 1990s and early 2000s.

Figure 3.2: Major banks' net interest margin, 1999 – 2023

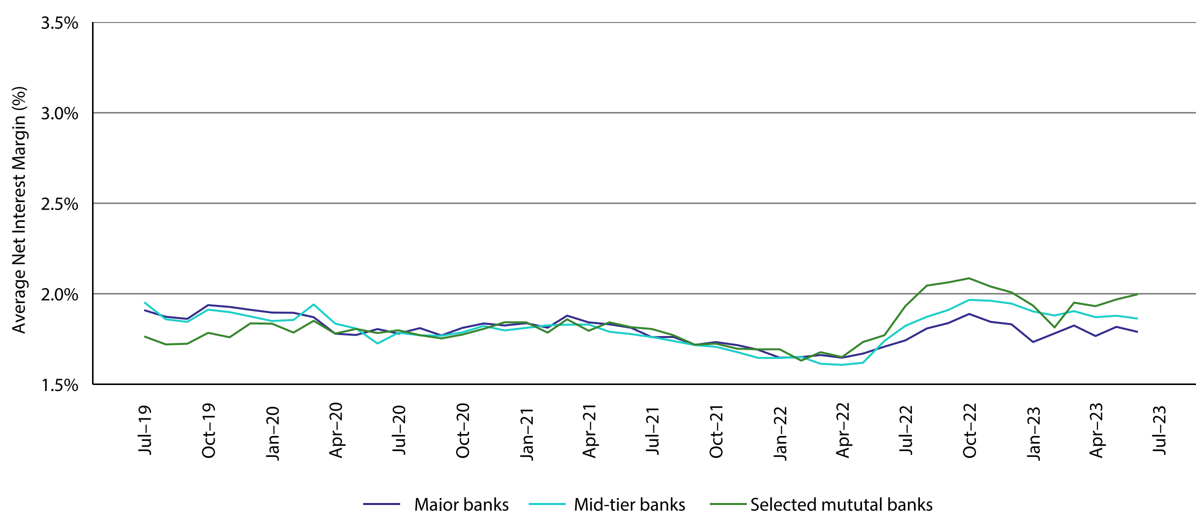


Source: Chart supplied by the RBA.

Figure 3.3 below shows that NIM for the mid-tier banks and mutuals we examined, exhibited a similar trend to that for the major banks during the 2019–2023 period.

119 RBA, Low Interest Rates and Bank Profitability – The International Experience So Far, RBA Bulletin, June 2021, p 78.

Figure 3.3: Average net interest margin by bank type, July 2019 – June 2023 (%)



Note: Net Interest Margin reported by ADIs in annual reports will likely not align precisely with that reported here due to minor scope differences. As Figure 3.2 relies on these reported numbers, this accounts for the difference in NIM between the 2 figures.

Source: ACCC analysis of data obtained from banks, NIM reported monthly on a domestic books consolidation basis.

In NAB's submission to the Inquiry, it stated that the decline in NIM in recent years was impacted by intense competition in deposit and lending markets[120], which is consistent with its submission to the 2018 Productivity Commission Inquiry.[121] However, not all banks have taken this position over time. In a submission to that inquiry, ANZ noted that the decrease in bank returns such as ROE and NIM warrants more detailed exploration as a marker of competition.[122]

The ACCC considers that there are several factors that may be contributing to the reduction in NIMs, of which competition may be one. The recent low interest rate environment, from the onset of the COVID-19 pandemic up until 2022, is another factor that may have contributed. Now that the low interest rate environment has passed, we have seen some increase in the NIM since 2022, as can be seen in figures 3.2 and 3.3.

Westpac noted in its submission to the 2018 Productivity Commission Inquiry, that it is very difficult to attribute changes in NIM entirely to competitive constraints, as movements in NIM driven by competition cannot be isolated from other factors.[123]

3.4 Innovation is not a straightforward indicator of competition

Investment in innovation can be both an indicator and a desirable outcome of effective competition. However, the ACCC notes that it is hard to be definitive about what innovation should be considered as part of the competitive dynamic of a sector, particularly one that is technology driven like banking.

Innovation that drives competition may be highly disruptive to markets or it may be more incremental and tend to reflect a level of improvement on existing products or services.[124] Both can be reflective

120 NAB submission, 19 May 2023, p 6.

121 Productivity Commission Inquiry 2018, NAB submission p.7, 22 September 2017, accessed 10 November 2023.

122 Productivity Commission Inquiry 2018, ANZ post-draft submission, p.20, March 2018, accessed 10 November 2023.

123 Productivity Commission Inquiry, Westpac post-draft submission, p.9, March 2018, accessed 10 November 2023.

124 OECD, Competition and innovation: a theoretical perspective, 2023, accessed 25 November 2023.

of non-price competition if they result in improved and differentiated products or services for customers. However, the ACCC considers that it is important to distinguish between technological developments that have occurred more broadly, or where banks are simply ensuring they are not falling behind in meeting consumer expectations that have become the norm, and where they are truly providing a differentiated product or service.

The ACCC has not sought to make detailed findings about innovation and its relationship with competition in this Inquiry. However, we have considered submissions from industry and available information and make some observations below.

Submissions from the major banks, the ABA and COBA, all noted that competition is driven through innovative offerings either in response to new entrants, or in response to consumer needs. CBA submitted that 'the emergence and growth of new entrants and digital banks with innovative digital offerings (such as Up and UBank) has been a key driver for this innovation'.[125]

The ACCC agrees that a number of digital banking brands, such as Up (owned by Bendigo and Adelaide) and UBank (owned by NAB), have been successful in acquiring customers through promotion of digital offerings[126] but we are cautious about generalising the level of innovation or competition this has brought, particularly in the absence of thorough consideration of relevant market conditions.

The ACCC notes that UBank launched in 2008 and acquired neobank 86 400 in 2021 with the intention of combining it with UBank. In its assessment of the proposed acquisition of 86 400, the ACCC stated:

> Whilst the ACCC found that 86 400's product and service offering is in some ways different to some of the large banks, it is not unique in the market. There are a number of other competitors, including other neobanks, non-bank lenders, and second-tier banks, who are replicating or providing a similar offering, including by:
>
> - providing streamlined back end technology which allows, for example, faster consideration and approval of home loan applications than the large banks
> - providing improvements to customer-facing technology, which improves the ability for consumers to analyse and track their spending habits
> - providing innovative product ideas to the market, including, for example, products which seek to reduce overall costs to consumers.[127]

The Productivity Commission considered that many new entrants were looking to collaborate with incumbent banks rather than compete against them.[128] Whether innovation introduced by new entrants is likely to improve consumer outcomes across the sector depends on a range of factors including whether incumbent banks are responding with their own innovations on an ongoing basis, or whether they are taking steps to dampen the competitive threat of those innovators (including by acquiring them).

The ACCC considers there can be a level of generality in how innovation and technology is discussed, including with respect to competition. There can also be a tendency to conflate innovation over time and in different sectors with specific innovation that is in response to current competition.

The major banks most frequently referred to digital account management tools as a product of competition. This appears to refer largely to the availability of mobile applications and features of

125 CBA submission, 25 May 2023, p 5.

126 J Eyers, Banks are increasingly vying for younger customers (and it's not easy), Australian Financial Review, 29 June 2023, accessed 25 November 2023

127 ACCC, Public informal merger review register, National Australia Bank Limited - 86 400 Holdings Ltd, accessed 25 November 2023.

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

those applications including budgeting and money management. For instance, COBA submitted that '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'.[129] Each of the major banks also cited banking apps and/or budgeting tools as a driver of competition.[130]

The ACCC considers that, at present, the availability of a banking app and budgeting, money management and spending tracking tools are relatively standard across banks, as well as a range of other service providers. Although they may differ, it is not clear the extent to which banks are responding to current or ongoing competition via their apps and budgeting tools. The PC Inquiry noted in 2018 that many (non-bank) mobile apps offer expense tracking and budgeting tools.[131]

A number of submissions touched on innovations in payment services such as the New Payments Platform (NPP), Apple Pay, or Buy Now Pay Later.[132] The degree to which a bank is more seamlessly able to integrate its retail deposit products with other payment systems and services, is likely to affect its overall brand and the likelihood that consumers will see it as a bank that can provide a full suite of services. It is also likely that integration with broader innovations such as these are an expectation of consumers and essential to compete, and it is not clear that they represent new or enhanced product offerings that banks use to compete for retail deposit customers.

3.5 Continued monitoring of competition and prices

This chapter describes a competitive dynamic in the retail deposits market characterised by dampened and opaque price competition, in the context of challenges faced in consumer engagement and switching. The use of market segmentation and selective pricing by banks has evolved over time and will continue to evolve.

Given the crucial role that retail deposits play in the economy, and in people's lives, we consider continued monitoring of how the market is working for consumers is warranted. The ACCC has previously called for continued monitoring in the home loans market.[133] Together, these markets have a significant impact on the lives of most Australians.

While the banking sector is monitored closely to ensure its compliance with prudential requirements, there is only limited monitoring and reporting of information to policy makers and the public about how competition is working in the interests of consumers.

In particular, the interest rate data currently collected by APRA is generally aggregated across multiple banks and products. While this is appropriate for considering aggregate changes in deposit rates, it provides only a limited view of consumer outcomes in the retail deposits product market and the strategic pricing of banks, as described in chapter 7. Further, policy-makers have little visibility of the level and nature of consumer switching or banks' discretionary pricing.

Continued monitoring at a more granular level would help create a more consumer- and competition-focused evidence base for future regulatory decisions. It would also enable a clearer assessment of the impact of the significant reforms underway (in particular 'open banking' through the CDR) along with future reforms such as those recommended elsewhere in this report.

129 COBA submission, 23 May 2023, p 2.

130 CBA submission, 25 May 2023, p 5; Westpac submission, 24 May 2023, p 5; NAB submission, 19 May 2023, p 6; ANZ submission, 9 June 2023, p 5.

131 Productivity Commission, Competition in the Australian Financial System, June 2018, p 501.

132 For example, CBA submission, 25 May 2023, p 14; NAB submission, 19 May 2023, p 6; ANZ submission, 9 June 2023, p 2, 3 and 6, Australian Banking Association submission, 29 May 2023, p 8

133 ACCC, Home loan price inquiry – final report, December 2020, pp 65–69.

Such monitoring, however, necessarily involves a cost for Government and the banking sector. These costs can be managed through the use of existing data reporting processes and a careful consideration of the metrics and banks to be monitored. Ultimately, the retail deposits market is too important to Australian consumers and the economy more generally to rely on the current level of transparency.

Recommendation 1

Continued monitoring of prices and competition in the retail deposits market

The retail deposits market requires increased transparency, given its importance to consumers and the economy more broadly. The opacity of retail deposit pricing (rates, fees and charges) and the limited competition observed justify ongoing scrutiny as the sector continues to evolve.

This monitoring should build on existing high-level reporting requirements and mechanisms which would minimise the regulatory burden, particularly on smaller banks. There should also be frequent and timely reporting on the results of the monitoring. This can provide much greater transparency to consumers and evidence to policy-makers on prices and competition in the retail deposits market.

4. Retail deposits and bank funding

Findings

- Banks seek funding to sustain and grow their business. In doing so, they must balance their funding and lending growth, manage key risks and compete in various funding markets.
- Banks obtain funding from a range of sources, including retail deposits, wholesale deposits, short-term and long-term wholesale debt, and equity.
- Retail deposits provide many benefits relative to other funding sources. Retail deposits are generally cheaper, more stable and more diversified than many other funding sources. Retail deposits can also bring additional benefits because retail depositors often become customers for loans and other products with their bank.
- Banks employ funding strategies to ensure they are funded at the lowest cost while remaining consistent with their risk appetite. Funding strategies consider banks' funding needs, costs and risks, and market conditions. As part of their funding strategies, banks set funding targets and limits, and specify approaches to managing various risks, including liquidity risk and interest rate risk.
- Banks have greater discretion on how they set interest rates for retail deposits than they do for other funding sources. Accordingly, interest rate setting is an important part of how banks meet their funding requirements.

This chapter explores the significance of retail deposits as a source of funding to support banks' lending and other activities, and how this compares to other funding sources.

Section 4.1 sets out why banks need funding and the constraints they face.

Section 4.2 outlines the various funding sources banks use to meet their funding needs.

Section 4.3 describes various components of banks' strategies to meet their funding needs.

4.1 Banks need funds to sustain and grow their business

Banks require funds, whether they are generated from business activities or obtained from external sources (such as through deposit taking, debt funding or equity raising), to sustain and grow their business activities. Banks use these funds to make loans, meet operational costs (such as staffing and rent), and undertake capital expenditure (for example into technology improvement) or investment into new or expanded activities.

Banks cannot expand their lending and other business activities without limitation. They face a range of constraints that require them to moderate the scale of their business activities and the speed at which they grow. Such constraints include the need to balance funding and lending growth to maintain a profitable business, ensuring that they manage both risk and return to maintain trust and credibility in the market, and to meet regulatory requirements and the economic conditions prevailing

at any point in time. In light of these constraints, banks seek to structure the funding of their lending and other business activities in support of their overall business objectives.

As outlined in chapter 2, banks face and must manage a number of key risks including liquidity risk and market risk. Banks manage these risks in various ways, including by adapting how they structure and grow their funding and lending activities. Additionally, prudential regulation stipulates how certain risks must be addressed, for example by imposing minimum holding requirements for capital and high quality liquid assets. In doing so, prudential regulation shapes banks' funding and asset strategies by influencing the relative benefits and costs of different funding and asset types and their maturities.

Another constraint on the structure and scale of banks' funding and lending activities can be competition for debt funding. The cost, volume and maturity profile of debt funding that banks can raise largely depends on their creditworthiness as reflected in an assigned external credit rating (for example, by S&P Global or Moody's) or as internally assessed by a lender to that bank. Banks with better creditworthiness are generally able to access debt funding on more attractive terms (for example, on lower interest rates and in higher volumes) relative to other banks. As most banks require debt funding, this puts competitive pressure on banks to manage risks appropriately (on top of the requirements of prudential regulation) and to moderate how quickly they grow their lending activities.

Access to debt funding can be limited for smaller banks and this may be a barrier to entry and expansion (see chapter 2). As explained in sections 4.2 and 4.3, debt funding enables banks to meet urgent funding needs, improve their funding certainty and grow more quickly and adaptably than what retail deposit growth alone enables.

The interrelationships between banks' use of different funding sources, their relative benefits, costs and risks, and how they are treated under prudential regulation requires banks to take a strategic approach to funding. These issues are considered next.

4.2 Banks' use of different funding sources, including retail deposits

Banks use a range of sources to meet their funding needs, while ensuring they meet their regulatory requirements. These funding sources can be broadly categorised as in table 4.1 below.

Table 4.1: Sources of funding[134]

Funding source	Description	Examples
Retail deposits	Deposit products supplied to households and trustees of self-managed superannuation funds	Transaction accounts Savings accounts Term deposits
Wholesale deposits	Deposit products supplied to businesses, other financial institutions, governments and investment funds	Transaction accounts Savings accounts Term deposits
Short-term wholesale debt	Bank debt instruments of up to 12 months' tenor	Bank bills and certificates of deposit Short-term security repurchase (repo) agreements with the RBA or other banks Inter-bank debt issuance within a banking group
Long-term wholesale debt	Bank debt instruments of over 12 months' tenor including securitisation	Bank bonds, including covered bonds Inter-bank debt issuance within a banking group Mortgage-backed securities Hybrid securities
Equity	Capital owned by shareholders	Shares Retained earnings

In response to the onset of the COVID-19 pandemic, the RBA established the Term Funding Facility (TFF) to provide banks with access to low-cost fixed rate funding for 3 year terms, as described in box 4.1.

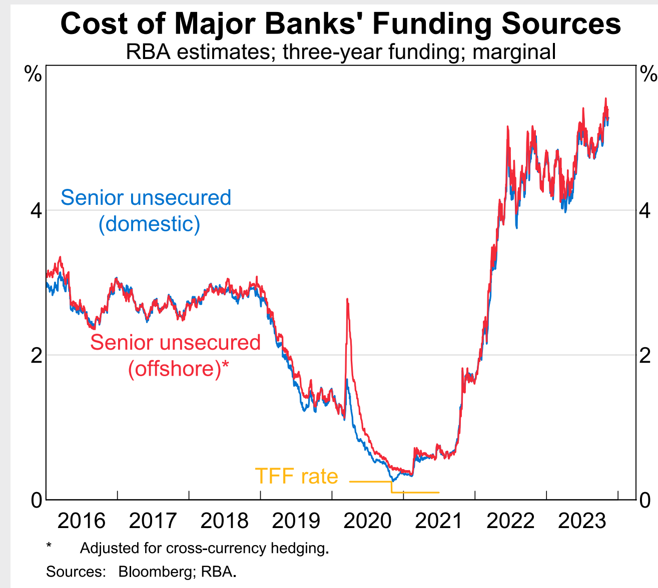
134 This table is not intended to be an exhaustive list of all security types falling within a type of funding source.

Box 4.1: The Term Funding Facility

Between April 2020 and June 2021, banks could access new funding from the RBA at an interest rate substantially below wholesale debt funding costs as shown in figure 4.1.

Access to the TFF therefore significantly reduced bank funding costs by providing banks with an alternative and significantly cheaper substitute to debt funding. Consequently, banks reduced their share of long-term wholesale debt funding over 2020 and 2021. Access to new funding through the TFF was closed on 30 June 2021, meaning that the TFF will continue to dampen funding costs until mid-2024.

Figure 4.1: Comparison of long-term wholesale debt and TFF funding costs for major banks

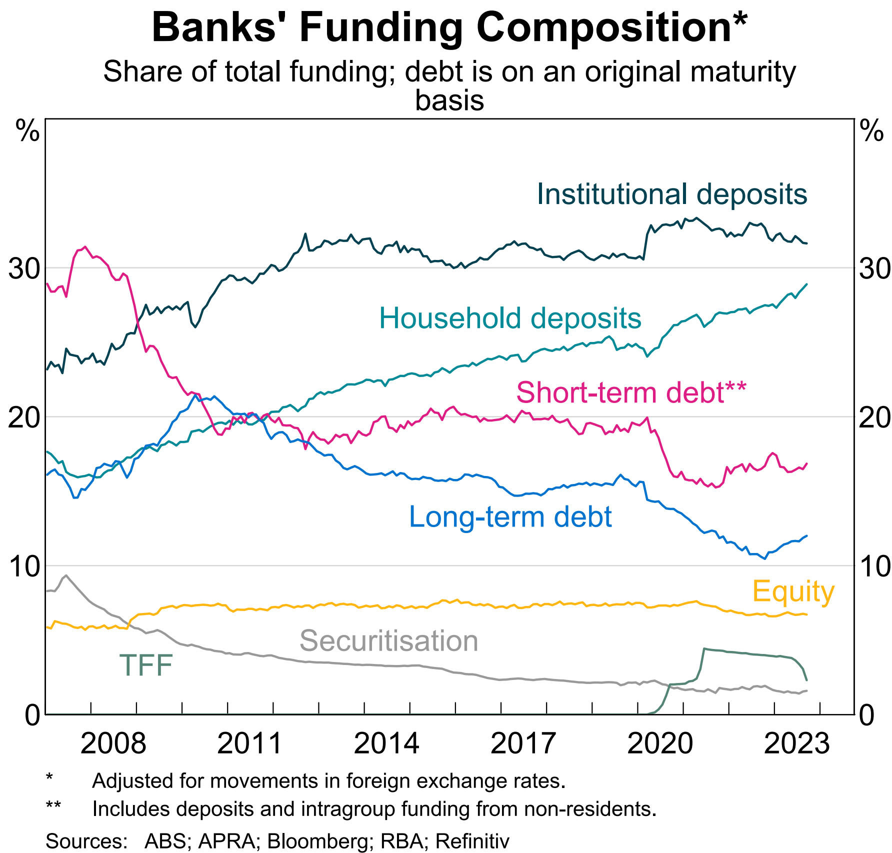


Source: Chart supplied by the RBA.

As shown in figure 4.2 below, since 2007, banks have steadily increased their reliance on deposits and decreased their share of funding sourced from short-term [wholesale] debt and securitisation, particularly following the global financial crisis. This shift was initially driven by banks reassessing their liquidity risk management, and later by the introduction of prudential regulations that further increased the need for stable funding sources.[135]

135 For example, the RBA observed that the introduction of a prudential standard for the Net Stable Funding Ratio in 2016 increased competition by banks for term deposits that year. T McKinnon, 'Developments in Banks' funding costs and lending rates', RBA Bulletin, March 2018, pp 3–4.

Figure 4.2: Banks' funding composition



Source: Chart supplied by the RBA.

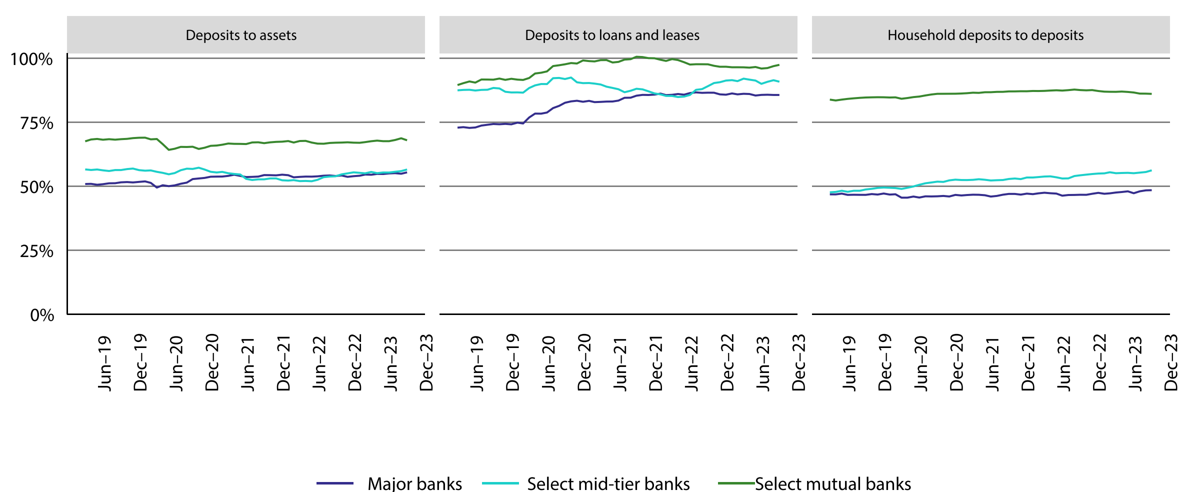
In its submission to the Inquiry, one of COBA's key points was that the smaller banks that make up its membership rely heavily on retail deposits as a source of funding. It stated that household deposits make up over 84% of deposits held by customer-owned banks, as 'most of our members do not have access to wholesale funding sources and limited access to other sources'.[136]

The ACCC's analysis finds that, within the sample of the banks reviewed in the Inquiry, the mutuals were more reliant on retail deposits for their funding than the major banks or the mid-tier banks. Figure 4.3 shows that between March 2019 and September 2023:

- compared to the other banks, the mutuals funded a greater proportion of their assets (including their loans and leases) using deposit funding
- the mutuals had a substantially higher household deposits to deposits ratio than the other banks during this period.

136 COBA submission, 23 May 2023, p 3.

Figure 4.3: Deposit ratios by bank type, March 2019 – September 2023



Sources: APRA, ACCC.

A bank's funding composition will be influenced by the relative advantages and disadvantages of different funding types. The main features of deposits, wholesale debt (short-term and long-term), and equity funding are considered next.

Retail deposit products provide many advantages as a funding source

For smaller banks which do not have as much access to other funding sources, the availability of retail deposit products is its main advantage. More generally, deposits (in particular retail deposits) provide multiple advantages relative to other sources of funding, including wholesale debt (short-term and long-term) and equity, as set out below.

Relative cost

Banks' funding costs comprise not only the interest rate paid for deposits or debt funding, but also transaction costs incurred to raise funding (including deposit customer acquisition and retention costs) and the cost of managing interest rate and other risks. For example, banks that raise debt funding overseas incur costs to hedge their exposure to currency volatility.

Inclusive of these additional costs, for many banks, retail deposits are generally one of the cheapest funding sources available to them. This is particularly the case for mutuals, which in comparison to the major banks and even the mid-tier banks, face significantly higher wholesale funding costs, primarily due to having lower credit ratings.

Liquidity risk and related costs

Retail deposits generally carry lower liquidity risk than wholesale deposits and short-term wholesale debt, especially in times of economic uncertainty.[137] This is reflected in prudential regulation, which treats retail deposits as a relatively stable funding source.[138] Banks that source a greater proportion of their funding from retail deposits can generally hold a smaller portfolio of high quality liquid assets or rely less on long-term wholesale debt funding to manage their liquidity risk in compliance with

137 This is partly because they are more likely to be covered by the Financial Claims Scheme, due to their normally lower balance relative to wholesale deposits.

138 See: APRA, Prudential Standard APS 210 Liquidity, December 2022, Attachment C, [12]-[13].

prudential regulation.[139] This can result in higher profitability, as high quality liquid assets generally bring lower returns than the loans that banks may otherwise issue, and long-term wholesale debt is often more expensive than retail deposits as a funding source.

Diversification

Retail deposits are well-diversified compared to wholesale funding, because they consist of a larger number of smaller individual account balances held by a diverse customer base. This contributes to the stability of retail deposit funding even in volatile economic periods. In comparison, wholesale funding is usually obtained from a more concentrated set of investors and depositors and tends to be more sensitive to changes in interest rates and economic conditions.

Nonetheless, there remains some risk of retail deposits being suddenly withdrawn in times of economic volatility. Partly in response to this risk, banks adopt various measures to help increase the 'stickiness' of retail deposits (see chapter 7).

Customer relationships

As discussed in previous chapters, retail deposits enable a bank to develop relationships with customers and increase the likelihood of those customers being higher value MFI customers. This includes customers who, because of their relationship with their bank as a depositor, seek other products from the same bank, such as home loans or credit cards. The specific strategies aimed at maximising customer relationship benefits derived from retail deposits can vary across banks.

Wholesale debt helps to meet banks' funding gaps and other needs

After deposits, short-term wholesale debt and long-term wholesale debt are generally the next largest funding sources for banks.

Banks raise wholesale debt funding for various reasons, including to help support their lending growth. As discussed in chapter 3, smaller banks which have limited or higher-cost access to debt funding may be more constrained in their growth. COBA noted this in its submission to the Inquiry, stating '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'.[140]

As explained in section 4.3 below, banks forecast the difference between their expected or targeted growth in loans and deposits, often referred to as a 'funding gap'. Most banks have a funding gap each year[141] that they can fund using short-term and long-term wholesale debt.

Ready access to large amounts of funding

Banks that need to raise urgent funding or meet a funding gap may do so using short-term wholesale debt due to the amount of funding that can be sourced in this way quickly. However, short-term wholesale debt is treated as a relatively unstable funding source under prudential regulation and therefore carries implicit costs compared to stabler funding sources.[142] Additionally, the availability of

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139 This applies specifically to 'liquidity coverage ratio' banks, which are generally the larger and more complex banks. See: APRA, Prudential Standard APS 210 Liquidity, December 2022, [55] and Attachment A, [52].

140 COBA submission, 23 May 2023, p 2.

141 Given historical growth in borrowings and savings in the Australian economy over time, it is unlikely for Australian banks in aggregate to be able to fund their marginal lending activity by retail and wholesale deposits alone. Therefore, usually at least some banks must source additional funding from the domestic and global wholesale debt markets.

142 Prudential regulation requires banks to hold a high quality liquid asset portfolio to help them meet and survive unexpected funding withdrawals. Banks that rely on funding deemed as less stable, including short-term wholesale debt, must hold a larger high quality liquid asset portfolio. This can lower their profitability, as such assets generally have lower returns than the loans that banks may otherwise issue, and in fact often have lower returns than the cost of funds that supports them.

short-term wholesale debt funding may be uncertain during periods of economic volatility. As a result, banks generally set limits on the share of funding they will source from short-term wholesale debt.

Many banks aim to regularly raise debt funding to maintain a presence in domestic and international wholesale debt markets. This helps to equip them to raise debt funding at short notice should an unforeseen funding need arise. It also improves certainty regarding their funding costs as, by issuing wholesale debt across a range of tenors regularly, they can facilitate regular price discovery of their relevant debt funding costs.

Banks may focus on maintaining or improving their credit ratings to ensure they can raise wholesale debt in the amounts and tenors needed at a low cost. For smaller banks, achieving an 'investment grade' credit rating enables access to a wider range of potential wholesale debt investors.[143] To support their credit rating, banks may consider and adjust their funding composition and maturity profile relative to other banks of similar size. In particular, banks may seek to diversify their debt funding across multiple countries, currencies, tenors and industries, and moderate their reliance on funding sources perceived to be riskier, such as short-term wholesale debt.

Banks may also seek to increase their funding certainty by increasing the proportion of their funding sourced from long-term wholesale debt.

Liquidity risk

The contractual certainty of wholesale debt provides benefits to managing liquidity risk. Despite being relatively expensive compared to other sources of funding such as deposits and short-term wholesale debt, long-term wholesale debt generally reduces banks' liquidity risk and is therefore treated as a stable form of funding under prudential regulation.[144] Banks may issue long-term wholesale debt to increase their funding certainty as, although retail deposits are a relatively stable source of funding, they carry some risk of being suddenly withdrawn for unforeseen reasons. Banks seeking to issue large amounts of long-term wholesale debt may identify ideal future points in time to do so. For example, they may avoid issuing during times of market sensitivity that may jeopardise the issuance, such as periods immediately prior to earnings releases.

Banks that are part of a banking group can seek funding from other banks in the group. Intragroup funding can be used in place of public debt issuance and can help to diversify funding across multiple countries and currencies if the group operates across multiple countries. It may also lower transaction costs, funding costs and funding risk, particularly for long-term wholesale debt funding.

Securitisation

Securitisation is the process of repackaging assets, commonly mortgages, credit card and other loans, into a pool and issuing interest-bearing securities supported by that pool. Subject to meeting certain specified requirements, banks may use securitisation in place of other forms of long-term debt, which can in some circumstances reduce the amount of capital they need to hold under prudential regulation and therefore can indirectly enable additional lending or other growth opportunities.

Banks may also use securitisation to add tenor to their funding profile, manage liquidity risk or free up capacity to issue additional covered bonds[145], which are subject to a limit under prudential regulation. Like other forms of long-term debt, securitisation can provide funding certainty.

143 In Australia, bank bonds with at least 2 'investment grade' credit ratings from Standard & Poor's, Moody's and Fitch are eligible for security repurchase agreements with the RBA. For many wholesale debt investors, this is a key consideration to their investment decisions.

144 Long-term debt, being a liability with effective maturity of one year or greater is considered as a form of stable funding. See: APRA, Prudential Standard APS 210 Liquidity, December 2022, Attachment C, [11].

145 Covered bonds are a form of long-term wholesale debt secured by a pool of assets, commonly residential mortgages.

We observe that, of the banks reviewed in the Inquiry, mid-tier banks and mutuals typically rely on securitisation more than the major banks.

Equity funding helps to support growth in scale of business activities and bolster credit ratings

Equity funding involves raising capital through the sale of shares or accumulating retained earnings (profits that are not distributed to shareholders). Equity funding is treated as a stable source of funding under prudential regulation and does not directly increase the amount of high quality liquid assets that banks must hold to mitigate liquidity risk.[146]

As set out in chapter 2, banks are required under prudential regulation to hold sufficient capital (which includes equity) relative to a risk-adjusted measure of their assets.[147] By raising equity funding, banks can increase or maintain the scale of their business. That is, they can expand the scope of their lending activities either commensurate with the capital raised or by taking on more debt or deposits.

Banks also maintain sufficient equity and other capital holdings to support their credit rating and therefore maintain or improve their ability to raise wholesale funding in large amounts or at low cost. Many banks maintain capital adequacy ratios significantly higher than regulatory minimums. While holding capital in itself does not directly mitigate banks' liquidity risk, it better enables them to absorb losses, and helps to protects depositors and wholesale debt investors from incurring losses.

4.3 Funding strategies guide how banks seek funding from deposits and other sources

Funding strategies set out how banks intend to be fully funded at the lowest cost consistent with the bank's risk appetite. As required under prudential regulation, banks maintain a three-year funding strategy and review it at least annually.[148]

Banks consider a range of factors when developing their funding strategies, including the amount of funding needed to achieve business objectives, how liquidity, interest rate and other risks will be managed and how funding can be obtained at the lowest cost.

While the exact process differs between them, banks generally undertake the following key steps to account for these considerations when developing their funding strategy:

- assessing funding needs and capacity
- evaluating funding sources and costs
- assessing risks and ensuring sufficient funding diversification
- stress testing and contingency planning
- monitoring market conditions.

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146 This is because unlike deposits and debt funding, equity funding once provided cannot be withdrawn and does not mature (and therefore does not require repayment or replacing). Additionally, capital (including equity) is considered as a form of stable funding. See: APRA, Prudential Standard APS 210 Liquidity, December 2022, Attachment C, [11].

147 As described in chapter 2, banks must maintain a 'capital adequacy ratio' above a prescribed minimum. This helps to protect depositors and other debtholders should a bank fail.

148 This chapter considers funding strategies in the broad sense of banks' objectives, processes and plans to fund their business activities, rather than its specific use as a prudential regulatory tool. We note that prudential regulation requires banks to undertake certain funding-related activities (such as regularly gauging their capacity to raise funds quickly) that may in practice be considered within banks' funding strategies. See: APRA, Prudential Standard APS 210 Liquidity, December 2022, [44].

Banks set funding targets for deposits and other funding sources

Banks set their funding strategy in response to their expectations of how economic, market and regulatory factors will influence business growth and the cost and availability of different funding sources. For example, banks may forecast the volume of deposits available in the banking system or how economic conditions and investor sentiment may impact funding costs and availability. As external conditions change, banks may review and adapt their funding strategy over time. Banks may also compare their funding composition with publicly available information about their close competitors to highlights areas of strategic deficiency or advantage, which can inform funding strategy.

As introduced in section 4.2, forecasts about their expected or targeted growth in loans and deposits directly inform banks' need for debt funding. Similarly, banks may seek to increase their level of deposit funding or set lending growth targets in line with forecasted deposit growth, to minimise their expected funding gap. Banks also need to source new funding to replace maturing debt. Given the contractual certainty of wholesale debt, the need to replace maturing debt is predictable and built into banks' funding forecasts.

