NATIONAL AUSTRALIA BANK SUBMISSION

Productivity Commission Inquiry into Competition in the Australian Financial System: Draft Report

20 March 2018

CONTENTS

I. INTRODUCTION

National Australia Bank (NAB) welcomes the opportunity to respond to the Productivity Commission's (PC) Inquiry into Competition in the Australian Financial System Draft Report. This builds upon NAB's submission to the PC's initial consultation in September 2017, and statements made at public hearings in March 2018.

A competitive, resilient and well regulated financial industry is critical to Australia's ongoing economic stability and the growth of the broader economy. These factors also play an important role in ensuring good customer outcomes.

NAB strongly believes the Australian financial system is competitive; we note the further work underway designed to improve customer outcomes, such as comprehensive credit reporting, Open Banking, reforms to design and distribution obligations and the introduction of the Australian Financial Complaints Authority (AFCA).

At the same time, Australian banks are taking steps to ensure they are 'unquestionably strong', in response to the implementation of recommendations in the Financial System Inquiry (FSI). While sound management and strong prudential oversight saw Australian banks weather the Global Financial Crisis (GFC) well, the domestic and global landscape has changed significantly in the past decade. As other jurisdictions implement further banking reform, Australian banks and the broader economy must also take steps to ensure that they remain comparatively attractive for investment, given Australia's status as a net importer of capital.

A stable financial system promotes economic growth and good customer outcomes; a fundamental aspect of this is banks' ability to maintain a sustainable level of profitability across the full economic cycle. Despite 26 years of continuous economic growth, Australian banks' margins continue to shrink. This is the result of sustained high levels of competition and related investments to innovate and improve customer outcomes.

Approach to the inquiry

NAB's response is organised into two key areas: the competitive landscape, addressing market dynamics and structure; and demand-side pressure, addressing the ability of customers to stimulate efficiency, transparency and customer-oriented products and services.

Where relevant, NAB has referenced the particular draft findings, recommendations or information requests contained in the PC's draft report, summarised in a table below (page 4). This submission also provides further information regarding some of the issues discussed during NAB's appearance before the PC on 1 March 2018.

We would be pleased to discuss any part of this submission further with the PC.

II. SUMMARY OF NAB'S RESPONSE

Topic	PC Draft Recommendation; Finding; Information Request	Addressed by NAB	Page ref.
Competitive landscape	Draft finding 2.1	✓	30
Competition and stability	Draft finding 2.2	✓	9
Competitive landscape	Draft finding II.1	✓	6
Demand side pressure	Draft finding III.1	✓	20
Oligopoly power	Draft finding 3.1	✓	6
Market consolidation	Draft finding 4.1	✓	16
Regulatory barriers to entry	Draft recommendation 4.1	X	-
Foreign banks	Draft finding 4.2	X	-
Fintechs	Draft finding 4.3	X	-
Fintechs	Draft finding 4.4	✓	16
ASIC regulatory sandbox	Information request 4.1	X	-
Cost of fund differences	Draft finding 5.1	✓	11
Cost of APRA interventions	Draft finding 6.1	X	-
Consolidation in financial advice	Draft finding 7.1	X	-
APS120	Draft finding 7.2	✓	15
APS120	Information request 7.1	✓	15
APS120	Draft recommendation 7.1	✓	15
M&A database	Draft recommendation 7.2	X	-
Interest rates across channels	Draft finding 8.1	✓	23
Cost of home loans across channels	Draft finding 8.2	X	-
Duty of care for aggregators	Draft recommendation 8.1	✓	25
Duty of care for aggregators	Information request 8.1	✓	25
Broker fee for service	Information request 8.2	✓	23
Broker disclosure requirements	Draft recommendation 8.2	✓	25
Collection of interest rate data	Draft recommendation 8.3	✓	22
Publication of interest rate data	Draft recommendation 8.4	✓	22
LMI refund	Draft recommendation 8.5	✓	21
Risk weights for SME lending	Draft recommendation 9.1	✓	14
Purchased payment facilities	Draft recommendation 10.1	X	-
ePayments Code	Draft recommendation 10.2	X	-
Unauthorised transactions	Information request 10.1	X	-
Banning interchange fees	Draft recommendation 10.3	✓	17
Merchant choice routing	Draft recommendation 10.4	✓	17
Access to the NPP	Draft recommendation 10.5	✓	18
NPP to facilitate switching	Draft finding 10.1	✓	21
Market power in general insurance	Draft finding 11.1	X	-
Consolidation of general insurers	Draft finding 11.2	X	-
Comparative pricing	Draft recommendation 11.1	✓	27
Transparency on underwriting	Draft recommendation 11.2	✓	27
Distortionary insurance taxes	Draft recommendation 11.3	✓	27
Scope of financial advice	Information request 12.1	✓	26
Renaming general advice	Draft recommendation 12.1	✓	26
Renaming general advice	Information request 12.2	✓	26
Switching with multiple accounts	Information request 13.1	X	-
Broker commissions and switching	Draft finding 13.1	✓	24
Rationale for broker commissions	Information request 13.2	✓	24
Switching	Draft finding 13.2	X	-
Red tape barriers to switching	Information request 13.3	✓	20

Data access for switching	Draft recommendation 13.1	X	-
Deferred add-on insurance model	Draft recommendation 14.1	✓	27
APRA consideration of competition	Draft finding 15.1	X	-
Statement of expectations	Draft recommendation 15.1	X	-
Residential mortgage risk weights	Draft recommendation 16.1	✓	13
Improving IRB accreditation model	Information request 16.1	✓	13
Ratings agencies	Draft finding 16.1	X	-
Four pillars policy	Draft finding 16.2	X	-
Competition function for regulator	Draft recommendation 17.1	X	-
Transparency of regulator decisions	Draft recommendation 17.2	X	-
Advancing competition	Information request 17.1	X	-
Macro-prudential policy analysis	Draft recommendation 17.3	X	-

III. COMPETITIVE LANDSCAPE – MARKET DYNAMICS & STRUCTURE

III.1 Concentration and contestability

Draft Finding 3.1: The Major Banks' Oligopoly Power
Australia's four major banks hold substantial market power, as a result of their size, strong brands and broad geographical reach. This is further supported by regulatory settings, which contribute to the major banks' structural advantages. As a result, the major banks have the ability to pass on cost increases and set prices that maintain high levels of profitability — without losing market share. The smaller banks and non-bank financial institutions follow the pricing trend set by the major banks, where they can. Size and scope, combined with regulatory advantages for the major banks, mean that competition from smaller institutions is not likely to prove sufficiently disruptive to offer consumers a market that is strongly competitive on prices.

NAB does not agree with draft finding 3.1. There are a number of assertions in the finding which are not supported by available evidence.

As outlined in NAB's previous submission to this inquiry, the Australian financial system has a large number of contestants and products and services.

- Australia has approximately 140 Authorised Deposit-taking Institutions (ADIs) in 2018, including the four major banks, foreign-owned banks, regional banks, building societies and credit unions, offering a wide range of products and value propositions.[1]
- Over 100 non-ADI system participants including Australian Financial Service licensees (regulated by ASIC) (for example, remittance service providers, peer-to-peer lenders, wholesale funders);[2] and more than 600 disruptive entrants including financial technology companies (fintechs).[3]

Market power

The PC asserts that Australia's major banks hold 'substantial market power' and that, as a result, 'the major banks have the ability to pass on cost increases and set prices that maintain high levels of profitability – without losing market share'.[4]

NAB competes strongly against all market participants and does not act collectively or in concert with any other market participant. NAB is not insulated from the effects of competition, which is objectively evident through changes to market share over time, as well as long term trend decline in profitability metrics. This is explained further below.

