395 Bourke Street
Melbourne, Victoria, 3000

19 May 2023

Ms Gina Cass-Gottlieb
Chair
Australian Competition and Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Dear Ms Cass-Gottlieb

ACCC Retail Deposits Inquiry

Summary

National Australia Bank (**NAB**) welcomes the opportunity to provide feedback in relation to the Issues Paper for the ACCC's Retail Deposits Inquiry.

NAB offers a broad range of retail deposit products to meet the needs of Australian consumers. This submission sets out the points that NAB considers are important to understanding the competitive dynamics for the supply of retail deposit products and the specific matters raised by the ACCC in the Issues Paper.

Funding, prudential and pricing considerations for deposit products

Deposits are an important source of stable funding for banks and therefore play a critical role in the stability of the Australian banking system. The prudential regulations governing capital, funding and liquidity requirements have led to Australia having a strong and stable banking industry and avoiding some of the problems witnessed in other countries during the Global Financial Crisis and in recent months.

These funding and regulatory compliance obligations, as well as the fact that deposits represent a cost for banks, have implications for the decisions banks make about their deposit product offering.

Rate decisions for retail deposit products are influenced by a range of factors, which will differ between banks. These include funding needs and costs (including the tenor of the deposit product and hedging and benchmark rates, funding diversity and risk management considerations and lending activities), prudential requirements and anticipated competition from other Authorised Deposit-taking Institutions (**ADIs**).

External economic conditions impact all of these factors and the economic cycle therefore has a direct bearing on the way in which both deposit and lending products are priced.

However, due to the broad range of factors that influence the pricing of retail deposit products, changes to the RBA cash rate often do not translate into linear or commensurate changes to rates for deposit products.

Competitive pressure for retail deposits

NAB faces significant competitive pressure for retail deposits and this is continuing to increase. Over the past decade, the number of ADIs in Australia holding retail deposits has increased and the share of household deposits held by the major banks has continued to decrease. NAB competes for retail deposits with major and regional banks, overseas banks and wealth companies, mutuals and start-up fintechs and large technology companies.

There have been, and it is expected that there will continue to be, examples of ADIs entering the market and offering aggressive pricing and innovative features for retail deposit products. NAB understands that the net interest margins (**NIMs**) of the non-major Australian banks have been higher than the NIMs of the major banks since around 2016, reflecting the fact that while smaller ADIs might have different funding costs, this does not necessarily impact their profitability and ability to compete.

The entry of ADIs and growth of deposits is facilitated by the ease with which consumers can switch between deposit accounts. Customers wishing to open a retail deposit account can do so within minutes, increasingly from their digital devices. While some retail deposit products involve (usually breakable) commitments to term (with rates that reflect this), consumers can move their money between many deposit products and ADIs rapidly, if not instantly. Additionally, when consumers consider their savings objectives, they may assess deposit products against the universe of other investment and financial products that could provide a return on their money. For example, managed funds and exchange listed securities.

Competition for retail deposits is leading to positive consumer outcomes. Consumers have a wide range of ADIs and deposit products to choose from and can shop around to compare and select competitive rates and innovative product features that suit their individual needs and preferences. This competitive pressure is expected to continue to increase as banking markets become more dynamic and fintechs and other technology companies – often with lower costs than more established banks – take advantage of this evolving environment.

Role of retail deposits in banking

Retail deposit products play several important roles in the banking system, including by providing:

- a secure means for consumers to store and access their funds and conduct financial transactions;
- options for consumers to earn returns on their savings, and offset interest on home lending, particularly at times when prevailing market interest rates are higher;
- a funding source for banks' lending and credit activities; and
- liquidity and stability for the banking system as a whole.

These different functions of retail deposits influence the decisions of ADIs concerning the types of retail deposit products they offer, the features of those products and how they are priced.

Funding and cost considerations

Deposits represent a source of funding for banks to carry out their lending and other activities, but they also represent a cost to banks in the form of the interest paid to consumers.

When banks consider their funding requirements, and subject to the prudential obligations discussed below, they will compare the cost of sourcing funds through deposits to the cost of obtaining funds from alternative sources. Other sources of funding for banks include borrowing through domestic and offshore wholesale markets and hybrid or equity capital. Funding costs will differ for different banks.