As part of their funding strategy, many banks set targets and limits relating to the amount or proportion of funding that they source from specific funding types. Funding limits or targets relating to deposits usually require that deposits make up the majority of all funding, and for some banks, specifically target that retail deposits make up at least a certain proportion of all funding. We consider this reflects the importance of deposits and especially retail deposits in the funding mix for banks.

Banks generally set funding limits in a hierarchical structure, with oversight by the board and senior managers. Some banks also set additional trigger levels that prompt and enable banks to take corrective action before any limits are breached.

Banks set their funding strategy to address a range of risks

As outlined in chapter 2, banks face liquidity risk because of differences between their funding and lending maturities. Banks manage liquidity risk in multiple ways, including by maintaining a high quality liquid asset portfolio to protect themselves from unexpected withdrawals of funding. As required by prudential regulation, banks conduct regular stress testing to assess the impact of adverse scenarios on their funding and liquidity positions.

Banks also structure their funding composition to help manage liquidity risk. As described in section 4.2, banks may set limits on their reliance on less stable funding sources like short-term wholesale debt, and may raise long-term wholesale debt to bolster their funding certainty despite it being a relatively expensive funding source. Banks may also try to reduce the liquidity risk of retail deposits by building stronger relationships with their retail customers by offering competitive products that meet customer needs, or by offering negotiated interest rates to certain customers (these are considered in chapter 7).

Banks face interest rate risk as a result of mismatches between when the interest rates of their assets and liabilities are set or repriced. For example, while the interest rates on at-call retail deposits are commonly repriced on a monthly or more frequent basis, banks may issue fixed interest rate home loans for specified terms. Where these mismatches occur on a bank's balance sheet in aggregate, the bank faces risk of loss due to changes in interest rates over time.

Some banks also raise wholesale funding in foreign currencies from overseas investors and therefore face risk of loss due to unfavourable movements in exchange rates. Banks can hedge against interest rate and exchange rate risks using financial derivatives.

By diversifying their funding sources, banks achieve greater funding certainty and stability

Different funding sources bring their own relative benefits, costs and risks as outlined in section 4.2. Relying on a narrow set of funding sources can therefore expose a bank to an unacceptable concentration of specific risks, also known as 'concentration risk'. By maintaining a diversified funding base, banks limit their vulnerability to concentration risk, which otherwise could lead to a severe funding shortfall if there is an unexpected withdrawal of funding from a specific source. For example, banks that are heavily reliant on large at-call deposits may be susceptible to this funding being withdrawn in volatile economic conditions if large depositors perceive that their funds would be safer elsewhere.[149]

As explained in section 4.2, retail deposits naturally tend to be diversified, whereas wholesale deposits and debt funding are generally obtained from a more concentrated set of counterparties. As a result, many banks seek to diversify their wholesale funding across tenor, geography, currency, investor segment and instrument, for example by raising debt in different overseas markets with different maturities and may use multiple types of wholesale debt instruments.

Banks also seek and maintain access to diverse funding sources to improve their capacity to raise funds in the event of unforeseen funding needs. For example, as described in section 4.2, smaller banks may seek to meet part of their funding needs with debt funding even when it is costly relative to other funding sources, partly because this enables them to seek debt funding at short notice should an unforeseen funding need arise.

Banks continually adjust their approach to meet their funding needs efficiently

Banks' funding needs change over time and are frequently reviewed.

The constraints described in section 4.1 incentivise banks to strategically grow their funding base in line with their current and expected business needs. For example, banks seeking to grow the scope of their business activities may require additional equity funding to meet prudential requirements, and to maintain their credit rating to help maintain their access to, and cost of, wholesale funding.

Underlying these considerations is a goal to meet funding needs at the lowest cost. This may incentivise banks to favour certain funding sources or occasionally deviate from their funding strategy to take advantage of market conditions where they are conducive to particular funding sources. For example, banks may opportunistically source wholesale debt when it is cheap. Banks' approach to meeting their funding needs in a cost-effective way can be part of their broader objective of maximising profit and shareholder returns.

Many banks prioritise retail deposits as their primary funding source partly for cost efficiency reasons. Mutuals in particular can lack access to long-term wholesale debt funding at a cost competitive with that paid by major banks and mid-tier banks and as a result they tend to rely heavily on retail deposits as a funding source. Mutuals commonly source 80% or more of their total funding from retail deposits, which is substantially higher than the industry average of under 30% share of funding from household deposits, as shown in figure 4.2. Additionally, at least one mid-tier bank also targets sourcing a significantly higher proportion of its funding from retail deposits compared to the industry average.

149 The consequences of this risk were demonstrated by the sudden withdrawal of at-call deposits in a short period of time from Silicon Valley Bank in the United States in March 2023 which led to the bank's collapse.

As discussed in section 4.2, retail deposits, being a stable funding source, also enable banks that rely on them over less stable funding sources to hold a smaller high quality liquid asset portfolio under prudential regulation, which can improve their profitability.

In addition to setting funding targets or limits (as described earlier in this section) for retail deposits and other funding sources, many banks use a process known as 'funds transfer pricing'. This is done to ensure they set interest rates, including for retail deposits, efficiently given the relative cost of the funding sources available to them. Funds transfer pricing, and its influence on retail deposit product interest rates, is considered further in chapter 6.

As outlined in this chapter, retail deposits are a key part of how Australian banks meet their funding needs. In contrast to funding from wholesale debt and to some extent wholesale deposits and equity, banks have considerable discretion in the price they pay for retail deposits, namely through their ability to set the interest rates they offer to depositors.

The effect of the cash rate and changes in the cash rate target are considered in chapter 5. Interest rate decisions for retail deposit products and home loans and interest rate setting practices for retail deposit products are examined in greater detail in chapters 6 and 7 respectively.

5. Effect of the RBA cash rate target

Findings

- The cash rate (often referred to as the 'official interest rate') is the rate paid on lending between banks in the overnight cash market. The cash rate is not paid directly by the RBA to banks, nor is it a regulated rate that banks must receive or pay.
- Changes to the cash rate target indirectly affect the cost of funding from retail deposits and the interest rates paid on retail deposit products. These effects differ between types of retail deposit products.
- In contrast, changes and expectations of changes to the cash rate target appear to have a more direct effect on a bank's costs of new wholesale debt, which is usually their marginal cost of funding. However, as banks may obtain wholesale funds from a variety of sources and for a range of maturity periods these effects on a bank's wholesale funding costs may not be immediate.
- Recent movements in deposit rates and the cost of funding from deposits have been significantly impacted by the unprecedented impacts of COVID-19, including a combination of the significant deposit inflows banks received over 2020 and 2021, and banks' access to very low-cost funding from the Term Funding Facility.
- Interest rates on different types of retail deposit products converged from mid-2019 to mid-2022, with greater decreases occurring on term deposits and bonus interest products, given interest rates on other at-call deposit products were already very low.
- As the cash rate target increased, interest rates paid on different retail deposit products have become increasingly distinct, with clear differentials between term deposit products, bonus interest products and other at-call deposit products.

This chapter sets out the relationship between the cash rate, the RBA's cash rate target, and banks' cost of funding. Section 5.1 explains what the cash rate is, how the RBA uses the cash rate target, how changes to the cash rate affect bank funding sources and why the effect varies depending on the funding source.

Section 5.2 considers the impact of cash rate target changes in recent years on key funding sources, including deposits, as well as on lending rates.

5.1 How the cash rate target affects banks' funding costs

The cash rate is the interest rate that banks pay to borrow from each other overnight

The cash rate is the interest rate that banks pay to borrow funds from each other on an unsecured basis in the cash market overnight. The cash rate is market-determined. The RBA does not set the cash rate itself, but does set the cash rate target and takes steps to ensure the cash rate aligns with that target. The RBA does not pay the cash rate to banks directly, nor is it a regulated interest rate that banks must receive or pay.

When banks transact in the cash market, the movements in cash occur via their Exchange Settlement accounts held at the RBA.

Exchange Settlement accounts are equivalent to a wallet and the balances are, in effect, the cash in that wallet. Banks use their Exchange Settlement accounts to settle their daily payments transfers and must always have a positive balance in their Exchange Settlement account. If a bank has an insufficient balance in their Exchange Settlement account to be able to maintain a positive balance, they must borrow funds from other banks in the cash market or from the RBA. Banks can lend money if they have a surplus in their Exchange Settlement account.[150]

The cash rate is the weighted average interest rate on these overnight unsecured loans between banks.[151] Banks do not receive the cash rate for the total of their own customers' deposits, only the proportion of their Exchange Settlement balance that is lent to another bank. This means that the cash rate only directly affects the proportion of Exchange Settlement balances that deposits which is equivalent to the net value of the funds that are transferred overnight as loans between banks.

The cash rate target is the operational target for transactions in the overnight cash market

The cash rate target is the RBA's operational target for monetary policy. It is the primary anchor for other interest rates in the economy that in turn influences households' and businesses' consumption, saving and investment decisions.[152]

The cash rate target is set by the Reserve Bank Board, which considers domestic and international economic and financial conditions – including the interest rates offered by banks on lending and deposit products. The cash rate target is both a reaction to and an influence on conditions in financial markets.

Prior to COVID-19, the aggregate level of Exchange Settlement balances was intentionally kept very low, and the cash rate traded very close to the cash rate target. This was because the RBA would manage the supply of Exchange Settlement balances to closely manage demand through open

150 ADIs are required to settle payment transfers in the cash market. The RBA manages the total value of banks' Exchange Settlement accounts such that all banks have positive balances once borrowing and lending has occurred.

151 A Hing, G Kelly and D Olivan, The Cash Market, RBA Bulletin, 15 December 2016, p 33.

152 For example, RBA's policy responses to COVID-19 cover a range of measures, including changes in the cash rate target. We discuss these policy responses and their impacts in the section 5.2.
RBA, About Monetary Policy, RBA website, n.d., accessed 13 July 2023; RBA, Review of the Yield Target, RBA website, n.d., accessed 6 September 2023; RBA, Supporting the economy and financial system in response to COVID-19, RBA website, n.d., accessed 13 July 2023.

market operations, including repurchasing (repo) and reverse repurchasing (reverse repo) contracts, and outright purchases of government bonds from banks.

The RBA's policy responses to COVID-19 (discussed further in section 5.2) led to substantial increases in Exchange Settlement balances, which in turn reduced the need for many banks to borrow in the overnight cash market.[153] The excess supply of Exchange Settlement balances pushed the cash rate below target and towards the interest rate paid on banks' deposits held at the RBA – known as the 'Exchange Settlement rate'.

The Exchange Settlement rate is 0.1 percentage points below the cash rate target, and acts as a floor for the cash rate because banks can earn this interest rate by holding their Exchange Settlement balances on deposit at the RBA rather than lending them in the interbank market. The effective ceiling for the cash rate is the lending rate, which is the rate at which the RBA will lend Exchange Settlement balances to banks and is currently 0.25 percentage points above the cash rate target.[154]

This means that banks have an incentive to lend any surplus Exchange Settlement balances in the overnight cash market to receive a return closer to the cash rate target on these loans.[155] Similarly, banks needing to borrow have an incentive to do so from other banks at a rate close to the cash rate target, rather than the higher rate from the RBA.

Banks' expectations of future cash rates and the credit risk of longer-term arrangements form the basis for their wholesale debt costs

The cash rate represents a (near) risk-free benchmark for interest rates on unsecured overnight loans between banks. However, the cash rate only applies to overnight lending between banks' Exchange Settlement accounts, which are maintained at the RBA.

Banks can also borrow from and lend to other banks directly with short-term 'bank paper' such as bank bills and certificates of deposit, which are debt instruments that can be bought and sold in wholesale markets for monthly terms (ranging from 1 to 12 months).[156] These instruments are issued outside of the cash market and the cost of borrowing will reflect the cash rate, cash rate expectations (to account for the longer-term nature of bank paper relative to overnight loans and the potential for changes to the cash rate over the period) and a credit risk premium that reflects additional counterparty risk of banks dealing with each other.

The Bank Bill Swap Rate (BBSW) is a benchmark established from the interest rates payable on bank bills and certificates of deposit by highly rated 'prime banks' in Australia over specified trading windows, and is administered by the Australian Securities Exchange (ASX).[157] The BBSW is a reference rate applied to variable rate term loans. The BBSW is also a reference rate some banks may use when setting the interest rates of retail deposit products (see chapter 6).

If banks expect the cash rate to fall over the maturity of the bank bill, then the BBSW rate may be below the cash rate even with the credit risk premium attached. The BBSW will be above the cash rate where banks expect the cash rate to remain stable or increase over the maturity of the bank paper. This means that the difference between the cash rate and the BBSW varies with both current and expected future market conditions.

153 See also: G Debelle, Monetary Policy During COVID, RBA, 6 May 2021; L Bristow and C de Roure, Recent Developments in the Cash Market, RBA Bulletin, 15 June 2023.

154 RBA, How the Reserve Bank Implements Monetary Policy, June 2023.

155 Although, as noted above, banks have had significant increases in Exchange Settlement balances that has reduced the need for many banks to borrow in the overnight cash market.

156 RBA, Interest Rate Benchmark Reform in Australia, RBA website, n.d., accessed 7 September 2023.

157 ASX, ASX Prime Bank Conventions, 25 February 2019; ASX, ASX Bank Bill Swap (BBSW) Conventions and BBSW Methodology, 10 February 2020.

When issuing bonds to borrow funds from a broader range of investors in wholesale debt markets over longer periods (generally 12 months or more), banks can price their bonds relative to the credit-based BBSW benchmark.[158] This additional premium will incorporate some level of compensation that non-bank investors expect for investing in the banks' bonds (a credit risk premium).

The RBA's changes to the cash rate target will impact wholesale funding costs to varying extents

There can be considerable uncertainty regarding the size and timing of the impact of changes to the cash rate target on a bank's specific wholesale funding costs.

When the RBA changes the cash rate target, domestic short-term wholesale markets will respond immediately with changes to bank paper yields and hence the BBSW. However, these rates may not always move by the same amount as the subsequent change to the cash rate, depending on whether markets anticipated the change and how the change influences markets' expectations of future monetary policy.[159]

A cash rate target change has a less immediate impact on the pricing of new longer-term wholesale debt, compared to the pricing of short-term wholesale debt. This is because the pricing of longer-term bonds depends on several factors besides the cash rate.

These include the current short-term interest rate for wholesale debt and market expectations about future interest rates and the credit risk of the bond issuer (see section 4.3).[160] Notwithstanding, sustained short-term interest rate decreases will typically place downward pressure on other interest rates.[161]

Some banks also source funds from international capital markets. These markets enable banks to diversify their funding sources, access deep and more liquid markets overseas and borrow for longer terms than they often can domestically.[162] A bank's offshore debt instruments are issued in foreign currencies but are typically converted into Australian Dollars through a cross-currency swap.[163] Therefore domestic factors including a change in the cash rate target affect the effective cost of banks' offshore debt. They are also influenced by factors in the denominated currency or the relevant debt market.

Changes to the cash rate target do not directly influence retail deposit and lending interest rates

Banks also source funds from wholesale and retail depositors. The impact of changes to the cash rate target on the interest rates set by banks for these 2 funding sources can differ.

Wholesale depositors, such as large corporations, superannuation funds and governments, with access to a broader range of market-based alternatives in which to invest their funds, may be offered

158 S Alim and E Connolly, Interest Rate Benchmarks for the Australian Dollar, RBA Bulletin, September 2018, p 1.

159 E George, M King, D Clementi, A Budd, W Buiter, C Goodhart, D Julius, I Plenderleith and J Vickers, The Transmission Mechanism of Monetary Policy, Bank of England Quarterly Bulletin, June 1999, p 162.

160 C Viney and P Phillips, Financial Institutions, Instruments and Markets, McGraw-Hill Education (Australia), 2019, pp 433, 438, 447; T Atkin and G La Cava, The Transmission of Monetary Policy: How Does It Work?, RBA Bulletin, September 2017, pp 1–8.

161 C Viney and P Phillips, Financial Institutions, Instruments and Markets, McGraw-Hill Education (Australia), 2019, p 402.

162 K Bellrose and D Norman, The Nature of Australian Banks' Offshore Funding, RBA Bulletin, December 2019, p 1.

163 The cross-currency basis swap is a derivative instrument where the Australian bank and its swap counterparty exchange a stream of interest payments in one currency for a stream of interest receipts in the other over the life of the swap. Principal amounts are re-exchanged at the original exchange rate at maturity.
C Kent, US Monetary Policy and Australian Financial Conditions, RBA, December 2018, p 4.

interest rates on their deposits that are priced relative to those alternatives.[164] As such, the impact of cash rate target changes on wholesale deposit interest rates (and therefore the funding costs for wholesale deposits) shares some similarities with the more direct impacts on wholesale debt funding described above.

Retail deposit rates are also influenced by changes to the cash rate target, although this appears to happen more indirectly. Banks are not price-takers for retail deposit products in the same way they are for other funding sources, in particular wholesale debt funding. Compared to other sources of funding, this means banks generally have more discretion on how they set retail deposit rates. In setting their retail deposit rates, banks have considerable influence over their own cost of funding from those retail deposits.[165]

Generally, a bank's deposit-taking business unit sets its prices on deposit products (while the loan-writing business unit sets prices on lending products) taking into account the internal funds transfer prices determined by the bank's internal treasury unit.[166] This is discussed further in chapter 6.

The funds transfer price assigned is typically based on a bank's marginal funding costs, among other considerations such as a bank's risk management and strategic priorities. In practice, banks may estimate their marginal funding costs by using market proxies, such as the marginal cost of unsecured wholesale debt funding.[167] The marginal funding costs for banks that are more significantly funded by deposits may be estimated by a proxy that more accurately represents the lower cost of deposits relative to wholesale debt funding.[168] That means a bank generally sets its funds transfer price for deposit products taking into account the costs of other funding sources (such as unsecured wholesale debt funding).

Changes to the cash rate target, therefore, have less of a direct impact on retail deposit rates compared to other sources of funding such as wholesale debt.

5.2 The effects of recent changes to the cash rate target on wholesale funding costs and deposit rates

Banks tend to be predominantly funded through retail and wholesale deposits, and wholesale debt (through issuing bonds). Equity and securitisation only represent a small proportion of funds. While the funding mix differs somewhat across banks, the pricing trends for each funding source are broadly similar given the linkages described in section 5.1.

164 S Black and D Titkov, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2019, p 13; V Carse, A Faferko and R Fitzpatrick, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2023, p 69.

165 All else being equal, banks will generally seek to minimise the cost of their retail deposit funding. The level of competition for retail deposits provides a constraint on a bank's pricing discretion.

166 F Cadamagnani, R Harimohan and K Tangri, A bank within a bank: how a commercial bank's treasury function affects the interest rates set for loans and deposits, Bank of England Quarterly Bulletin, June 2015, p 155.

167 F Cadamagnani, R Harimohan and K Tangri, A bank within a bank: how a commercial bank's treasury function affects the interest rates set for loans and deposits, Bank of England Quarterly Bulletin, June 2015, p 163.

168 F Cadamagnani, R Harimohan and K Tangri, A bank within a bank: how a commercial bank's treasury function affects the interest rates set for loans and deposits, Bank of England Quarterly Bulletin, June 2015, p 163.

The cost of new wholesale debt funding over the 2019–2023 period has varied significantly

Banks' absolute costs of wholesale debt funding had steadily decreased over 2011 to 2017 before stabilising over 2018 and 2019, broadly in line with movements in the BBSW and the cash rate target.[169] Banks' demand for new wholesale funding was also lower in 2019 than in previous years reflecting slow credit growth.[170]

The onset of the COVID-19 pandemic in February and March 2020 brought economic uncertainty and volatility to financial markets. In response, many central banks implemented a range of measures to provide monetary policy stimulus to address the tightening financial conditions.[171] The RBA's monetary policy measures sought to lower funding costs and support the supply of credit to the economy through:

- lowering the cash rate target to boost the cash flow of households and businesses
- supplying a TFF for the banking system to lower the cost of credit to households and businesses
- announcing a government bond yield target to lower funding costs and support the provision of credit to the economy
- purchasing a nominated amount of government bonds from the secondary market to help lower funding costs across the economy.[172]

Banks' wholesale debt costs decreased over 2020, primarily reflecting that BBSW rates had fallen to historically low levels.[173] However, access to the TFF from April 2020 to June 2021 offered banks a source of funding that was even less expensive than market-based wholesale debt for the same three-year term.[174] The TFF funds and deposit inflows from the RBA's provision of credit reduced banks' need for new wholesale debt funding over 2020 and 2021.[175] Banks' reduced demand for new wholesale debt funding also meant that funds from non-bank investors' maturing bank bonds were not being reinvested into new bank bonds, further increasing deposit inflows.[176]

Banks' demand for wholesale debt started to increase in mid-2021.[177] While banks' new wholesale debt costs remained low over most of 2021, they increased in late 2021 due to increases in the BBSW and increases in the difference between bank bond yields and BBSW, which may have been due to banks' demand for funding.[178]

169 B Robertson and A Rush, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2013, p 67; S Black and D Titkov, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2019, p 13.

170 RBA, Statement on Monetary Policy, February 2020, pp 44, 49.

171 RBA, Statement on Monetary Policy, May 2020, pp 19–22, 60–61.

172 RBA, About Monetary Policy, RBA website, n.d., accessed 13 July 2023; RBA, Review of the Yield Target, RBA website, n.d., accessed 6 September 2023; RBA, Supporting the economy and financial system in response to COVID-19, RBA website, n.d., accessed 13 July 2023.

173 T McKinnon, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2021, p 54; R Fitzpatrick, C Shaw and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2022, p 68.

174 R Fitzpatrick, C Shaw and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2022, p 65.

175 RBA, Statement on Monetary Policy, February 2021, p 38; RBA, Statement on Monetary Policy, February 2022, p 39.

176 RBA, Statement on Monetary Policy, February 2022, p 35.

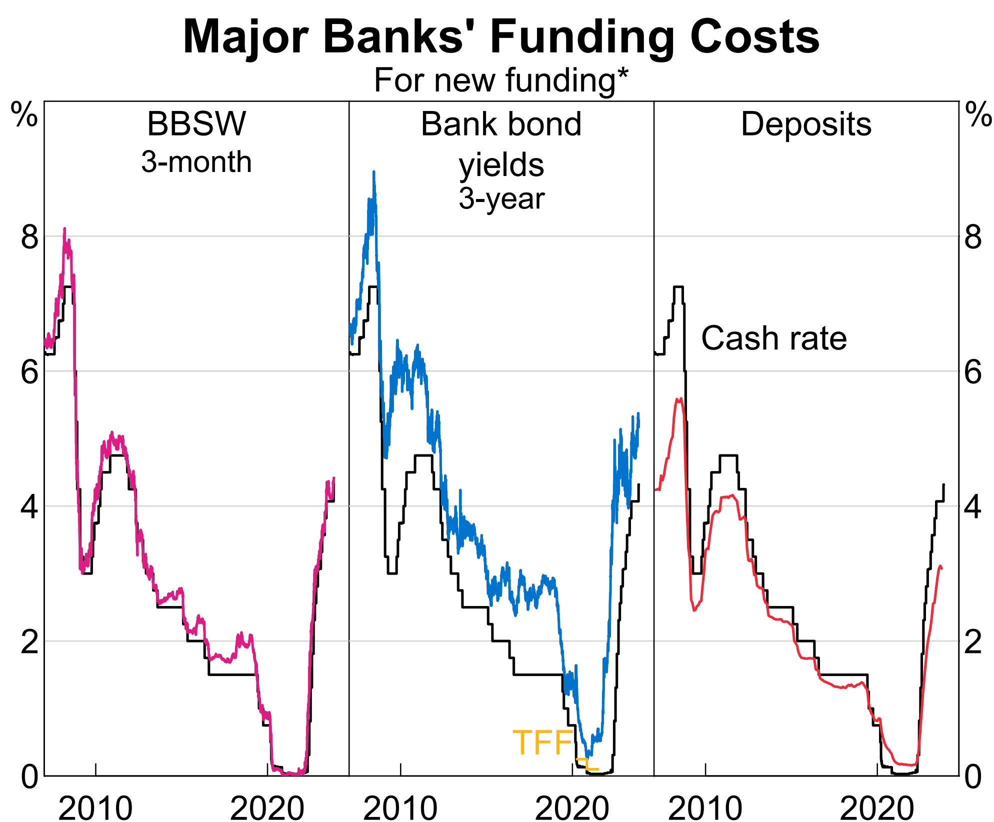
177 R Fitzpatrick, C Shaw and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2022, p 65.

178 R Fitzpatrick, C Shaw and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2022, p 65; RBA, Statement on Monetary Policy, February 2022, p 35.

Banks' cost of issuing wholesale debt continued to increase over 2022, following increases in the cash rate target and BBSW benchmark market rates and further increases in the difference between bank bond yields and BBSW.[179]

For the major banks, wholesale debt costs have generally been greater than the cash rate, while deposit costs have usually been less than the cash rate – except during 2020–2021 when the cash rate target was at record lows (figure 5.1).[180] How deposit interest rates have moved in relation to the cash rate target – including differences between retail and wholesale deposits – is considered below.

Figure 5.1: Major banks' funding costs (for new funding), January 2007 – November 2023



Source: Chart supplied by the RBA.

The effect of cash rate changes on deposits varies by product and depositor type

As noted above, the cost of funding from retail deposits is heavily influenced by a bank through the interest rate it sets for its retail deposit products.[181]

179 V Carse, A Faferko and R Fitzpatrick, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2023, p 69.

180 The deposit costs shown in this figure are based on a combination of the interest rates the major banks have paid on different retail deposit products and on wholesale deposits, and the volumes of funds held under each of these deposit types.

181 Other costs that contribute to the cost of deposit funding include banks' use of interest rate hedges to buffer changes in the cost of low interest retail deposit products, such as transaction accounts and some cash management accounts. L Berkelmans and A Duong, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2014, p 71.

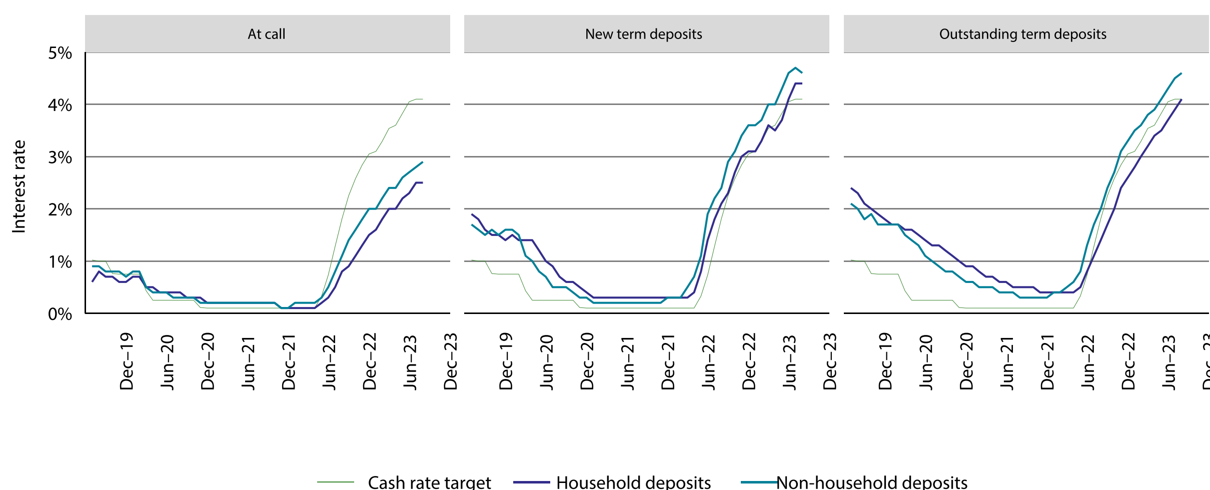
Retail vs wholesale deposits

While banks source deposits from both retail and wholesale customers, there are differences in the interest rates paid for funding from these 2 sources (figure 5.2).

Non-household depositors (which includes wholesale depositors, community service organisations and smaller corporations and businesses) have consistently received better interest rates than retail (household) depositors for at-call products.[182]

However, on term deposits, household depositors generally received better interest rates than non-household depositors from mid-2019 to late 2021. This may partly have been due to retail deposits generally being more favourable than some wholesale deposits for the purposes of managing liquidity risk.[183] It has only been since 2022 that non-household depositors have received better interest rates on new term deposits than household deposit holders. This trend may be a result of the 'below the line' competition that increased in late 2021 for term deposits, where some banks provided higher interest rate offers for wholesale and other customers with larger deposit balances (see section 7.5).

Figure 5.2: Interest rates on retail deposit products by counterparty, July 2019 – August 2023



Note: Excludes offset accounts.
Source: ACCC analysis of RBA, Paid Deposit Rates – F4.1, Statistical Tables, September 2023.

Retail deposit rate effects

Interest rates on retail deposit products began a long decline in 2011 as the cash rate target declined.[184] Despite this, by mid-2019 there was still some difference between the interest rates paid

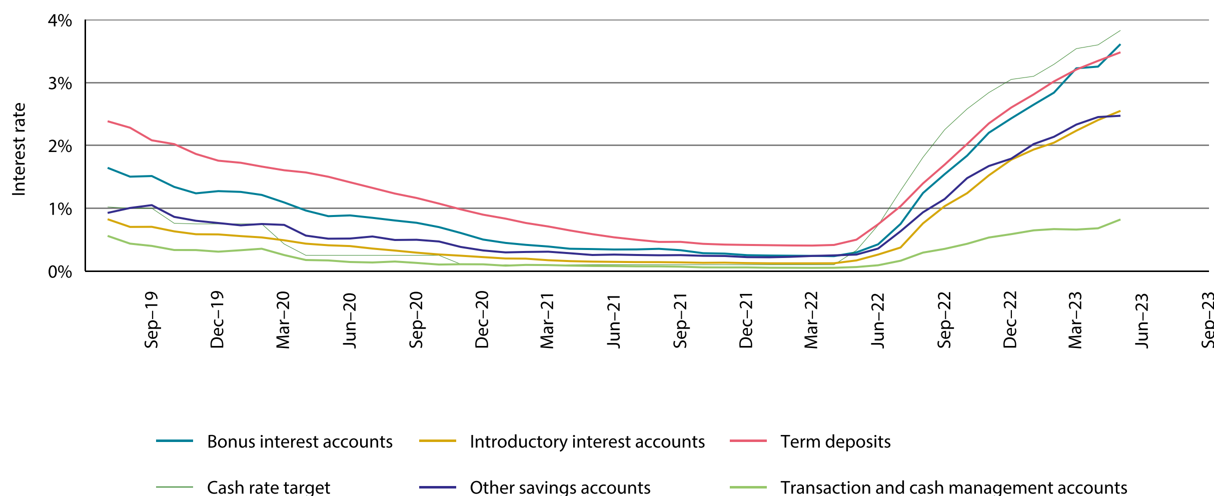
182 As discussed in chapter 1, at-call products include transaction accounts, bonus interest accounts, and other savings accounts that are not term deposits. Community service organisations and smaller corporations may only have access to retail deposit products.

183 As discussed in section 2.3, APRA seeks to ensure banks manage their liquidity risk. There are 2 approaches for this, depending on how APRA determines the bank should be classified. For banks classified as a Liquidity Coverage Ratio (LCR) ADI, a bank must calculate its total net cash outflows over the next 30 calendar days. Different retail and wholesale deposit products will be treated differently for the purposes of calculating a bank's cash outflows.
For example, retail deposit funds and wholesale operational deposits (wholesale deposits held with a bank to facilitate the wholesale counterparty's ability to make payments) are regarded to be less likely to be withdrawn in a time of stress. Deposits considered more likely to be withdrawn in a time of stress will have a greater impact on the bank's total estimated net cash outflows and require the banks to hold more high quality liquid assets to be able to repay any short-term funding withdrawals.
Source: APRA, Prudential Standard APS 210 Liquidity, December 2022, pp 10, 13, 21–29.

184 S Black, D Titkov and L Wang, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2020, p 33.

by banks on higher interest retail deposit products (term deposits and bonus interest products) and other at-call savings products (figure 5.3). Excluding bonus interest accounts, interest rates on at-call deposit products were generally less than the cash rate target over the second half of 2019, while interest rates on term deposits and bonus interest accounts were above the cash rate target. Similar trends were observed for many banks when considered individually.

Figure 5.3: Estimated average effective interest rates of select banks' retail deposit products, July 2019 – May 2023



Note: Excludes offset accounts. Interest rates for term deposits are as accrued. Interest rates for other retail deposit products are based on estimates of interest accrued in a month (or quarter, where relevant) and the account balance for the same month (or quarter, where relevant), and then annualised. The effective interest rate is the estimated average across all accounts for each retail deposit product type.

Source: RBA, ACCC analysis of APRA data and data obtained from banks.

Banks received significant deposit inflows over 2020.[185] There were also further decreases to the cash rate target and BBSW benchmark market rates (leading to lower wholesale funding costs), and banks had access to low-cost TFF funding.[186] These factors all contributed to the downward pressure being placed on retail deposit product interest rates, with greater decreases occurring on new term deposits and bonus interest products given the already very low rates on other at-call deposit products.