NAB market share

NAB's market share in key product lines as at the end of FY17 is set out below.

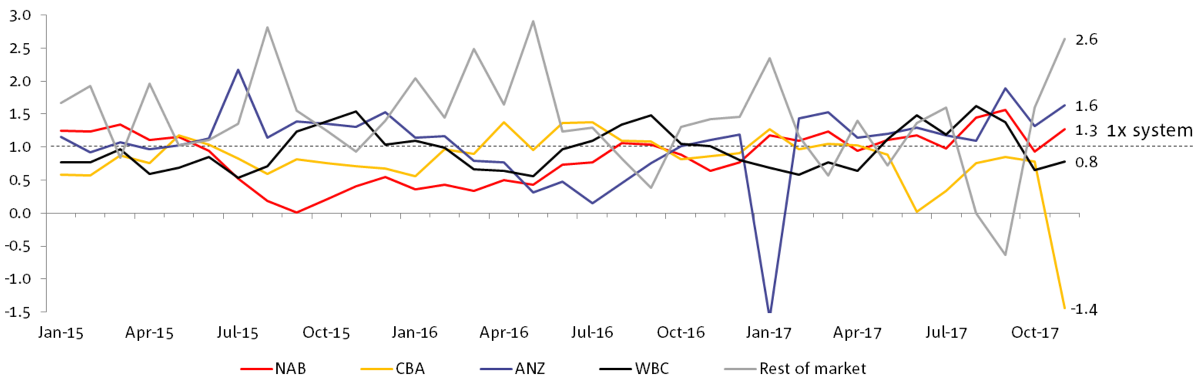
Business lending	20.4%[5]
Housing lending	14.6%[5]
Personal lending	10.6%[6]
Cards	13.6%[6]

[1] http://www.apra.gov.au/adi/Pages/adilist.aspx
[2] https://www.rba.gov.au/fin-stability/fin-inst/main-types-of-financial-institutions.html#nonadi
[3] EY FinTech Australia Census 2017, https://fintechauscensus.ey.com/2017/
[4] See also draft finding II.1.
[5] RBA.
[6] APRA.

Business deposits	19.5%[6]
Household deposits	14.2%[6]

This market share is measured on a 'stock' basis. Measuring market share by stock of lending is not a good indicator of the level of dynamism in the market. The size of existing lending stock in Australia compared to yearly flow of new lending means that changes in market share measured by stock can take time to occur. Measuring market share by 'flow' of new lending provides a clearer indication of competition in the market at any given point in time. Flow data is volatile, showing that the market is dynamic, but consistently shows smaller institutions (both ADIs and non-bank lenders) taking market share from the major banks.

Reflecting this competitive dynamic, mortgage flow data shows major bank market share is declining with the non-major financial institutions (the 'rest of the market') consistently growing market share (growing at greater than 1x system means increasing market share, less than 1x system means losing market share). The following charts are based on APRA data which excludes non-bank lenders, which are also increasing market share.



Annual average, year-end September (unless otherwise stated)

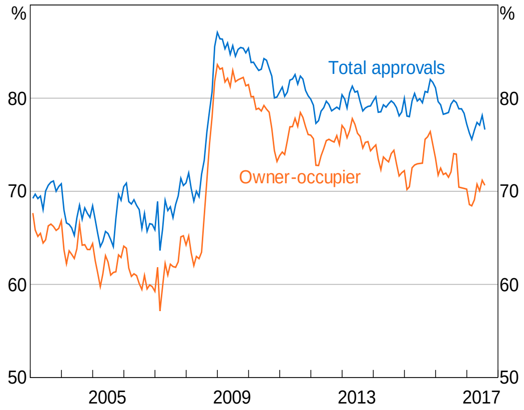
Institution	Sep-15	Sep-16	Sep-17	Nov-17 (YTD)
NAB	1.0	0.6	1.1	1.1
CBA	0.8	1.0	0.8	-0.3
ANZ	1.2	0.8	1.0	1.5
WBC	0.8	1.1	1.0	0.7
Rest of market	1.5	1.5	1.1	2.1

Note: YTD number based on financial year (i.e. number in table refers to average for Oct-17 and Nov-2017).

Furthermore, there is a long term trend of Australia's major banks losing market share. While the major banks collectively increased their market share in residential mortgage lending in the last 10 years, this can be traced almost entirely to two specific events around the time of the GFC: the first being the acquisitions of BankWest and St George by Commonwealth Bank and Westpac respectively; the second being the temporary but sustained disruption to securitisation markets, which impacted the ability of non-bank lenders to compete vigorously (securitsation markets have since resumed more normal operation). Since those events, the market share of the major banks has resumed a gradual declining trend. NAB's housing lending market share has declined since the global financial crisis. Any suggestion that there is a structural impediment to non-major bank financial institutions growing market share is not supported by available data.

Major Banks' Housing Loan Approvals*

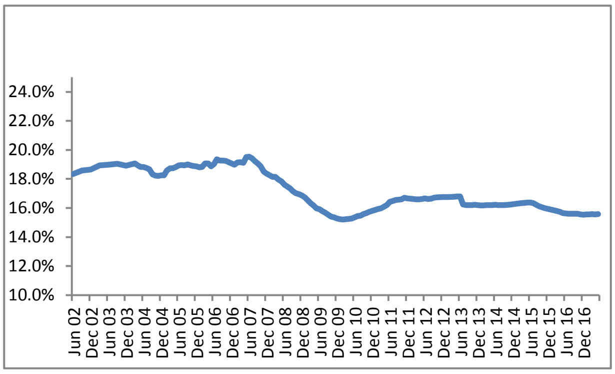
Market share



* Excludes refinancing; not seasonally adjusted or break-adjusted

Sources: APRA; RBA

NAB housing lending market share



Source: APRA

Pricing and profitability

We note the PC's comments regarding price rivalry and that profitability metrics indicate that price competition is weak.[7]

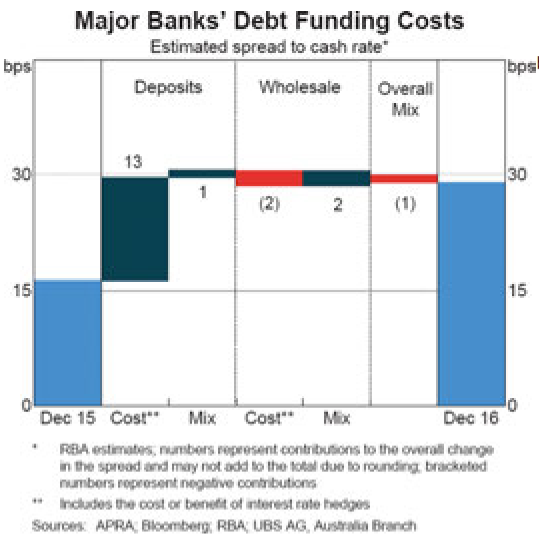
In NAB's experience, there is strong competition on price, and while we do not compete on price alone, it has an impact on flow. NAB sees very real market share ('volume' or 'flow') impacts from its own pricing decisions and those of other market participants, and is constrained in its ability to attract new customers and retain existing customers by price (and non-price based) competition from major banks and non-major lenders.