In addition to the price of various funding sources, banks will consider other factors when attempting to find the right mix between those sources. This includes the necessity to comply with various prudential regulatory requirements, such as the Net Stable Funding Ratio and Liquidity Coverage Ratio discussed below, and the appropriate management of capital, funding and liquidity risk to maintain financial stability. At times, the need to appropriately diversify funding sources for risk management reasons may be prioritised above the price of funding.

How ADIs compete for and price their deposit products is therefore influenced by their need for particular types of funding – which in turn will depend on their individual asset and liability position, amount of funding available in wholesale markets, risk appetite, the returns on lending and the cost of raising those funds through deposits compared to alternative sources. ADIs with smaller loan books will most likely have lower funding requirements and, accordingly, require a lower volume of deposits.

During the COVID-19 pandemic, the Reserve Bank of Australia introduced a three year low-cost fixed rate funding facility to ADIs, called the Term Funding Facility. The low-cost funding provided under this facility is due to expire and be repaid in 2023 and 2024. The expiry and repayment of this facility could place pressure on funding, which means competition may increase for deposits to support funding and prudential requirements.

As we are presently seeing in Australia, external economic conditions play a major role in how deposit (and lending) products are priced, as different points in the economic cycle can result in significant differences in the costs of funding, liquidity and stability considerations as well as consumer demand for lending and saving products.

Prudential requirements

As has been demonstrated recently by the banking solvency issues occurring in the US and Europe, deposits are critical to ensuring stability and security for the banking system.

Australia is recognised as having one of the most secure and stable banking systems in the world. This security is underpinned by the Australian Prudential Regulation Authority (**APRA**) framework. As described in the ACCC's Issues Paper, this framework sets out minimum funding, liquidity and capital standards for ADIs, including in relation to the amount of liquid assets (the Liquidity Coverage Ratio) and stable funding (the Net Stable Funding Ratio) they must hold, depending on their individual liquidity requirements and asset mix.

As noted above, deposits are a highly stable source of funding and therefore play an important role in meeting these regulatory requirements. The prudential regulations also result in different types of deposits holding different stability weightings, which impacts the way in which they are valued by banks.

The volume and mix of deposits needed to be held by ADIs to help meet their prudential obligations will differ between ADIs depending on their operations, but naturally impacts how they each price and compete for deposit products.

Characteristics of deposit products

NAB offers a range of retail deposit products to suit different customer needs. These include products in all of the main categories identified by the ACCC in the Issues Paper, being:

- transaction accounts, whereby consumers can withdraw money on demand and engage in other financial transactions, so that money could be moving in and out of the account frequently;
- savings accounts, which are generally not used for day to day transactions but could be used to store money on a shorter or longer term basis, depending on the nature of the account; and
- term deposits, which provide a fixed rate of interest for a specified period.

The interest rates for these different categories of deposit products are influenced by their product features (e.g. tenure vs at-call), consumer expectations and demand, in addition to the funding considerations and prudential regulatory requirements outlined above and anticipated competition outlined below.

Consumers consider a range of factors when choosing a deposit product. For example, the key feature of transaction accounts sought by consumers is the ability to execute day to day transactions and access funds on demand – not the ability to earn higher rates of interest. Transaction accounts might also be used by customers to offset interest in a linked home loan account.

Consumers using savings accounts may be more focussed on rates of interest. Term deposits offer consumers more certainty about their earnings with a commitment as to tenor.

The pricing of deposit products also reflects the tenor of, and risk management strategy for, those products. Accordingly, different deposit products are priced with different reference points. For example, term deposits are priced with reference to interbank rates like the Bank Bill Swap rate, and the pricing for savings products includes banks' hedged positions.

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. This is another reason, in addition to prudential requirements, why it will be important for banks to remain competitive to attract and retain deposits even where they represent a more expensive source of funding.

A range of factors influence the pricing of retail deposits

As outlined in the preceding paragraphs, the setting of interest rates for retail deposit products depends on a range of complex considerations that will differ between ADIs – it is not simply a function of the prevailing RBA cash rate or changes to it. This is also the case for decisions relating to lending and mortgage products.