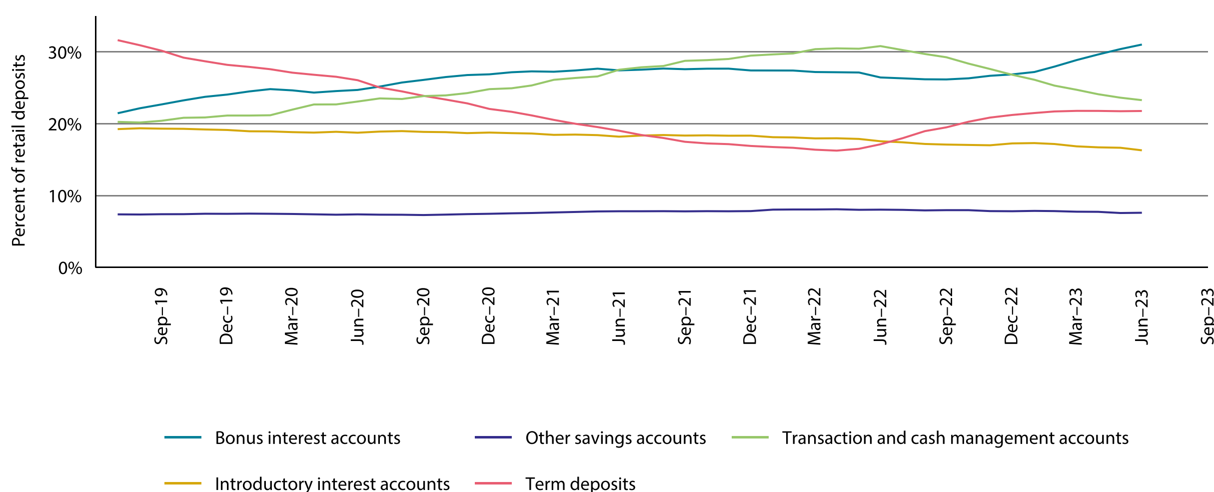
Consequently, interest rates on different retail deposit products converged, and there was more switching from term deposit accounts to at-call deposit products (figure 5.4). This behaviour has also been observed in deposit markets in other jurisdictions.[187] While term deposits have generally had higher interest rates than at-call deposits, particularly for longer terms, the convergence of interest rates between the types of deposit products meant that consumers would no longer be receiving a significant benefit from banks for surrendering access to their funds for a specified period through a term deposit.

185 M Garner and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2021, p 51.

186 M Garner and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2021, p 51.

187 European Central Bank, Financial Stability Review, May 2023, p 60; T Messer and F Niepmann, What determines passthrough of policy rates to deposit rates in the euro area?, Board of Governors of the Federal Reserve System, 28 July 2023.

Figure 5.4: Composition of select banks' retail deposit products, July 2019 – June 2023



Note: Excludes offset accounts.
Source: RBA, ACCC analysis of APRA data and data obtained from banks.

During 2021, banks continued to be well funded with significant retail deposit volumes and access to the TFF.[188] Consequently, retail deposit interest rates continued to decline.

However, in late 2021 banks' funding appetites had increased and they started to increase interest rates using targeted offers on new term deposits and on selected at-call accounts (discussed in section 7.5). However, this demand for funds did not translate into higher rates for most retail deposit holders until early 2022.

Since mid-2022 the interest rates paid on different retail deposit products have again become increasingly distinct, with clear differentials between term deposit products, bonus interest accounts and other at-call savings products. Despite this, there was significant volume in retail deposit accounts that paid very little, if any, interest (see figures 5.4 and 5.5).

From mid-2019 to early 2022, effective interest rates on outstanding term deposits were greater than the cash rate target. However, since mid-2022, this situation has reversed. This is likely because only new term deposits receive interest rates priced against the prevailing market reference rate (some banks use the BBSW) when the term deposit is opened.[189] The effective interest rate across all outstanding term deposits is therefore still heavily influenced by the lower rates that applied until recently. In addition, the margin of the BBSW over the cash rate began to erode from 2020. Prior to 2020, which is the start of the very low interest rate period, the BBSW was generally greater than the cash rate (see figure 5.1). This has not been the case since.

The effects of recent changes to the cash rate target on the cost of funding from wholesale debt funding (discussed above) and deposits, have also been apparent in the rates banks set for their lending, as described in box 5.1.

188 RBA, Statement on Monetary Policy, November 2021, p 44.

189 ABA submission, 29 May 2023, p 5; NAB submission, 19 May 2023, p 3.

Box 5.1: Lending interest rates and changes to the cash rate target

Interest rates on home loans and personal loans have had a similar trajectory to those for retail deposit products and the cash rate target, where they generally decreased over the 2011–2019 period.[190]

Over 2019, banks decreased the interest rates on variable- and fixed-rate loans due to decreases to the cash rate and BBSW benchmark market rates and competition for new high-quality home loan customers.[191] Interest rates for variable- and new fixed-rate home loans continued to decrease over 2020 as the cash rate and BBSW benchmark market rates continued to decline and banks competed for new and refinancing borrowers.[192] For much of 2021, there were no changes to the cash rate target but interest rates on new fixed-rate loans decreased and were below variable-rate loan interest rates.[193]

While variable rates remained low, interest rates for new fixed-rate home loans increased sharply at the end of 2021, due to increased longer-term funding costs following the reduction and removal of the Committed Liquidity Facility (CLF)[194], the end of the TFF and offshore funding pressures.[195] This change prompted new borrowers to select variable-rate loans[196] which in turn left the effective interest rate on outstanding balances for fixed-rate home loans largely unchanged.

While interest rates on variable-rate loans stayed low during early 2022, they began to increase significantly over 2022 and 2023 in line with increases to the cash rate, BBSW, and wholesale debt and deposit costs (shown in figure 5.1 above).

Movements in personal loans, which are a mix of variable- and fixed-rate loans, broadly followed similar trends to variable-rate home loans from mid-2019 to mid-2022. Since then, interest rates on the outstanding balances of personal loans have had a relatively small increase, similar to that observed for fixed-rate home loans over the same period.

190 S Black, D Titkov and L Wang, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2020, p 33.

191 S Black, D Titkov and L Wang, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2020, p 34.

192 M Garner and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2021, p 56.

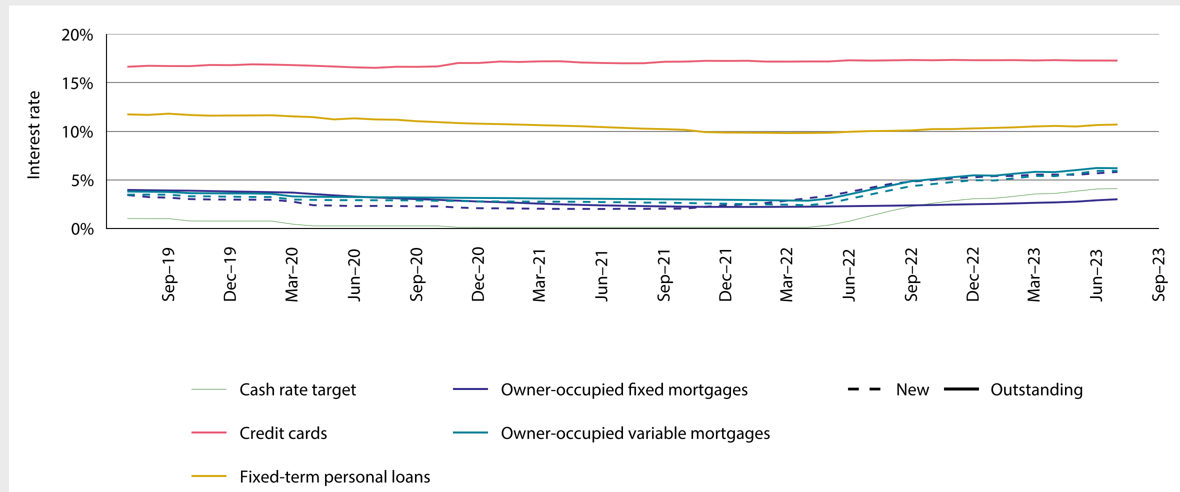
193 R Fitzpatrick, C Shaw and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2022, p 71.

194 APRA, Letter to locally incorporated LCR ADIs: Committed Liquidity Facility update, 10 September 2021.

195 C Lefort and J Shapiro, Bank funding costs tick up as liquidity facility retired, Financial Review, 13 September 2021; ANZ submission, 9 June 2023, p 11; COBA submission, 23 May 2023, p 3; NAB submission, 19 May 2023, p 2.

196 R Fitzpatrick, C Shaw and A Suthakar, Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2022, p 71.

Figure 5.5: Effective interest rates of select banks' lending products, July 2019-July 2023



In contrast to the above, interest rates on credit cards have been relatively stable over many years[197], with little apparent impact from changes in the cash rate. This difference could be attributed to how credit cards are marketed – where the focus is on the range of features and services, such as rewards programs, travel insurance and other features necessary for the supply of secure and reliable payment services. While the pricing of credit cards will need to cover these costs and those associated with writing off bad debts[198], credit card interest rates are only paid by the proportion of the population that do not pay off their balance in full each month. Additionally, the uptake of credit cards may be driven by promotional offers such as interest-free periods for balance transfers or reward point bonuses that do not require providers to compete on the interest rate charged on overdue balances.

197 RBA, Personal Lending Rates – F5, RBA Statistical Tables, October 2023; RBA, Personal Lending Rates – F8, RBA Statistical Tables, October 2023.

198 ABA, ABA response to the Inquiry into credit card interest rates, 10 August 2015, p 14.

6. How banks set interest rates

Findings

- Banks use a range of processes to make interest rate decisions for retail deposit products and home loans, depending on the financial impact and urgency of the possible rate change.
- Decisions about interest rates can be made in formal forums, such as a bank's pricing committee, or in less formal settings, such as by an exchange of emails among executives and senior managers, where circumstances allow.
- Many banks use a combination of regular and ad hoc decision-making to enable timely decisions based on external changes affecting the market.
- 'Funds transfer pricing' is an integral part of the interest rate decision-making process for many banks. It helps banks allocate costs, measure profitability, incorporate risk considerations, and make informed decisions about interest rates.
- Banks make decisions about interest rates on different products based on a combination of factors, including:
  - profitability objectives
  - the competitive landscape
  - funding requirements
  - economic and regulatory factors
  - customer satisfaction and reputational risk.
- There is significant overlap between the factors considered in interest rate decisions for retail deposit products and home loans.

As we saw in chapter 4, banks do not generally make decisions about a particular funding type in isolation; rather, they make strategic decisions about overall funding to best meet their business objectives. These funding decisions are significantly impacted by changes in the cash rate target, and the effect that these can have on the cost of funding from retail deposits and other sources, as discussed in chapter 5.

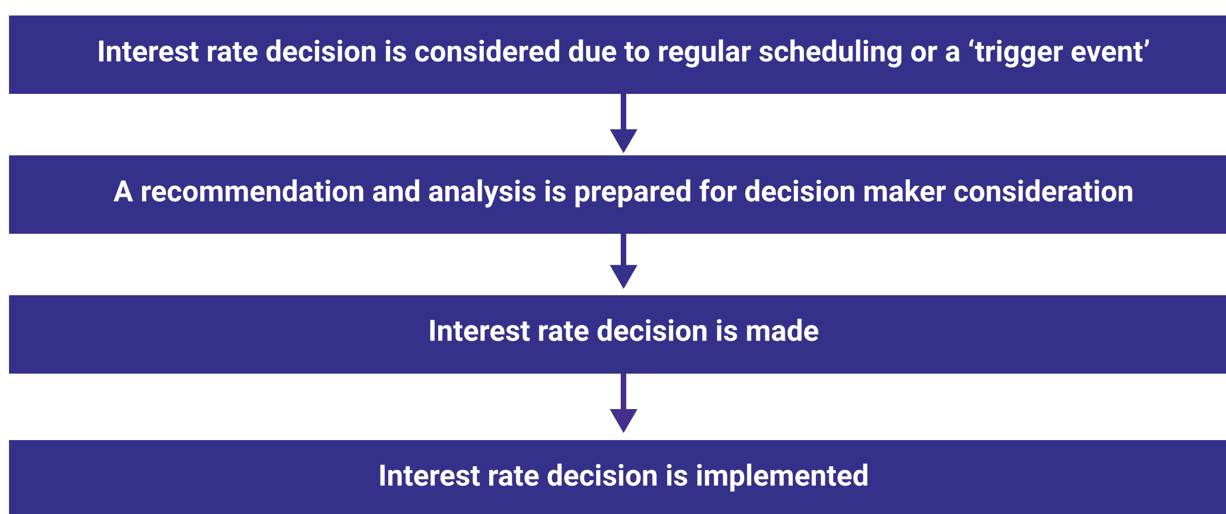
Similarly, when making decisions about interest rates on their retail deposit product, banks will assess their broader operating environment. This chapter explores how banks set interest rates for retail deposit products; both the process banks generally follow to make interest rate decisions, as well as the key factors banks take into account when making interest rate decisions.[199]

199 This chapter focuses on interest rates applicable to retail deposit products and home loans generally, noting differences between product types where relevant. Banks also make decisions about how they set and design rates for their individual products, for customer segments and even for individual customers – these decisions are considered in chapter 7.

6.1 Banks' processes for making interest rate decisions

Banks use a range of processes to make interest rate decisions for retail deposit products and home loans, depending on the financial impact and urgency of the possible rate change. While the specific processes used can differ significantly between banks, especially their regularity and degree of centralisation, most banks make interest rate decisions for retail deposit products and home loans in line with the simplified model in figure 6.1.

Figure 6.1: Simplified model of banks' interest rate decision process for retail deposit products and home loans



Interest rate decisions can be made by committees or senior managers, and certain decisions are delegated

Most banks make interest rate decisions in multiple forums, for example, in pricing committee meetings or in consultation with senior managers or the CEO by telephone or email. Pricing committees are commonly formed by senior and middle managers from deposit and lending units, as well as the treasury, finance, legal and other relevant units of the bank.

Many banks hold pricing committee meetings to discuss recommendation papers for interest rate decisions ('pricing papers') and general updates on relevant internal and external drivers including profitability, funding requirements, the regulatory environment, and economic and market conditions. In some banks, decisions about interest rates are made by pricing committees, whereas in other banks, pricing committees serve only an advisory purpose.

The identity of the decision maker differs between banks and depending on the urgency and financial impact of the decision. In many banks, unlimited authority to make interest rate decisions sits with the CEO, a senior manager, or a pricing committee. Especially in larger banks with more complex organisational structures, decision-making authority may be delegated, with or without limits on estimated financial impacts, to managers or committees reporting to the originating authority or other delegates.

We observe that, as a general trend, smaller banks are more likely to make interest rate decisions through a pricing committee. Larger banks with more complex organisational structures may delegate decision-making to a hierarchy of individual managers, who will generally also be members of a relevant pricing committee.

Banks that own subsidiary banks or operate sub-brands may differ in how involved they are in setting the interest rates of their subsidiaries or sub-brands. Some parent banks make interest rate decisions for their Australian subsidiaries or sub-brands centrally while others enable them to make interest rate decisions with a level of independence.

Some banks also set a limited amount of discretion for the setting of negotiated interest rates (considered in chapter 7) to branch or call centre managers and staff. Senior decision-makers generally have input by setting the bounds of this discretion in the form of a pricing matrix or framework. For retail deposit products, this is most commonly seen with term deposits.

Formality and frequency of the decision-making process varies

Interest rate decisions are generally made on proposals put forward to decision-makers by teams in deposit and lending units. Some proposals, especially for decisions with a high level of financial impact, are submitted to senior decision makers as pricing papers that cover considerations specific to the recommendations and the products affected. Pricing papers are commonly supplemented with information on economic and market conditions, competitor interest rates and products, and expected impacts on profitability and volume.[200]

Interest rate decisions made under delegations can follow a simpler process, especially if the significance of the change in interest rate proposed is relatively minor or it applies to a low-profile product. For example, a recommendation for an interest rate change and summary analysis of the interest rates of close competitors may be provided to the delegate for decision by email.

Interest rate decisions can take place on a scheduled basis, such as in preparation for a regular pricing committee meeting, or on an ad hoc basis due to the occurrence of a significant economic or competitive driver. Many banks use a combination of regular and ad hoc decision-making to enable regular oversight and timely responses to external changes affecting market conditions.

Regular decisions

Banks generally have regular interest rate decision-making processes involving senior decision makers. These processes may take place on a weekly, fortnightly, or monthly basis, and may be scheduled by reference to the monthly monetary policy meetings of the RBA Board. Regular processes commonly take the form of scheduled meetings, economic and market monitoring reports, analysis and papers.

Ad hoc decisions

Most banks have processes to facilitate ad hoc interest rate decisions to respond to unexpected changes to relevant internal and external drivers, sometimes referred to as ‘trigger events’. Trigger events are often broadly defined, and can include changes in the regulatory environment, market conditions, competitor interest rates, or balance sheet forecasts. Depending on the circumstances, the nature of ad hoc processes can range from the calling of meetings with decision makers, to the approval of interest rate decisions by email exchanges. Some banks rely exclusively on ad hoc decision-making and do not use regular processes.

Where a trigger event is identified, the affected business units may hold preliminary discussions with relevant decision makers to discuss potential interest rate changes, and prepare a proposal for decision-maker approval. In some cases, usually for decisions made by delegates, proposals may be submitted together with brief analysis or information on factors most relevant to the decision, without prior discussion with decision-makers.

200 In the absence of a proposed change to interest rates (and therefore a pricing paper), decision makers in most banks are still provided with regular reporting and analysis on at least a subset of these factors.

Decision implementation

Following a decision to change interest rates, the decision is communicated to the relevant business units and implemented in internal systems. Revised interest rates are uploaded to product management systems that interface with systems that connect to client accounts. The new interest rates are also updated on the bank's website and apps and, for some banks, advertised through specific media channels. The specific process varies between banks, but can take up to 4 weeks for decisions affecting home loan products, and up to 2 weeks for retail deposit products from the point the interest rate decision is made.

Multiple business units contribute to interest rate decisions

Although most banks make separate interest rate decisions for retail deposit products and home loans, these decisions are often overseen by senior decision-makers and delegates responsible for a combination of deposit and lending units. In some banks, teams that work on retail deposit products may also work on home loans. Accordingly, some decision-makers involved in setting interest rates may have knowledge of multiple retail deposit products and home loans and are interested in the bank's overall profitability.

Interest rate decisions may also involve input from a range of other business units, including in pricing committee meetings. In addition to providing input in pricing committee meetings, the treasury and finance units generally have indirect input into interest rate decisions through the setting of funding targets and limits and funds transfer pricing.

As detailed in 6.3 below, funding targets and limits are considered as part of interest rate decisions, and funds transfer pricing is indirectly a key input to interest rate decisions due to its influence on profitability. Funds transfer pricing is examined further in the next section, with further technical detail in Appendix C.

6.2 Many banks use funds transfer pricing to inform interest rate decisions

Of the banks reviewed in the Inquiry, most use funds transfer pricing to help guide internal decisions, including on interest rates for retail deposit products and home loans. Funds transfer pricing refers to a process by which a bank sets internal prices on funds transferred between its business units.[201] Such funds include funds raised by deposits units and used by lending units to make loans.

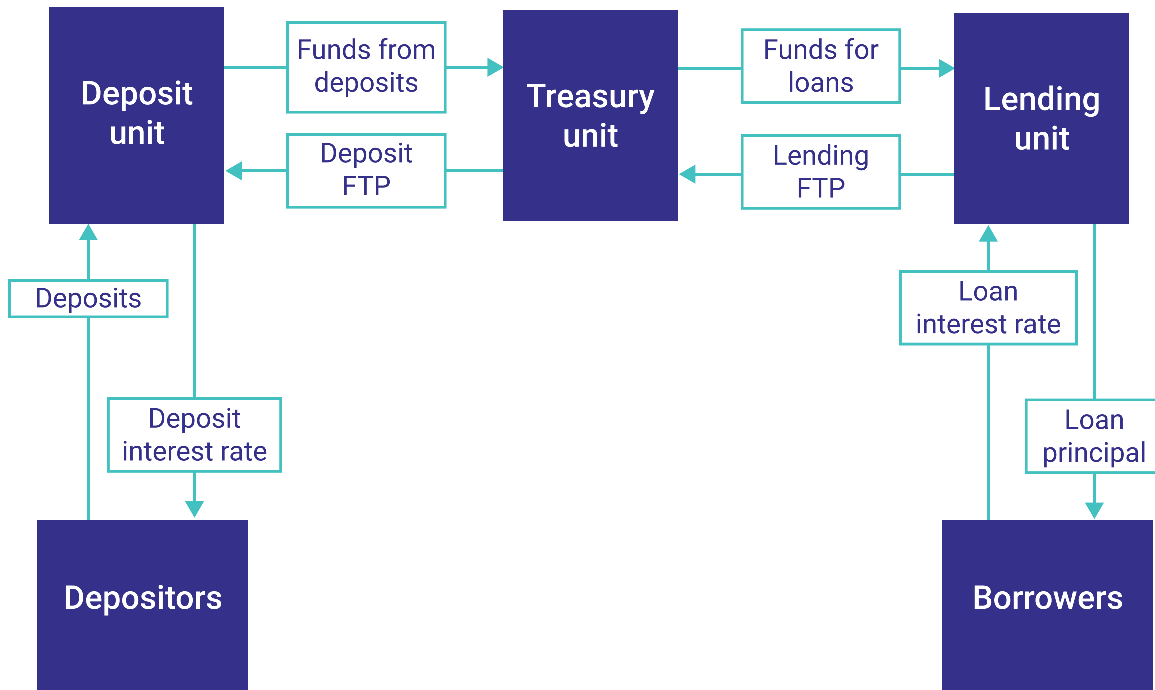
Internal prices, known as 'funds transfer prices' (FTPs), provide a measure of the value of funds used or raised by its business units, including funds raised by deposit units. Accordingly, banks that use funds transfer pricing can measure the profitability of specific business units or specific uses of funds against relevant FTPs, and incentivise their business units to pursue activities that support their profitability.

Typically, banks incorporate a range of whole-of-business considerations into FTPs to centralise these away from individual business units. These considerations include the costs of managing interest rate risk, liquidity risk and complying with certain prudential requirements and, for some banks, other funding strategy objectives. By incorporating these factors into FTPs, banks ensure they are implicitly considered in internal decisions that consider profitability impacts, including interest rate decisions on retail deposit products and home loans (see section 6.3).

201 The concept of transfer pricing is not unique to banks. Businesses in many industries set internal prices for goods and services exchanged between divisions or subsidiaries.

FTPs are generally managed by the treasury unit in a bank, and are commonly updated daily. Figure 6.2 below shows how funds and interest rates are transferred between depositors, borrowers, the treasury unit and deposit and lending units under a typical funds transfer pricing process.

Figure 6.2: Simplified model showing how funds are transferred between business units in a bank under a typical funds transfer pricing process



Banks differ to each other in terms of the level of specificity of their funds transfer pricing processes. Some calculate an FTP for each individual deposit or lending product (depending on their characteristics) while others apply the same FTP across all deposits or loans.

Funds transfer pricing enables banks to assess profitability at the product-level as measured by net interest margin (NIM, as explained in chapter 3).

For example, the product-level NIM for deposit products can be approximated by:

Deposit product NIM = deposit FTP – deposit interest rate

Similarly, the product-level NIM for lending products can be approximated by:

Lending product NIM = loan interest rate – lending FTP

The banks reviewed for this Inquiry typically make interest rate decisions informed by the expected impact of a potential interest rate change on profitability at the product level, as measured by the product-level NIM.

6.3 Factors banks consider when making interest rate decisions

Banks consider a range of different factors when setting interest rates including:

- profitability objectives
- the competitive landscape
- funding requirements
- economic and regulatory factors
- customer satisfaction and reputational risk.

We have observed that there is significant overlap between the factors considered in interest rate decisions for retail deposit products and home loans.[202] However, the rationale for individual decisions will differ depending on the relevant market conditions for the specific products at the time.

Profitability and margins are key considerations in interest rate decisions

Profitability is critical to achieving a bank's broader business objective of generating return on equity for shareholders. Profitability is a key concern for decision makers as it is a benchmark for comparing the performance of different products and business units, and assessing the effectiveness of the bank's retail deposits and home loan strategies.

Banks usually consider the expected impact of potential interest rate decisions on their whole-of-bank net interest income and profitability. This consideration may be made on the projected profitability impacts of recommended interest rate decisions and alternative options as presented in pricing papers.

Profit is a product of the volume of deposits banks can attract and the margin they make on those deposits, at a given deposit rate level. Higher deposit rates mean lower margin but higher volume, and vice versa. Where banks set their retail deposit rates relative to their competitors has a large influence on the amount of deposits banks can attract. We discuss banks' consideration of their competitor pricing in the next sub-section.

For banks that use funds transfer pricing, the margins on individual retail deposit products and home loans are also considered. These are assessed by reference to the product-level NIM, which is determined using the FTP set for that product (as discussed above in 6.2). Accordingly, by considering profitability, banks that use funds transfer pricing are implicitly considering the various considerations that comprise the relevant FTP, including the cost of managing interest rate risk, certain costs related to liquidity risk and prudential requirements, and potentially strategic factors such as funding mix targets.

In addition, some banks include detailed information about relevant FTPs in pricing papers for retail deposit products and home loans, indicating that decision-makers may also have explicit regard to the different components of FTP when making interest rate decisions (these components are detailed in Appendix C).

While profitability is a key consideration, decision makers will sometimes set interest rates in a manner that results in very low margins or loss for the business unit to achieve other strategic goals. Such goals may include the need to meet specific funding growth or funding composition targets, defend market share or to maintain or improve their reputation.

202 As noted above, senior managers may oversee interest rate decisions for both retail deposits and lending.

Banks consider their close competitors when setting interest rates

Decision-makers also consider the interest rates of comparable retail deposit products and home loans offered by other banks when making interest rate decisions. Pricing papers demonstrate banks generally consider the competitive environment for each product and usually include information on competitors' interest rates for comparison.

The specific competitors included in these comparisons differ between banks. Banks, regardless of size, typically consider the interest rates of major banks when setting interest rates. Generally, the major banks tend to refer to a narrower set of banks in their pricing papers relative to the comparisons undertaken by mid-tier banks and mutuals. For example, the pricing papers of major banks largely do not refer to the interest rates of mutuals, or refer to only a small number of mutuals from time to time. Notably, in some instances the pricing papers of some major banks considered new entrants or neobanks including Judo Bank and UP Bank, possibly suggesting they were at times at least as concerned with the interest rates of certain neobanks as those of mutuals.

By contrast, the pricing papers of mid-tier banks and mutuals generally refer to the interest rates of the major banks as well as other mid-tier banks and mutuals, with especially greater emphasis on other banks of comparable size or classification. Where bank subsidiaries or sub-brands make their own interest rate decisions, the set of competitors considered in their pricing papers generally includes banks of similar size (such as mid-tier banks and some mutuals) as well as major banks.

Some banks target a specific position in the market as part of their competitive pricing strategy. For example, some major banks do not consistently aim to match the interest rates of price leaders for retail deposit products.[203] We have also observed that at least some major banks have set or maintained interest rates on many products noticeably lower than those of price leaders for comparable retail deposit products. Additionally, they largely view or focus on their interest rates relative to other major banks.

Interest rate decisions consider funding requirements directly and through funds transfer prices

Banks also consider their funding requirements when making interest rate decisions. While banks that use funds transfer pricing already incorporate many elements of funding strategy into their FTPs for specific products,[204] they may also consider their funding requirements as a separate factor in interest rate decisions. This enables banks to assess the volume impact of interest rate decisions and how this may affect their funding needs and ability to comply with funding limits or targets.

Banks may also frame interest rate decisions from the angle of the estimated cost to maintain or increase existing funding levels from specific retail deposit products. Some banks may also use retention rate targets for term deposits to help maintain a proportion of funding sourced through term deposits.

203 We note that banks may also compete on non-price factors.

204 As discussed in section 6.2 and in earlier sub-sections of section 6.3 above, FTP commonly incorporates the cost of managing interest rate risk, and certain liquidity and prudential requirement costs, and for some banks, additional parameters reflecting or incentivising their target funding mix.

Economic and regulatory factors inform interest rate decisions

As described in 6.1, the reporting and analysis prepared for pricing committee meetings may include information on economic and regulatory factors. This information is commonly communicated in a written report or an oral update from the treasury unit or an internal economist. This may include information on economic indicators, the official cash rate, conditions in wholesale funding markets and movements in exchange rates.

While decision makers generally have access to economic and regulatory updates, proposed interest rate changes are rarely framed by reference to economic or regulatory factors. Instead, these factors are considered in the formation of funding strategies and also influence the calculation of FTPs. They are therefore implicitly contemplated in interest rate decisions that consider banks' profitability or funding mix.

Banks vary in how they consider customer satisfaction and reputational risks

In some cases, banks consider customer satisfaction and reputational risks when making interest rate decisions. This is especially the case when interest rate decisions cause detriment to a customer group, for example, to retail depositors when retail deposit interest rates are lowered.

Different banks consider customer satisfaction to varying degrees. For one major bank, this involves significant consideration of relevant risks and impacts on the equity of customer outcomes.

We observed that some major banks consider broader reputational risks and potential mitigating factors when making interest rate decisions, especially where media coverage of interest rate changes is expected.

Mutuals also tend to be concerned about customer satisfaction, with the pricing papers of some mutuals regularly considering customer satisfaction and one mutual regularly assessing the likely impacts on customer satisfaction if cash rate changes were not fully passed through.

7. Strategic pricing

Findings

- Banks typically seek to minimise their retail deposit funding costs but may use short-term and limited time offers such as term deposit specials and introductory offer products, which are relatively more expensive for a bank, to attract customers and their funds.
- Bonus interest rates and introductory interest rates can boost the headline interest rates consumers can receive, however the actual interest rates received by many consumers are lower.
- For savings products, changes in headline interest rates are often driven by changes to a bonus or introductory interest rate rather than the base interest rate.
- Further, the tactics banks use to retain or win higher value customers can be very selective and only a proportion of customers may benefit. Offers can be highly conditional to encourage 'sticky' behaviour in customers and establish a 'main financial institution' (MFI) relationship. Alternatively, these offers are only available to specific segments of the customer demographic, such as those in early adulthood or those with larger deposit volumes.
- In the first half of 2023, 71% of bonus interest accounts did not receive the bonus interest rate on average each month.
- Banks use fees and charges to recoup operational costs from their customers, including those on retail deposit products. However, the fixed nature of fees means they have a more significant impact on retail deposit accounts with smaller balances.
- Banks' strategic pricing at the product and customer level makes retail deposit rates opaque and adds complexity for consumers engaging in the market.
- Interest rates for the same type of retail deposit product can vary significantly between, and sometimes within, banks. This rate dispersion is most pronounced with savings products.

As discussed in chapter 4, banks rely on retail deposits as a source of relatively low-cost funding. Banks have some discretion over their cost of obtaining funds from deposits, through the interest rates they offer.

Chapter 6 explained how banks consider a range of different factors when setting interest rates in a broad sense. However, banks need to make interest rate decisions at the product and customer level.

This chapter explores how banks design their products and interest rate offerings to attract higher value customers that will offer the bank future cross-selling opportunities.

Section 7.1 provides an overview of the various product designs and interest rate offerings that banks use to target certain customers or customer segments.

Sections 7.2 to 7.4 explore the key ways banks adjust their pricing at the product and customer segment level for term deposit products, bonus interest accounts and introductory offer products.

Section 7.5 explores how banks use targeted pricing and negotiated interest rates to retain consumers and their funds.

Section 7.6 finds that that the pricing approaches detailed in the chapter result in complexity and opaqueness in the retail deposits market.

Section 7.7 considers the fees and charges incurred for retail deposit products, and how the burden of these is distributed across customers.

7.1 Banks use a range of product designs and interest rate offerings

This chapter focuses on term deposits and those (typically savings) products that feature bonus interest rates and introductory interest rates.

As outlined in chapter 1, these types of accounts have very different features, which can vary between and within banks, and generally offer interest rates that compensate the consumer for having less access to their funds.

For savings accounts in particular, banks may offer a conditional bonus interest rate (see section 7.3) or a time-limited introductory interest rate (see section 7.4) on top of the base interest rate for the product. This chapter refers to:

- **'Bonus interest accounts'** for those accounts with a conditional bonus interest rate in addition to the base interest rate. Together, the base interest rate and bonus interest rate comprise the 'headline interest rate' for these accounts.
- '**Introductory interest accounts**' for those accounts offering a time-limited introductory interest rate in addition to the base interest rate. Together, the base interest rate and introductory interest rate comprise the 'headline interest rate' for these accounts.
- **'Unconditional savings accounts'** for those accounts that do not have conditional bonus interest rates or introductory interest rates.
- **'Savings products'** to describe all savings products whether or not they offer introductory interest rates or bonus interest rates.
- **'Retail deposit products'** to refer generally to savings products, transaction products and term deposit products.

Whether a change in interest rates is applied to the base interest rate or the bonus or introductory interest rate has a significantly different impact on a bank's profitability. This is because the amount of deposits subject to the base interest rate is generally greater than the amount of deposits subject to the bonus or introductory interest rate.[205] Therefore, a change to the bonus or introductory interest rate may have a smaller impact on profitability (depending on how the deposit volumes change) while still enabling banks to compete for certain types of retail deposit consumers.

We have observed that for those products that offer bonus interest or introductory interest rates, to the extent that banks compete on headline interest rates, they often do so by adjusting the introductory or bonus interest rate rather than the base interest rate. Section 7.6 illustrates that despite the recent increases in headline interest rates, the base interest rate for many of these products – particularly bonus interest accounts – remains negligible or relatively low.

205 Section 7.3 gives further consideration to the proportion of bonus interest account consumers and funds that receive bonus interest rates.

7.2 Term deposit rates vary significantly and change quickly

Term deposits allow consumers to earn fixed-rate interest over a specified period, in exchange for not accessing their funds before the end of the term.[206] Only 19% of consumers reported holding at least one term deposit (compared to 79% holding at least one savings account).[207] Consumers also reported higher balances on average in their main term deposit accounts, compared to their main savings accounts.[208]

Banks also benefit from offering term deposits. Retail deposit products provide banks with a low-cost funding source and, for some banks, term deposits can be particularly important as they generally attract higher deposit balances and provide a stable funding source for a defined period.

Term deposits help banks manage liquidity risks

As discussed in section 2.2, one of the risks that banks need to manage is liquidity risk. This risk can occur where banks are unable to replace deposit outflows (or wholesale debt payments) with new funding. The fixed period nature of term deposits means that a bank can monitor its expected upcoming withdrawals (based on the known maturity times of existing term deposits) and subsequently adjust its pricing strategy for new term deposits to incentivise customers to select term deposits that better suit the bank's funding requirements.

These funding requirements could include a general need for more funding, to replace existing term deposits that are due to expire, or to add volume to particular term deposit maturity periods that may be smaller than other maturity periods. In return for more stability, term deposits are generally a more expensive source of funding than other retail deposit products.