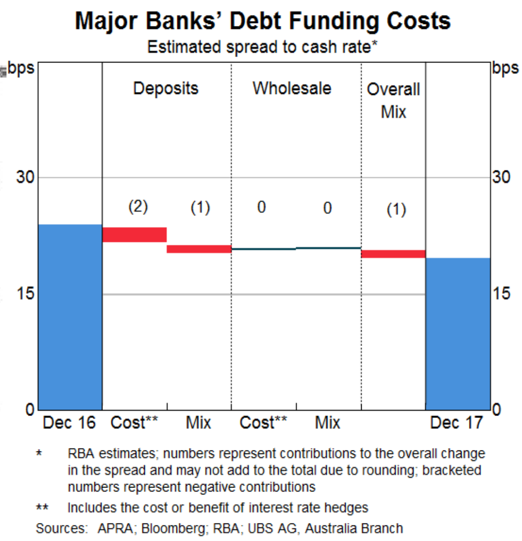
For example, of the requests received by NAB to negotiate a rate, a disproportionately high number of those requests were in relation to non-major banks relative to those banks' market share. These requests were responded to in equal measure to those queries received in relation to major bank pricing.

As a result of this competition, prices for residential mortgages products are close to historic lows in absolute and marginal terms (evident through our Net Interest Margin (NIM) decline). In a market with weak price rivalry, it would be expected that NIM would be large, or increase over time. This is not seen in the Australian market, where a steady decline has seen NAB's NIM more than halve over two decades, reflective of the broader market experience. The decline in NIM is also mirrored in declining return on equity (ROE). In the last 15 years, NAB's statutory ROE has declined by over seven percentage points – from 18.3 per cent in 2003 to 10.9% in 2017.

While funding costs have indeed fallen in recent years, each funding type has different costs which do not move in line with each other or the cash rate (see charts below). Regulations such as the Net Stable Funding Ratio mean NAB requires more deposits and longer term wholesale debt, which are more stable. This has driven deposit competition resulting in NAB paying more to customers for term deposits, relative to the cash rate. The price of international wholesale funding is also determined by supply and demand for Australian bank and NAB-specific debt in the global market rather than the Australian cash rate. Importantly, borrowing rates have fallen faster than deposit rates.

[7] PC draft report p117.





We also note the PC's suggestions that a decline in profitability is attributable to regulatory factors and the decrease in overall price the result of lower input costs (for example, the RBA's overnight cash rate), rather than strong price competition.[8] NAB believe that this draws the wrong conclusion.

To the extent that NAB's margins have declined due to factors such as holding more low yielding securities for regulatory reasons, or ROE has declined due to higher capital levels, then it is the competitive market that has prevented NAB from recouping those lost returns. If the PC's assertion about market power in Draft Finding 3.1 were true, repricing would be expected so as to maintain profitability (i.e. ROE) and margins (i.e. NIM), but this has not occurred in the Australian market. Statutory ROE is now at NAB's cost of capital. Any further reduction in ROE now may result in difficulty raising capital to support lending. This is, of course, precisely what economic theory would predict of a firm operating in a perfectly competitive market: it would be generating no more than a 'normal' profit (defined by ROE equal to its cost of capital).

III.2 Regulation and stability

Draft Finding 2.2: Competition and Stability Must Co-Exist
Competition and stability are both important to the Australian financial system. In order to preserve both, a genuine debate is essential before every material regulatory intervention. The stability of Australia's financial system has increased since the global financial crisis and prudentially regulated institutions are unquestionably strong. However, competition has suffered. It is important to ensure that the essential role of competition in economic growth is not eroded further by having stability as the default regulatory position.

NAB agrees that competition and stability must co-exist, with the correct balance delivering optimal consumer outcomes throughout the credit cycle.

It is important to keep in mind that whilst the principal mechanisms used by regulators to enhance system stability (capital ratios, liquidity requirements and risk weights) necessarily mean higher prices for bank customers, they simultaneously reduce bank profitability (that is, the average ROE is compressed relative to the bank's cost of capital). And they have no obvious impact on the competitive dynamics of the market. These points, which are expanded below, could be brought out more clearly in the final report.

8 PC draft report p7.

NAB strongly believes that a continuing focus on stability is fundamental to the ongoing sustainability and international competitiveness of the Australian financial system. As a net importer of capital, Australia is reliant on overseas confidence to maintain an efficient and well-functioning local market – this is a result of many factors, including the strong ratings, risk management, healthy profit levels of domestic banks and high regard for Australia's regulatory framework.

As stated in our previous submission, a safer banking system – the result of capital ratios, liquidity holdings and risk weights – is a more expensive banking system when compared with similar international markets. However, while prudential regulation may impact the price at which financial products and services can be sustainably provided, it does not necessarily impact whether there is strong competition in the market for those products or services. On a marginal basis, Australia's major banks' NIMs are in the range of large banks in other countries and close to that of Canada (with similar asset and funding composition and market structure).[9]

Additionally, while there may be a higher cost to consumers to maintain a more stable financial system during periods of positive economic growth, the Basel Committee on Banking Supervision has suggested 'the main benefits of a stronger financial system reflect a lower probability of banking crises and their associated output losses'.[10] In this way, stability can also deliver better and lower cost customer outcomes over the economic cycle.

Nonetheless, distortion has been seen through recent macro-prudential interventions. NAB agrees with the PC that the use of macro-prudential instruments, which amounts to a fundamental reshaping of the monetary policy framework and its system of governance, should have been given serious policy consideration, including a period of public debate. The public understanding of the interventions thus far has suffered from the less than transparent manner in which they have been introduced. Moreover, they have had a negative impact on competitive dynamics, in effect, entrenching market shares.

As stated in our previous submission, NAB supports balancing cost with financial stability and believes that any proposed reforms should take both stability and consumer impact into account. A fundamental aspect of this consideration should be the potential effect of proposed legislative or prudential reform on the competitiveness of Australian banks in international markets. For example, the major bank levy was introduced in part to improve competitiveness in the Australian financial system by offsetting the perceived cost advantages of the major banks.[11] NAB agrees with the PC's observation that the bank levy 'does nothing to improve competition' by artificially raising the cost of some banks in a domestic context. It has also affected Australian banks' international competitiveness, which must be considered given reliance on offshore wholesale funding sources.

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[9] Reserve Bank of Australia, *Submission to the Productivity Commission Inquiry into Competition in the Australian Financial System*, 2017, p15.
[10] Bank for International Settlements, *An Assessment of the long-term economic impact of stronger capital and liquidity requirements*, 2010, p1.
[11] Explanatory Memorandum, Major Bank Levy Bill 2017 (Cth), paragraph 1.9.

III.3 Funding and risk weights

Draft Finding 5.1 : Cost of Funds For Different Size Banks
Larger authorised deposit-taking institutions (ADIs) benefit from lower costs of funding, compared with smaller institutions, as they can access funding markets overseas more easily and have higher credit ratings, which in part reflect an expectation of government support. In addition, larger institutions gain a cost advantage from being allowed to use risk weights that are lower than the Australian Prudential Regulation Authority's standard requirements. These lower costs of funds are not fully passed on to borrowers in the form of lower interest rates. Attempts to artificially raise the cost of funds for larger institutions to offset their cost advantages do not improve competition and harm consumers.

NAB believes it is important to distinguish between the cost of funds and the amount of capital required to be allocated to lending (cost of deploying capital). While there are differences in the cost of funds for individual institutions, the lending profile and application of regulation to each institution also differs, with the result that cost of funds comparisons between different sized banks do not provide a comprehensive representation.

Cost of funds

NAB is not able to comment on the overall cost of funding for each organisation, given the different funding and capital structures of banks in Australia and reporting of funding costs is relatively limited. Larger ADIs such as NAB do have higher credit ratings, which is one aspect of facilitating access to larger volumes of overseas funding compared to smaller institutions. However, this is reflective of the structural differences between institutions, of which credit ratings are an outcome.

