National Australia Bank

National Australia Bank Limited
ABN 12 004 044 937

500 Bourke Street
Melbourne Victoria 3000
AUSTRALIA

21 September 2009

Mr John Hawkins
The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Economics.sen@aph.gov.au

Dear Mr Hawkins,

Banking Amendment (Keeping Banks Accountable) Bill 2009

The following submission is made on behalf of National Australia Bank Limited (NAB) in response to the Committee's Inquiry into the Banking Amendment (Keeping Banks Accountable) Bill 2009. NAB has also contributed to and supports the submission to this Inquiry made by the Australian Bankers' Association (ABA).

This submission reflects the importance NAB attaches to being accountable for our decisions to our 3.3 million Australian customers, our shareholders and the wider community. The submission summarises the steps NAB has taken to help customers and the broader community understand movements in mortgage rates, especially as rates have become de-coupled from the Reserve Bank of Australia's official cash rate during the global financial crisis. NAB would welcome suggestions from the Committee on further steps we could take to increase the transparency and accountability of our interest rate decision making. We do not believe, however, that regulatory intervention is necessary to achieve greater transparency.

The key points of our submission are:

- since the beginning of the global financial crisis, the costs of funds used to support mortgages and other lending has increased significantly and is no longer accurately reflected by the cash rate set by the Reserve Bank of Australia; and

- NAB has taken a number of steps to increase the transparency of interest rate setting for our customers, regulators, Government and the wider community.

NAB's cost of funds

NAB's three key sources of funds are:

- customer deposits;
- wholesale term funding (usually 2-5 years); and
- short-term wholesale funding (usually 1-6 months).

Wholesale funds are sourced both domestically and from overseas.

Both short-term and long-term wholesale funding costs have increased significantly since the global crisis began. The crisis closed many markets from which funding was drawn, making funds more scarce and therefore more costly. Wholesale lenders have also become significantly more risk averse and are therefore demanding greater returns on funds lent to commercial banks.

In the case of long term funding, these costs have risen from an average of between 0.15 % and 0.20% pre-crisis to over 1.70% in the half year ending March. Recently, term funding costs have eased, but still remain well above pre-crisis levels and are expected to remain so into 2010.

The global financial crisis has also caused short term funding costs to rise sharply as banks have needed to raise more money onshore. Pre-crisis, short term funding costs averaged 0.07%-0.10%, but post-crisis, these costs have averaged 0.45%. As financial markets have become more stable, short term funding costs have eased, however they remain volatile.

As international markets have become difficult and expensive, NAB and other Australian lenders have increased their reliance on consumer deposits. Increased demand for deposits has seen their price rise by around 1% over the past 12 months and the rise is expected to continue.

Cash rate and cost of funds

As NAB understands the Bill, one of its key premises is that the cash rate set by the Reserve Bank of Australia (RBA) should be the sole determinant of banks raising or lowering standard variable interest rates.

As set out above, since the global financial crisis began in 2007, the relevance of the cash rate as an indicator of market funding costs has diminished, given the increased influence of global events. These events have increased the cost of offshore wholesale borrowing and made access to overseas markets more difficult.

Over the recent period of RBA cash rate reductions, the market cost of funds has continued to rise independently of the cash rate. Despite this, Australia's major banks have endeavoured to pass on interest rate cuts. It has been identified by the RBA[1] that the major banks have passed on 55 basis points more in reductions to standard variable rates than the average reduction in overall funding costs over the same period.

[1] June 2009. Reserve Bank of Australia Bulletin 'The impact of capital market turbulence on banks' funding costs'

Transparency

NAB has acknowledged that there is more we can do to help our customers understand the factors that determine how we set interest rates. We are aware that the disconnect between the RBA cash rate and bank interest rate movements has left many in the community feeling confused and even suspicious. That is why we have, publicly, set ourselves the challenge to improve the level of information we provide to our customers, the public and the media around our decisions on interest rates.

Since August 2008, when we held a media briefing to explain the key impacts of the global financial crisis, we have provided detailed explanations and information on the costs of funds to customers as well as the media and other stakeholders.

With each adjustment in our variable mortgage interest rate NAB has publicised and made widely available detailed information on our over-all funding costs and how these have impacted our decisions on rates. In addition to our scheduled updates, we regularly brief and respond to media requests around credit funding costs, as media reporting is also an effective conduit to our customers and the wider public.

As you will see from the most recent information pack from April 2009 (Annex 1) and a previous pack from February 2009 (Annex 2), we aim to make this information comprehensive and meaningful to our customers. The screen shot taken from the internet page that led internet customers to our April pack shows clearly how we can make this type of information accessible and meaningful, by explaining the impact of reductions in interest rates on an average $250,000 home loan (Annex 3).

NAB is committed to continuing and improving this level of transparency. Speaking publicly in March 2009, NAB CEO Cameron Clyne said

> *At NAB, I have set us the challenge of working towards being transparent with our customers on funding costs and their impact on interest rates*[2].

In conclusion, NAB reiterates its commitment to continue the practice of explaining key developments to our customers and more broadly. This is, we believe, an effective means of meeting our own commitment to accountability. NAB would however welcome any suggestions from the Committee on steps it could take to further enhance the transparency around interest rate decisions.

If the Committee would like to discuss further any of the issues raised in this submission, please contact me (Steven.Munchenberg@national.com.au or tel 0418 597 917).

Steven Münchenberg

Group Manager, Government Affairs & Public Policy
National Australia Bank

[2] Cameron Clyne, NAB CEO, Address to the Australia Israel Chamber of Commerce, Melbourne, 25 March 2009