A bank's funding requirements will influence its term deposit pricing

Banks generally price their term deposits with reference to market reference rates such as the BBSW.[209] The ABA submitted that longer terms nearly always offered higher interest rates for term deposit customers, which allows banks access to secure medium-term funding.[210]

However, a bank may offer term deposit interest rates that do not always increase with term length depending on their funding requirements and the market's expectations for future interest rates. Interest rates offered on term deposits can also vary with the size of the deposit, where larger deposits are generally offered better interest rates.[211]

Some banks may also offer term deposit consumers a variety of payment frequency options on interest rates, such as 4 weekly, 6 monthly, annually or at maturity. Where there is a difference in interest rates offered for different payment frequencies, customers are generally offered a better nominal rate for less frequent interest payments.

206 While consumers can have early access to their funds, they may incur a break fee and/or forgo some or all of the accrued interest. As noted in chapter 1, some term deposit accounts also require the consumer to provide advance notice before early withdrawal of funds.

207 SEC Newgate Research, *Retail deposits research*, 22 June 2023, p 1.

208 SEC Newgate Research, *Retail deposits research*, 22 June 2023, p 16.

209 ABA submission, 29 May 2023, p 5; NAB submission, 19 May 2023, p 3.

210 ABA submission, 29 May 2023, p 5.

211 Some banks may also require a minimum term deposit balance, for example $5,000.

Term deposit specials are used selectively by banks

Banks may offer term deposit specials from time to time. These specials are for specific terms (for example, 7 months or 18 months), and are generally designed to meet a banks' funding needs by offering higher rates for specific tenors, rather than in response to consumer demand for particular length term deposits. While term deposit specials can increase a bank's funding volume, the increased interest rate paid to the term deposit customer increases the bank's funding costs. Consequently, a bank may only offer one or 2 of these specials at any point in time.

Some banks offered term deposit specials as TFF funding progressively matured and they looked to replace this funding with term deposits or other funding sources.

A bank may also offer a term deposit special when decreasing the price of other term deposits to still have a competitive offer in the term deposits market.

The special offer tenors may be designed so that new deposits mature during periods where the bank may otherwise have a smaller volume of maturities, or due to the profitability of those terms relative to other terms (including those with high maturity volumes). Having a more level funding profile reduces the occurrence and size of funding peaks, which can take more effort for a bank to retain at maturity and may require the bank to produce another (relatively expensive) term deposit special.

A bank's term deposit pricing can change quickly if the bank's funding needs change in the short-term. For example, a bank may reprice interest rates for new deposits (whether on a term deposit special or more generally) where there is too much or too little growth to meet funding needs.[212]

In summary, the approach a bank may take in setting interest rates for term deposits will vary depending on its actual and projected funding needs. This can result in different banks offering a variety of combinations of term deposit lengths and interest rates, which can change quickly in response to changes to a bank's funding requirements. Consequently, this can challenge consumers trying to compare term deposit offers within and across banks.

212 For example, one consumer was advised that their bank had decreased its interest rate due to high consumer demand. Submission Provider M submission, 22 April 2023, p 1.

7.3 Bonus interest rates are attractive to many consumers, but add complexity and uncertainty

Bonus interest accounts are a staple for many banks' consumer value proposition

Bonus interest accounts offer consumers an opportunity to access a relatively high interest rate on an ongoing basis while still retaining access to their funds.[213] Despite the interest rate being conditional on how a consumer uses their account, the bonus interest accounts have continued to attract significant deposit volumes throughout the mid-2019 to mid-2023 period, doubling in size to around $300 billion over this period.

Banks adopt various strategies to attract and retain certain customer segments with bonus interest accounts.

Many of the larger banks offer at least one bonus interest product, although the conditions that a customer must meet to receive the headline interest rate varies by product and bank (discussed further below).

Bonus interest accounts provide banks with an opportunity to pay the conditional high headline interest rate only to certain customer segments with which a bank may seek to build a profitable ongoing relationship, that is, those customers who meet the bonus conditions set by their bank. Such conditions may be framed so that customers who demonstrate certain behaviours considered valuable to a bank may be able to meet the bonus conditions and receive higher interest rates. For example, one bank offered customers who demonstrated behaviours valued by the bank (such as using their transaction accounts for purchases, or growing their deposit balances) better interest rates to encourage and reward these behaviours to retain the customers in anticipation of them becoming first home buyers with that bank in the future.

Other customers that do not meet the conditions set by the bank are paid only the lower base interest rate. As of November 2023, many banks offered very low base rates close to 0.01% although a few offered a base rate of at least 2.00% (see section 7.6).

This price structure minimises the negative impact on banks' funding costs and profitability of offering higher rates to all their customers.

Many banks use these products to attract and retain customers and their deposits, using bonus interest rates to incentivise consumers to display particular saving behaviours, an ability to earn regular income (in some cases) and, to some extent, encourage consumers to develop 'sticky' behaviour (see section 3.3). For example, some banks design their bonus interest accounts to attract and retain customers that demonstrate behaviours valued by the bank, such as using linked transaction accounts for purchases, growing deposit balances or receiving salary deposits to the account.

The specific conditions set by banks on bonus interest accounts are discussed further below.

213 Unlike, for example, a term deposit where a consumer may need to provide advance notice before early withdrawal of funds.

How banks set bonus interest account conditions

Banks are incentivised to attract higher value customers for prudential regulation and longer-term business benefits. As discussed in chapter 2, MFI customers are also more likely to acquire future services from the bank. Under current prudential regulations, retail deposits that are fully covered by the Financial Claims Scheme and where the depositor has an established relationship with the ADI that makes deposit withdrawal highly unlikely (or the deposits are in transactional accounts) are regarded more favourably than other deposits for the purposes of managing liquidity risk.[214]

Bonus interest accounts give banks the opportunity to attract MFI customers through a combination of high headline interest rates and bonus interest conditions that suit both these customers and the bank.

In setting their bonus interest conditions, banks have considered conditions that would:

- attract customers, such as avoiding a withdrawal condition
- encourage positive savings outcomes, such as a balance growth condition, or
- drive MFI behaviour, such as a condition requiring customers to regularly receive significant deposits or make transactions with a linked account.

This does not necessarily mean that all banks will seek to attract customers in the same way, or that all MFI customers have the same preferences. For example, one bank that considered adding a transaction condition to an existing bonus interest account did not implement the change out of reputational concerns.

Our review of banks' decision documents also found that some banks review their customers' experiences with bonus interest conditions. We also observed occasions where some banks considered their customers' experiences with bonus interest conditions to identify if any adjustments were necessary.

However, a lack of clarity surrounding bonus interest conditions and changes to conditions can make it difficult for consumers to receive bonus interest rates.[215] Consumers also submitted that ineffective bank communication resulted in consumers not receiving notifications of changes to bonus interest conditions and accordingly, consumers found themselves with a bonus interest account that no longer suited their needs or how they used the account.[216]

Bonus interest account conditions vary significantly between and within banks

The conditions a bank sets for its bonus interest accounts will vary depending on the consumer segment they are aiming to target. This results in conditions that will vary between and within banks (as illustrated in table 7.1) and makes it difficult for a consumer to compare bonus interest accounts.

214 These deposits are less likely to be withdrawn in a time of stress. As discussed in section 2.3, APRA seeks to ensure banks manage their liquidity risk. There are 2 approaches for this, depending on how APRA determines the bank should be classified. For banks classified as a Liquidity Coverage Ratio (LCR) ADI, a bank must calculate its total net cash outflows over the next 30 calendar days. Different retail deposit products will be treated differently for the purposes of calculating retail deposit outflows. Deposits considered more likely to be withdrawn in a time of stress will have a greater impact on a bank's total estimated net cash outflows and require a bank to hold more high quality liquid assets to be able to repay any short-term funding withdrawals.
Source: APRA, Prudential Standard APS 210 Liquidity, December 2022, pp 10, 13, 21–23, 26.

215 For example, see L Weidenhofer submission, 12 May 2023, p 1.

216 Submission Provider H submission, 12 May 2023, p 1; Submission Provider J submission, 17 May 2023, p 1.

Table 7.1: Bonus interest rate eligibility criteria on select bonus interest products, November 2023

Bank/ Product	Minimum number of deposits per month	Minimum value of deposits per month	Balance growth (excluding interest and bank-initiated transactions)	Maximum withdrawals per month	Minimum number of transactions on linked account	Maximum balance for maximum rate	Base interest rate	Bonus interest rate	Headline interest rate (combined base and bonus interest rates)
ANZ Progress Saver	-	$10	-	0	-	-	0.01%	4.24%	4.25%
Bankwest Hero Saver	-	$200	-	0	-	$250,000.99[a]	1.00%	3.60%	4.60%
Bendigo Reward Saver	1	-	Yes	-	-	$100,000[a]	0.30%	4.95%	5.25%
BOQ Smart Saver	-	$1,000	-	-	5	$250,000[a]	0.05%	4.95%	5.00%
CBA GoalSaver	1	-	Yes	-	-	-	0.40%	4.50%	4.90%
Great Southern Bank Advantage Saver	-	-	Yes, by at least $250	-	-	$100,000[b]	0.10%	4.75%	4.85%
Great Southern Bank Home Saver	-	$2,000	-	-	5	$100,000[a]	0.50%	4.75%	5.25%
Heritage Target Bonus	1	-	-	0	-	-	0.01%	4.24%	4.25%
ING Savings Maximiser	-	$1,000	Yes	-	5	$100,000[a]	0.55%	4.95%	5.50%
NAB Reward Saver	1	-	-	0	-	-	0.35%	4.65%	5.00%
Newcastle Permanent Smart Saver	-	-	Yes, by at least $150	2	-	-	0.00%	4.50%	4.50%
People's Choice Dream Fund	-	-	Yes	-	-	-	0.01%	4.84%	4.85%
People's Choice Bonus Saver	-	$50	-	0	-	-	0.01%	4.24%	4.25%

St George Incentive Saver	-	-	Yes, by at least $50[c]	-	-	$250,000[d]	1.85%	3.15%	5.00%
Suncorp Growth Saver	-	-	Yes, by at least $200	1	-	-	0.35%	4.70%	5.05%
UBank Save Account	-	$200	-	-	-	$250,000[a]	0.10%	4.90%	5.00%
Westpac Life	1	-	Yes	-	-[e]	-	2.00%	3.00%	5.00%

Note: Customer seeking to open a bonus interest account will generally require a linked transaction account. If the customer does not have an existing transaction account, the bank may automatically open one for the customer.
(a) The base and bonus rate will be applied up to this balance. On any part of the balance above this (up to $5,000,000.99 in the case of the Bankwest product) will only receive the base rate.
(b) A tiered interest rate applies to this bonus interest account, where the bonus interest rate offered decreases as the balance band increases and the interest is paid at the rate applicable to each band on the portion of the account balance within that band.
(c) For customers 21 or over. For customers under 21, the minimum balance growth is $0.01.
(d) A tiered interest rate applies to this bonus interest account, where the bonus interest rate offered decreases as the balance band increases and the bonus interest rate on the highest band applies to the total account balance.
(e) Customers aged 18–29 are eligible for an additional bonus interest rate when an eligible debit card is used 5 times per month.

Source: Banks' websites, viewed 20 November 2023.

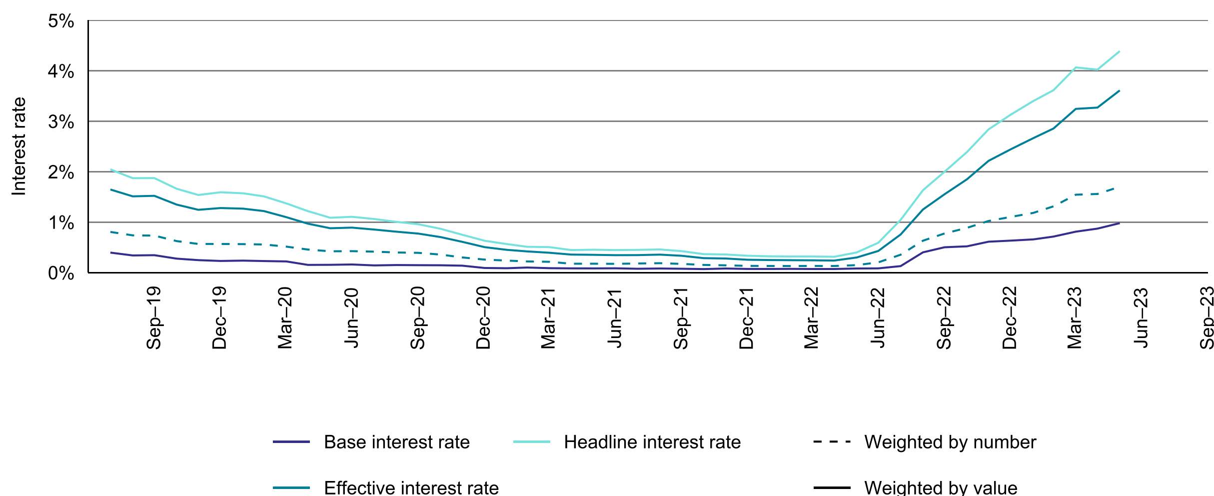
Bonus interest conditions that may seem very similar at first glance, such as those requiring a deposit, can vary significantly. Some bonus interest accounts only require one deposit per month (of an unspecified value) while one requires $2,000 per month. Balance growth conditions have a similar range – for some accounts the customer only needs to grow their balance by $0.01 (excluding interest earned) while another account requires the balance to increase by $200 (excluding interest earned). Some bonus interest accounts allow for withdrawals to be made without penalty – but there are many where a single withdrawal will result in the loss of the bonus interest for that period.

The variety of bonus interest conditions offered across different accounts means very few bonus interest accounts are directly comparable and, as a result, consumers cannot easily identify which is the best bonus interest account for them. Instead, consumers will need to carefully consider their savings goals and how they expect they will use savings accounts, including whether they can make regular contributions and the likelihood of needing to withdraw funds from the account. As noted in chapter 1, such decisions can be influenced by an overconfidence bias for some consumers, where they overestimate their likelihood of meeting bonus interest rate conditions.

Most bonus interest accounts are not receiving any bonus interest

As noted above, consumers need to meet a range of different bonus interest conditions to receive the headline interest rates on their account (the base interest rate plus the bonus interest rate). In any given month, not all do so. This means that bonus interest account customers collectively receive an effective interest rate that is between the base interest rate and the headline interest rate (figure 7.1).

Figure 7.1: Estimated average interest rates paid on bonus interest accounts – select banks, July 2019 – May 2023



Note: Limited to 10 of the 14 Inquiry ADIs. Headline interest rate is the base interest rate plus the bonus interest rate. Interest rates are based on estimates of interest accrued in a month and the account balance for the same month, and then annualised. Includes inactive (dormant) accounts.

Source: ACCC analysis of data obtained from banks.

Over the first half of 2023, 71% of accounts did not receive the bonus interest rate on average each month, representing 24% of the total funds in these products in the same period.[217] This suggests accounts with larger balances are more likely to meet bonus interest conditions and make up most of the funds in these products that earn the bonus rate. This observation is consistent with several bonus interest conditions that encourage customers to accumulate balances in their bonus interest accounts, such as balance growth and withdrawal limit conditions.

Consumers with larger account balances also have stronger incentives to meet the bonus interest conditions and earn the bonus interest rate than consumers with smaller balances, given the higher financial impacts on larger balances. While there may be a proportion of dormant accounts with small balances,[218] this may be a result of account holders with smaller balances prioritising having access to funds as opposed to earning small amounts of bonus interest on them.

It is also likely that consumers find it difficult to consistently monitor whether they fail to meet any of the bonus conditions and thus do not receive the bonus rate (this is considered further below).

Some bonus interest rate conditions are harder to meet

Many bonus interest accounts have conditions that could change consumer behaviour regarding deposits balance growth, withdrawals and spending. However, the likelihood of consumers meeting the bonus interest conditions on these accounts will depend on the consumers' individual circumstances.

One common bonus interest rate condition requires consumers to have a minimum number of deposits per month, or to have a minimum value of deposits per month. While this is beneficial for consumers receiving a salary, this may be limiting to consumers without regular income streams

217 This analysis was based on data provided by 9 banks. As noted below, some banks do not expressly record whether or not their customers achieve bonus interest rates.

218 These accounts could not be reliably removed from our analyses.

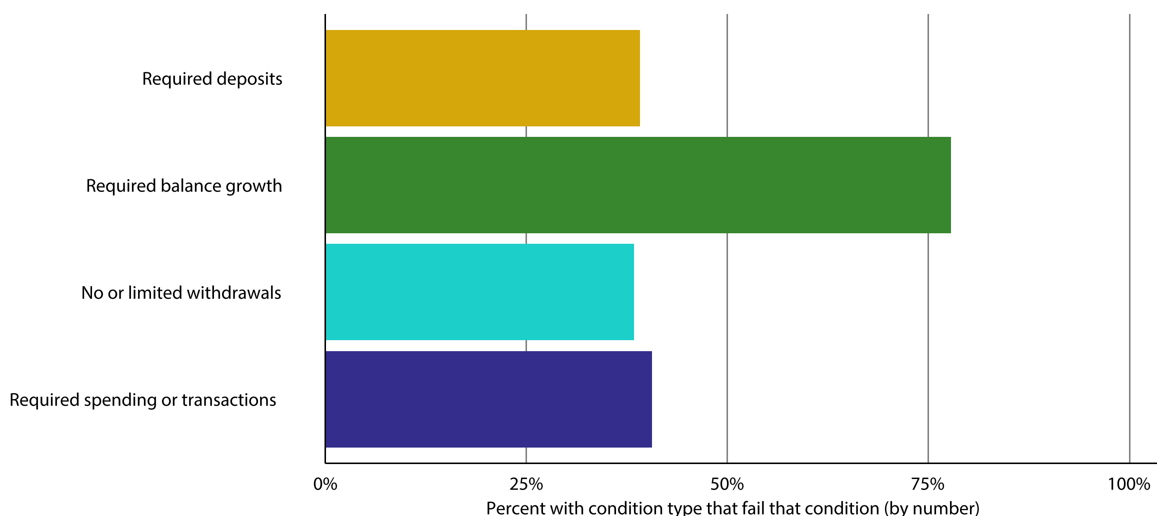
who may struggle to make regular deposits.[219] These conditions may also be onerous for consumers with lower overall earnings or savings who do not comfortably meet the minimum deposit threshold.

Some products offering bonus interest rates are conditional on consumers not withdrawing any funds in that month. Consumers with overall lower savings may have trouble meeting this condition as they may not have other savings funds to draw from. One consumer noted that this condition may become more relevant as the cost of living continues to increase.[220] The same consumer also submitted that modern banking practices and the ease by which consumers can transfer funds (for example, through mobile phone apps) may often lead to them forfeiting the bonus rate without as much as a warning.[221]

While at least one bank considered developing technological solutions to help their customers meet bonus interest conditions (such as pop-up warnings when a customer is about to withdraw funds from a bonus interest account with a withdrawal limitation condition), we did not find evidence that such alerts were widespread.

Different consumers may find certain conditions easier or harder to meet. For example, we found that around 75% of bonus interest accounts with a balance growth condition failed to meet this condition in any given month over the first half of 2023. Other bonus interest conditions on deposits, withdrawals and spending also had high failure rates of around 40% (see figure 7.2).

Figure 7.2: Average monthly proportion of bonus interest accounts failing to meet bonus conditions by condition type, January 2023–June 2023



Note: Condition categories each contained at least 2 bonus interest account products and between 1.5 to 3 million bonus interest accounts failing to meet the condition over the period (on average).

Source: ACCC analysis of data obtained from banks.

We consider that while dormant accounts would have increased the failure rate of the deposit, balance growth and spending conditions (that is, that the true failure rate of active accounts for these conditions is likely less than reported), they would have decreased the failure rate of the withdrawal condition (that is, that the true failure rate of active accounts for this condition is likely greater than reported).

219 Association of Independent Retirees submission, 19 May 2023, p 7; CHOICE submission, 26 May 2023, p 6; B Harper submission, 16 May 2023, p 1.

220 J Clarke submission, 16 February 2023, p 1. See also: ABS, Selected Living Cost Indexes, Australia – Annual living costs, November 2023.

221 J Clarke submission, 16 February 2023, p 1.

Consumers and banks need better information on bonus interest rates

The section above sets out the high proportion of bonus interest accounts that were not receiving the bonus interest rate in any given month. A proportion of this result can be explained by conscious consumer choices or the existence of dormant accounts with no or negligible balances. However, a substantial number of customers may inadvertently breach a bonus interest rate condition (for example, if they have not made a deposit into a bonus interest account during the month, or they make more withdrawals than permitted).

The ACCC considers that banks should be required to alert a customer if they are about to breach a bonus interest rate condition. Alerts could be provided through a banking app notification, email, pop-up window or in person, depending on the channel the customer is using to undertake their banking.

For instance, if a bonus interest account has a condition limiting the number of withdrawals, a bank could alert a customer attempting to send money from the account on their phone if a transaction would breach the condition. Of course, a customer should still be free to proceed with the transaction, but would do so knowing that they would not earn the bonus interest for that period.

This Inquiry has found banks can vary considerably in whether and how they monitor and record bonus interest rate conditions. Instituting real-time alerts would also require different adjustments from different banks. Some banks already have some processes in place to provide such alerts, while other banks making bonus interest offers would need to develop this capability.

Recommendation 2

Consumers should be provided with an alert if they are about to breach bonus interest rate conditions

Banks choosing to offer conditional bonus interest rates on their retail deposit products should provide real-time alerts to customers at risk of breaching these conditions.

If these measures are not voluntarily taken by banks in a reasonable timeframe, they should be mandated.

Any mandatory requirements should be extensively tested to ensure alerts are presented in an effective manner.

When designing and distributing their products, banks should have regard to whether these products are meeting the needs of their target markets. In order to make a reasonable assessment of the ongoing suitability of their bonus interest rate products, banks need to understand how the product is performing in the hands of consumers in the target market.[222]

We have found that only some banks from which we requested data had records of consumers' experiences with specific bonus interest conditions available. While our review of banks' documents suggested that other banks did produce these types of statistics from time to time, the lack of ongoing monitoring suggests that some banks are not considering whether consumers are achieving the headline rates banks are advertising on bonus interest accounts.

222 ASIC, Regulatory Guide 274: Product design and distribution obligations, December 2020, p 7.

The ACCC considers banks should be recording whether their customers achieve a bonus interest rate each period and – when they do not – each of the criteria that they failed to meet.[223]

This information could be reviewed by banks to ensure their bonus interest rate products are meeting the needs of their customers. A bank could do this at the individual customer level, but at a minimum, should do so at the product level.

Consumers would also benefit from knowing what proportion of customers achieve the bonus interest rate offered on a product. Banks should publish this information alongside their promotional material for that bonus interest rate product. This information will help consumers form a more realistic expectation about their own chances of meeting the bonus interest rate criteria, and also help them compare between different bonus interest rate offers.

Recommendation 3

Banks should be required to record and report bonus rate achievement for their products

Banks should record, for each bonus interest rate product they offer, the proportion of accounts receiving the bonus interest rate per month. Banks should also record which bonus interest rate criteria are met or not met for each customer.

Banks should use this data to consider the ongoing appropriateness of their bonus interest rate products for their customers.

Banks should also report on the overall proportion of accounts receiving the bonus interest rate for each product alongside their promotional material for the product.

7.4 Introductory interest offers benefit new customers but those that stay can be worse off over time

Introductory offers are used to attract new customers

As noted in chapter 3, introductory interest rates on retail deposits products are designed to attract new customers and encourage them to open a transaction account and switch to a particular bank, or in some circumstances to a new product with their current bank.

When selecting an introductory interest account, a consumer needs to not only consider the headline rate (inclusive of the introductory interest rate) and the base rate that the product will revert to at the end of the introductory offer, but also the length of the introductory offer.

While banks may offer attractive rates to new customers, they are generally not available beyond the term of the introductory period. Once the introductory interest rate period ends, some higher value customers may receive a targeted offer from their bank (see section 7.5), otherwise customers transition to a lower base interest rate. As a result, customers who stay with the same account after the introductory period ends may be worse off over time depending on the difference between the

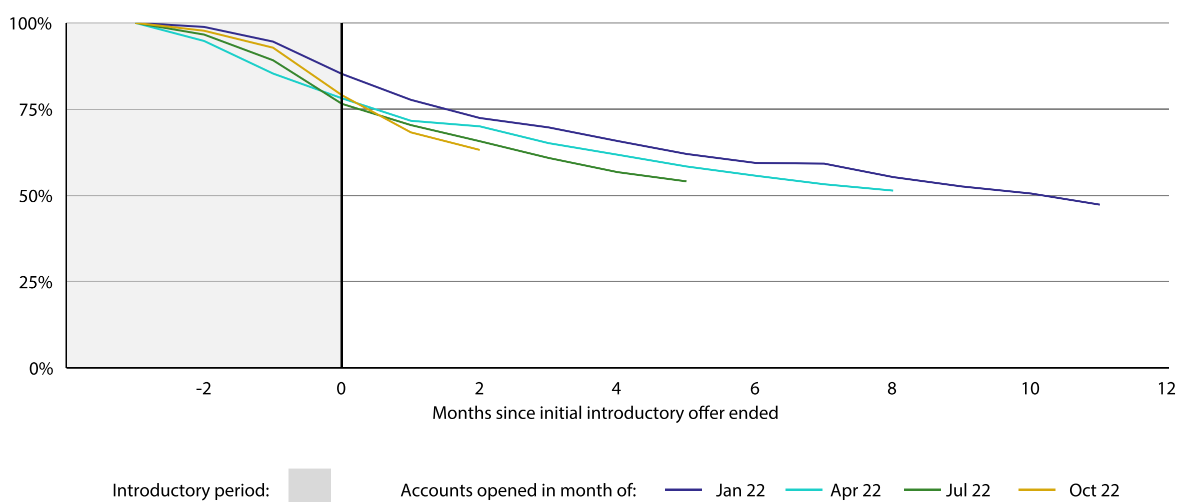
223 In recording this, banks could adjust or exclude those accounts with very little or no funds in them (for example, where a customer has transferred their funds to a new account but not closed the old account).

headline interest rate, inclusive of the introductory interest rate, and the base rate. This will vary from bank to bank, as shown in figure 7.6 in section 7.6.

Consumer outcomes after the introductory offer period

Figure 7.3 shows how customers of these accounts adjusted the amount deposited in introductory interest accounts before and after the introductory period. Balances in these accounts were decreasing even before the introductory period expired. However, the decrease becomes more pronounced once the introductory offer period ends and then slows. Eight months after the end of the introductory offer (for accounts opened in January 2022) the accounts, in aggregate, have around 50% of the balance that was in these accounts 3 months before the expiry of the introductory offer.

Figure 7.3: Changes to consumer balances held in introductory interest accounts before and after expiry of the introductory offer, accounts opened in January, April, July and October 2022



Note: Data represents deposit balances up to June 2023. This means some accounts (such as those opened in January 2022) have been open for longer than others (such as those opened in October 2022), resulting in time series of different lengths. Data has been shifted to align the end of each introductory interest offer period. Not shown is data for time periods where not all accounts had data available during the introductory interest offer period (for example, if the shortest offer period was 3 months, only the last 3 months of data are shown).

Source: ACCC analysis of data obtained from banks.

The decreasing balances prior to the expiry of the introductory offer may be due in part to pre-emptive transfers by customers seeking better rates elsewhere, given the lack of withdrawal restriction on introductory interest accounts.

The more pronounced decrease in balances at the end of the introductory offer period is likely the more price-sensitive consumers switching to another account. The rate at which balances are withdrawn from these accounts has been increasing over time. As interest rates started to increase throughout 2022 then the incentives to switch to alternative retail deposit products would also have increased.

A consumer's incentive to move their funds depends on:

- the difference between the introductory interest rate available at the time they opened the account
- the base interest rate they will revert to
- any targeted offer made by their bank to retain them
- the interest rates offered on other retail deposit products at the end of the introductory period.

Consumers have a stronger incentive to move their funds when base interest rates are negligible compared to other products that offer more attractive rates. However, this in turn depends on the extent to which a consumer engages with the market again to search for an alternative product.

While we note that many of the funds in introductory interest accounts are withdrawn at or shortly after the expiry of the introductory rate, a significant proportion of the funds are not.

Our review of banks' decision documents suggests at least some banks are well aware of this decreasing balance trend. One bank considered that while this trend is particularly prevalent for the more price-sensitive consumers[224], other customers' balances also decline over time, albeit at a much lower rate. This can also be observed in figure 7.3, as there remains a significant proportion of funds that have reverted to only receiving the base interest rate.

One explanation is where a bank provides its customers with a targeted or negotiated interest rate after the introductory period (these are considered further in section 7.5). If its customers generally consider the offer to be favourable and keep their funds in the account, the bank would be able to limit the attrition of funds after the expiry of the introductory interest rate.

Another explanation for the relatively high proportion of customer balances remaining on the less attractive base interest rate is that consumers may not be sufficiently aware of what the ongoing base interest rate is and/or when their introductory interest period is due to end.[225] Some consumers may be overly confident that they will remember to switch their funds out of the account at the end of their introductory interest period.

In these circumstances, consumers may end up receiving a poorer interest rate in their introductory interest account compared to a product with a better base interest rate.

Depending on the base interest rate a consumer reverts to after the expiry of the introductory interest rate, and what alternative unconditional savings account(s) may be available, a consumer may be worse off over time if they keep their funds in the introductory interest account. More specifically, the lower the base interest rate is on the introductory interest account, and the shorter time period it is available, the more likely a consumer would have been better off depositing their funds in an unconditional savings account.

For example, if the base interest rate is 1.0% and the introductory interest rate is an additional 4.0% for 6 months (giving a headline interest rate of 5.0%), but a consumer could achieve a rate of 3.5% on an alternative product without any conditions, the consumer would be better off with the alternative product after 10 months.[226]

224 These are customers who 'game' introductory offers solely for the short-term access to higher interest rates and then promptly shift their funds to another bank's introductory interest accounts.

225 Chapter 8 considers how consumers are notified of changes in the interest rate they receive on their retail deposit products.

226 For example, for a customer with a $1,000 deposit that allows the interest they earn each month to compound: after 10 months on the introductory interest product, they would have earned about $29; after 10 months on the unconditional savings product, they would have earned about $30.

Consumers should receive clear information to assess introductory interest rate offers

While introductory interest rate offers can play a positive role in encouraging consumer switching, we find that many customers (and a significant proportion of deposits) remain in these accounts even after they have reverted to relatively low base interest rates.

To help consumers make more informed and realistic decisions regarding introductory interest accounts, the ACCC considers banks should be required to do 2 things.

First, banks should ensure that the base interest rate for the product featuring an introductory interest rate is prominently displayed, to improve the likelihood that consumers are aware of what rate they will revert to. This would also highlight to consumers where there is a significant difference between the headline interest rate and the base interest rate.

Second, banks should also be required to advise consumers where they offer an unconditional savings account with a better base interest rate than the base interest rate on the introductory interest account. Further, the bank should state – given the current interest rates – the number of months after which the consumer would earn more interest in the unconditional savings account.

This is a relatively simple calculation that banks are best placed to do for the consumer, so they could make a more informed judgement on whether the introductory interest rate offer is a good option for them.

Any such requirement would need to be carefully designed and tested, and accommodate circumstances where such a comparison is not feasible.

While this would add to the amount of information presented to consumers, it is adding information that is essential to their decision and in a way that reduces the cognitive burden on them.

Recommendation 4

Clearer disclosure of introductory interest rates and alternatives

Banks offering an introductory interest rate on a retail deposit product should:

- Prominently disclose the base interest rate applicable at the end of the introductory period.
- If the bank offers a retail deposit product with a better base interest rate (that is, a rate that is not time-limited or conditional), the bank should also disclose this when promoting its introductory interest rate offer. This should include a statement about the length of time it would take before a given deposit amount would return a greater amount of interest if the other product was used for the deposit.

7.5 Banks' targeted offers and negotiated interest rates benefit certain customers but make deposit rates more opaque

Consumers do not necessarily need to switch banks to receive preferable interest rates or terms and conditions on a retail deposit product. Some consumers that may be able to negotiate a better interest rate with their existing bank, but banks may also proactively use targeted offers to retain existing customers.

For the purposes of this Inquiry we consider:

- **Targeted** pricing to be where a bank proactively offers a better interest rate for depositors from particular cohorts that the bank is targeting, such as customers who hold home loans or large deposit balances, are relatively new to a product or meet particular demographic attributes such as retirees. This benefit may be delivered as a premium on top of an existing interest rate. These offers are not generally available to the public.
- **Negotiated** pricing to be where a consumer initiates contact with their existing bank to request a better interest rate. A consumer will only be able to negotiate within the parameters set in advance by the bank, including the limits/values of negotiated pricing for a given product at any particular time and which staff members are authorised to provide negotiated interest rate offers. However, there may be capacity for exceptions in some circumstances.

Targeted pricing

Banks use targeted pricing as part of a broader customer retention strategy; it is, however, at the complete discretion of a bank as to which customers, on which retail deposit products and when they will provide targeted offers. Banks generally use targeted pricing to retain *preferred* consumers and their deposit balances, although at least one bank also targeted consumers believed to have deposit balances with other suppliers.

We have observed that not all banks provide targeted pricing on their savings products, and that banks were more likely to offer targeted pricing on term deposits. This may be partly because term deposits are considered a more stable funding source, especially term deposits that have a notice period of at least 31 days.[227]

As noted in the previous section, some banks offered targeted rates to customers on introductory interest accounts to retain customers after the expiry of their introductory offer period.

However, a bank's motivations for targeted pricing can vary depending on their funding position and the level of competition in the retail deposits market. We have observed this throughout the period from mid-2019 to mid-2023.

- Mid-2019 – early 2020: while there is limited evidence of the banks' use of targeted pricing during this period, some banks were making some offers to specific groups, such as pensioners, and to retain existing customers during a period of decreasing interest rates.
- Early 2020 – end of 2020: targeted offers during this period were generally used to retain customers of savings accounts once the introductory interest rate had expired, or to higher value consumers on term deposits. These offers became increasingly targeted to core customers – such as home loan and MFI customers – as banks' funding appetites subsided. Targeted offers were also used to attract new consumers with large balances or retain customers that renewed their term deposits online.