Factors driving these differences include balance sheet structure (capital, funding and liquidity profile), profitability, economic environment, regulatory requirements as well as implied/assumed government support. NAB notes that each ratings agency publishes its ratings methodology and the extent to which government support is incorporated. Importantly, NAB does not manage its business or balance sheet with the expectation of government support.

Specific factors that contribute to larger banks being able to access offshore funding and potentially cheaper funding sources include:

- Higher capital buffers, as required for those banks designated as domestic systemically important banks (D-SIB);
- More diverse funding mix of short term, long term wholesale and deposits; and
- More diversified earnings profile (through business lending, markets divisions et cetera).

Importantly, debt investors do not just rely on credit ratings to make investment decisions. The credit rating is an important part of investor mandates however the decision to invest in NAB and other major bank issuance reflects a range of other factors including the outlook for the Australian economy.

Cost of deploying capital

Under APRA regulation, Australian banks use a standardised or internal ratings-based (IRB) approach to credit risk. NAB believes that the IRB approach promotes better risk sensitivity in the capital framework and that all Australian banks should be incentivised to be IRB-accredited.

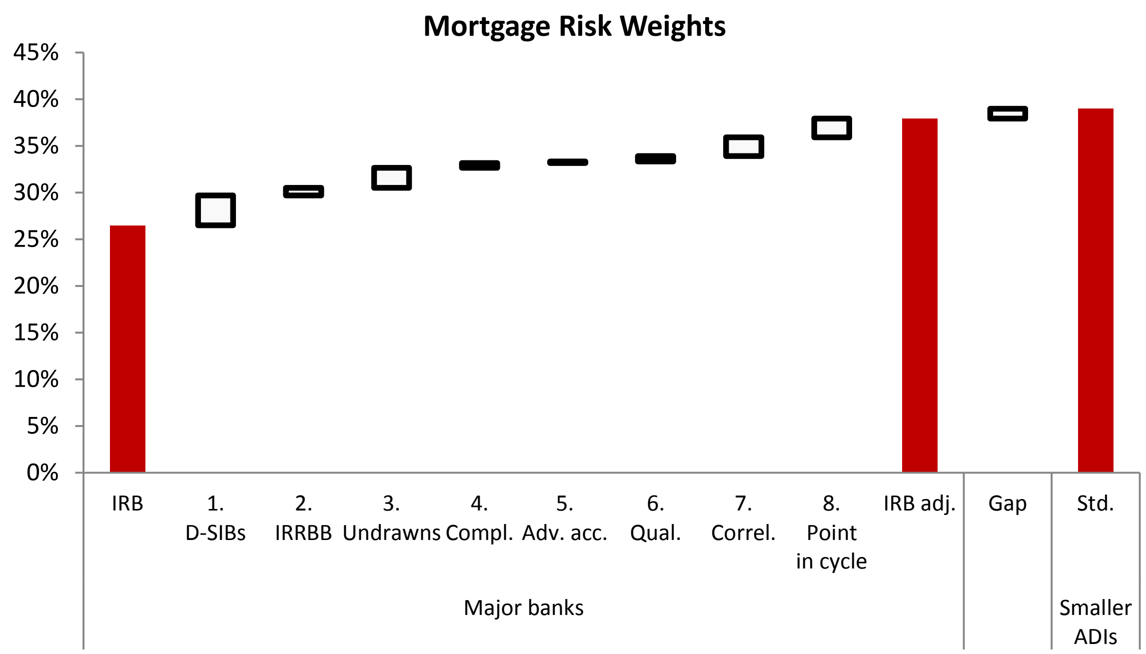
While headline risk weights would suggest that the cost of deploying capital is cheaper for an IRB accredited bank when compared with standardised risk weights, the competitive advantage of IRB/Advanced banks is nil or marginal once broader costs of holding advanced accreditation and broader costs imposed on Australia's major banks are taken into account. In addition, APRA has responded to the FSI's recommendation to narrow the gap between IRB and Standardised mortgage risk weights. This change, deployed in July 2016, saw NAB's average mortgage risk weight increase from ~18 per cent to ~27 per cent.

As detailed below, and as highlighted in NAB's submission to the FSI,[12] the difference between an advanced and standardised mortgage capital requirement is far less than headline numbers would suggest. To make a meaningful comparison, the following adjustments must be made to headline IRB risk weights:

- The higher capital charge to major banks from the D-SIB charge of one per cent;
- Requirements on advanced banks to hold additional risk weighted assets (RWA) for Interest rate risk in the Banking Book (IRRBB);
- The higher RWA requirement on IRB banks for undrawn (unutilised) balances;
- Systems and capability to obtain advanced accreditation;
- The significant compliance costs in maintaining advanced accreditation;
- The higher average credit quality of advanced portfolios versus standardised books. Delinquency is 2x higher for standardised banks. A riskier book should have more capital allocated. If an IRB bank book exhibited these risk characteristics, higher risk weights would be required;
- The greater portfolio diversification achieved by advanced banks; and
- The point in the economic cycle at which comparisons are made (i.e. IRB risk weights increase as historically low credit cycles normalise).

The remaining gap is not material for pricing decisions. It can be expected to close further as major banks implement APRA's approach to the FSI recommendation on being 'unquestionably strong'. The Major Bank Levy introduced in 2016 has also provided an additional cost to IRB banks.

Comparison – Standard versus Advanced



[12] NAB Submission to the Interim FSI Report, p12, http://fsi.gov.au/files/2014/08/NAB.pdf

Risk weights

Draft Recommendation 16.1: Review Standardised Risk Weights For Residential Mortgages
The Australian Prudential Regulation Authority should commence and complete a review of the standardised risk weights for residential mortgages set out in Prudential Standard APS 112 by June 2020. The review should be focused on more finely calibrating the risk weights to better reflect the risk inherent in individual mortgages. In particular, consideration should be given to replacing the single risk weight that applies to standard eligible residential mortgages with a loan-to-valuation ratio below 80% with risk weights defined in more narrow bands.

We note APRA has released a discussion paper on 14 February 2018 that includes changes to APRA 112 which largely addresses this draft recommendation. NAB supports the approach of introducing more granular risk weights, however believes that a less sophisticated (i.e. standardised) approach should still attract a regulatory capital premium.

The proposal for all IRB banks to formally calculate risk weights on a standardised approach will provide comparability and transparency of risk measured on a uniform basis across the industry.

While final impact on RWAs cannot be calibrated at this time, under the proposed changes in the discussion paper, IRB risk weights will increase, and as a consequence likely reduce any remaining gap with the standardised approach.

Information Request 16.1: Where Can IRB Accreditation Processes Be Improved?
We are interested in any suggestions for improvements to the internal risk-based (IRB) accreditation process to make IRB modelling more accessible to non-major banks. Of particular interest is: • Information on existing international programs or proposals for alleviating data requirement burdens (such as use of external/shared loan data) • Availability of expertise to develop IRB models outside of major banks and potential to outsource IRB model development (or for external parties to develop 'off the shelf' solutions) • Any other recommendations for APRA's accreditation processes (such as process transparency)

The standardised approach to credit risk has risk sensitive elements. However, by design, this approach cannot be tightly tuned to the credit risk framework embedded in any individual bank's lending assets and therefore has limited use in informing management and providing it with tools to manage credit risk. In contrast, as the IRB approach dynamically models credit risk at the facility level, it is able to be used to inform and manage that risk. This is the intent of IRB accreditation and accordingly the models are not a means to an end but instead serve to inform a bank about its own portfolio.