While NAB's expectations of how other banks will respond to RBA cash rate changes influences its decisions concerning its own products, it would be a misnomer to view reactions to RBA cash rate changes as being indicative of the competitiveness of the retail deposit or lending markets.

The competitive nature of retail deposits is discussed in the following section of this submission.

Competitiveness of retail deposits

The market for retail deposits is competitive and concentration is decreasing

As the ACCC recognises in the Issues Paper, the share of household deposits presently held by the major banks in Australia is not necessarily indicative of weak competition for those products. Given the role of deposits and their prudential significance (outlined above), it is not surprising, nor concerning, that the major banks hold a greater share of retail deposits than ADIs that have a lower need for deposits to fund their operations or to meet their regulatory obligations.

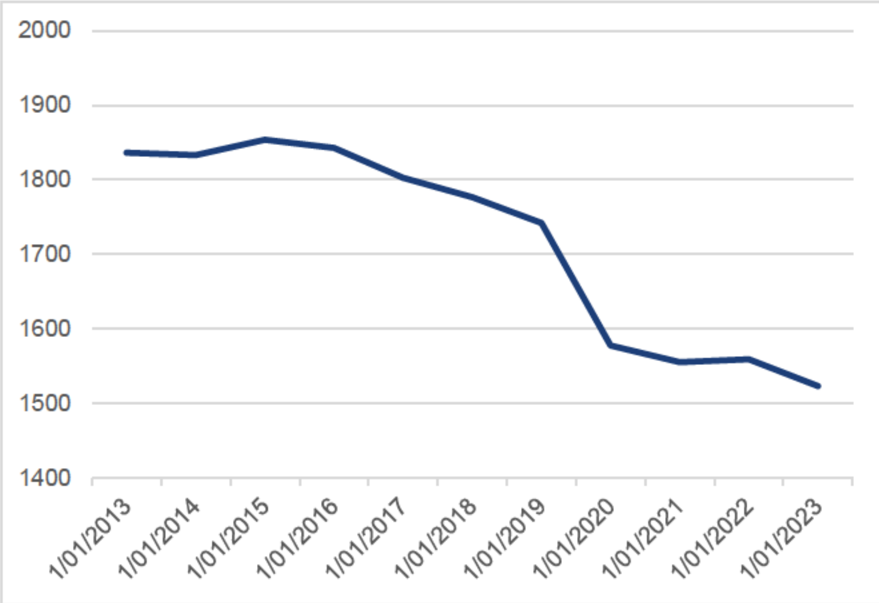
As the ACCC also recognises in the Issues Paper, economies of scale may lead to efficient and competitive outcomes. Lower levels of concentration do not necessarily equate to increased competition and lower margins.

In any event, concentration for the supply of household deposits in Australia has been steadily decreasing over the past decade. As shown in Figure 1 below, over the past decade the level of concentration, measured by the Herfindahl-Hirschman Index (**HHI**), has decreased and is at a level of 1,523 which, based on the ACCC's Merger Guidelines, the ACCC considers "will generally be less likely to identify horizontal competition concerns".

As the number of ADIs in Australia has increased over this period, the share of household deposits held by the major banks has steadily decreased while the share of household deposits held by the non-major ADIs has increased from 19% to 27%.[1]

[1] APRA, Monthly ADI stat st cs. Data comb ned from the APRA Monthly author sed depos t-tak ng nst tut on stat st cs back-ser es March 2019 - March 2023 (Depos ts by households) and the APRA Monthly bank ng stat st cs June 2019 back ser es (Depos ts from households). Monthly ADI Stat st cs replaced Monthly Bank ng Stat st cs from the July 2019 reference per od. In most cases, publ shed data tems n Monthly ADI Stat st cs w ll be conceptually s m lar to those that were publ shed n Monthly Bank ng Stat st cs. However, there w ll be some d fferences between the publ cat ons, related to the new scope and mproved def n t ons n the EFS data collect on. For nstance, NAB understands that the Monthly ADI Stat st cs nclude data for certa n nst tut ons that were not ncluded n the Monthly Bank ng Stat st cs.

Figure 1: HHI in supply of deposits 2013-2023[2]



Competition is driving positive consumer outcomes

Competition for retail deposits is delivering positive outcomes for Australian consumers, in the form of competitive pressure on pricing as well as product innovation and service.