227 APRA, Prudential Standard APS 210 Liquidity, December 2022, p 23.

- 2021: as banks generally continued to have lower demand for retail deposit products and advertised interest rates decreased, targeted interest rate offers during this period were starting to be reduced in magnitude or scope, or being removed entirely. However, during 2021 and continuing into 2022, some banks did use targeted pricing from time to time to address specific issues, such as to encourage consumers to undertake longer-length term deposit renewals or to retain consumers during service disruptions.
- Early–mid 2022: as demand for home loans started to grow and banks tended to increase their demand for funding, some banks offered targeted interest rates for new and renewing term deposits, or for consumers who had previously held a term deposit and likely moved these funds to another bank. For at-call products, many banks started to increase the targeted interest rates offered to their customers.
- Mid-2022 – mid-2023: as advertised interest rates and competition for deposits picked up, banks appeared to increasingly use targeted interest rate offers to retain consumers, coupling them with advertised term deposit specials. While some banks later started to increase their targeted offers, particularly for 'quality' consumers, others used targeted offers to assess whether they could encourage customers to renew their term deposits more quickly. For at-call products, banks continued to increase the targeted rates offered to their customers.

Negotiated interest rates

Banks may also negotiate rates as part of a broader customer retention or growth strategy,[228] but, in contrast to targeted pricing, consumers need to initiate contact with an existing or prospective bank to access these rates.

In practice, a bank will generally consider the customer's relationship with the bank, their deposit size and competitors' interest rates to determine whether a customer is eligible for a negotiated rate. Obtaining a larger deposit balance through one customer may be beneficial for some banks when they are seeking to secure funding volume, compared to needing to attract multiple customers to obtain the same funding volume. However, large volume customers are more likely to be price-sensitive and seek to maximise the interest earned on their deposit by searching and switching deposit products and suppliers.

Our review of banks' documents indicates that banks set limits to negotiated rates in a variety of ways, sometimes depending on the retail deposit product.

For term deposits, some banks have negotiated pricing tables with pricing structures similar to their headline interest rates. The negotiated and headline interest rates are subject to the same pricing pressures, which can result in the negotiated interest rates available being no higher than the headline interest rates during low interest periods. This suggests that consumers may be more likely to obtain a favourable, negotiated interest rate, at least for term deposits, during periods where the cash rate target is higher.

While we observed that banks were generally more likely to provide negotiated interest rates on term deposit products, even outside of periods of high interest rates, some banks also offered negotiated interest rates on savings accounts – predominantly introductory interest accounts. In these cases, we observed that some banks may offer negotiated rates to retain customers at risk of switching away from the bank. While some banks may set a limit or an absolute value on negotiated rates for savings products which frontline staff can then offer customers, some of these banks may offer negotiated rates above these pre-determined levels to attract and retain higher value customers or deposit volumes.

228 Deloitte Access Economics, Choice in Banking: A Report for the Australian Banking Association, April 2019, p 8.

Consumers benefit from 'below the line' pricing practices, but these tend to be consumers with significant deposit balances

Targeted and negotiated interest rates can be referred to as 'below the line' pricing practices, where banks set interest rates for particular customers that are not generally available to others for the same product. We observed that 'below the line pricing' is predominantly used by banks to retain term deposit customers with larger deposit volumes.

Around 72% of 12-month term deposit funds were on a negotiated or targeted interest rate as of June 2023. These funds represented around 56% of 12-month term deposit accounts, which suggests that customers with larger deposit balances are those benefiting from these interest rate pricing practices. We also observed that these trends occur across a range of bank types, but to different degrees (table 7.2).

These statistics indicate that, in aggregate, mid-tier and mutual banks have a smaller proportion of 12-month term deposit funds and an even smaller proportion of accounts on targeted or negotiated rates. This suggests that mid-tier banks and mutuals concentrated their negotiated and targeted interest rates on a smaller proportion of the term deposit customers compared to the major banks.

Table 7.2: Proportion of 12-month term deposit funds and accounts on negotiated (or targeted) rates for select banks, by bank type, June 2023

Bank type	Proportion of funds on a negotiated/ targeted rate	Proportion of accounts on a negotiated/ targeted rate
Majors	81%	69%
Mid-tiers	19%	6%
Mutuals	7%	2%

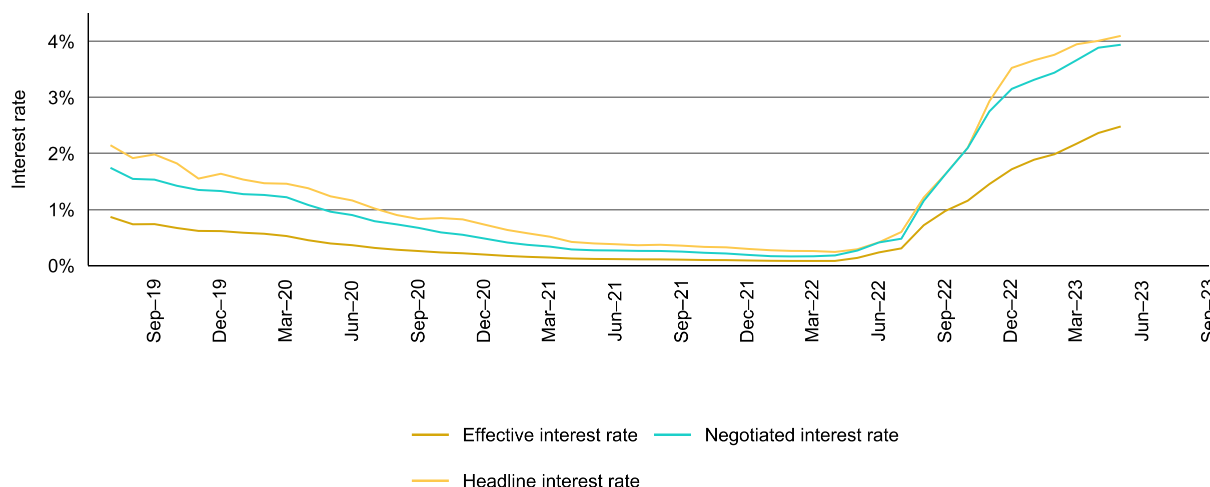
Note: Some banks could not identify whether term deposits had negotiated or targeted interest rates. These banks are not included in the table.

Source: ACCC analysis of data obtained from banks.

We observed that targeted and negotiated rates were sometimes also used to retain savings product customers. By value, around 90% of funds in retail deposit products (other than term deposits) that had targeted or negotiated rates, were in introductory interest accounts. While not all banks offered targeted or negotiated rates on these accounts, for those that did, a quarter of funds by value were on negotiated interest rates better than the base interest rates that were widely available (that is, the base interest rate that these accounts revert to at the end of the introductory offer period). This compares to only around 4% of accounts by number, again suggesting that larger account balances are more likely to be on targeted or negotiated interest rates.

However, the relative benefit these customers receive has varied over time (figure 7.4). For example, since mid-2022, as interest rates on retail deposit products began to increase, the difference between the interest rate received by consumers on targeted or negotiated interest rates and the interest rate received by consumers on introductory offers was far smaller than during the mid-2019 to mid-2022 period. This suggests that as interest rates on retail deposit products began to increase and consumers had incentives to switch away from their existing accounts to receive a better interest rate, banks offered more attractive targeted and negotiated interest rates to retain customers than they had in the preceding period.

Figure 7.4: Estimated average interest rates paid across introductory interest accounts, July 2019 – May 2023



Note: Excludes offset accounts. Limited to products offering introductory interest rates, for which negotiated interest rates were also reported. Interest rates are based on estimates of interest accrued in a month and the account balance for the same month, and then annualised. The headline interest rate (which is the base interest rate plus the introductory interest rate) is the estimated average for those accounts that received the introductory interest rate. The negotiated interest rate is the estimated average for those accounts that received a negotiated interest rate. The effective interest rate is the estimated average across all introductory interest accounts.

Source: ACCC analysis of data obtained from banks.

While banks' practices of offering targeted or negotiated interest rates provides benefits to some retail deposit product consumers, the majority of consumers do not receive these interest rates. Consumers without significant deposit balances, or that do not meet their bank's preferred customer eligibility criteria, are unlikely to have access to better interest rates than the base interest rates that are widely available.

Widespread 'below the line' pricing practices by banks reduces transparency and dampens broader price competition

The use of targeted offers and negotiated interest rates also means banks do not generally need to compete as aggressively on their headline interest rates, since they only need to provide targeted and negotiated rates to a relatively small segment of consumers to secure a larger proportion of retail deposit funding. This opacity of these practices also helps banks minimise their funding costs, as they do not need to offer higher interest rates to their entire customer base.

While the existence of targeted and negotiated interest rates provides some consumers (particularly those with larger balances) the opportunity to obtain a better interest rate on retail deposit products, other consumers may only be able to improve the interest rates they receive on their deposit balances by switching to another bank. Even when a consumer satisfies their existing bank's criteria for targeted or negotiated interest rate eligibility, they may still be able to obtain a better rate at a different bank.

However, banks do not generally provide information publicly about their targeted and negotiated interest rate practices. This lack of transparency around targeted and negotiated pricing creates challenges for consumers seeking to make genuine comparisons between retail deposit product interest rates across different banks. Similarly, the ACCC has previously found that banks' use of discretionary discounts on home loans limits potential borrowers from finding a better offer.[229]

229 ACCC, Home loan price inquiry – final report, November 2020, p xi.

Opaque deposit pricing practices add to the high costs already incurred by consumers when searching for alternative retail deposit products, which are discussed further in chapter 8.

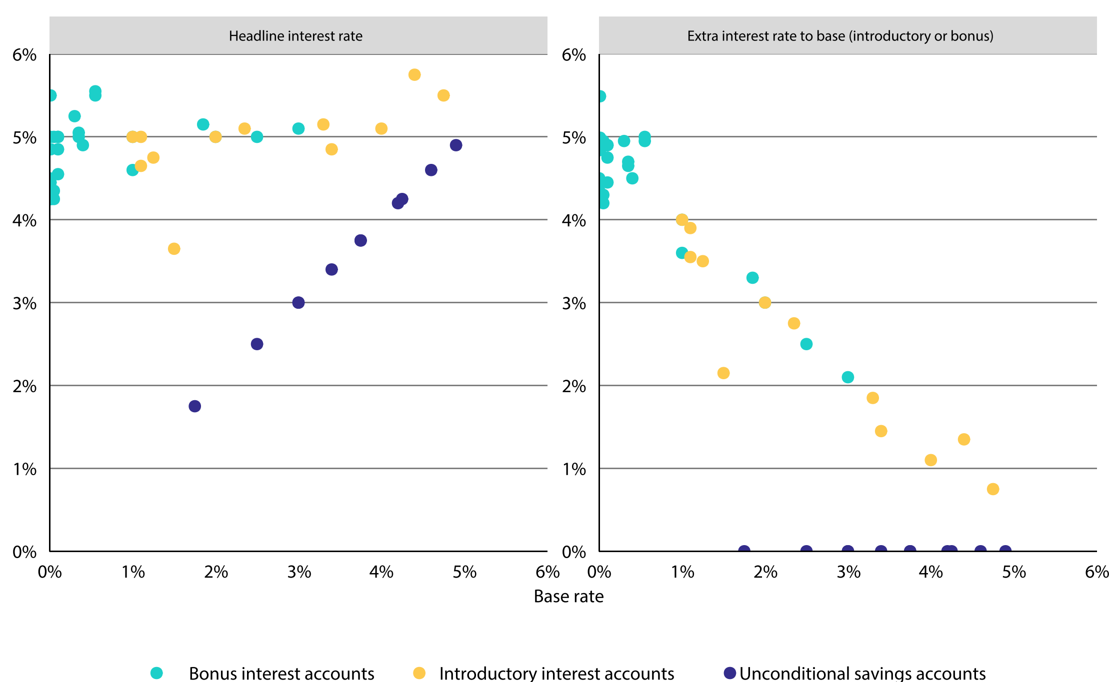
7.6 Interest rates for similar products can vary significantly between banks

Many banks currently offer savings products that, at first glance, have very similar headline interest rates. However as noted above, some headline interest rates may only be temporary or highly conditional.

Figure 7.5 shows the range of headline, base and bonus interest rates available for a selection of bonus interest accounts, introductory interest accounts and unconditional savings accounts in November 2023. Most of these savings accounts had a headline rate between a relatively narrow range of 4.00% and 5.50%.

However, the base interest rates were available for a much greater range of between 0.01% to 4.90%.[230] This is due to some banks offering products with a very low base interest rate along with a high bonus or introductory interest rate (see the second panel of figure 7.5). This price structure allows a bank to attract customers through the high headline interest rates while reducing funding costs as they only need pay the low base interest rate if bonus interest conditions are not met, or after the introductory period.

Figure 7.5: Interest rates on select bonus interest accounts, introductory interest accounts and unconditional savings accounts, November 2023



Note: Interest rates are as applicable to a $5,000 deposit balance. Headline interest rate is the base interest rate plus the bonus interest rate (for bonus interest accounts), the base interest rate plus the introductory interest rate (for introductory interest accounts) or only the base interest rate (for unconditional savings accounts).

Source: Banks' websites, viewed 20 November 2023.

230 Although we have observed at least one bonus interest account with a base rate of 0% and one unconditional savings account with a base rate of 4.65% (see figure 7.6).

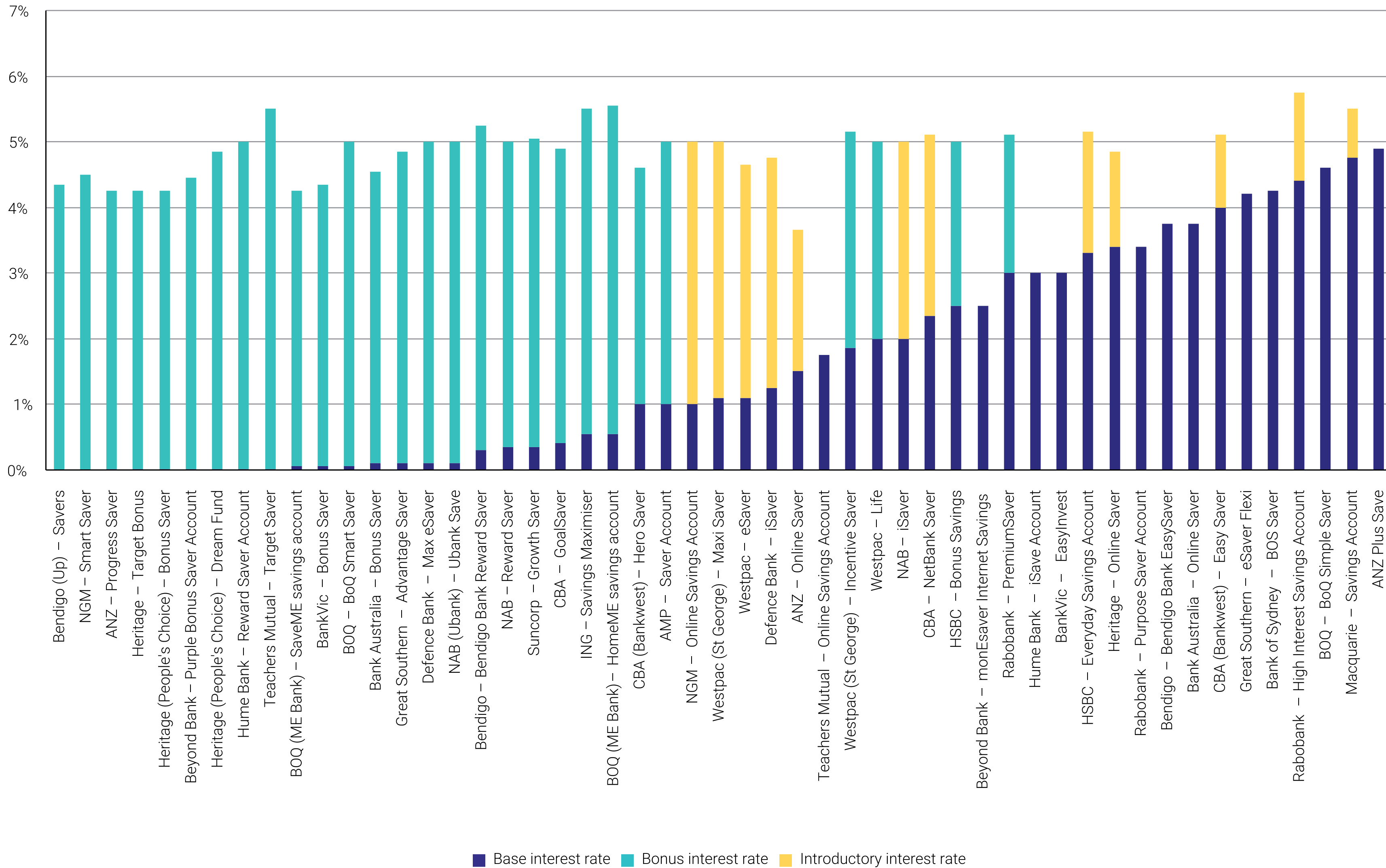
Figure 7.6 below shows the wide dispersion in interest rates offered by banks, even when comparing across similar products (for example, bonus interest accounts, introductory interest accounts or unconditional savings accounts). There is also variation in the relative contribution of the base, bonus and introductory interest rates to the headline interest rates. Banks are generally able to change these interest rate structures at any time, although not all consumers consider they are adequately notified of such changes.[231]

For consumers that have a history of meeting bonus interest product conditions, figure 7.6 shows that some of the best rates were available from mid-tier and mutual banks. Even for unconditional savings accounts, the banks we considered offered rates ranging from 1.75% to 4.75%. However, some products at the top of this range are only available online or through an app, and there may be limited connectivity with other accounts held at the bank.[232]

231 A Brooke submission, 10 September 2023, p 1; B Koh submission, 27 March 2023, p 2; Submission Provider C submission, 23 April 2023.

232 For example, 2 of the accounts with some of the highest base interest rates (ANZ Plus Save and BOQ Simple Saver) are only available through newer mobile apps that offer accounts not otherwise accessible in-branch, through existing online banking services or through the bank's existing app. Similarly, a customer's existing banking accounts are not accessible through the newer apps.
Sources: ANZ, Already with ANZ?, ANZ website, n.d., viewed 11 November 2023; BoQ, Simple Saver, BoQ website, n.d, viewed 11 November 2023.

Figure 7.6: Interest rates on select banks' bonus interest accounts, introductory interest accounts and unconditional savings accounts, November 2023



Note: Interest rates are as applicable to a $5,000 deposit balance.

Source: Banks' websites, accessed 20 November 2023.

Even setting aside these more limited higher rate offerings, figure 7.6 makes clear that many consumers could achieve better outcomes by switching banks, or even switching products within banks. For example, some consumers may be better off with unconditional savings accounts. While these accounts may not have the highest headline interest rates, they pay interest at a higher rate than most of the base interest rates available on bonus interest accounts or introductory interest accounts (see box 7.1).[233]

Box 7.1: The benefits of switching, example 1

A consumer that fails to meet bonus interest conditions

A consumer on Bendigo and Adelaide Bank's bonus interest account that starts with $5,000 and adds $200 per month could earn $328 of interest over a 12 month period if they meet the bonus conditions each month in order to receive the headline interest rate of 5.25%. This drops to only $18 if they never meet the bonus conditions and only receive the base interest rate of 0.30%.

In contrast, switching to Bendigo and Adelaide Bank's unconditional saver (with a base rate of 3.75%) allows the consumer to earn $232 of interest without needing to keep track of bonus interest conditions.

Banks may take different approaches when setting the base and headline interest rates on their savings products depending on the type of consumer they are seeking to attract. In some cases, the base interest rate for a bonus interest account or introductory account can in fact be higher than the interest rate for an unconditional savings account with the same bank.

Box 7.2: The benefits of switching, example 2

A consumer that is no longer eligible for their bank's introductory interest account offer

A consumer on the St George introductory interest account who has just come off the 5.00% headline interest rate and onto the 1.10% base interest rate would be better off on the bonus interest account and its base rate of 1.85%.

For a consumer that starts with $5,000 and adds $200 per month, they would earn an extra $46 per year in interest.

In other cases, banks may offer an unconditional savings product with a higher rate than their conditional product, to incentivise their customers to switch to another product.

233 Examples set out in boxes 7.1–7.3 are based on hypothetical consumers and interest rates available on banks' websites on 20 November 2023 and calculated using the Moneysmart Compound Interest Calculator. These examples assume, when calculating interest to be received, that the interest rates do not change over the 12 month period, other than the expiry of the introductory interest rates.

Box 7.3: The benefits of switching, example 3

A consumer that is eligible for their bank's introductory interest account offer

For example, ANZ have an introductory interest account with a headline interest rate of 3.65% (and a base interest rate of 1.50%) but are offering a newer account, ANZ Plus Save, with a base interest rate of 4.90% (although it is only available through the ANZ app).

For a consumer that starts with $5,000 and adds $200 per month, they would earn an extra $185 in interest over their first year.

Nonetheless, consumers looking for a new savings account would benefit from considering a range of banks and their products.

However, for many other consumers, the low level of consumer engagement described in chapter 8 may mean they are simply unaware of the existence of better offers elsewhere. Even where a consumer is aware of a more compelling product, the real and significant switching costs explored in chapter 9 can mean banks are largely insulated from more competitive offerings.

7.7 Fees and charges have declined overall but can still be significant for some consumers

As noted in chapter 1, banks levy a range of fees and charges on retail deposit products. These fees may recoup some of banks' operational costs from their retail deposit product customers. As is the case with interest rates, banks have and use considerable discretion on what fees they impose and on whom, predominantly through the use of waivers and fee reversals.

Fees charged by banks on retail deposit products have generally declined over the past 10 years.[234] A considerable part of this can be attributed to banks reducing or removing fees on certain products, in part as a response to the 2018 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.[235] Some banks have also been simplifying their fee policies[236], removing or reducing account keeping fees and transaction fees.[237]

Banks also experienced a decrease in fee income over 2020 and 2021 as reduced spending by consumers over this period led to a reduction in overdraw and dishonour fees and other fees (such as foreign exchange fees).[238] Some banks also temporarily waived fees for some customers in light of COVID-19 recession pressures and the subsequent financial unpredictability many consumers were experiencing.

However, compared to previous years, banks increased their fee income from retail deposit product holders over the 2021–22 financial year.[239] This increase was predominantly due to fees associated with term deposits, and from overdraw and overdraft late payment fees.[240]

234 From 1997 to 2020, the RBA collected fee data from 15 banks operating in Australia through its annual survey of fees. This data has since been collected by APRA from banks that have at least $10 billion of total assets. The APRA collected data is available from the RBA's Statistical Tables (table C9) while the retired data set is available from the RBA's Historical Data webpage (table C9).

235 L Nunn, Bank Fees in Australia, RBA Bulletin, March 2023, p 59.

236 L Nunn, Bank Fees in Australia, RBA Bulletin, March 2023, p 59.

237 S Crews & M Lewis, Bank Fees in Australia, RBA Bulletin, June 2020, p 39.

238 K Sparks & R Fitzpatrick, Bank Fees in Australia, RBA Bulletin, June 2022, p 60; K Sparks & M Garner, Bank Fees in Australia During the COVID-19 Pandemic, RBA Bulletin, June 2021, p 73.

239 L Nunn, Bank Fees in Australia, RBA Bulletin, March 2023, p 60.

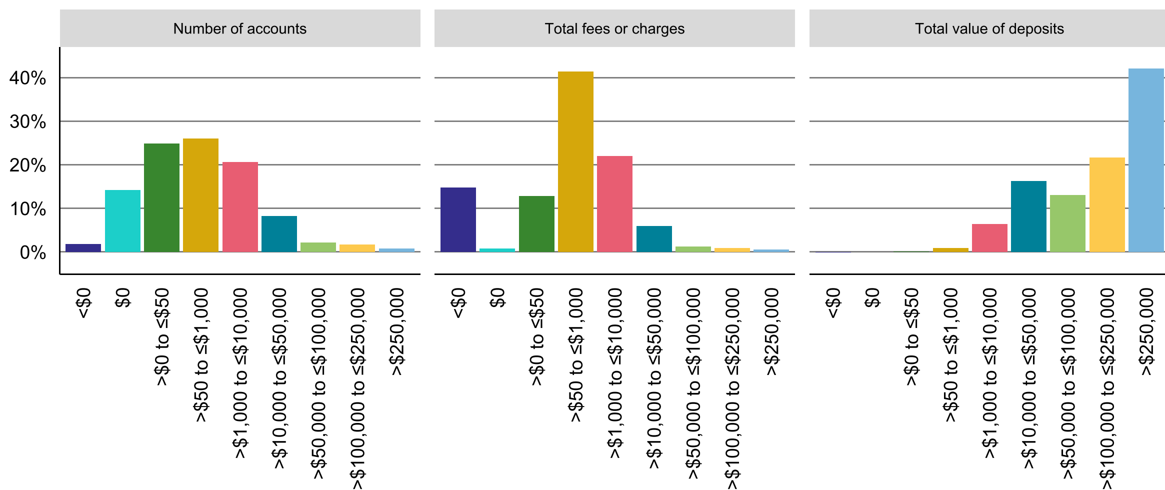
240 L Nunn, Bank Fees in Australia, RBA Bulletin, March 2023, pp 60–61.

The rising interest rate environment (see figure 5.3 in section 5.2) also increased the incentives for existing term deposit customers to break their term deposits early to access new term deposits at higher interest rates, an action which can trigger fees at some banks.[241] In response to this behaviour, at least one bank reduced the interest rate payable on term deposit balances that were withdrawn early in attempts to deter consumers from closing and reopening term deposit accounts, however this measure had limited impact.

The incidence of fees and charges can vary significantly with balance size

However, not all retail deposit product customers have similar experiences with fees and charges (figure 7.7). In particular, customers with smaller and negative balances (those who have overdrawn their account) incur a greater proportion of fees relative to their balance, or are incurring greater monthly fees. For example, accounts with balances between $0 and $50 incurred, on average, fees and charges of 6.3% of funds held in the account in June 2023.

Figure 7.7: At-call deposits, fees and charges by account balance, June 2023

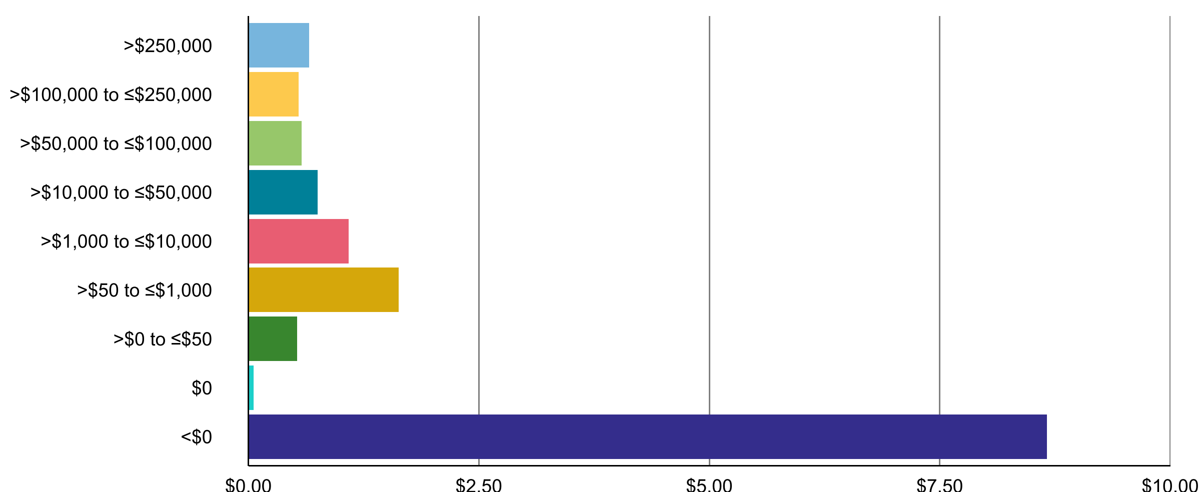


Note: Figure does not include fees and charges on term deposits or accounts used for offsets and does not account for instances where a bank may have provided a refund or reversal after a fee was charged to a consumer. As a result, the total amount of fees depicted may be slightly higher than if these reversals could be accounted for.

Source: ACCC analysis of data obtained from banks.

241 These fees do not include foregone interest. For example, one consumer only received part of the interest accrued on their term deposit when they sought to access their funds earlier than the term period.
Submission Provider B submission, 22 April 2023, p 1.

Figure 7.8: Average fees and charges by at-call account balance, June 2023



Note: Figure does not include fees and charges on term deposits or accounts used for offsets and does not account for instances where a bank may have provided a refund or reversal after a fee was charged to a consumer. As a result, the total amount of fees depicted may be slightly higher than if these reversals could be accounted for.

Source: ACCC analysis of data obtained from banks.

As most fees are fixed and not dependent on account balance, or only apply when customers have insufficient funds in their account, they have a more significant impact on retail deposit accounts with smaller balances. This is reinforced by some banks' use of fee waivers or reductions to attract higher value and/or large volume retail deposit customers, either through product design or at a bank's discretion.[242]

It is also likely that consumers with lower balances are more likely to overdraw their accounts, resulting in exception fees and a negative balance. Where fees are deducted directly from the consumer's account balance, those with low balances may lose a considerable portion of their funds to fees and charges. This can make it even more challenging for these customers to maintain and grow their savings funds. These customers may be better off switching to a retail deposit product with fewer features and fees, however as with interest rates, consumers need to be sufficiently engaged in order to do so.[243]

242 Fee data supplied to the ACCC for this Inquiry did not always account for instances where a bank may have provided a refund or reversal after a fee was charged to a consumer. Some banks noted they were unable to identify and remove these instances of fees from the underlying data.

243 The Australian Banking Association has previously published a list of basic bank accounts on its website: https://www.ausbanking.org.au/wp-content/uploads/2019/04/Basic_Bank_Accounts_July_2016.pdf. These are discussed further in chapter 8.

8. Consumer engagement

Findings

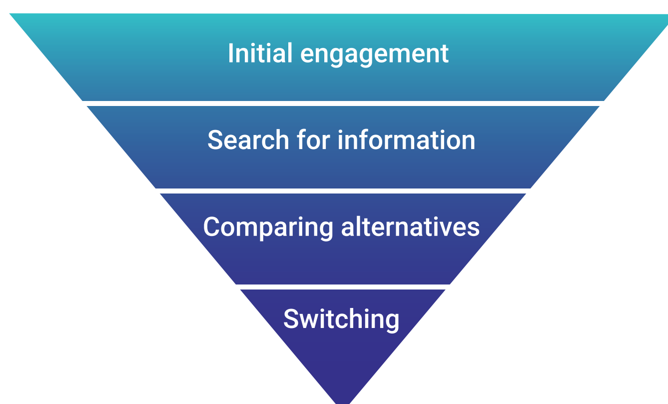
- There are several barriers for consumers at all stages of consumer engagement and switching (see chapter 9 for switching).
- While the nature and size of certain barriers may vary for different consumers, there are clear deficiencies throughout the process which may be addressed by a combination of measures.
- Consumer engagement is often influenced by consumer preferences and biases, such as status quo bias and loss aversion, which may lead to prolonged inertia in the absence of triggers to engage.
- Those consumers who are engaged care most about price (including interest rates) but also take other factors into account.
- Key information on retail deposit products is available through bank websites and comparison websites, but can be too complex, not always easy to locate, and is inconsistent between providers.
- It is difficult for consumers to obtain an objective view of the best products due to lack of consistency between banks and conflicted arrangements with comparison websites.

8.1 There are several barriers to consumer engagement

Consumer engagement and the ability to easily search for, and switch, products exert pressure on suppliers to offer better products and rates. If consumers are less engaged or there are significant barriers to switching, both competition and consumer outcomes are likely to suffer.

The decisions and actions involved in consumer engagement and switching are numerous and, at times, complex. We consider there are 4 stages consumers go through on the path to switching retail deposit products, as shown in figure 8.1.

Figure 8.1: A typical consumer path to switching



Rather than a steady decline in the proportion of consumers at each stage of this path, there is an immediate drop as only 38% of savings account consumers search for information on alternatives, following through to only 25% of consumers switching over a 3 year period.[244] The time taken for a consumer to go through the entire searching and switching path can also vary wildly. For some, the progression from engagement to a switch could be hours and may skip stages, while for many others, it can take much longer.

This chapter discusses the first 3 stages: initial engagement, the search for information and comparing alternatives. These are the stages at which consumers are required to actively engage and evaluate their options. Part of this evaluation relates to the costs of searching and switching in terms of the time and effort required. Consumers may be delayed or deterred by both the actual costs of searching, as well as expected costs of searching and switching, if these are perceived to outweigh the actual or expected benefits from switching. This is an ongoing evaluation, which may also be influenced by a consumer's experiences and preferences, as outlined in chapter 1.

Chapter 9 discusses barriers to switching to a new account. This is the stage at which a consumer may not need to engage as much in evaluating options or looking for information, but there are numerous practical barriers which are time consuming and costly to overcome. Knowledge of these barriers could prevent consumers from engaging at the initial stage[245], or cause them to disengage at any stage – as actual difficulties contribute significantly to perceptions that time and effort to change accounts is not worth it.

We have focused our analysis on where evidence has shown that consumers tend to disengage, where there are deficiencies in the tools available to consumers, or where the onus placed on consumers is out of step with what we know about consumer behaviour.

8.2 Initial engagement tends to be low

The ACCC's consumer survey found that initial engagement – that is, meaningful consideration of the suitability of their own product and willingness to explore alternatives – is low. Only 37% of consumers had searched for a new transaction account in the previous 3 years.[246] A similar proportion had searched for a new savings account (38%), and fewer had searched for a new term deposit provider (18%).[247] Similarly, a 2019 study by Deloitte, which considered a wider range of banking products, found that holders of two-thirds of the banking products considered had not undertaken any activity to gather information about other banking products or offerings in the 3 years prior.[248]

Consumers don't consider searching for several reasons

At the initial engagement stage, there appear to be several factors that reflect a perception that the expected costs of searching/switching outweigh the expected benefits (figure 8.2).