In terms of expense and accessibility to non-major banks, the actual process of modelling is relatively inexpensive. Major sources of cost typically come from the ecosystem required to use the models (rating systems, reporting and portfolio management) or maintain models (data and model maintenance). In relation to the particular questions posed in information request 16.1:

- System outsourcing technology continues to evolve (for example, cloud based solutions) and cost effective solutions may feature prominently in the near future.
- In relation to alleviating data requirement burdens through shared data, if done well, this would be a service to the entire industry. For example, Global Credit Data provides such a service for low default, institutional data that any one bank would lack for modelling and monitoring purposes.
- Care needs to be taken in relation to 'off the shelf' solutions, as the purpose of the IRB approach is to enable modelling and risk management for each bank's own portfolio. In this sense, sufficient expertise must be kept in-house though efficiencies and cost effectiveness can be gained with supplementing internal expertise with industry providers.

Draft Recommendation 9.1: Standardised Risk Weightings For SME Lending
Instead of applying a single risk weight to all small and medium business lending not secured by a residence, the Australian Prudential Regulation Authority (APRA) should provide a broader schedule of risk weights in its Prudential Standard APS 112. It should take into account the different risk profile and the type of lending (such as the value of the loans made to an individual business and alternative forms of loan security including commercial property and differing loan to value ratios on this security) to better reflect the Basel Committee's standardised risk weightings. International best practice should be closely considered. In light of apparent major improvements in the use of Artificial Intelligence algorithms and data collection via the new payments platform, APRA should consider proposals by ADIs for variations to the standardised risk assessment for business lending, based on their data and risk management systems.

As stated above, NAB supports the introduction of more granular risk weights, noting that a standardised approach should still attract a regulatory premium which reflects its less sophisticated assessment of risk. NAB believes that greater granularity could be considered through security type, LVR, and industry at a minimum. Final calibration should be assessed using consolidated industry level data.

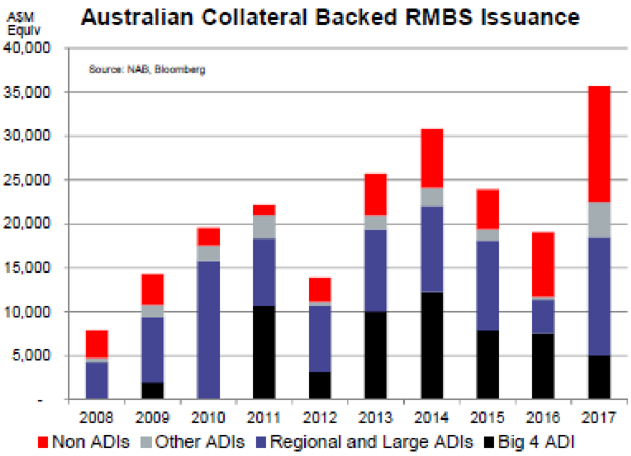
In relation to the use of artificial intelligence algorithms and data collection through the new payments platform (NPP), while there have been improvements in artificial intelligence (AI), primarily due to advances in processing speed and memory capacity, there is insufficient understanding of how AI and machine learning (ML) algorithms perform under all conditions. These algorithms tend to be heavily point-in-time and there is little available literature or practical experience on performance throughout an economic cycle or in severe downturns – requisite requirements for unexpected loss and the basis of the Basel III framework.

NAB believes that AI/ML has a significant future role to play in credit and credit decisioning. We note though, these techniques are also data intensive and rely on systems and processes to collect, maintain and report on this data as well as model maintenance cycles that would typically be more onerous than (or at least on par with) IRB accreditation.

III.4 Integrated services – warehousing

We note the PC's interest in the integrated nature of the financial system, where institutions can be both a competitor and customer. This is an important aspect of the market; particularly for smaller ADIs, where 'funding only' warehouses may be used in the lead up to issuance of residential mortgage backed securities (RMBS) to capital markets. In this circumstance, the warehouse provides access to a form of 'wholesale' funding that may otherwise be unavailable. Non-bank lenders are reliant on capital markets to sustain their business funding.

Prior to the GFC, RMBS markets provided a funding source for competitors in the mortgage market, with this reflected in major banks' market share. However, the GFC saw availability of these markets considerably reduce. In recent years has seen this market re-emerge as a funding source for mortgage originators, non-bank lenders and smaller ADIs.



The effects of APS 120 and warehousing

Information Request 7.1: How will Prudential Standard APS 120 affect you?
We are seeking detailed estimates or hypothetical scenarios of how revised APS 120 will affect warehouse costs for standard ADIs and non-ADIs. We are also seeking estimates of the costs of obtaining similar levels of finance to that obtained through warehousing, such as through commercial loans in retail markets.

While NAB does not raise finance through warehouses provided by other ADIs, is is a significant provider of warehouse funding to smaller ADIs and non-ADI lenders.

Given their more extensive access to alternative liabilities (deposits, senior unsecured, covered bonds et cetera), ADIs are the only real users of the 'funding only' approach, while non-bank consumer lenders have limited alternative financing tools. In considering a more graduated approach to warehousing, in line with the PC's draft recommendation and findings on this issue, NAB believes attention should be given to the distinctions between 'funding only' and 'capital relief' warehousing, as well as the double counting of capital for credit risk in a common pool of assets.

For 'funding only' warehouses provided to originating ADIs, the result of the changes to APS 120 sees a significant increase in regulatory capital in the financial system, given the originating ADI would still be risk weighting assets (predominantly residential mortgages) on its balance sheet and the financial intermediary is risk weighting assets pursuant to APS 120.

In contrast, warehouses for non-bank lenders do not have the same 'double counting' issue as the non-bank lender is not required to hold regulatory capital for the underlying assets in addition to regulatory capital applied to the warehouse itself. As frequent issuers (funding through recycling their assets from warehouse to term markets), non-bank lenders arguably warrant a lower 'loss horizon' consideration for the purposes of regulatory capital applied to warehouses.

In this context, we note that on 14 February 2018, APRA released a discussion paper including a proposal for changes to APS 112 risk weights, which will directly affect APS 120 risk weights for unrated exposures.[13] The paper proposes an increase to the risk weights for auto, equipment and personal loans from 100 per cent to 125 per cent (in contrast, the Basel Committee proposed a decrease from 100 per cent to 75 per cent). This will significantly increase the cost for non-ADI borrowers and users of securitisation.

[13] See PC draft finding 7.2, information request 7.1 and draft recommendation 7.1.

As discussed at our appearance before the PC on 1 March 2018, NAB believes that more can be done in Australia to facilitate an increase to fixed income investment, which will have the consequence of supporting wholesale markets and therefore benefiting competition.

III.5 New entrants

The competitive landscape is undergoing significant change, with new entrants across all parts of the sector. In particular, fintechs and other new entrants are using the increasing digitisation of financial services to segment and modularise the sector; while there may be little material change to the number of ADIs in Australia (indeed the trend is declining),[14] there are a growing number of companies which target aspects of the traditional end-to-end role of banks.

The competitive effect of new entrants such as fintechs is most evident in the payments and unsecured consumer and small business lending sectors, with many new entrants gaining traction. These new players are using technology (AI, automation, user experience design) to either offer an improved customer value proposition or reach new customers (where once branches were a requirement to enter the market).

Collaboration with fintechs delivers new capabilities that benefit our customers, which can differentiate NAB from our competitors (both incumbents and new entrants). Such partnerships are beneficial for NAB, as NAB can go to market more efficiently, and are beneficial for the fintech, which achieves rapid scale.