NAB has regard to the rates for deposit products set by a range of ADIs. In addition to the funding and prudential considerations outlined above, competition on rates constrains NAB's decisions and strategy for its own deposit rates, including anticipated rate movements following changes to the RBA cash rate.

Competition has also led to positive consumer outcomes in relation to fees for deposit accounts, with competitive pressure to offer many fee-free aspects of accounts, such as account keeping fees and ATM fees.

As noted at the outset of this response, retail deposit products also face competition from other forms of financial and investment products that might bear a return for consumers. For example, savers might consider investing their money in a savings or term deposit account bearing interest, or they might alternatively consider other financial products such as, among other things, investments in bonds, shares, managed funds or increased superannuation contributions.

The decision concerning which deposit or financial product to choose will depend on individual consumers' needs, such as the term for which they intend to invest the money, whether they want to be able to access their money during this time and their personal risk appetite, as well as current financial market conditions and the performance of alternative investment products.

Competition, particularly from smaller ADIs and newer entrants, has led to innovation in the features and services offered for deposit accounts. This has included:

- innovation in customers' digital experience, through online banking, banking apps and compatibility with fintech solutions;
- significant advances in payment technologies accompanying retail deposit products (and particularly for transaction accounts), for example, digital wallets;
- improvements in origination processes and platforms, making the consumer experience for acquiring deposit products as fast and simple as possible;

[2] APRA, Monthly ADI stat st cs. As set out n footnote 1, the d fference between data for 2019 and 2020 may be nfluenced by the fact that APRA trans t oned from Monthly Bank ng Stat st cs to Monthly ADI Stat st cs.

- the development of tools that allow customers to optimally manage their financial position according to their individual needs; and
- innovation in payment options, including the rise in Buy Now Pay Later products, many of which are often linked to transaction accounts, which allow customers to manage their cash flow by splitting payments into smaller instalments.

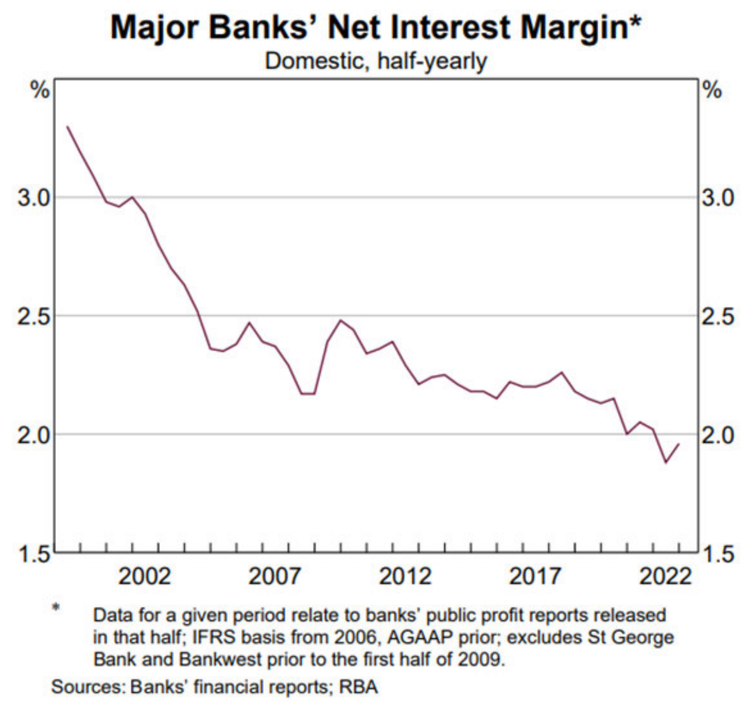
This innovation has been driven by a range of ADIs, including the major banks, which have invested in new services as well as improvements to the customer experience.

Competitiveness evidenced by declining margins

The strong and increasing competition between ADIs, including for retail deposits, is evidenced by the long-term consistent decline in the profit margins achieved by banks since de-regulation in the early 1990's. As the ACCC is aware, the NIM is the difference between the cost to a bank of borrowing funds (including interest paid to depositors) and the price it receives for lending funds.