244 SEC Newgate, *Retail deposits research*, 22 June 2023, pp 28, 38.

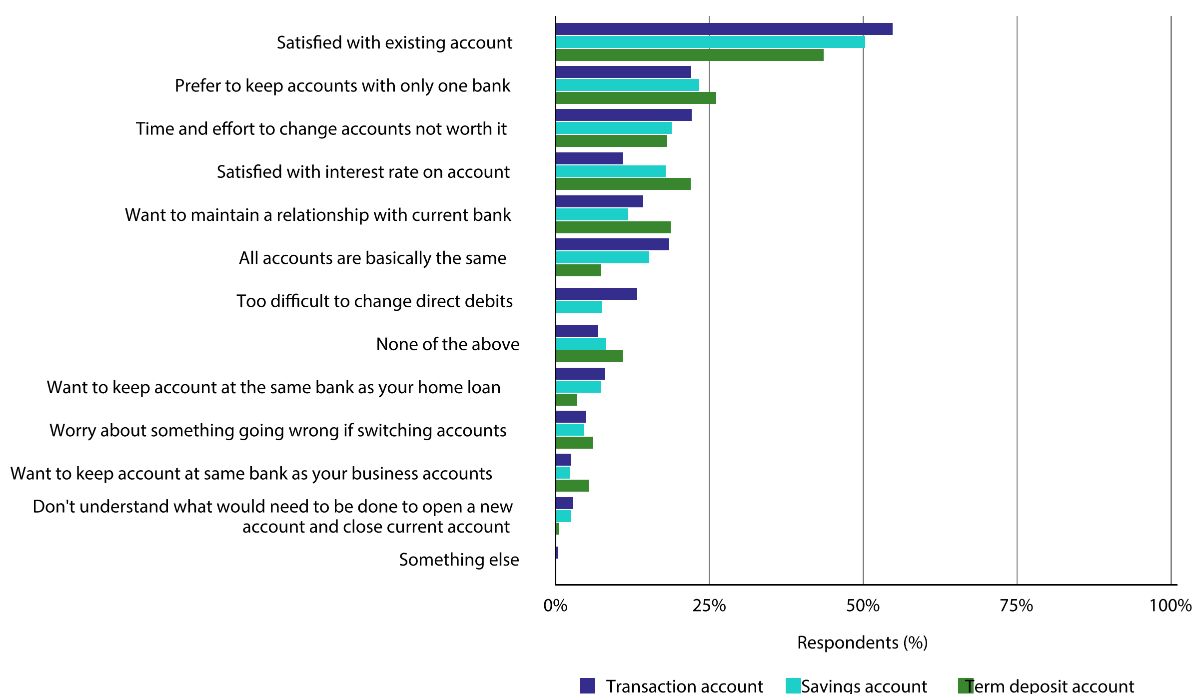
245 The ACCC consumer survey shows a number of these barriers were reported as reasons for not searching for a new account: the time and effort to change accounts, worry about something going wrong if switching accounts, not understanding what to do to open and close an account, and difficulty changing direct debits as reasons for not searching for a new account. There was a similar pattern of responses reported as to why consumers (who had searched) had not switched to a new transaction account. This supports the notion that possible barriers to switching may also be deterring consumers from searching in the first place. See SEC Newgate, *Retail deposits research*, 22 June 2023, pp 32, 44.

246 SEC Newgate, *Retail deposits research*, 22 June 2023, p 28.

247 SEC Newgate, *Retail deposits research*, 22 June 2023, p 28.

248 Deloitte, Open banking: stick or switch, Deloitte, October 2019, p 36, accessed 3 November 2023.

Figure 8.2: Reasons consumers have not searched for a new account



Note: Participants who had not searched for a new account in the last 3 years were asked "Which of the following, if any, are reasons why you have not searched for a new account in the last 3 years?"

Source: SEC Newgate, *Retail deposits research*, 22 June 2023, p 32.

General satisfaction with an existing account was the most common reason that consumers across all 3 product categories reported for not searching for a new account.

Consumers are likely to be satisfied with their current account if they believe their product needs and expectations are being met. It is possible for this to be the case simply due to the absence of any cause for dissatisfaction,[249] or any prompt or trigger to cause a consumer to more closely evaluate whether their needs are being met. It may also be influenced by general satisfaction with other products held at the same bank.

A significantly smaller proportion of consumers cited satisfaction with the interest rate on their account as a reason for not searching.

However, it is important to also note that, while between 44–55% of consumers cited general satisfaction, there is a substantial remainder of consumers who had not searched for a new account and did not choose satisfaction with their existing account as one of their reasons.

249 Deloitte, Open banking: stick or switch, Deloitte, October 2019, p 36, accessed 9 October 2023; Financial Conduct Authority, Making current account switching easier, FCA, March 2015, p 33, accessed 9 October 2023; Y Hartfree, J vans, E Kempson and A Finney, Personal current account switching: why more people don't switch and what could encourage them to do so?, University of Bristol Personal Finance and Research Centre, April 2016, p 18, accessed 9 October 2023.

The ACCC consumer survey results highlighted a range of other reasons for not searching, across all product types, which are likely to be informed by any existing consumer biases, particularly status quo bias and loss aversion, as well as general consumer attitudes and preferences including:

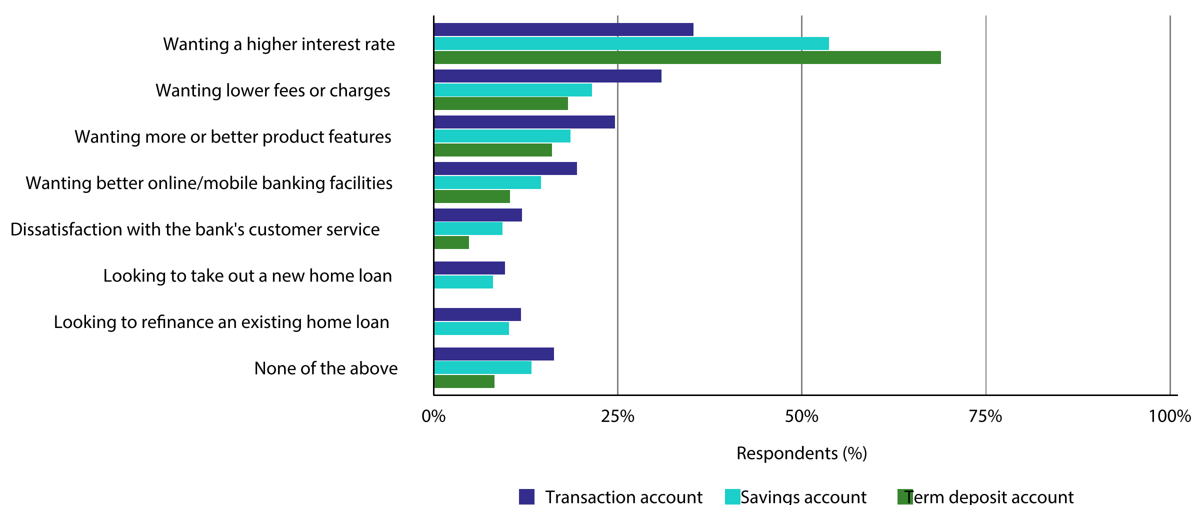
- a belief that the time and effort to change accounts is not worth it (issues associated with switching accounts are explored in chapter 9)
- a belief that all accounts are 'basically the same'
- wanting to maintain a relationship with current bank
- a preference to keep accounts with only one bank (the effect of product bundling is discussed in chapter 1).

Consumers who consider searching are mainly motivated by price

Consumers appear to focus on interest rates, fees and charges throughout the path to switching, although the priority level differs depending on the stage the consumer is at. The ACCC consumer survey found that price was a particularly prominent driver for searching for a new account, as shown in figure 8.3.

Notably, most consumers' reasons for searching for a new account are based around looking for a better or new deal on a specific product feature or based on their specific circumstances. This stands in contrast to consumers who had not searched for a new account and whose views were frequently based around generalised attitudes, preferences and biases that contributed to inertia.

Figure 8.3: Reasons consumers have searched for a new account



Note: Participants were asked "Which of the following were reasons why you were searching for a new account?".
Source: SEC Newgate, *Retail deposits research*, 22 June 2023, p 29.

Pursuit of a higher interest rate was the most prevalent factor, particularly for savings accounts (54%), and even more so for term deposits (69%), followed by wanting lower fees or charges.

Figure 7.3 (in section 7.4) highlighted a large proportion of consumers using these accounts are price sensitive as shown via the decline in deposits held in introductory accounts once the introductory period ends. Section 7.7 also demonstrated why, despite a general lowering of fees over the last decade, fees remain an important consideration for many consumers since they can heavily and disproportionately affect consumers with smaller balances.

Other drivers that respondents noted for searching included wanting more or better product features and wanting better online or mobile banking facilities. This was true across every account type but particularly for transaction accounts.[250]

As outlined in section 1.2, many transaction and savings accounts have common product features which may lead to consumers being less inclined to switch products.

With some exceptions, such as term deposits which have fixed end-dates or savings accounts with introductory rate periods, there are rarely points at which a consumer would be prompted for a decision and have cause to re-assess their product in the ordinary course of holding it. This is in contrast to other essential services, where consumers receive a monthly invoice or an annual renewal notice that are more likely to require action from the consumer.

Under the Banking Code of Practice, signatories are required to advise consumers of the applicable interest rate(s) when or before an account is opened.[251] However any subsequent interest rate changes may only be advertised in the national, or local, media, and do not need to be provided by written notice.[252] COBA's Code of Practice (whose signatories are mutual banks) only requires members to answer customer questions about interest rates in a timely manner – there is no positive obligation to advise customers of interest rate changes for deposit products beyond the information being readily available and up to date.[253]

The Banking Code of Practice does outline a process through which banks can offer a 'basic account' to those who hold government concession cards which have low-cost features such as no account keeping fees or no overdrawn fees.[254] However the code only requires this at the time an account is being opened. The ACCC imposed a condition when authorising the Banking Code of Practice in November 2019, requiring signatories to periodically, and at least once annually, take reasonable steps to identify and contact existing customers who are, or may be, eligible for a 'basic account' but do not yet have one.[255]

The ACCC considers that banks should directly inform their customers of interest rate changes and, where relevant, prompt them to consider whether alternative products may better suit their needs as set out in recommendation 5 below.

Prompts may have either a direct or indirect effect on consumer switching rates. A study commissioned by the UK's Financial Conduct Authority notes the potential effectiveness of switching prompts in influencing consumer's thinking or behaviour.[256] Though the study did not investigate the direct effects of switching prompts, it found that effective prompts can increase consumers'

250 SEC Newgate, *Retail deposits research*, 22 June 2023, p 29.

251 Australian Banking Association, Banking code of practice, ABA, 5 October 2021, pp 17-19, accessed 20 October 2023.

252 Banks are not required to tell consumers of rate changes where the interest rate is calculated according to a money market or some other external reference rate, or a rate otherwise designated as a variable or floating rate. See Australian Banking Association, Banking code of practice, ABA, 5 October 2021, p 43, accessed 20 October 2023.

253 Customer Owned Banking Association, Code of practice 2022 v2.0, COBA, October 2023, p 23, accessed 4 November 2023.

254 Australian Banking Association, Banking code of practice, ABA, 5 October 2021, pp 17-19, accessed 20 October 2023.
Under the code (paragraph 44B), "basic accounts have, at a minimum:
a) no account keeping fees;
b) free periodic statements (you can choose monthly or longer intervals);
c) no minimum deposits (except that, if your government benefit is paid into a bank account of yours, you may be required to have it paid into this account);
d) free direct debit facilities;
e) access to your choice of a debit card (such as eftpos), or a scheme debit card offered by us (such as Visa Debit or Mastercard Debit) at no extra cost; and
f) free and unlimited Australian domestic transactions".

255 ACCC, Determination – Application for authorisation lodged by the Australian Banking Association in respect of certain amendments to the 2019 Banking Code, 21 November 2019, p 27.
The ACCC also imposed a condition requiring signatory banks (through the Australian Banking Association) to report on what actions they took to make customers aware of their eligibility.

256 Accent, Personal and business current account prompt pilot findings, FCA, 20 November 2018, p 16, accessed 16 November 2023.

awareness of account features, fees and charges, for both their own accounts and others.[257] This increased informational awareness could streamline consumers' decision making processes, possibly leading to indirect effects on switching rates (noting that interest rates, fees and charges are not the only thing consumers consider when considering switching).

The Behavioural Economics Team of the Australian Government (BETA) notes that making information easily comprehensible is key in improving consumers' financial decision making.[258] With the introduction of well-researched prompts, consumers will likely be better informed about their banking products and other options available in the market. They may still choose to stay with their current account despite prompts, but would likely be more informed when making that decision.

Recommendation 5

Banks should tell consumers directly when they change interest rates, and prompt them to consider switching for a better rate

Banks should be required to directly **notify** transaction and savings account holders of changes to their interest rates, and changes to the eligibility requirements for a bonus interest rate.

As part of these notifications, the bank should **prompt** the account holder to consider whether alternative products may better suit their needs. If the bank offers other transaction or savings products (as relevant) with a higher interest rate that is not conditional or a time-limited offer, the prompt should detail how to obtain more information about those products.

The prompt should be provided to account holders at least annually (in the absence of an interest rate change).

The notification and prompt requirements should be determined following consumer testing and trials.

Banks that are signatories to the Banking Code of Practice could use these prompts to raise awareness of any Basic Accounts they have available for holders of relevant government concession cards.

8.3 Product information varies in accessibility and relevance

A consumer who makes the decision to engage in the market and search for alternatives will then need to seek out information that assists them to identify and evaluate other options. The ability to easily find relevant and reliable information is essential.

The ACCC considers that key information, while available, is not always easy to locate and is inconsistent in terms of how information is presented. The amount of information is often overly simplified, does not always disclose the impact of important terms and conditions, or is lengthy and complex.

257 Accent, Personal and business current account prompt pilot findings, FCA, 20 November 2018, p 23, accessed 16 November 2023.

258 Behavioural Economics Team of the Australian Government (BETA), Richer veins for behavioural insights, Department of the Prime Minister and Cabinet, April 2019, p 14, accessed 16 November 2023.

Consumers look for both price and non-price information

For retail deposit products, price information includes the interest rate that a consumer will receive from a bank, as well as the fees and charges the consumer will pay to the bank for holding and using their account (including any fees for overdrawing their account).

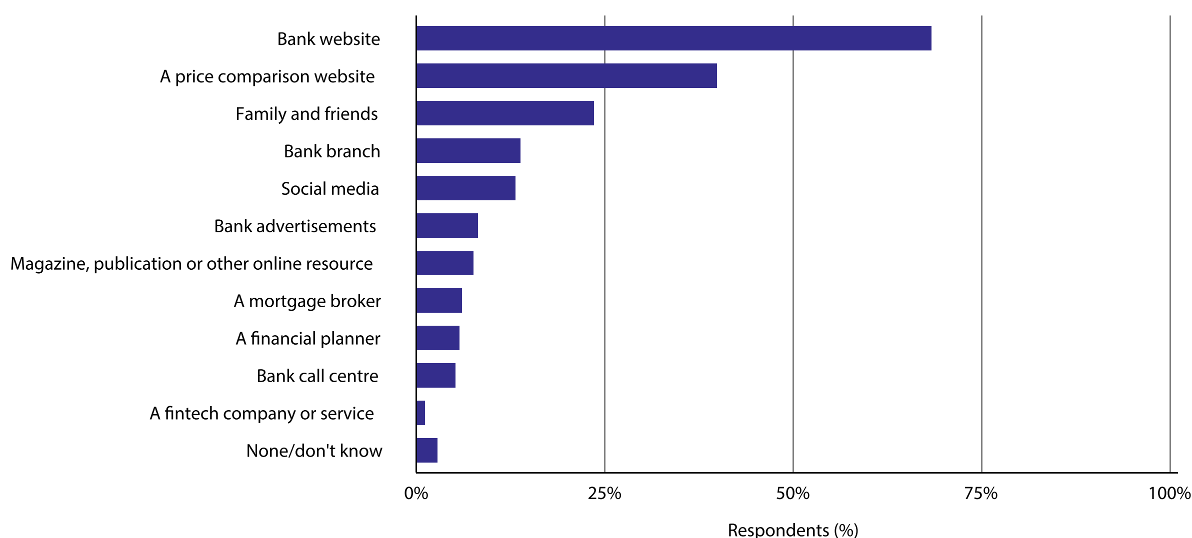
As discussed above, the ACCC consumer survey found that most consumers searching for a new account were motivated by the pursuit of a higher interest rate and lower fees or charges. However, even when price is not a primary driver of searching, it is a key factor in evaluating alternative products. For example, while 31% of respondents had searched for a new transaction account in pursuit of lower fees, 55% considered fees were the most important factor when choosing a new transaction account.[259]

Consumers use a variety of information sources

Consumers use a number of sources when assessing retail deposits. While online sources are the most common, in-person contacts, including family, friends, bank branches and call centres remain important to consumers.

Figure 8.4 shows the sources used by respondents to the ACCC consumer survey when searching for new accounts.[260] The most common were bank websites and comparison websites, which were also cited by CBA, Westpac and the ABA in their submissions to the ACCC.[261]

Figure 8.4: Information sources when searching for a new account



Note: Participants were asked "Which of the following did you use when you were searching for information on a new account?"
Source: SEC Newgate, *Retail deposits research*, 22 June 2023, p 31.

The ACCC consumer survey found that respondents aged 18–34 were more likely to have used family and friends as a trusted information source, particularly in comparison to those aged over 50.[262] While information from family and friends can be an important resource, it is not widely available to

259 SEC Newgate, *Retail deposits research*, 22 June 2023, pp 29 and 35.

260 SEC Newgate, *Retail deposits research*, 22 June 2023, p 31. Other like surveys have found a lower proportion of consumers are using the information sources compared to the ACCC's survey. However, the relative order of preference for sources was similar. See: Australian Government, National Financial Capability Strategy 2022 Financial products 'Adult survey dashboard', January 2022, accessed 9 October 2023.

261 ABA submission, 29 May 2023, p 7; CBA submission, 25 May 2023, p 13; Westpac submission, 24 May 2023, p 3.

262 SEC Newgate, *Retail deposits research*, 22 June 2023, p 31.

all, and it is not necessarily accurate or comprehensive.[263] We consider there are limitations to how useful this information may be for those who can access it, particularly to the extent that it is the main or only source of information. The 18-34 age group were also more likely to use social media as a source of information, with 20% citing it as an information source, compared to 7% for those aged over 50.[264]

Bank branches were cited by 14% of respondents as a source of information.[265] As discussed in chapter 1, there has been a substantial reduction in bank branches in cities, and regional and remote areas, which may present a barrier to consumers who rely on branches. This is likely to include older consumers and consumers who either need or prefer to have information presented to them in person, such as consumers who have "a fear of being scammed online or on the phone".[266]

Information is available but complex and inapproachable

The ACCC's consumer survey found a majority felt that it was easy to find out information about their own account (75%), about other accounts (68%), or to work out which banks to consider (62%); however the overall searching experience was not considered as easy.[267] When consumers were asked to rate the overall searching experience when they last searched for a new account, 61% of respondents rated it as 'somewhat easy' or 'very easy'.[268]

Many of the major banks submitted that information is easy for consumers to find and/or understand.[269]

The ACCC considers that when it comes to finding information needed to assess, compare and make decisions on financial products, the onus on individual consumers is unnecessarily high. There are a range of issues in how information is presented, which are discussed below, which may include information that is too complex, contained in lengthy documents, or overly simplified and missing key information.

Product information can be overly complex

Consumers may feel overwhelmed by product terms and conditions, which are typically set out in one or more large documents. Consumers also tend to have less focus on pricing terms that are not adequately outlined up front or they may not look at them at all.[270] There is no standardised way of presenting key terms and conditions to consumers, and banks have significant discretion as to how information is presented, which can make searching for relevant information harder for consumers. When offers are structured differently and their explanation uses different presentation, and language, they are more difficult to understand and compare.[271] This is discussed further below in relation to bank websites.

263 Productivity Commission, Competition in the Australian Financial System, 29 June 2018, p 630.

264 SEC Newgate, *Retail deposits research*, 22 June 2023, p 31.

265 SEC Newgate, *Retail deposits research*, 22 June 2023, p 36.

266 CHOICE, Consumer Action Law Centre, Financial Counselling Australia, Financial Rights Legal Centre, Indigenous Consumer Assistance Network, Super Consumers Australia, Uniting Communities Consumer Credit Law Centre SA and Victorian Aboriginal Legal Service, Joint consumer submission to regional banking taskforce, Treasury, 2021, pp 9–11, accessed 16 November 2023.

267 SEC Newgate, *Retail deposits research*, June 2023, p 30.

268 SEC Newgate, *Retail deposits research*, June 2023, p 30.

269 CBA submission, 25 May 2023, p 13; NAB submission, 19 May 2023, p.7; Westpac submission, 24 May 2023, p 3.

270 M Bennett, J Fingleton, A Fletcher, L Hurley and D Ruck, What does behavioural economics mean for competition policy?, *Competition Policy International*, 2010, p 117, accessed 29 September 2023.

271 M Bennett, J Fingleton, A Fletcher, L Hurley and D Ruck, What does behavioural economics mean for competition policy?, *Competition Policy International,* 2010, p 117–118, accessed 29 September 2023.

There is a significant amount of information

The amount and complexity of information consumers must understand and compare to make an informed decision can also cause cognitive overload and fatigue. This may be because of the volume and presentation of information, or because products are designed in a way that makes them inherently complex and difficult to compare, such as multiple conditions for earning bonus rates, which may differ between products and between banks. This can result in decision paralysis or making more 'instinctive' decisions which are more likely to be influenced by behavioural biases – including a preference to retain the status quo.[272]

For example, for all 4 major banks, the terms and conditions relevant to each savings account also included the terms and conditions for transaction accounts and other savings accounts. While some were more concise, they still ranged from 25 pages to 108 pages.[273] The average word count in the relevant terms and conditions document(s) for the major banks' main transaction product is 32,902 words, which would take an average consumer 2 hours and 45 minutes to read.[274] However, even if we assume that a consumer has a relatively high degree of literacy and English language proficiency, we consider it is unlikely any consumers would spend the amount of time required to read a product information document or decipher which key terms applied to their specific product.

However, efforts to simplify information need to be carefully considered, so that they do not leave consumers under-informed. For example, the way some key account information is presented on a bank's website may not contain the relevant context. Consumers may perceive the information presented as easy to find and easy to understand, however they may be missing key information to make an informed decision on the product best suited for them. For example, some consumers may only be comparing the headline interest rate and not closely considering the conditions they must meet to receive bonus interest rates, or other fees and terms and conditions.[275]

272 Deloitte, Open banking: stick or switch, Deloitte, October 2019, p 50, accessed 9 October 2023; Productivity Commission, Competition in the Australian Financial System, June 2018, pp 630–631.

273 See: ANZ's 'ANZ Saving & Transaction Products Terms and Conditions' document is 108 pages long. Page 2 of the document instructs consumers to read the document alongside the 'ANZ Personal Banking Account Fees and Charges' document, as well as referring to other terms and conditions documents consumers should read. See Australia and New Zealand Banking Group, ANZ saving & transaction products terms and conditions, ANZ, n.d., accessed 2 November 2023.
CBA's 'CommBank transaction, Savings and Investment Account Terms and Conditions' document is 25 pages long. The document also refers to other terms and conditions documents, which a consumer would need to navigate to themselves. See Commonwealth Bank of Australia, CommBank transaction, savings and investment account terms and conditions, CBA, n.d., accessed 2 November 2023.
NAB's 'Personal Transaction and Savings Products Terms and Conditions' document is 96 pages long. See National Australia Bank, Personal transaction and savings products terms and conditions, NAB, n.d., accessed 2 November 2023.
Westpac's 'Deposit Accounts for Personal Customers Terms and Conditions' document is 36 pages long. See Westpac Banking Corporation, Deposit accounts for personal customers terms and conditions, Westpac, n.d., accessed 2 November 2023.

274 Based on 200 words per minute readings of: Commonwealth Bank of Australia, CommBank transaction, savings and investment account terms and conditions', CBA, 22 September 2023, accessed 28 September 2023; Westpac Banking Corporation, Deposit accounts for personal customers: terms and conditions, Westpac, 21 July 2023, accessed 28 September 2023; National Australia Bank, Changes to personal transaction and savings products (addendum) terms and conditions, NAB, 1 November 2023, accessed 28 September 2023; Australia and New Zealand Banking Group, ANZ saving & transaction products terms and conditions, ANZ, 1 June 2023, accessed 28 September 2023.

275 The Association of Independent Retirees noted in their submission to the ACCC, comparing the headline interest rate is not always an accurate comparison. See: Association of Independent Retirees submission, May 2023, p 8.

Display of product information is not conducive to consumers' search

Some banks present information on their website in a way that does not enable consumers to easily make an informed assessment. Information should be presented in a way that is easily accessible and comprehensible for consumers when on a product landing page.

The ACCC has identified 3 key issues with how banks typically present information:

1. Banks' use of different or vague terminology.
2. Banks don't display all important information on product landing pages.
3. There is an overuse of qualifying statements, asterisks and fine print.

Differences in the way information is presented between suppliers or different definitions for the same or similar terms, may hinder a consumer's ability to accurately assess product offerings. For example, as one submission to the ACCC Inquiry identified, differences in what counts as an 'eligible transaction' or 'eligible purchase'[276], or differences or vagueness on when a bonus interest rate is applied, can be confusing and difficult for consumers to evaluate or compare as shown in table 7.1.[277]

This can then lead to consumers not fully understanding conditional interest rates and other product features before they take out a product. The second issue identified by the ACCC is that important information may not always be prominently displayed on the product landing page, requiring consumers to search through lengthy terms and condition documents to find information relevant to their decision on whether to take out a particular retail deposit product.

For example, the ACCC has found that the websites of some banks promoting a bonus interest rate account do not include their product's base rate on their product landing page (as shown in table 8.1) but many are included in terms and conditions documents. Also, some banks showed an inadequate upfront presentation of conditions to access the bonus or introductory rate which further contributes to a consumer not fully understanding how to achieve the desired rate.

As discussed below, we consider banks should ensure important information or information that would enable a consumer to have an informed view of a product, is located in an accessible way. Situations where consumers must consult multiple documents or different web pages to access terms and conditions should be avoided.

We identified that, even when banks' websites do include key information on product landing pages, it is often difficult to find as it is located in footnotes, expandable tabs, or in considerably smaller font. If it is upfront, it is typically qualified by disclaimers which exist on less noticeable parts of the webpage.

We consider that banks should avoid situations where consumers may have to scroll significantly or search to find further important information or qualifying information.

276 The consumer submission noted the following examples:
Bank of Queensland's 'Future Saver' account notes that eligible transactions include: 'direct debit payments, ATM withdrawals, BPAY payments or purchases with your Visa Debit Card.' See Bank of Queensland, Future saver, BoQ, n.d., accessed 13 November 2023.
ING's 'Savings Maximiser' account notes that eligible transactions exclude: 'ATM withdrawals, balance enquiries, cash advances, BPAY transactions, Direct Debits using an account number, EFTPOS cash out only transactions and any transaction that does not use a card number'. See ING, How do I get ING's highest savings maximiser variable rate?, ING, n.d., accessed 2 November 2023.
Westpac's 'Spend'n'Save' bonus interest criteria notes that eligible purchases exclude: 'ATM transactions, PayID, BPAY, EFTPOS cash out only transactions, direct debits and paying off your credit card account.' Westpac Banking Corporation, What counts as an eligible purchase, Westpac, n.d., accessed 2 November 2023.

277 Submission Provider K and Submission Provider L submission, 14 July 2023, p 5.

Table 8.1: Upfront presentation of savings account information

	Total headline interest rate	Base interest rate	Bonus interest rates	Introductory Interest rate	Introductory interest period	Complete introductory/ bonus rate conditions	Cost of account keeping fees
CBA	✓	✓	N/A	✓	✓	N/A	✓
ANZ	✓	✓	✓	N/A	N/A	✓	✓
NAB	✓	✓	✓	N/A	N/A	✓	✓
Westpac	✓	✓	✓	✓	✓	✗	✓
Macquarie	✓	✓	N/A	✓	✓	✓	✓
Bendigo	✓	✗	✗	N/A	N/A	✓	✓
BOQ	✓	✗	✗	N/A	N/A	✗	✓
Suncorp	✓	✓	✓	N/A	N/A	✓	✓
ING	✓	✓	✓	N/A	N/A	✗	✓
HSBC	✓	✓	✓	N/A	N/A	✓	✓
Great Southern	✓	✓	✓	N/A	N/A	✗	✓
Newcastle Permanent	✓	✓	N/A	✓	✓	✓	✓
TMBL	✓	✓	✓	N/A	N/A	✓	✓
Heritage	✓	✓	✓	N/A	N/A	✓	✓

Note: The assessment in this table is based on whether the information described is contained upfront and clearly noticeable to a consumer on the landing page for each of the bank's respective products. This means if all, or a part of the information, that the ACCC considers relevant is contained in fine print, expandable tabs, separate terms and conditions documents, links to separate webpages or if the information is not included at all, the bank will be marked as an 'X'. The ACCC chose a single savings account currently offered by each bank as of 9 November 2023.[278]

Accessible and understandable information is critical for all consumers

The ACCC's consumer survey sought to measure consumers' ability to calculate and understand interest rates and inflation.[279] It included a multiple-choice question asking consumers to calculate

278 CBA NetBank Saver https://www.commbank.com.au/banking/netbank-saver.html?ei=prod_NBsaver, 7 November 2023; ANZ Progress Saver account | ANZ, accessed 7 November 2023; NAB NAB Reward Saver | Bonus interest rate savings account - NAB, accessed 7 November 2023; Westpac Online Savings Account: With Intro Fixed Rate - eSaver | Westpac, accessed 8 November 2023; Macquarie Savings account | Macquarie. Accessed 9 November 2023; Bendigo High interest savings account - Reward Saver | Bendigo Bank, accessed 9 November 2023; BOQ Smart Saver | High-interest savings account | BOQ, accessed 9 November 2023; Suncorp, Growth Saver Account for Long Term Saving | Suncorp Bank; ING Savings Maximiser – High Interest Savings Account | ING, 10 November 2023; HSBC Online Savings Account | No Monthly Account Fees - HSBC AU, accessed 10 November 2023; GSB Advantage Saver Savings Account | Great Southern Bank, accessed 10 November 2023; Newcastle Permanent Online Savings Account | Newcastle Permanent, accessed 10 November 2023; TMBL Target Saver account | Teachers Mutual Bank (tmbank.com.au), accessed 10 November 2023; Heritage Online Saver | High Interest Savings Account | Heritage Bank, accessed 20 November 2023.

279 The survey asked the following questions:
1) Suppose you put $100 into a no-fee savings account with a guaranteed interest rate of 2% per year. You don't make any further payments into this account, and you don't withdraw any money. How much would be in the account at the end of the first year once the interest payment is made?
2) Suppose that by the year 2024 your post-tax income has doubled, but the prices of all of the things you buy have also doubled. In 2024, will you be able to buy more than today, exactly the same as today, or less than today with your income?
SEC Newgate, *Retail deposits research*, 22 June 2023, pp 57–58.

the balance of an account assuming a specified interest rate and no withdrawals or credits to the account:

> Suppose you put $100 into a no-fee savings account with a guaranteed interest rate of 2% per year. You don't make any further payments into this account, and you don't withdraw any money. How much would be in the account at the end of the first year once the interest payment is made?[280]

Only 84% of respondents selected the correct response, with no single age, personal income, or educational demographic group scoring over 91%.[281] This is consistent with the view that a substantial number of consumers can find it difficult to make calculations based on interest rates.

The ACCC's recommendation for better introductory interest rate information (in section 7.4) is designed in part to facilitate consumer decision making by requiring banks to do certain calculations for consumers.

The ACCC acknowledges that financial capability is complex and involves a much broader range of factors than those relevant to our survey questions. There are a number of organisations working to better understand and address key issues, including as part of the National Financial Capability Strategy.[282]

The ACCC considers that it is appropriate to focus on the quality and accessibility of information presented to consumers. Given the issues discussed above, it is likely that search costs currently present a barrier to a broad range of consumers with varying levels of financial capability.

8.4 It is not easy to objectively compare alternatives

Based on responses to the ACCC consumer survey, bank websites and comparison websites are the 2 main information sources used by consumers when searching for a new account (as shown in figure 8.4). These have been cited by both consumers and banks as enabling consumers to compare products.[283] The Consumer Data Right (CDR) also offers the means to facilitate comparisons, however as discussed in 9.3, is not yet fulfilling this role for a meaningful number of consumers. Information obtained through a bank branch, call centre or bank advertising will be limited to that bank's products.

The ACCC considers that the ease of comparing products is easily overstated, or that difficulties are minimised or overlooked. The ABA stated that consumers are 'able to easily access price comparisons via a range of websites' and both CBA and Westpac submitted that consumers were able to compare products through product information available on their respective bank websites, as well as by using comparison websites.[284] ANZ noted the potential for CDR to make it easier for consumers to compare products.[285]

The ACCC has examined how consumers might use bank websites and comparison websites to compare products. We have found that while both sources may assist consumers in making a decision, it is unlikely that they assist consumers in reaching a fully informed decision on the best product for them.

280 SEC Newgate, *Retail deposits research*, 22 June 2023, p 57.

281 SEC Newgate, *Retail deposits research*, 22 June 2023, p 57.

282 Australian Government, National financial capability strategy, February 2022.

283 ABA submission, 29 May 2023, p 7; CBA submission, 25 May 2023, p 13; Westpac submission, 24 May 2023, p 3; Submission Provider K and Submission Provider L submission, 14 July 2023, p 4.

284 ABA submission, 29 May 2023, p 7; CBA submission, 25 May 2023, p 13; Westpac submission, 24 May 2023, p 3.

285 ANZ submission, 9 June 2023, p 2.

Information obtained through commercial comparison websites, financial planners, mortgage brokers, fintechs and some social media may enable comparison between a broader range of banks. However, selection and/or presentation of banks and products are likely to be influenced by remuneration and other commercial arrangements.

Bank websites present information in different ways

As figure 8.4 shows, bank websites are survey respondent's most commonly used information source (68%). Using bank websites may assist consumers to compare alternative products within the bank. For example, some banks have a comparison tool outlining different product types.[286] However, it can be difficult for consumers to compare across suppliers having to visit several bank websites to access all this information. For the most part, banks are not required to provide standardised information for retail deposit products. Product information is generally found either on the webpage for that particular product, or type of product and/or in a separate terms and conditions document.

Banks are typically subject to voluntary industry codes which include broad principles for how information should be presented (see 9.3 for discussion on the effectiveness). However, the ACCC has observed that while the information is available, it often exhibits a number of characteristics discussed above in 8.3, which may limit its usefulness to consumers for comparisons across suppliers.