In the context of the PC's draft finding 4.4, NAB believes the fact fintechs are also seeking to collaborate with incumbent banks does not mean that they are not developing services to benefit competition more generally. In fact, the vast majority of fintechs can and do compete with incumbent market participants. As well, partnerships with banks may enable them to attain greater insight into delivering more competition to the market while also assisting incumbent banks in providing more cost effective, transparent and competitive propositions.

NAB agrees that access to consumer data may lower barriers to entry for fintechs as it will improve price and functionality transparency for customers, enabling them to understand competing offerings (see also below at page 17).

III.6 Payments system

As detailed in our previous submission, the rapid evolution of technology and customer expectations are driving three major trends in payments:

- Frictionless digital payments;
- Value add services; and
- New banking networks.

These trends have seen significant investment, uplifted customer outcomes and improved efficiencies in the payments system, through initiatives such as contactless payments, mobile wallets and the NPP.

[14] PC draft finding 4.1

Draft Recommendation 10.3: Ban Card Interchange Fees
The Payments System Board should introduce a ban on card payment interchange fees by mid-2019. Any remaining fees should be directly related to the costs of operating the system. Such fees should be made transparent and published.

NAB does not agree with the PC's draft recommendation that interchange fees should be banned. Changes to interchange and interchange regulation were proposed in both the 2014 FSI and the RBA's 2015 Review of Cards Payments Regulations. NAB supported many of the recommendations in these reviews including the RBA's standardised system of regulation of interchange fees, which was implemented by the RBA on the 1 July 2017. The effects of this change should be reviewed and considered in due course, to see if further changes are necessary.

NAB supports actions that increase the positive contribution from electronic payments in the economy and is of the view that an unintended consequence of a ban on card payment interchange fees could be to diminish this contribution moving forwards. There is a significant annual cost attached to running the interchange system; though the PC has proposed a cost recovery mechanism as part of its recommendation, NAB believes additional changes to this system of interchange regulation risk stifling investment and innovation in electronic payments – from both incumbents and new entrants – an outcome that is not in the interests of consumers, businesses, or participants in the payments system.

Draft Recommendation 10.4: Merchant Choice of Default Network Routing
Merchants should be given the ability to choose the default network to route contactless transactions for dual-network cards. As the technology is readily available, this option should be offered from 1 January 2019 at the latest. The Payments System Board should require that neither a scheme, nor any of its participants (including issuers and/or acquirers), can prevent merchants from setting (or asking their acquirers to set) the default route.

NAB is committed to delivering simple, reliable and cost-effective payment solutions to our merchant customers, whilst maintaining the integrity of the payments system and preserving cardholder choice and experience.

There are significant investments in card innovation, such as contactless payment, instant issuances, fraud prevention and consumer protection. Should the PC's recommendation be taken up, NAB believes it is important to manage the end to end customer impact, and mitigate the risks that can arise in changing from a 'consumer centric' model to a 'merchant choice' model, including:

- Many card propositions for customers are attached to the scheme and not the bank (including extended warranty, rewards, cash-back and various insurances, such as purchase protection); and
- Introduction of friction and inconsistency into an otherwise simple process, potentially increasing the time taken to complete a transaction, creating confusion for customers, and the possibility of incorrect or unintended accounts being debited.

Enabling merchant choice routing requires technical work for both issuers and acquirers, and NAB believes this should be aligned to consistent industry standards.

Draft Recommendation 10.5: Access Regime For The New Payments Platform
The New Payments Platform (NPP) is a significant piece of national infrastructure that can benefit competition in retail banking and payments. But more transparency is needed to facilitate third-party access. The NPP should be subject to an access regime imposed by the Payments System Board. As part of an access regime, the Payments System Board should: • review the fees set by participant entities of the NPP and transaction fees set by New Payments Platform Australia • require all transacting participant entities that use an overlay service to share de-identified transaction-level data with the overlay service provider • consult the Australian Competition and Consumer Commission on the final design of the data sharing obligations.

The launch of the NPP in early 2018 is the result of significant innovation and investment by incumbent industry participants, and is a real-time and data-rich system that will provide the foundation for innovation beyond the initial features of fast payments, Osko and PayID.

The NPP was launched on 13 February 2018 by NAB, and offers fast payments and PayID to both consumer and business customers through online and mobile channels. Already, around 4.7 million NAB customers have around eight million transaction and savings accounts enabled for fast payments. In the three weeks following the launch, NAB customers have received approximately 100,000 inbound payments and sent almost 400,000 payments.

In an increasingly digital world, and with customers' evolving demand for immediacy and frictionless user experience, we see businesses continuing to innovate in order to service their customers more efficiently. NAB supports this pursuit and expects, over time, competitive pressures will see the NPP participants increasing and subscribing to additional overlay services building on the foundation work recently delivered.

NAB supports the position referred to in the recent speech by the RBA's Assistant Governor Michele Bullock, in that we have reason to be "optimistic that access will not be an issue". With assurance through NPPA's board structure that includes a director representing the RBA, and if necessary the power of the RBA to designate and set an access regime.[15]

III.7 Customer satisfaction

NAB continues to make significant investment in technology, digital innovation and customer experience to remain competitive.

Product and service differentiation
"*As in many other sectors in the economy, financial service providers offer a choice of products varying to some extent on price, service, product features and add-ons to attract additional customers, enhance existing customer satisfaction and prevent loss of customers.*" (PC draft report, p7)

Customer expectations continue to change and are increasingly shaped by non-banking experiences. NAB believes customer satisfaction is also indicative of competition in the market. The general upward trend reflects banks' significant investments in innovation designed to improve customer experience and remain competitive.

As stated in our previous submission, NAB uses the Net Promoter Score (NPS) to provide a more detailed analysis of customer satisfaction. In doing so, NAB also promotes a customer-centric focus by linking staff remuneration to customer advocacy levels.

[15] http://www.rba.gov.au/speeches/2018/sp-ag-2018-03-13.html

While a cohort of customers are indeed driven by price, NAB rejects the proposition that price is the most important factor considered by all customers.[16] Market research performed by the RFi Group in June 2017 using NAB Mortgage NPS data found that the most important attributes driving positive NPS scores were:

1. Feeling their home loan offers the features and benefits that meet their needs.
2. Feeling their home loan offers good value for money given the features and services available.
3. Price considerations (competitive interest rate and fees) ranked equal third along with customers' desire to feel valued by their lender.

Reflecting this, NAB is focused on improving its customer proposition, so as to differentiate NAB's products and services in a highly competitive market. Operationally, NAB is continuing to use NPS to improve customer 'pain points', and in the financial year to July 2017, resolved over 200 customer 'pain points', seeing a 10 per cent reduction in complaints for mortgage account openings and 60 per cent reduction in complaints for small business account openings.

NAB is also investing significantly in the broader customer experience, particularly through our Customer Journeys program, which is designed to improve the end-to-end experience when a customer interacts with NAB.

[16] PC draft report, p375.

IV. DEMAND-SIDE PRESSURE – SWITCHING & TRANSPARENCY

Draft Finding III.1: Consumers' Capacity to put Competitive Pressure on Providers is often Limited
For many financial products, consumers are limited in their responses to variations in price and service and currently cannot be a source of significant competitive pressure on financial institutions. Consumers face information and switching barriers; and they perceive insufficient ongoing difference between providers and product offerings to make the process of switching worthwhile.

The PC suggests a number of factors which inhibit customers' ability to place competitive pressure on product and service providers, to the detriment of greater efficiencies and investment in customer focused outcomes.