As Figure 2 shows, the overall bank NIMs of the major Australian banks have been consistently falling over the last 25 years. By contrast, as recognised by the Productivity Commission in 2018, NAB understands that the non-major Australian owned ADIs consistently increased their NIMs between 2009 and 2017, and have been higher than the NIMs of the major banks.

Figure 2: Overall NIM of Australian banks – RBA published data[3]



As historically low global cash rates recently started to increase, there was a corresponding increase in NIMs in Australia, although still at levels well below historical rates. However, the intense competition occurring in the deposits and lending markets meant this impact on NIM was temporary and NIMs are once again in decline.[4]

[3] Reserve Bank of Austral a, Chart Pack "Major Banks Net Interest Marg n", Released on 3 May 2023 (data updated to 27 Apr l 2023).
[4] As s set out n NAB's Half Year Results 2023 Investor Presentat on, NAB's NIM decreased from 1Q23 to 2Q23. See: https://www nab com au/content/dam/nab/documents/reports/corporate/2023-ha f-year- nvestor-presentat on pdf, page 20.

Entry, growth and the ease of customer switching

Smaller ADIs do not face meaningful barriers to profitability or effectively competing for deposits

NAB does not consider that smaller ADIs or new entrants face cost or scale disadvantages which impact their ability to compete for deposits. While their costs of funding may be different to the major banks in some respects, differences in their overall costs – including the impact on funding costs of lower regulatory capital requirements – mean that smaller ADIs have achieved higher NIMs than the major banks in recent years. For example, the major banks face larger operating costs associated with branch networks and greater overhead costs.

NAB considers that the stable and trusted Australian prudential framework also lowers potential barriers to growth for smaller ADIs and new entrants. In many overseas jurisdictions, there has been a material “flight to quality” resulting from recent market conditions and banking instability, meaning that consumers have switched their deposits away from smaller or less established banks. NAB does not believe that the Australian market has experienced an equivalent impact, with consumers having much higher confidence to keep their deposits with smaller and newer ADIs.

The ease of switching deposit products

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 (e.g. due to instant transfers through Osko).

Given the low (or zero) cost of holding a savings account, customers will often “multi-home” across a number of deposit accounts, and have the ability to move funds between existing or new accounts to maximise interest returns on savings funds or to take advantage of different product features.

While some deposit products, such as term deposits, have a commitment or interest rate certainty or an incentive reflected in higher interest rates associated with tenor, the decision to acquire these types of products usually reflects consumer preferences for such commitments rather than the ability to switch.

Generally, interest rate offerings for deposit products are not complex and should not be difficult for most consumers to understand. While some products may include a different rate for a period of time (e.g. introductory periods) or when regular contributions are made to the account, these offerings also reflect consumer demand.

Entry, including by fintechs, is contributing to positive consumer outcomes

The increase and growth of financial institutions in Australia (and in particular, more recent and anticipated entry from fintechs and global technology companies) is changing the nature of banking in Australia, including for retail deposits.

Examples of new entrants competing for retail deposits include Judo Bank, which offers a range of term deposit products, and Alex, which is a digital bank offering both savings and term deposit accounts. Tyro has also entered the business deposit market, offering a range of banking accounts and term deposits.

In addition, 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. For example, Apple has recently launched the Apple Card high interest savings account in the US and could look to launch similar products in Australia in the future.

Smaller ADIs and new entrants are able to respond with agility to changing consumer demand, including through vigorous pricing, product innovations, modern technology platforms and service channels. As explained above, this has resulted in non-major ADIs steadily growing their share of retail deposits in Australia.

Competitive pressure from smaller ADIs and fintech entry in particular has helped to drive positive consumer outcomes in terms of the product innovation and service offering described above.

Conclusion

As shown by the consistent decline of the major bank NIMs, competition for both deposit and lending products is strong in Australia. This is leading to positive consumer outcomes, including in respect of competitive rates, innovation and the abolishment of many types of fees. There are low barriers to customers switching between retail deposit products which has led to many consumers holding multiple accounts between and at banks, with the ability to easily move their money between accounts to suit their needs.

Given the broad range of factors that influence decisions concerning the pricing of deposit products, including their significance from a prudential and risk management perspective, any assessment of the competitiveness of the retail deposit market must take into consideration factors beyond responses to the RBA cash rate.

Sincerely,

Rachel Slade

Group Executive, Personal Banking