Comparison websites are an important tool for consolidating information but do not display all products or some key information

Westpac, CBA and the ABA all submitted that consumers are aided in their search for information through comparison websites.[287] Comparison websites were the second most common information source nominated by consumers in response to the ACCC consumer survey (40%).[288]

Comparison websites may make it easier for people to shop around by providing certain information (both price and non-price) which may reduce the complexity of making a comparison.[289] They can enable consumers to view multiple products from multiple providers in one central location, which may show consumers products or providers they were previously not considering or were not aware of.[290] However, as discussed below, they have several limitations which may impact their effectiveness as well as consumer trust and usage.

Comparison websites including Canstar, Finder, Rate City, Mozo, and Savings.com enable consumers to compare retail deposit products. These sites generally offer comparisons on transaction accounts, savings accounts and term deposits.

The key information consumers can compare for savings accounts and term deposits is the interest rate (including the base interest rate and any bonus or introductory interest rates), while for transaction accounts they generally show fees and payment options.[291] Some websites also include information on whether the product needs to be linked to another account, eligibility criteria,

286 For example: Westpac Banking Corporation, 'Compare Savings Accounts & Term Deposits', Westpac website, n.d., accessed 28 September 2023.

287 Westpac submission, 24 May 2023, p 3; CBA submission, 25 May 2023, p 13; ABA submission, 29 May 2023, p 7.

288 SEC Newgate, *Retail deposits research*, 22 June 2023, p 31.

289 Comparison websites can vary in design and functionality. The terminology of what exactly a comparison website does can vary across industry. For the purposes of this report, comparison websites encompass all comparators and aggregators of product information offered by banks. For further information, see Australian Competition and Consumer Commission (ACCC), The comparator website industry in Australia, ACCC, 28 November 2014, accessed 2 November 2023.

290 Australian Competition and Consumer Commission (ACCC), The comparator website industry in Australia, ACCC, 28 November 2014, p 15, accessed 2 November 2023.

291 Based on an ACCC review of the Canstar, Finder, Rate City, Mozo and Savings.com websites.

bonus interest rate requirements and minimum and maximum deposit amounts. Some websites also include a product rating, although the product ratings are determined by the website and are sometimes based on opaque and difficult to measure criteria.

While comparison websites collate this type of headline product information, some of it may be over simplified. Comparison websites may not be able to provide all information consumers require, including key terms and conditions that may affect fees or charges, mobile/online banking features, or product bundling deals. Consumers may perceive the information presented on comparison websites as easy to find and easy to understand, however it may not be clear that key information is not provided.

Further, a comparison website's methodology for searching and the ranking of search results is not always transparent and may be dependent on that website's business model and any commercial arrangements it may have in place with banks. For instance, while some comparison websites gain revenue from advertising, others operate as sales channels to promote and/or sell products and have remuneration arrangements with particular businesses.[292]

Concerns have been raised by some consumers that comparison websites don't reflect all the deposit products available.[293] Imperium Markets (an investment intermediary for deposits and bonds) shared this sentiment, also noting that broking businesses can only show consumer products of banks they are affiliated with, and may not be obligated to disclose commissions.[294] Some consumers are also concerned that comparison websites may not be objective or independent when displaying product offerings.[295]

Comparison websites can enter commercial relationships with banks. When partnered, comparison websites generally provide a direct link from their search results to the product page on a bank's website.

The ACCC has found that many banks have remuneration arrangements with one or more of Canstar, Finder, Rate City, Mozo and Savings.com, as well as some others. Comparison websites can act as a sales channel and may charge on a 'cost-per-click' basis, regardless of whether a consumer ends up opening an account. Based on the data supplied to the ACCC, comparison websites can be paid an average of around $10 per click.

Products that are 'sponsored' are generally paying a higher cost per click amount in return for 'top' positioning in search results. In some cases, banks may pay a much more significant charge when a customer does follow through from a comparison website, to open an account; this charge can range from approximately $150–400 per acquisition depending on comparison website and bank.

The commercial arrangements in place between banks and comparison websites necessarily affect the scope and manner in which results are presented to consumers. We consider a bank would be unlikely to enter into such arrangements if it did not change the way a comparison website operates.

The impact this can have on a consumer's search is explored in an exercise outlined in box 8.1 below.

292 ACCC, The comparator website industry in Australia, p 8.

293 Submission Provider K and Submission Provider L submission, ACCC, 14 July 2023.

294 Imperium Markets submission, ACCC, 14 July 2023, p 4.

295 Submission Provider K and Submission Provider L submission, ACCC, 14 July 2023, p 5, accessed 2 November 2023; Association of Independent Retirees submission, ACCC, 14 July 2023, p 8, accessed 2 November 2023.

Box 8.1: Using comparison websites can lead to inconsistent results

Some consumers use comparison websites to help them find high interest rate savings accounts. However, there can be significant differences in the range of products presented on these websites and how they are presented.

The websites we considered, and the number of results they showed, are:

- Finder (7)
- RateCity (300)
- Canstar (130)
- Mozo (207)
- Savings.com (60).

While the top results typically show a combination of major banks, mid-tiers and mutuals, the default rankings applied by each website can be inconsistent. It may not always be clear to consumers if any of the results presented on the websites are advertisements, if there is a commercial arrangement in place where these products are being sponsored in some way, or if the website is highlighting particular products based on their suitability for the consumer.

In some cases, a consumer can click through to see a larger number of products than initially presented. For example, while the initial Mozo webpage only listed 8 promoted products, a consumer can click through to see a broader range of 207.

The outcome for a consumer can differ depending on which comparison website they use and how they decide on a product: whether they use the website's default ranking or choose another way to sort and rank products. Results will also vary from day to day as the products that are sponsored and shown to them may change frequently.

Table 8.2 outlines the results of an exercise where 2 hypothetical consumers – Jonathan and Shatha – both have $5,000 dollars and are each looking for a savings account. Both Jonathan and Shatha are most interested in maximising their returns. They are searching for an account which has the highest headline interest rate, and assume they will fulfill any eligibility criteria such as age and minimum monthly deposit amounts.

Jonathon relies on the default rankings which are provided by the comparison websites and chooses the top product listed.

Jonathon selects the highest interest rate product, an introductory rate product that will net $238 in interest over a 12-month period.

Shatha re-ranks the results by highest headline interest rate and ignores products marked as featured or promoted. Shatha selects the highest interest rate product, a bonus rate product at 5.65% that will net $290 in interest over a 12-month period.

In this example, despite using the same websites reporting hundreds of products, Jonathan would receive 18% less in interest on his savings than Shatha. Even if Jonathon opted for the highest-ranked non-sponsored result, he still would have been worse off by using the default ranking.

Table 8.2: Consumers differing experience using comparison websites and their rankings

		Canstar	Mozo	Savings.com	RateCity	Finder
Jonathon – uses website's default ranking	Headline interest rate	5.40%^	5.40%^	5.60%^	5.00%*	5.20%*
	Total interest after 12 months	$245	$245	$238	$256	$266
Shatha – uses highest headline interest rate ranking	Headline interest rate	5.65%*	5.65%*	5.65%*	5.60%^	5.50%*
	Total interest after 12 months	$290	$290	$290	$238	$282

Note: This table is based on an exercise carried out by the ACCC on Finder, RateCity, Canstar, Mozo and Savings.com on 16 October 2023. If details were needed to use the comparison website, the exercise was based on a consumer who was comparing savings accounts, had $5,000, lived in Victoria and was over 18 years of age.
The total interest after 12 months will be impacted by the type of product and the length of bonus or introductory rates. For example, the product with a 5.6% headline interest rate was an introductory rate which reverted down to 4.2% after 4 months, thus had a lower Total interest after 12 months. Bonus rate products and introductory rate products are identified in the table using the following:
* = Bonus rate product
^ = Introductory rate product

The examples shown in box 8.1 illustrate the disparity between consumers using different comparison websites, especially if a consumer only relies on one comparison website and does not sort or analyse the products themselves. When consumers choose a sponsored or promoted product, it can lead to mixed consumer outcomes ultimately depending on which bank and product is sponsored at that time.

Comparison websites should be clear on which banks they are including in their search, the existence of commercial arrangements with them, and which banks are not being considered.[296] While the simple disclosure of these potential conflicts does not remove the conflict, it will enable consumers to make a more informed decision about which comparison website (if any) they should use.

Recommendation 6

Comparison websites should be more transparent about any commercial arrangements they have with banks

Comparison websites should clearly and prominently display:

- the number and names of the banks they include in their searches
- which of these banks they receive payments from and on what basis (for example, if payment is made per-click or only if an account is opened)
- an explanation of how any product ratings are determined, including what (if any) role the comparison website's commercial arrangements with a bank affect the ratings of that bank's products.

296 The ACCC considered the role of comparison websites in relation to home, contents and strata insurance, as part of its Northern Australia Insurance Inquiry, and recommended that comparison websites (and insurance brokers) be required to have clearer disclosure of the products they consider and their remuneration arrangements. ACCC, Northern Australia Insurance Inquiry – final report, November 2020, pp 486–487.

9. Consumer switching

Findings

- Relatively few consumers switch deposit products, despite there often being a range of alternative products offering better interest rates and conditions.
- There are significant impediments to switching which take time and effort to overcome, and which occur at several points in the process. These include changing direct debits and other recurring payments, redirecting incoming payments and proving identity.
- There have been a number of initiatives to date that have so far been ineffective at addressing both barriers to switching, and barriers in consumer engagement more generally.
- Measures that could reduce or remove these barriers have the potential to facilitate more widespread competition between banks and enhance consumer outcomes in the retail deposits market.

This chapter details the switching process, barriers consumers face and various Australian and international initiatives to facilitate switching. Retail deposit products are often described as 'sticky' which translates to low rates of consumers switching products.[297] Within retail deposits, some product types are stickier than others. For example, consumers are less likely to switch their transaction account than term deposit customers.[298] Similarly, consumers holding the same retail deposit product will also vary on their likelihood of switching.

As discussed in chapter 3, banks are aware of customers' stickiness and develop strategies to increase it, particularly targeting higher value customers and focusing on growing their MFI base. The use of targeted and negotiated pricing reduces reliance on universal pricing initiatives that could trigger intense price competition, and instead enable banks to compete on acquiring and retaining customers at the lowest cost. Bank measures designed to increase customer loyalty can have the effect of reducing the number of consumers who shop around and/or switch to an account which may provide them more benefit.

A bank's incentive to minimise their retail deposit funding costs through lower interest rates is, in part, constrained by the extent to which consumers can actively switch between products and banks.

The ACCC considers that, despite advances in switching processes, particularly as facilitated by technology, there are several points in the switching process which remain as significant challenges and further action should be considered to lower the time and effort it takes to switch products.

297 Productivity Commission, Competition in the Australian Financial System, 29 June 2018, p 149.

298 The ACCC consumer survey found that 81% of respondents with transaction accounts had not changed their main account compared to 75% of respondents with savings accounts and 64% of respondents with term deposit accounts. See SEC Newgate, *Retail deposits research*, 22 June 2023, p 38.

9.1 Few consumers switch deposit products

As discussed in chapter 3, it is the threat of customer switching which can incentivise banks to compete more vigorously. Accordingly, there is no set level of switching that can be considered optimal for competition. Nevertheless, observations around trends in switching can be a useful indicator.

The ACCC consumer survey found that a low proportion of consumers had switched their main transaction account (11%) or main savings account (16%) to a different bank within the last 3 years. 14% of survey respondents with a term deposit switched on maturity to a different bank. Similarly, bank data considered by the Inquiry indicates that approximately 90–94% of term deposits are rolled over.[299]

The ACCC consumer survey also found that around half of the consumers who search for a new transaction or savings account did not go on to switch.

Analysis of switching is complex for retail deposit products, as products may be partially substituted. For example, a consumer may 'switch' by transferring some or all of their funds to a different retail deposit product within their current bank (internal switching) or between banks. Further, there is often no cost to consumers for keeping a transaction or savings account open, meaning that consumers frequently don't close accounts they have switched away from. The ACCC consumer survey found that 68% of transaction account holders and 73% of savings account holders who switched their main account to another bank did not close the account they had switched away from.[300]

While switching rates can be generally described as relatively low, there are certain consumer groups who are more likely to switch transaction and savings accounts. In particular:

- younger consumers (18 to 29 year olds) compared to consumers aged over 50
- consumers with higher account balance ($100,000–$249,999) compared to consumers with less than $100,000 in their account
- consumers with an offset account compared to consumers without this feature.[301]

Low rates of switching could indicate that many consumers are holding products that are not in their best interests, and not delivering good outcomes for them. As noted in chapter 7, on average 71% of eligible accounts did not receive bonus interest each month over the first half of June 2023, indicating that many consumers are missing out on the full benefits their account could provide. Coupled with low switching rates, many consumers are likely to be disadvantaged by continuing to hold their funds in the same account. These consumers would likely benefit from switching to an account in which they could regularly meet the bonus rate conditions, or has a higher (unconditional) base interest rate.

Chapter 7 also notes that consumers who hold funds in accounts with introductory bonus rate offers and are not offered, or not able to negotiate a better interest rate once the introductory period ends may be worse off over time. Once the introductory offer period ends and these consumers roll onto the base interest rate, they would likely benefit more if they switched to other savings products available in the market.

299 Based on all term deposits (of any duration) that reached maturity during January 2022 and reported to the ACCC.

300 SEC Newgate, *Retail deposits research*, 22 June 2023, p 39.

301 SEC Newgate, *Retail deposits research*, 22 June 2023, p 38.

9.2 Switching deposit products can be difficult and time consuming

Consumers consider that switching accounts can be difficult. Many consumers consider the time and effort to switch accounts is not worth it and perceive certain steps in the switching process to be more difficult than others. For example, the ACCC consumer survey found that consumers find changing direct debits and redirecting incoming payments (such as wages or salary) more difficult than proving their identity.[302]

However, banks often contend that the switching process is easy. For example, CBA submitted that 'customers are able to easily open new deposit accounts and transfer their funds to an alternative deposit product, both within CBA and between ADIs'.[303] NAB submitted that 'retail deposit products are one of the easiest and quickest banking products to acquire. Customers can set up an account within minutes and move their money between accounts rapidly, if not instantly'.[304]

Switching accounts generally involves the following functional steps, following the search and selection steps set out in chapter 8:

1. Opening the new account.
2. Transferring direct debits, direct credits and other payments.
3. Transferring funds and, if desired, closing the old account.[305]

Opening an account

Opening an account has become a significantly easier process in recent years, particularly for those who are able to complete the process online.

The account opening process varies depending on the bank, the type of account being opened, and the specific customer. Although there is a trend towards enabling accounts to be opened online, there remain circumstances in which consumers are required to open an account in person at a branch or on the phone (for example, this is often the case with joint accounts).

The ACCC considers that the points of friction in the account opening process tend to centre around needing to provide documentation for verifying identification and demonstrating that eligibility criteria for a particular account are met.

Identification requirements

These may differ depending on the circumstances, such as the age or nationality of the consumer. In some circumstances, a consumer may be able to provide sufficient forms of identification and other requirements such as proof of address online or via an app.

Identification requirements are mandatory and part of satisfying a bank's 'know your customer' obligations under the *Anti-Money Laundering and Counter Terrorism Financing Act 2006*. They also may assist in prevention of scams and fraud. The Government is currently undertaking work to

302 SEC Newgate, *Retail deposits research*, 22 June 2023, p 41.

303 CBA submission, 25 May 2023, p 14.

304 NAB submission, 19 May 2023, p 7.

305 A range of online resources provide information on switching accounts and generally include these general steps. See, for example: A Kollmorgen, 'How to switch bank accounts', *CHOICE*, 31 March 2017, accessed 9 October 2023; A Duncan, How to change banks, *Canstar*, 13 July 2023, accessed 9 October 2023; L Wong, Switching banks is less painful than you think, *ABC*, 31 January 2020, accessed 9 October 2023; E Duffy, How to change banks, *Savings.com.au*, 11 May 2022, accessed 9 October 2023; M Gil, How to change bank accounts in 4 easy steps, *Mozo*, 22 June 2022, accessed 9 October 2023.

develop reforms to the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* which could simplify how consumers interact with the identity process in the future.[306]

Identification requirements can be a barrier for consumers generally, but particularly those required to attend in person. They can also be a barrier for consumers who do not have access to standard identification documents, however AUSTRAC provides guidance to assist banks develop and use alternative processes to help these consumers while meeting their legislative obligations.[307]

The Government is seeking to implement a voluntary national Digital ID system that allows consumers to verify who they are online, against existing government-held identity documents without having to hand over any physical copies. This program, once rolled out, may reduce the effort in meeting identification requirements for some consumers.[308]

Eligibility requirements

Eligibility requirements may vary depending on the type of bank, product or consumer. Generally, customers need to provide documents to prove they meet the essential requirements for a particular product, such as student status or age. There may also be specific bank requirements such as becoming a member for customer-owned banks.

Switching payments

Consumers and consumer representatives have highlighted challenges with switching direct debits and recurring payments, including needing to contact each service provider to provide updated details, and the possible frustration or embarrassment if a payment is missed because a direct debit was not changed.[309] Table 9.1 gives an overview of the processes outlined by banks which may need to be undertaken to switch.[310]

306 Attorney-General's Department, Modernising Australia's anti-money laundering and counter-terrorism financing regime, Attorney-General's Department, n.d., accessed 17 October 2023.

307 AUSTRAC (Australian Transaction Reports and Analysis Centre), Assisting customers who don't have standard forms of identification, AUSTRAC, 29 June 2023, accessed October 2023.

308 Senator the Hon Katy Gallagher, Digital ID and AI insights: How the Albanese Government is leading the digital evolution, Department of the Prime Minster and Cabinet, 19 September 2023, accessed October 2023.

309 CHOICE submission, ACCC, 14 July 2023, p 10; Ben Koh submission, ACCC, 14 July 2023, p 3.

310 This table is a basic overview as banks use a variety of terms and descriptions for these processes and may not fully align with each banks descriptions of these payments.

Table 9.1: Processes for switching payments

Type of payment	Switching process
Direct debits A direct debit is an automatic payment a consumer authorises to be taken from their deposit account using a BSB and account number.	Consumers can either: - manually identify all direct debit arrangements or request the bank provide a list of arrangements for the previous 13 months,[311] and then contact each service provider (for example, by letter, phone or online) asking them to directly debit the payment from the consumer's new account, or - complete a form that provides authority to the new bank to transfer direct debits identified by the consumer to the new account.[312] This process is set out in the voluntary ePayments code, and appears not to be well known or used by consumers as discussed below in section 9.3. In particular, the forms are frequently difficult to locate on a bank's website, and require a consumer to print out statements, highlight which debits should be switched or cancelled, and return the form to the bank via email, mail or in branch.[313] There may also be over a 2 week wait for debits to be transferred.[314] PayTo is a digital alternative to direct debits, which allows customers to set up, through their bank's app or online banking, payment agreements with service providers or merchants that offer PayTo as a payment option, taking money directly from their bank account. Consumers will be able to authorise, view, pause and cancel their PayTo agreements (such as gym membership and energy bills) in their banking app.[315] A PayID (described below) can also be used to set up a PayTo agreement.[316] PayTo and PayID are progressively being rolled out and, if widely used, may reduce the administrative hurdle of transferring direct debits to a new account, however at this stage it does not appear possible to transfer PayTo arrangements between banks.
Recurring payments A recurring payment generally refers to a payment a consumer authorises to be charged to their debit or credit card.	Consumers must contact each merchant they have arrangements with, and provide their new credit or debit card details. The ACCC is not aware of a process for a bank to transfer or facilitate recurring payments. However, the ePayments code and the ABA Banking Code of Practice provides for consumers to request their new bank provide them with information that helps them identify their own scheme debit card or scheme credit card arrangements (see section 9.3).[317] While recurring credit card payments are not directly relevant to retail deposit products, many consumers looking to switch their transaction or savings accounts will also want to switch to a credit card issued by their new bank.

311 The ePayments code provides an obligation for banks to provide this information. See Australian Securities and Investments Commission (ASIC), ePayments Code, ASIC, 2 June 2022, pp 34–35, accessed October 2023.

312 ASIC, ePayments Code, ASIC, 2 June 2022, pp 33–35, accessed October 2023.

313 For example, see Commonwealth Bank of Australia, Notice of variation of account form, CBA, n.d., accessed 2 November 2023.

314 Commonwealth Bank of Australia, Notice of variation of Account form, p 2.

315 PayTo, '*For consumers*', accessed 9 October 2023; PayTo, FAQs - Why should I use PayTo?, accessed 17 October 2023

316 PayTo, '*For consumers*', accessed 9 October 2023; PayTo, FAQs - Why should I use PayTo?, accessed 17 October 2023.

317 ASIC, ePayments Code, p 34; Australian Banking Association, Banking code of practice, *ABA, 5 October* 2021, p 28, accessed 20 October 2023.

Scheduled payments	
Scheduled payments Scheduled payments allow consumers to initiate an automatic transfer of money to occur on a specific date at a chosen amount (either to one of their own accounts, or to someone else's Australian account (often known as 'pay anyone)'. Scheduled transfers may be a one-off payment or recurring.	It appears that a consumer switching their main account may be required to delete scheduled payments from their old bank and set it up again at the new bank. The process to set up scheduled payments differs between banks, but generally requires the consumer to enter the details of the payee, the amount to be transferred, the payment frequency, and end date (if applicable).[318]
Direct credits Direct credits may include salary payments, or government payments that a third party pays directly into a bank account.	Like direct debits, consumers can either ▪ manually identify all direct credits and contact payors to provide new payment details. Some banks provide forms that can be used to notify employers of new payment details, however employers might have their own forms and processes[319], or ▪ complete a form that provides authority to the new bank to transfer direct credits identified by the consumer to the new account.[320] PayID is another payment tool which allows consumers to register a mobile number, email address or other organisation identifier to receive payments instead of sharing BSB account details.[321] A PayID can only be linked to one account at a time, but multiple PayIDs can be created using different methods to facilitate receiving payments to different banks.[322] Where a consumer has established a PayID with their bank, and direct credits are made to that PayID, they may transfer their PayID to a new account at a different bank.

There are a range of associated processes that a consumer might undertake as part of switching their payment arrangements, which must be completed manually. These include transferring the consumer's payee address book, BPay biller details, adding new account or card details to linked payment systems such as digital wallets or PayPal, and transferring their PayID to their new account. Most notably, switching some types of payments still requires consumers to coordinate directly with merchants or individuals, and is an ongoing issue consumers face as a barrier to switching.

These processes can take significant time and effort, and payments may be missed, or incorrectly entered and subsequently misdirected, potentially causing a significant burden on consumers' lives. These risks can impact a consumer's decision to switch as evidenced by a small proportion of respondents to the ACCC consumer survey who raised something going wrong when switching as a reason for why they have not switched.[323]

318 For example, see Macquarie, Managing your scheduled payments, Macquarie website, n.d., accessed 16 November 2023.

319 For example, see Commonwealth Bank of Australia, Switch your payments, CBA website, n.d., accessed 6 November 2023.

320 ASIC, ePayments Code, pp 32–33.

321 PayID, PayID - How it works, PayID, n.d., accessed 16 November 2023.

322 PayID, PayID - How it works, PayID, n.d., accessed 16 November 2023.

323 SEC Newgate, *Retail deposits research*, 22 June 2023, p 44.

Closing accounts

Difficulties consumers face in closing accounts may be a barrier to switching, especially where there is also a cost associated with keeping the former account open. Factors that prevent or delay a consumer closing an account can include:

- the channels available to close accounts (such as needing to attend a branch)
- accounts ineligible for closure (for reasons such as outstanding pending payments, accounts in overdraft, accounts held jointly, unpaid accrued interest)
- where accounts are linked[324]
- funds transfer (consumers will generally transfer funds to their new account before closing the existing one).

However, for accounts that do not impose any costs on consumers to remain open (such as some transaction and savings accounts), it is unlikely to be a barrier to switch. Consumers may instead keep the account open and dormant. The ACCC has found that approximately 24% of all savings accounts and 12% of transaction accounts can be considered dormant.[325]

9.3 Initiatives have been introduced to facilitate switching

A number of initiatives to reduce barriers have been introduced, both in Australia and internationally, to help various stages of searching and switching, including:

- access to transparent and understandable information
- promoting shopping around and making comparisons, and
- facilitating the switching process.[326]

Initiatives are generally aimed at reducing friction for consumers who are actively willing to shop around and prepared to consider switching. Changes that make the switching process easier will, over time, help shift persistent consumer attitudes that inhibit initial engagement.

Improving the actionable information available to consumers

Initiatives targeting information aim to address consumer understanding and awareness of both their supplier's products and competitors' products.

These initiatives should contribute to better consumer decision-making and encourage more consumers to shop around and potentially switch. However, there is a tension between providing enough information, and presenting information clearly and succinctly to prevent information overload. Information initiatives should be aimed at striking the right balance, with clear regard to how consumers behave, and should be easy to find, when needed.

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324 For savings accounts that require a transaction account to be linked, where the transaction account is being closed, the savings account must also be closed, if the customer does not have another transaction account held with the same bank to which the savings account can be linked. See, for example, Commonwealth Bank of Australia, CommBank transaction, savings and investment account terms and conditions, CBA, n.d., accessed 16 November 2023.

325 Based on data supplied to the ACCC by 11 banks in relation to their savings and transaction accounts. For the purposes of our inquiry, we considered an account dormant if it held less than $100 and has been inactive for 6 months (apart from fees, charges and interest payments).

326 For further discussion on the effectiveness of initiatives to enable consumer pressures on competition highlighted in this section, see A Fletcher, The role of demand-side remedies in driving effective competition: a review for which? , Centre for Competition Policy, 7 November 2016, accessed 2 November 2023.

Making it easier to compare products

Shopping around initiatives generally involve reducing the search and time costs put on consumers to undertake comparisons and ensuring any third-party services are reliable and transparent. This can encourage inactive consumers to engage in the market which can lead to a switch, or a threat to switch. Examples of shopping around initiatives include comparison services and websites which can collate and disseminate key information on behalf of a consumer.

Reducing barriers to switching

Switching initiatives help consumers overcome barriers in opening an account, switching payment arrangements, transferring funds, and closing accounts. This facilitates a quicker and easier move to another product, particularly with a new bank, but can also improve consumer engagement over time. Barriers to switching are well known by consumers, which can contribute to inertia at every stage. Removing or reducing some of these barriers may assist in better balancing the time cost and effort of switching against the reward of a product which better suits consumer needs.

Australian initiatives

Disclosure requirements for banks

There have been policy initiatives developed over time by both government and industry which have aimed to improve availability of information to consumers. These initiatives have typically focused on what banks are required to disclose. Given the proliferation of complex financial service products, it is perhaps unsurprising that disclosure obligations and guidance are not always fit for purpose.

There is also a tension between wanting to ensure consumers have all the information they need to make an informed decision, and the need to ensure that information is clear and concise enough that consumers can, and do, read and understand the information before them. For example, product disclosure statements (PDS) were introduced in 2001 to assist consumers understand products at the point of sale, as well as provide certain ongoing disclosure about changes.

However, there is a complex regime of exclusions from PDS requirements, including for basic banking products in some circumstances. Basic deposit products were exempted in 2005 to streamline written disclosure and reduce the compliance burden on industry.[327]

Banks have certain disclosure obligations under the voluntary ePayments code which require the publication of terms and conditions.[328] However, we consider this is of limited practical effect. Not only does information remain difficult to understand in many cases, but there are limited mechanisms to ensure compliance. Consumers who are aware of the code, and its provisions, and consider that it has been breached may access mandatory internal dispute resolution, or make a complaint to the Australian Financial Complaints Authority (AFCA).[329]

Information disclosure is also covered under the Banking Code of Practice, which is a voluntary industry standard set by the ABA which requires specific types of 'clear' information to be set out in terms and conditions.[330] It is also included under COBA's Customer Owned Banking Code of Practice 2022, which, among other things, includes commitments to providing clear, concise and accurate product information, which is written in plain language, to customers and the public.[331] However, as

327 Hon Chris Pearce MP, Pearce Delivers on Refinements to Financial Services Regulation, Australian Government, 19 December 2005, accessed 16 November 2023; Corporations Regulations 2001, r 7.9.07FA.

328 ASIC, ePayments Code, p 9.

329 ASIC, ePayments Code, p 39.

330 Australian Banking Association, Banking code of practice, ABA, 5 October 2021, pp 17-18, accessed 20 October 2023.

331 Customer Owned Banking Association, Code of practice 2022 v2.0, COBA, October 2023, p 23, accessed 4 November 2023.

with the ePayments code, consumer redress procedures typically require consumers to go through bank's internal resolution process or make a complaint to AFCA.

The ACCC notes that banks' disclosure of information is also subject to other obligations under ASIC regulations and the Australian Consumer Law, for example, to the extent information cannot be misleading or deceptive under the *Australian Securities and Investments Commission Act 2001*.[332]

It is notable that all mechanisms to enforce banks' compliance with information disclosure requirements (regardless of the adequacy of those requirements) requires a significant, and potentially unrealistic, amount of knowledge and effort on the part of a consumer.

Consumer Data Right (CDR)

The Consumer Data Right (CDR) is a data portability initiative that enables consumers to share the data that Australian businesses hold about them. It was first implemented in the banking sector in 2020.

The CDR enables consumers to consent to sharing their banking data with accredited third parties, such as fintechs, so they can provide products and services to benefit the consumer. The CDR also requires banks to share data about the products and services they offer in a standardised way (with this data known as 'product reference data'). This makes it easier for third-party providers to develop products enabling consumers to compare products and offers.

For example, with a consumer's consent, an accredited third party offering a budgeting app and comparison service might collect the consumer's banking data across a variety of providers. It could then aggregate the data to provide an overall view of that consumer's financial position. The accredited third party could also access CDR product reference data from other banks to provide targeted recommendations to the consumer about products that may better suit their needs.

This has the potential to save consumers time shopping around, as it enables recommendations to be provided based on a consumer's actual data about their use of a product.

As of November 2023, there were more than 70 banks participating in the CDR as a data holder, covering an estimated 99.7 per cent of Australians' customer accounts. More than 40 fintechs and accredited third party recipients are offering CDR services to consumers who have consented to the sharing of their data.

The ability of the CDR to reduce searching costs for consumers is itself dependent on consumer awareness and usage of both the CDR and CDR-enabled comparison services.

To understand the extent to which banks are leveraging the CDR to encourage consumers to move to new products or providers, the ACCC sought information from banks as part of this Inquiry. This included information on actions they currently take or propose to take to attract customers to their retail deposit products using the CDR. We also sought information on measures they have taken in response to consumer usage of the CDR.

Some of the larger banks undertook some level of monitoring of consumers' or competitors' use or consideration of CDR-supported switching. Some banks indicated they monitor the volume of consumer requests to share data via the CDR, even if they appear to have only limited specific strategies in place to either promote or mitigate CDR-supported switching.

Some smaller banks indicated they have not taken specific measures to retain or acquire customers in response to CDR-supported switching.

332 *Australian Securities and Investments Commission Act 2001*, s 12DA.

The reasons that banks may not have adopted specific measures in response to CDR-supported switching might include low consumer usage of CDR services, banks' reliance on their existing attraction and retention methods, or a preference to wait for the CDR program to mature.

Some banks provided information to the ACCC about innovative uses of the CDR that they are developing, or considering developing, which could allow them to offer services or insights within their platform across brands or even across customer accounts held with other banks. The development of these types of services could encourage further CDR use by consumers. However, one bank noted they decommissioned this type of service in order to prioritise other CDR investments and compliance requirements.

A feature of the CDR is its potential application across other sectors of the economy, and it has recently been extended to the energy sector. In addition, the *Inquiry into the Future Directions for the Consumer Data Right* recommended strengthening and deepening the CDR's functionality and use through the implementation of third-party 'action initiation' reforms. Amendments to enable action initiation in the CDR are currently before the Parliament.[333]

Increasing functionality of the CDR to include action initiation is intended to further empower consumers to authorise, manage and facilitate actions securely in the digital economy. Under this arrangement, consumers could potentially be able to use the CDR to open and close an account, switch providers, apply for services or make payments where the CDR system extends to such actions.

We note that it has not yet been determined which specific actions will be implemented under a CDR action initiation framework and, in particular, whether this will extend to switching the relevant account for direct debits and direct credits with third parties. However an expansion of the CDR to enable action initiation could assist in reducing certain barriers to switching.[334]

However, for the moment, the ACCC has found that many banks do not yet have active measures or future plans in place to facilitate switching through the CDR.

The Government has indicated that for the intended benefits of action initiation to be realised, extensive consultation and consideration, road mapping and a measured rollout of action initiation will be required. We further note that any expansion of the CDR to action initiation must ensure that strong levels of trust in the CDR are maintained, especially in relation to consumer protections.

Payments switching services in the ePayments Code

Following a 2011 report on 'Banking services: cost-effective switching arrangements'[335] (see section 9.4 for further detail), the Australian Government implemented a switching initiative which would allow consumers to sign a single form, to authorise their new bank to arrange the transfer of all automatic transactions linked to the customer's account and inform associated creditors and debtors about the new account details.[336]

This initiative built on obligations placed on banks in 2008 which required banks to provide their customer with a list of the past 13 months of direct debits and credits, and for the new bank to assist customers to re-establish their direct debits and credits.

When evaluating whether the listing and switching provisions of the ePayments Code (also referred to as 'tick and flick') has helped switching, CHOICE submitted to the ACCC that "it is the experience

333 APH, Treasury Laws Amendment (Consumer Data Right) Bill 2022, APH, accessed 9 October 2023.

334 The Australian Government the Treasury, Government statement in response to the Statutory Review of the Consumer Data Right, June 2023, pp 3 and 9.

335 B W Fraser, Banking services: cost-effective switching arrangements, Australian Government, 30 June 2011, accessed 16 November 2023.

336 W Swan, New measures starting today to empower Australian banking customers, Australian Government, 1 July 2012, accessed 13 September 2023.

of CHOICE members and supporters that this process is rarely promoted by the major banks".[337] In 2018, the Productivity Commission found 'tick and flick' was not achieving its intended outcome, with submitters to that inquiry suggesting it was because of low awareness, multi-banking and failure from banks to promote the initiative.[338]

Overall, the ACCC considers that the listing and switching provisions in the ePayments Code do not reduce the burden on consumers to any significant degree. This is because these measures still require several manual steps from consumers, which may include printing and filling out a paper form and then sending it to the relevant bank. Further, it does not appear that these provisions are well known or promoted by banks.