NAB is in the process of halving the number of proprietary products offered, as part of our simple bank agenda. This will enable customers to more easily understand our product and service propositions.

IV.1 Switching and availability of information

In contrast to the PC's conclusion that switching is low,[17] NAB's experience would suggest that switching is at healthy levels, and increasing. In recent years, the average rate of switching across key product lines has been approximately seven per cent for SME loans (refinanced to or from other institutions); eight per cent of credit card accounts (moved to a lower rate credit card or personal loan, both within NAB and other institutions); and approximately 15 per cent of all new home loans originated at NAB are refinancing from another financial institution without any property transaction included.

NAB believes switching levels are a result of competition that promotes innovation and improved products and services, as well as the removal of some barriers to switching such as exit fees. Reforms currently in progress such as Open Banking will also have the potential to further increase levels of switching.

However, NAB agrees more can be done, particularly in relation to regulatory barriers.[18] For example, in relation to mortgages, state based property laws, state based property and security registration processes and fees, the slow and inconsistent update of e-conveyancing and AML/identification issues mean it is difficult to offer a seamless switching process. Reform that reduces frictions and promotes consistency across jurisdictions would be of benefit. In this context NSW has recently sought submissions on a discussion paper which examines whether contracts and other parts of the conveyancing, leasing and mortgaging processes (like disclosure) can be made electronic.[19]

[17] PC draft report, pp381, 382.
[18] PC information request 13.3.
[19] NSW Office of the Registrar General, *Discussion paper – removing barriers to electronic land contracts*, 2017.

Draft Recommendation 8.5: Lenders Mortgage Insurance Refund
The Australian Government should require all lenders to offer home loan customers refunds for the cost of lenders mortgage insurance when customers choose to refinance or pay out their loan. The refund schedule for the remaining life of the loan should be set and made available to the borrower at the time the policy is started.

NAB has external providers of LMI. While we note the intent of the PC's recommendation, there are complexities that need to be considered. Were insurers required to refund premiums, this may affect their capital pool and therefore risk profile. Given insurers need to make a return in order to continue providing insurance, there is the potential that requiring an LMI refund might see the premium rise.

Draft Finding 10.1: The New Payments Platform Could Do More To Ease Customer Switching
The New Payments Platform's addressing service, PayID, has the potential to improve competition by making it easier for customers to switch financial institutions or products. However, at launch, PayID will have very limited functionality. New Payments Platform Australia Limited and its participating financial institutions have the capacity to improve the capability of PayID to give customers the ability to both send and receive *recurring* bank transfers, direct debits and card payments. Changing bank accounts with many direct debits, or credit cards with recurring charges, would then require only a single update, removing one of the apparent reasons why there is limited switching of accounts.

NAB agrees that as the NPP develops, it will further facilitate switching, particularly through the use of PayIDs in place of account and BSB numbers. Additionally, other in-progress reforms will also deliver strong competitive benefits; the open banking regime will lead to greater transparency, allowing customers to better understand their own situation and what products and services may suit their needs.

Comprehensive Credit Reporting (CCR) will also allow competitors to deliver more accurate and competitive pricing. NAB voluntarily implemented CCR in February 2018 for personal loans, credit cards and overdrafts and will comply with the CCR legislation when it comes into force later this year.

IV.2 Transparency – home lending

Chapter 8: The residential home loan market
"*The lack of transparency across the financial system makes it very difficult for consumers to identify the most suitable products for their circumstances, let alone innovation that can benefit them. In the market for home loans, unadvertised discounts mean the standard variable rate is often a meaningless number, that few borrowers pay. This makes price comparison very difficult and some consumers end up with high-priced products even though cheaper and better products may be available. This 'price discrimination' protects banks' profits.*" (Draft Report, p100)

NAB agrees there is a proliferation of financial products, which can make it difficult for customers to compare products. As mentioned above, we have recognised this issue and are pursuing a product simplification agenda, aimed at halving the number of products offered by NAB.

On the broad issue of price variation across mortgage products, NAB believes this is a result of many factors. Just as mortgage products themselves are not homogenous, neither are the customers who use them. Increasingly, a number of metrics and customer-specific information are considered when offering a mortgage price, to appropriately account for risk and regulatory constraints. NAB firmly believes this is good for banking and aligns with regulatory objectives to lower system risk.

A 'one size fits all' approach would require NAB to set higher prices than would be offered to some customers today to ensure risk and return could be managed appropriately. However, the increased granularity of pricing is likely to continue as further information becomes available through open data and CCR, and continue to form a key competitive driver. Importantly, the process to obtain a price for a home loan can be achieved within minutes after a customer discusses their situation with a banker or broker.

Reflecting the intense nature of competition, prices for mortgages have continued to decrease; lower front book rates can be seen as an indication of aggressive competition to win business.

Collection and publication of median interest rate data (draft recommendations 8.3 and 8.4)
As discussed above, home loan pricing has become much more specific to individual customer attributes to ensure risk is managed appropriately across the portfolio. Where risk-appropriate and taking into account competitive pressures, NAB will negotiate with customers to secure a lower rate than what is advertised through relevant reference rates.

Recognising the need to have ongoing contact with our customers, NAB has initiated a Home Loan Check In. This sees NAB proactively call existing customers each year to have a tailored conversation, which can include discussion of interest rates. Since April last year, NAB has contacted more than 300,000 customers.

With regard to the PC's draft recommendation 8.3, the Reporting Standard 744 ABS/RBA Housing Credit Stocks, Flows & Interest Rates form, due for implementation for the reporting period ending 31 March 2019, will address a large number of the loan characteristics. Once implemented, NAB will provide APRA on a monthly basis the weighted average interest rate of new housing loans funded during the month by loan size, loan-to-valuation ratio, borrower type, repayment type, interest rate type, and fixed interest rate term. NAB continues to work with key regulatory bodies to ensure information requirements are met as they evolve.

However, NAB does not believe publication of median interest rate data per draft recommendation 8.4 will ultimately deliver benefits to consumers. It will create unreasonable expectations, whereby all consumers anticipate receiving an interest rate at or below the median. There are legitimate, risk-based reasons for customers to receive a price that is above a median rate; for example high risk loans require significantly more capital compared with low risk loans, necessitating a different price strategy.

IV.3 Transparency – brokers

The PC's draft report highlights the proportion of consumers using brokers continues to increase, with the share of residential mortgage market flows growing from 45 per cent to over 55 per cent in four years.[20] As noted in our previous submission, NAB believes brokers play an important role in customer outcomes and competitive dynamics of the residential mortgage market. This is particularly so for banks or non-banks with limited or no physical presence.

From NAB's perspective, the broker business model is continuing to evolve as a result of innovation and competition, including through digital solutions (though this is in its infancy). Digital disruptors continue to emerge in this area, focused on improving elements of the value chain and enhancing the digital customer experience. NAB is now seeing variations of the traditional broker in the market through assisted digital broker models, online lead origination,

[20] Comparator data, 'MFAA's quarterly survey of lending mortgage brokers and aggregators for July, August, September 2017'.

direct digital models as well as ongoing digital enablement. These factors will increase competition in the broker industry as well as the broader market.

NAB's participation in the mortgage broking industry
NAB participates in the mortgage broking market as both a lender, through NAB branded loans as well as white label branded loans through Advantedge, and as an aggregator.

NAB has full-ownership of three aggregators, PLAN Australia (PLAN), Choice Aggregation Services (Choice) and Finance and Systems Technology Group (FAST) (together, PCF). PCF provides aggregations services to approximately 30 per cent of brokers in the market and provide access to approximately 40 lenders and over 1200 products.