Eight banks could provide data on the ePayments code switching and listing services as part of the Inquiry. From these banks, only 116 consumers used the switching service from their new bank, while only 963 used the listing service from their current bank in 2022. This continues the downward trend of the services' use over the previous 3 years.

Given the lack of usage after 12 years, that banks have little incentive to make switching away easier and that consumer awareness is so low, the ACCC rejects that the switching service is effectively facilitating switching or "reducing administrative burden of switching…and significantly reduces the time incurred by customers" as stated by one major bank.[339]

However, banks may offer listing services which meet some elements of the ePayments Code service, but in a more accessible way. For example, one bank offers to show ongoing and one-off payments in its app, and this was accessed over 90,000 times in June 2023 alone. This demonstrates that consumers do value these services if they are accessible.

Overseas initiatives

United Kingdom: Current Account Switch Service (CASS)

The UK's Current Account Switch Service (CASS) is a switching initiative launched in September 2013 as a voluntary scheme to help consumers switch transaction accounts. After a consumer has decided to move to a new bank, with the consumer's permission, the new bank is able to facilitate the closure of the old account, open the new account, move the balance and transfer existing direct debits within 7 working days.[340]

The UK's Financial Conduct Authority (FCA) conducted a review of the effectiveness of CASS in 2015 and found that CASS had made the switching process simpler and easier, but its impact on overall rates of switching had been limited due to lack of awareness of the services, or how to use it[341], meaning that perceived barriers remained prohibitive.[342]

To address these issues CASS's operator implemented the following measures to address the FCA's key findings:

- A public awareness campaign across traditional and digital media channels in prime-time advertising slots which focused on market segments where switching was lowest. The result of this initial campaign was a steep increase in consumer awareness in a 3-month period from 70% to 77%.

337 CHOICE submission, ACCC, 14 July 2023, p 12.

338 Productivity Commission, Competition in the Australian Financial System, June 2018, p 160.

339 ANZ submission, 9 June 2023, pp 7–8.

340 Pay.UK, How to switch, Pay.UK website, n.d, accessed 8 September 2023.

341 Financial Conduct Authority, Making current account switching easier, FCA, March 2015, p 6 accessed 8 November 2023.

342 R Fincham, R Reynolds and N Spicer, Engagement with current accounts and the switching process, Financial Conduct Authority, March 2015, p 6, accessed 8 November 2023.

- Increased consumer confidence in the initiative through emphasising the error-free nature and robustness of the switching process as well as increasing the number of participating banks and ensuring they are using their own channels to promote CASS.
- Extended the incorrect payment redirection service and specifically engaged with business users of direct debit and direct credit to ensure they update customer details. The operator also noted they would work with the industry on initiatives to help address the issue of misdirected payments including by directly ensuring business users update customer details when customers switch which may affect their direct debit or direct credit.[343]

Since then, consumer awareness has greatly increased and by June 2023, 98.5% of account switches were facilitated through CASS. There was also a 36.76% increase in total switches from June 2019 to June 2023.[344] The high number of switches using CASS show that initiatives can successfully target active consumers. The increase in switching may indicate the positive effect CASS has had on helping increase the willingness to switch among inactive consumers.

United Kingdom: Consumer Duty

The UK FCA has developed a Consumer Duty which represents a comprehensive shift to outcomes-based regulation, aimed at delivering good consumer outcomes in the following key areas:

1. products and services
2. price and value
3. consumer understanding
4. consumer support.

The Consumer Duty is led by the principle that financial services firms must 'act to deliver good outcomes for retail customers' and firms are expected to be able to evidence whether good customer outcomes are being delivered.[345] For example, a bank may have to consider whether there are any products in the bank's deposit range that offer a higher interest rate for essentially the same (or better) service and functionality than another account.[346]

In terms of information disclosure, firms will need to review their communications across their product suite and communication channels, including in support of achieving consumer understanding.

New Zealand: Consumer Data Right (NZCDR)

The New Zealand Government in July 2023 announced the introduction of legislation establishing a Consumer Data Right framework to give individuals and businesses greater choice and control over their data and facilitate access to real-time information on products and pricing.[347]

The proposed legislative framework will give customers the power to require entities such as banks to share information which will in turn give customers the ability to compare and 'shop around' for products in real-time, manage accounts across different providers simultaneously and switch between providers more easily, while also promoting innovation and competition.

343 Bacs, Current account switch service: making account switching easier, Pay.UK, March 2016, pp 2–4, accessed 3 November 2023.

344 There were 114,139 total switches in June 2023 compared to 83,460 total switches June 2019. See Pay.UK, Current Account Switch Service statistics: Switching dashboard issue 39, 27 July 2023, p 3, accessed 8 September 2023; Pay.UK Current Account Switch Service statistics: Switching dashboard issue 24, 24 October 2019, p 3, accessed 8 September 2023.

345 Financial Conduct Authority, PS22/9: A new consumer duty, FCA, 27 July 2022, p 5, accessed 3 November 2023.

346 Financial Conduct Authority, Cash savings market review 2023, FCA, 31 July 2023, accessed 6 November 2023.

347 Ministry of Business, Innovation & Employment (MBIE), Consumer data right, MBIE website, 18 August 2023, accessed 1 November 2023.

The Customer and Product Data Bill 2023 will set out the rules around access to, and exchange of, customer and product data and sets out the high-level framework of the NZCDR regime, with the specific detail about how the regime will work to be detailed in the regulations standards and designations once they are developed.[348]

Netherlands: Switching Service

The Switching Service is a joint initiative of banks in the Netherlands, which allows customers to convert their current account to a new or existing current account with another Dutch bank.[349] The initiative ensures reoccurring payments, scheduled direct debits and other transactions charged to the customer's old account get redirected to the new account automatically.[350] Banks that participate in the Switching Service also pass on the customer's new International Bank Account Number (IBAN) to private individuals, companies and organisations that want to transfer money to the customer's old IBAN.[351] The customer therefore benefits from the reoccurring subscriptions or automatic direct debits being transferred in one single request, instead of having to individually change the International Bank Account Number (IBAN) for every single service.[352]

The service is free to use and available to anyone with a Dutch bank account. It encourages customers to compare deals across different banks' websites before choosing to switch. The process takes approximately 2 weeks and essentially involves filling out a new request form with the desired bank (or on the switching service website). Then the old and new banks will process the request, which involves both banks checking and processing the data, and preparing the Switching Service for the customer. The customer can then choose whether to close their previous account or keep it open.[353]

Currently all major Dutch Banks have signed up to participate in the initiative. The switching service has assisted customers to switch to different providers and has facilitated more competition from newer banks in a traditionally consolidated banking sector.[354]

Sweden: Bank Account Portability

In 2012 Sweden implemented a new payment system which acts as a 'hybrid' account portability.[355] The system uses a unique number ('bankgiro number') which is used in payments and is connected to a consumer's bank account where they still have the equivalent of a BSB and account number.[356] While the bankgiro number is portable, the underlying account number is not.

If a consumer needs to switch banks, they still are required to contact their bank and their new account number can be attached to their bankgiro number and payments can seamlessly be credited/debited to/from the correct account.[357]

348 Ministry of Business, Innovation & Employment (MBIE), Core principles, *Consumer data right*, MBIE website, 20 July 2023, accessed 1 November 2023.

349 Dutch Payments Association, Overstapservice, Overstapservice website, n.d., accessed 6 November 2023.

350 Dutch Payments Association, Overstapservice, Overstapservice website, n.d., accessed 6 November 2023.

351 Dutch Payments Association, Private individuals, *Overstapservice*, Overstapservice website, n.d., accessed 6 November 2023.

352 I McKenzie, How to: bank switch service in NL (overstapservice), *FinTech Compass*, 4 May 2023. accessed 6 November 2023.

353 I McKenzie, How to: bank switch service in NL (overstapservice), *FinTech Compass*, 4 May 2023. accessed November 2023.

354 I McKenzie, How to: bank switch service in NL (overstapservice), *FinTech Compass*, 4 May 2023. accessed November 2023.

355 Bankgirot, The Bankgiro system, *Our payment systems*, Bankgirot website, 6 October 2022, accessed 6 October 2023.

356 Bankgirot, The Bankgiro system, *Our payment systems*, Bankgirot website , 6 October 2022, accessed 6 October 2023.

357 Bankgirot, Frequently asked questions, *Support*, Bankgirot website, n.d., accessed 6 October 2023.

9.4 Action needs to be taken to reduce barriers to switching

The impediments to switching set out above are significant and enduring. They deter many consumers from switching to better-suited products and impose a significant burden on those that do.

Properly addressing these impediments is critical in order to improve competition and consumer outcomes in the retail deposits market. A bank's incentive to minimise their retail deposit funding costs through lower interest rates is constrained, in part, by the extent to which consumers can actively switch between products and banks.

In a number of other sectors, reforms have sought to simplify the switching process for consumers, for example in gas, electricity or mobile services. Switching providers in these cases can be as simple as filling out an online form or making a phone call with the new provider.

In contrast, effectively switching retail deposit products, particularly transaction accounts, requires consumers to engage not only with the current and new bank, but to also update their account details with the potentially wide range of individuals and businesses that they have payment arrangements with.

The concept of bank account portability seeks to overcome these impediments in a similar way to how mobile phone number portability removed a significant disincentive to switching mobile service providers – the need to notify contacts of a change in phone number.

The ACCC considers there is significant benefit in seeking to reduce the real and material impediments to switching in the retail deposits market. This would reduce transaction costs and improve outcomes for consumers. It would also sharpen the competitive focus of banks as switching would become a more credible constraint.

This concept has been considered previously. In 2011, the Government commissioned a feasibility study of switching arrangements in banking from former RBA Governor Bernie Fraser (the 2011 study).[358]

The 2011 study noted:

> Full account portability is a deceptively simple concept. In essence individuals (and businesses) would be issued with a unique account number(s) which would be passed to the new institution when the customer decided to move so that existing direct debits and credits associated with that account could be moved automatically to the account with the new institution. This contrasts with the current arrangements for switching accounts which require the creation of a new account number at a new institution, and the additional task of redirecting direct debits and credits to that new account number.[359]

358 B W Fraser, Banking services: cost-effective switching arrangements, Australian Government, 30 June 2011, accessed 16 November 2023.

359 B W Fraser, Banking services: cost-effective switching arrangements, Australian Government, 30 June 2011, accessed 16 November 2023, p 7.

The 2011 study found bank account portability was not feasible at that time for several reasons, but namely:

- the considerable changes needed to the payments system to require a centralised clearing house instead of the BSB number system
- the cost which may be passed to payments system users
- a hesitancy to tackle new, major infrastructure and IT system projects in the financial sector.[360]

Instead, the 2011 study noted that a simple switching arrangement could be implemented in place of account portability. This led to the switching and listing services set out in the ePayments Code, discussed earlier in this chapter.

The ACCC notes that there have been significant developments in the banking sector since the 2011 study.

The New Payments Platform (NPP) launched in February 2018, enabling near real-time payments and fund availability.[361] The NPP's addressing service, known as PayID, allows an email address or mobile phone number to be linked to a bank account. Payments can then be addressed to that email address or mobile phone number rather than using a BSB and account number.[362] PayTo is a service allowing people to see and manage their regular payments through their bank's app or online banking service and is an alternative to direct debits.

However, these initiatives each only partly address the barriers to account switching we identify above. For example, customers cannot currently transfer their PayTo agreements when they switch banks (they need to be cancelled and re-established with the new bank), however a switching capability may be added in the future.[363]

As noted earlier, the CDR has also been introduced during this time.

The ACCC also notes that there are currently extensive payments reform being undertaken by Government including reforms to the *Payments Systems (Regulation) Act 1998* and licencing of payments service providers.[364]

These and other initiatives mean that the payments system and banking infrastructure in place now is very different to that considered by the 2011 study, however the impediments consumers face in switching remain largely in place.

The ACCC considers that, given the enormous potential for a form of bank account portability to drive switching and greater competition between banks, a fresh review is warranted.

This review should carefully consider possible models for account portability that could be pursued, for transaction and savings accounts in particular. The ACCC considers that for a model to be effective, it needs to minimise the burden (in time and effort) on consumers as has been done for switching other essential services.

The review should also consider the potential for recent and planned developments (including in relation to PayTo and PayID) to address impediments to consumer switching.

360 B W Fraser, Banking services: cost-effective switching arrangements, Australian Government, 30 June 2011, accessed 16 November 2023, pp 8–10.

361 New Payments Platform Australia (NPPA), The company, NPPA, n.d., accessed 16 November 2023.

362 NPP Australia, PayID – How it works, PayID, n.d., accessed 16 November 2023.

363 NPP Australia, Pay To – Service Overview, PayTo, November 2021, accessed 16 November 2021, p 8.

364 These and other reforms are outlined in the June 2023 Strategic Plan: The Australian Government the Treasury, A Strategic Plan for Australia's Payments System, June 2023, accessed 18 November 2023.

As noted earlier, the ongoing development of the CDR also has the potential to address some of these barriers, and the review should consider the extent to which these developments in the CDR could address barriers to switching or otherwise complement bank account portability.

Recommendation 7

The Australian Government should review the merits of bank account portability

The retail deposits market, and the banking system, has changed considerably over the last decade, however barriers to switching remain very high.

The Australian Government should review the merits of bank account portability.

The review should consider the likely costs, benefits, risks and opportunities that different approaches to bank account portability would present.

Appendix A: Glossary, Acronyms & abbreviations

Glossary

Authorised deposit-taking institution (ADI)	A financial institution licensed by APRA to carry on banking business, including accepting deposits from the public.
Bank Bill Swap Rate	Key benchmark interest rates in Australian financial markets which measure the cost for highly rated banks in Australia to issue short-term bank paper for each monthly tenor between one month and 6 months.
Base Interest Rate	The interest rate payable to the holder of a Retail Deposit Product excluding any Bonus Interest Rate or Introductory Interest Rate. It is the rate available generally to all holders of the Retail Deposit Product. If a Retail Deposit Product has a tiered interest rate depending on the amount of funds in the account, each interest rate is a Base Interest Rate for that tier.
Basis points	A unit of measurement for interest rates. 1 basis point equals 0.01%.
Bonus Interest Rate	The interest rate offered generally on a Retail Deposit Product in addition to the Base Interest Rate, that is contingent on the customer meeting certain conditions. If a Retail Deposit Product has a tiered bonus interest rate depending on the amount of funds in the account, each interest rate is a Bonus Interest Rate for that tier.
Cash Rate	The interest rate that banks pay to borrow funds from each other in the money market on an overnight basis. The cash rate is calculated as the weighted average interest rate on overnight unsecured loans between banks settled in the Reserve Bank Information and Transfer System.
Cash Rate Target	The RBA implements monetary policy in Australia through setting a target for the cash rate, and takes steps to ensure that the cash rate aligns with that target.
Direction	The direction dated 14 February 2023, given under section 95H of the Competition and Consumer Act 2010 and pursuant to which the ACCC is conducting its inquiry into the market for the supply of retail deposit products.
Exchange Settlement Account	An account held at the RBA by financial institutions to settle financial obligations arising from the clearing of payments
Financial Claims Scheme	An Australian Government-backed safety net that protects deposits of up to $250,000 per account holder per authorised deposit-taking institution in the unlikely event of the ADI failing.
Funds transfer pricing	A process by which a bank sets internal prices on funds transferred between its business units. Such funds include funds raised by deposits units and used by lending units to make loans.
Headline interest rate	The total interest rate payable on a retail deposit product inclusive of bonus or introductory rates. ▪ For bonus interest accounts, it comprises the Base Interest Rate and Bonus Interest Rate. ▪ For introductory interest accounts, it comprises the Base Interest Rate and Introductory Interest Rate.
Introductory Interest Rate	An interest rate offered generally on a Retail Deposit Product above the Base Interest Rate for a limited period of time following the opening of an account.

Liquidity	The ability for an asset to be converted to cash and/or sold with little to no loss of value.
Main Financial Institution	The institution where the consumer holds their main transaction account and transacts with most frequently.
Major banks	For the purposes of this report: ANZ, CBA, NAB and Westpac.
Major Bank Levy	Applies to ADIs whose total liabilities exceed the levy threshold of $100 billion in any quarter. The Major Bank Levy is applied to applicable liabilities, at a rate of 0.015% each quarter, or 0.06% annually. ANZ, CBA, Macquarie Bank, NAB and Westpac have been subject to the Major Bank Levy since it commenced on 1 July 2017.
Mid-tier banks	For the purposes of this report: Macquarie Bank, ING Bank, Bendigo and Adelaide Bank, Bank of Queensland, Suncorp Bank and HSBC Bank Australia.
Mutuals	For the purposes of this report: Great Southern, Heritage, NGM and Teachers Mutual.
Negotiated Interest Rate	An interest rate for a Retail Deposit Product that: a) is agreed with the relevant customer on an individual basis b) differs from the Base Interest Rate, and c) is not a Bonus Interest Rate or an Introductory Interest Rate.
Net Interest Margin	A measure of the difference between a bank's interest earnings and interest expenses, expressed as a proportion of their interest-earning assets.
Retail Deposit Product	A protected account (within the meaning of the Banking Act 1959) held by: a) an individual whose dealings in relation to the account are for personal or housing purposes, or b) the trustee of a self-managed superannuation fund (within the meaning of the Superannuation Industry (Supervision) Act 1993).
Savings Account	A deposit account held at a bank or other financial institution that offers a higher interest rate than most basic transaction accounts. Account holders can usually access their account at any time.
Self-managed superannuation fund (SMSF)	An entity used for providing for an individual's retirement. Members of an SMSF are its trustees or, if the SMSF has a company trustee, are the directors of the company. This means the members of the SMSF run it for their benefit.
Targeted Interest Rate	A higher interest rate that a bank proactively offers for depositors from particular cohorts that the bank is targeting, such as customers who hold home loans or large deposit balances, are relatively new to a product or meet particular demographic attributes such as retirees. This benefit may be delivered as a premium on top of an existing interest rate. These offers are not generally available to the public.
Term Deposit	A retail deposit product which provides individuals a fixed rate of interest for a specified period, typically ranging from 1 month to up to 3 years. Term deposits generally provide higher interest rates than other retail deposit products to compensate for lack of access to funds before the end of term.
Term Funding Facility	The facility established by the Reserve Bank of Australia to support the supply of credit by providing low-cost funding to ADIs operating in Australia against high quality collateral.

Acronyms & abbreviations

ADI	Authorised Deposit-taking Institution
AFSL	Australian Financial Services Licence
BBSW	Bank Bill Swap Rate
CDR	Consumer Data Right
ESA	Exchange Settlement Account
FCS	Financial Claims Scheme
MFI	Main Financial Institution
Organisation	
ABA	Australian Banking Association
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
APRA	Australian Prudential Regulation Authority
ANZ	Australia and New Zealand Banking Group Limited
ASIC	Australian Securities and Investments Commission
Bendigo and Adelaide	Bendigo and Adelaide Bank Limited
BOQ	Bank of Queensland Limited
CBA	Commonwealth Bank of Australia
Great Southern	Credit Union Australia Ltd (t/a Great Southern Bank)
Heritage	Heritage and People's Choice Limited
HSBC	HSBC Bank Australia Limited
ING	ING Bank (Australia) Limited
Macquarie	Macquarie Bank Limited
NAB	National Australia Bank Limited
NGM	Newcastle Greater Mutual Group Ltd
RBA	Reserve Bank of Australia
Suncorp	Suncorp-Metway Limited
Teachers Mutual	Teachers Mutual Bank Limited
Westpac	Westpac Banking Corporation

Appendix B: Terms of reference

Competition and Consumer (Price Inquiry—Retail Deposit Products) Direction 2023

I, Jim Chalmers, Treasurer, give the following direction to the Australian Competition and Consumer Commission.

Dated 14 February 2023

Dr Jim Chalmers
Treasurer

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Part 1—Preliminary

1 Name

This instrument is the *Competition and Consumer (Price Inquiry—Retail Deposit Products) Direction 2023*.

2 Commencement

(1) Each provision of instrument specified in column 1 of the table commences, or is taken to have commenced, in accordance with column 2 of the table. Any other statement in column 2 has effect according to its terms.

Commencement information		
Column 1	**Column 2**	**Column 3**
Provisions	**Commencement**	**Date/Details**
1. The whole of this instrument	The day after this instrument is registered.	

Note: This table relates only to the provisions of this instrument as originally made. It will not be amended to deal with any later amendments of this instrument.

(2) Any information in column 3 of the table is not part of this instrument. Information may be inserted in this column, or information in it may be edited, in any published version of this instrument.

3 Authority

This instrument is made under the *Competition and Consumer Act 2010.*

4 Definitions

authorised deposit-taking institution has the meaning given by the *Banking Act 1959*.

goods has the meaning given by subsection 95A(1) of the Act.

inquiry has the meaning given by subsection 95A(1) of the Act.

price has the meaning given by subsection 95A(1) of the Act.

retail deposit product means a protected account (within the meaning of the *Banking Act 1959)* held by:

(a) an individual whose dealings in relation to the account are for personal or housing purposes; or

(b) the trustee of a self managed superannuation fund (within the meaning of the *Superannuation Industry (Supervision) Act 1993*).

services has the meaning given by subsection 95A(1) of the Act.

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State or Territory authority has the meaning given by subsection 95A(1) of the Act.

supply has the meaning given by subsection 95A(1) of the Act.

the Act means the *Competition and Consumer Act 2010*

Part 2—Price inquiry into retail deposit services

5 Commission to hold an inquiry

(1) Under subsection 95H(1) of the Act, the Commission is required to hold an inquiry into the market for the supply of retail deposit products. The inquiry is *not* to extend to any of the following:

(a) the supply of a good or service by a State or Territory authority;

(b) the supply of a good or service that is an exempt supply;

(c) the conduct of the Australian Prudential Regulation Authority or the Australian Securities and Investments Commission;

(d) the conduct of a mortgage broker;

(e) reviewing the operation of any Australian law (other than the Act) relating to prudential regulation, banking or the provision of credit, except as necessary to consider the matters set out in section 6.

(2) For the purposes of subsection 95J(1), the inquiry is to be held in relation to goods and services of the following description:

(a) retail deposit products supplied by authorised deposit-taking institutions; and

(b) products for the provision of credit supplied by authorised deposit-taking institutions, to the extent that these products are relevant to the matters mentioned in subparagraph 6(d)(ii) of this instrument.

(3) Under subsection 95J(2), the inquiry is *not* to be held in relation to the supply of goods and services by a particular person or persons.

6 Directions on matters to be taken into consideration in the inquiry

Under subsection 95J(6) of the Act, the Commission is directed to take into consideration all of the following matters in holding the inquiry:

(a) the rates of interest paid on amounts deposited or held in retail deposit products, including with reference to any differences in rates of interest:

(i) depending on the amount deposited or held; and

(ii) between new and existing customers; and

(iii) depending on any other products held by the customer; and

(iv) between those publicly advertised and those actually paid to customers; and

(b) terms and conditions, other than interest rates, on which retail deposit products are supplied, including:

(i) fees and charges paid by account holders; and

(ii) restrictions on customer access to deposited funds; and

(c) supplier strategies in relation to retail deposit products, including supplier approaches to setting interest rates on retail deposit products; and

(d) supplier decisions relating to terms and conditions (including interest rates) on which retail deposit products are supplied in light of changes in the

Reserve Bank of Australia's target for the cash rate (which is the overnight money market interest rate), including:

(i) the timing of supplier announcements of interest rate changes and their implementation of those changes; and

(ii) any differences in approach taken towards setting interest rates on retail deposit products and products for the provision of credit; and

(e) the nature and extent of price and non-price competition in the supply of retail deposit products, including:

(i) barriers to entry and expansion in retail deposit product markets; and

(ii) innovation in retail deposit product markets; and

(iii) factors that affect customers switching to alternative retail deposit products, including the extent and existence of supplier practices and strategies, consumer behaviour, and the availability of information on products; and

(f) the use of retail deposit products as a source of funding for suppliers' provision of credit, including:

(i) the significance of retail deposit products in the funding of suppliers; and

(ii) the cost of using retail deposit products as a source of funding, compared to other sources of funding; and

(iii) how the factors listed in subparagraphs (i) and (ii) differ according to the size and business model of the supplier.

7 Period for completing the inquiry

For the purposes of subsection 95K(1) of the Act, the inquiry is be completed, and a report on the matter of inquiry given to the Treasurer, by no later than 1 December 2023.

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Appendix C: Funds transfer pricing

This appendix sets out the ACCC's understanding of funds transfer pricing, based on publicly available material and information provided to us by banks. The description below is generalised and does not represent the precise process used by any bank or group of banks.

The banks reviewed in the Inquiry typically follow a matched-maturity marginal cost of funding approach to funds transfer pricing.[365] Under this approach, the FTP for a specific deposit product or loan incorporates its repricing tenor[366], expected behavioural maturity and the bank's marginal cost of funding with equivalent maturity.

This enables banks to price in the relevant funding and liquidity costs or benefits attributable to that product and formulate a measure of the value of funds used or raised through that product to assess its profitability against this measure.

The banks reviewed in the Inquiry typically incorporate the following components into an FTP for a specific product: [367]

- an **FTP base rate** that represents the cost of managing the interest rate risk of the product
- a **term liquidity premium** that represents the liquidity cost or benefit of the product
- a **contingent liquidity premium** that represents the costs of maintaining a liquidity buffer mandated under prudential regulation to manage contingent liquidity risk attributable to the product
- **further adjustments** that are set to improve the relevance of the FTP or to achieve specific balance sheet management or other business objectives.

The FTP base rate approximates the cost of managing interest rate risk given the repricing tenor of the product

The FTP base rate reflects banks' expected cost of managing interest rate risk by, for example, entering into derivative instruments (such as interest rate swaps and basis swaps) with maturities largely corresponding to repricing tenor of the deposit or lending product. In practice, banks may not actually enter into such contracts, but this process of calculating the FTP base rate enables banks to attribute their expected cost of managing interest rate risk into their FTPs.

365 For more explanation of this approach see, for example, J Grant, 'Liquidity transfer pricing: a guide to better practice', December 2011, Occasional Paper No 10, Bank for International Settlements. Other approaches to funds transfer pricing include the pooled average cost of funding approach.

366 We use the term 'repricing tenor' to mean the frequency at which the bank can change the interest rate on a product.

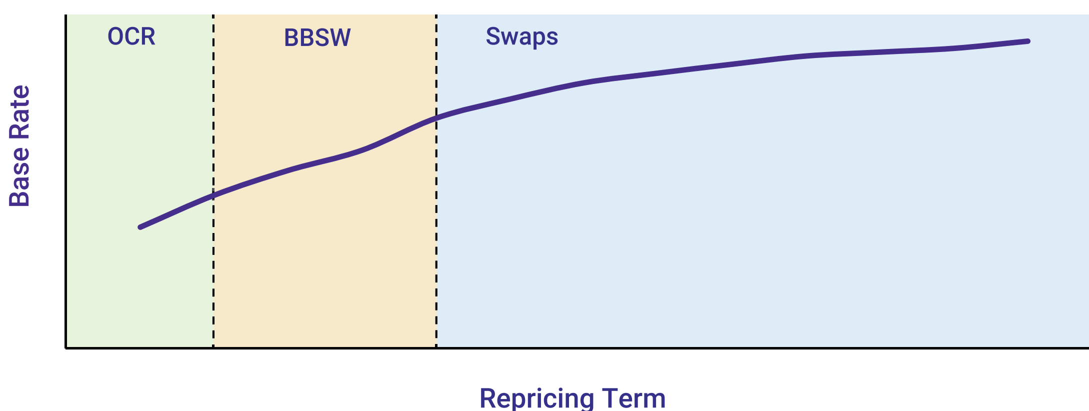
367 FTPs have been divided into these 4 components for clarity of description and analysis. However, banks may describe these components using differing terminology.

The typical approach to calculating the FTP base rate includes the following main steps:

- a 'base curve' is constructed from a combination of market interest rates largely reflecting the interest rate on interbank lending at different maturities:
  - for shorter maturities on the curve, the overnight cash rate and BBSW spot rates for different maturities are chosen as points on the curve
  - for longer maturities on the curve, a floating benchmark rate (generally the 3-month BBSW or 1-month BBSW) is chosen as a reference, and an interest rate swap curve for the benchmark rate is constructed, representing market expectations of the future level of the benchmark rate
- the FTP base rate is calculated as the point on the base curve reflecting the repricing tenor of the product.

A generalised example of a base curve is shown in figure C.1 below, with additional labels indicating the type of financial instrument that is the reference for the FTP base rate at different repricing tenors.

Figure C.1: Generalised example of a base curve



As the base curve largely reflects a term structure of interbank lending rates, it can be understood that a key component of FTP is the interest rate on interbank lending at the equivalent repricing tenor to the product.

The term liquidity premium incorporates the liquidity cost or benefit of the product

The term liquidity premium is the liquidity cost or benefit of the product, which can be understood as the net effect on a bank's ability to fund increases in lending activity and meet obligations as they come due without incurring unacceptable losses.[368]

Banks make money by generally funding long-term loans with short-term deposits (a process commonly known as 'maturity transformation'). This process makes banks 'inherently vulnerable to liquidity risk'.[369] However, by including a term liquidity premium in FTPs to account for liquidity costs and benefits, and in turn by incorporating these considerations in internal decisions on interest rates

368 Basel Committee on Banking Supervision, 'Principles for sound liquidity risk management and supervision', September 2008, Bank for International Settlements, p 1.

369 Basel Committee on Banking Supervision, 'Principles for sound liquidity risk management and supervision', September 2008, Bank for International Settlements, p 1.

and other matters, banks can in principle increase their lending activity while appropriately managing liquidity risk.[370]

The banks reviewed in the Inquiry typically calculate the term liquidity premium as the difference between their marginal wholesale debt funding costs and the interbank lending rate at the relevant maturity, as reflected in the FTP base rate. This difference results from a combination of the bank's market access premium and the market's perception of its idiosyncratic solvency risk. From the bank's perspective, it reflects the liquidity cost or benefit of the product subject to the FTP.

The term liquidity premium reflects that liquidity costs and benefits are higher for products with longer maturities. The banks reviewed in the Inquiry typically calculate the term liquidity premium by reference to the behavioural maturity of the product rather than its contractual maturity.

Behavioural maturity measures the duration that funding is expected to be provided (for a deposit product) or used (for a loan). Behavioural maturity incorporates, for example, banks' expectations of how long borrowers may hold a home loan with them before refinancing or paying off the loan, or how frequently depositors may roll over a term deposit before withdrawing their funds. By using behavioural maturity instead of contractual maturity, banks can more accurately determine the liquidity cost or benefit of their products.

The contingent liquidity premium recoups the implicit cost of holding liquid assets to manage contingent liquidity risk attributable to the product

As explained in chapter 2, banks are required to hold a high quality liquid asset portfolio as a buffer to help them survive periods of unexpected funding outflows. There is an implicit cost associated with holding this portfolio because the funding costs of the assets in the portfolio generally outweigh the returns they generate.

Banks typically seek to reduce this implicit cost by minimising the size of the high quality liquid asset portfolio they are required to hold. To incentivise this, banks commonly incorporate a contingency liquidity premium into their FTPs to recoup the implicit cost attributable to a product because of its contribution to contingent liquidity risk.

The banks reviewed in the Inquiry adopt various approaches to calculating the contingent liquidity premium and applying it to different business units through FTP and other measures.

Some banks apply further adjustments to improve the relevance of their FTPs or to achieve strategic objectives

In combination, the components described in the above subsections estimate the various funding and liquidity costs or benefits to banks to raise or use marginal funding. Where a bank is indifferent between funding from deposits or wholesale debt, these components approximate the bank's risk-adjusted market equivalent cost of sourcing deposits, and therefore help to guide deposit units to make efficient interest rate decisions. However, banks may seek to further adapt their FTPs to business needs, using structural or discretionary adjustments to their FTPs for some or all products.

370 J Grant, 'Liquidity transfer pricing: a guide to better practice', December 2011, Occasional Paper No 10, Bank for International Settlements, p 3.

These adjustments are applied differently across banks and reflect the range of approaches that banks take towards funds transfer pricing. Some banks use funds transfer pricing as a tool for managing funding and liquidity risks and adjustments are accordingly applied only for this purpose. For example, adjustments may relate to improving how the liquidity of short-term wholesale funding is assessed.

Other banks use funds transfer pricing more flexibly as a price signal to achieve balance sheet management and other business objectives, and therefore apply adjustments to promote these goals. For example, some banks apply weightings to different funding sources to incentivise decisions that guide towards the bank's target funding mix, and some banks apply tactical measures to FTPs for specific products or customer segments to enable their pricing strategy.

Regardless of their approach to funds transfer pricing, banks generally have processes to ensure their FTPs are adaptable to internal and external conditions. For example, some banks monitor funding and liquidity behaviour of products to identify potential areas for change in FTPs, and some banks have processes for managers to propose changes to FTP policies or request a specific adjustment. It is possible for banks to apply bespoke FTPs for an individual transaction where the application of the usual framework is unsuitable.

The implications of funds transfer pricing on interest rate decisions

As set out earlier in chapter 6, funds transfer pricing enables most of the banks reviewed in this Inquiry to assess their profitability at the product level, including as part of their interest rate decision process for retail deposit products and home loans. The factors that drive or are incorporated in FTPs are therefore also implicitly considered in these interest rate decisions.

One such factor is the FTP base rate, which is simply the interbank lending rate or is pegged to an interbank lending rate (for example, 3-month BBSW), depending on the repricing tenor of the product being considered. Interbank lending rates are therefore a key input, through the FTP base rate, to the interest rates of retail deposit products and home loans for many banks. For example, for some banks the cash rate or the 1-month BBSW are key inputs to the FTPs of at-call deposit products and variable rate loans, whereas the swap curve of the 3-month BBSW is commonly a key input to the FTPs for term deposits and fixed interest rate loans.

As interbank lending rates change, for example, in response to a change in the cash rate target, FTPs and banks' internal profitability assessments for different products will also change. However, this does not necessarily mean that changes in interbank lending rates must result in immediate or linear changes to interest rates as, for example, changes in interbank lending rates may accompany other changes in market conditions that more directly influence bank interest rates.

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