PCF support over 4600 brokers by providing access to:

- A broad panel of lenders and products;
- Systems and technology;
- Support with professional and business development; and
- Assistance with licensing and compliance.

NAB, including Advantedge and each owned aggregator, has rigorous processes to manage conflicts, and perceived conflicts, to protect the interests of customers and brokers. Individual brokers who aggregate with PCF are not employees of NAB.[21]

Origination channels
Generally, the price of NAB's products is determined by the brand, as well as product, customer and loan characteristics rather than the channel through which the product is originated.[22] The cost of providing a loan through a broker is incorporated into total NAB costs. Accordingly our proprietary and broker originated loans are generally aligned on price in relation to NAB branded products, though from time to time pricing specials are offered to target segments. The Advantedge brand offers broker-originated customers a basic mortgage product and typically a lower interest rate to reflect the different features available in the product (for example, no offset, non-package product).

In response to ASIC's review of mortgage broker remuneration proposal five regarding a new reporting regime, the Combined Industry Forum (CIF) has committed to reporting the weighted average interest rate of home loans in the previous financial year across different distribution channels using standard scenarios to ASIC.

Commissions
As noted by ASIC, it is standard practice for lenders to pay brokers both an upfront and a trailing commission for the services that they provide to customers.[23] Under NCCP, brokers must disclose to the customer that they receive a commission.

When considering the PC's information request 8.2 regarding a broker fee for service, NAB believes its introduction may be detrimental to competition in the mortgage market as it would see brokers become unaffordable for customers. In this regard, NAB notes the CIF report, which details the potential unintended consequences if a broker fee for service was introduced;[24] these

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[21] With the exception of 15 brokers employed through PLAN Australia, who offer an in-house mortgage broking service via MLC Mortgage Solutions for financial advisors who wish to refer debt.
[22] See – PC draft finding 8.1.
[23] ASIC Report 516, *Review of mortgage broker remuneration*, section 26, p.9.
[24] CIF Report p.12,
https://www.mfaa.com.au/sites/default/files/users/user130/CIF_Report_Submitted_281117_0.pdf

may include a negative impact on competition and customer outcomes, for example disadvantaging brokers compared with proprietary channels, and resulting in the rationalising of brokers and increasing barriers to entry for brokers.

The changes proposed by the CIF seek to address the potential conflicts which underpin the PC's information request. In its review of Mortgage Broker Remuneration, ASIC defined 'product strategy conflict' as when a broker recommends a product or strategy to maximise their commission, and 'lender choice conflict', where a broker is incentivised to recommend a loan from one lender over another. NAB refers the PC to the CIF's program of reforms which includes changes to the standard commission model intended to reduce and manage these conflicts of interest in the mortgage broking industry. NAB as a lender, and the aggregators PLAN, Choice and FAST, supports the reform package created by the CIF that are aligned to ASIC's recommendations in the Broker Remuneration Review, and we will be working across the industry implementing these by the due dates.

In reference to the PC's draft finding 13.1, NAB has no evidence the incidence of switching is lower for mortgage broker originated borrowers compared to those originated via direct channels. In fact, refinance out rates for NAB's mortgage broker originated loans was more than double the rate of direct channels in FY17.

The 'standard commission model' is a variable cost model that remunerates the broker only once a home loan has been settled. This means brokers' services are affordable to customers (as they are paid for by the lender), creates economic alignment between the lender and the broker and creates a level playing field for competition for smaller and more geographically dispersed lenders.[25] The different commission types are set out in further detail below.

Upfront commission

Upfront commissions are generally higher than trail to compensate for the time taken in establishing the loan which is usually more than that needed for ongoing servicing of the loan.

Trail and ramped trail commissions

Trail commission paid to brokers is an incentive to both place the customer in a loan that is not unsuitable for the longer term and to service customers on an ongoing basis. Ramped trail is also about providing recognition for the ongoing work that is required for ongoing service and ensuring that when customer's circumstances change they have the appropriate support.

We note that if a broker were to assist the customer to move the loan to another lender, they would cease receiving a trail commission from the incumbent, but earn upfront and trail commission from the new lender.

Clawbacks

Clawback of commission is designed to allow lenders to recover the cost of originating the loan if it is refinanced within 24 months of drawdown. If the broker arranges new lending for the customer, they would receive similar upfront commission from the new lender.

We note the CIF's proposed changes to the standard commission structure are being implemented by the industry by the end of 2018, with the principle to pay commissions based on the funds being utilised by the customer. The purpose of this change is to address the potential risk to consumers of product strategy or lender choice conflict as raised by ASIC in their review.

[25] See PC information request 13.2.

Draft Recommendation 8.1: Duty of Care Obligations for Lender-Owned Aggregators
The Australian Securities and Investments Commission should impose a clear legal duty on mortgage aggregators *owned by lenders* to act in the consumer's best interests. Such a duty should be imposed even if these aggregators operate as independent subsidiaries of their parent lender institution, and should also apply to the mortgage brokers operating under them.

NAB supports always putting customers' interests first, and that brokers should also put customers' interests ahead of their own. Under current legislative obligations, brokers are required to ensure a customer is placed with a product that is not unsuitable for them.

NAB is concerned a best interests' duty may be difficult to achieve practically; in particular regarding how a best interests' duty would be ascertained. As noted previously, both mortgage products and customers themselves are not homogenous, and price is not the sole determinate of a good customer outcome. We note the CIF has outlined a definition that sets a higher obligation than NCCP requirements, to address concerns that customers' interests are not always at the fore:

- Appropriate size and structure of the loan;
- Meeting the customer's stated requirements and objectives;
- Affordability for the customer; and
- Applied for in a compliant manner (meeting all responsible lending requirements).

It is also important to note in this context that aggregators, in that role, do not interact with consumers.[26] Aggregators, as 'intermediaries' licensed under NCCP are required to have arrangements to ensure customers are not disadvantaged by any conflict of interest that may arise in relation to its credit activities (sec 47(1)(a)). In this way, NAB does not believe it is practicable to require aggregators or lender owned aggregators only to uphold a best interests' duty.

Additionally, to apply this standard to lender-owned aggregators only would create an uneven playing field. Currently, NCCP obligations to customers are the same regardless of who a broker aggregates under and are also the same regardless of the channel through which a customer chooses to obtain their lending.

Draft Recommendation 8.2: Mortgage Broker Disclosure Requirements
The Australian Securities and Investments Commission should require that before mortgage brokers recommend loans to consumers, they must have a discussion with consumers about, and provide plain-English documents to consumers on: • the types of products offered by different lenders (including white-label loans and which lender provides the funding for them) and associated loan features • the role of mortgage brokers in matching borrowers with home loan providers, including how brokers are limited in their ability to help consumers apply for loans from all lenders because not all lenders are on the aggregator's panel or the broker is not accredited with a particular lender • how mortgage brokers are paid (including specific information about their payment arrangements) • any ownership relationships between lenders and the aggregator, and the requirement for brokers to act in consumers' interest where an ownership relationship exists (draft recommendation 8.1). Specific details regarding the information provided and the way it is presented should be developed through consumer testing to ensure that consumers understand the information, and the effect of these measures should be reviewed after they have been implemented.

Brokers are already required to disclose commissions paid to them under NCCP. NAB believes the work being done by the CIF to implement its proposed disclosure changes and reporting regime by the end of 2018 will address a number of the issues outlined in this recommendation. Specifically, in response to ASIC's proposal 'to Establish a Public Reporting Regime', the CIF are implementing the following disclosures by the end of 2018:

[26] Note, there are rare exceptions of 'in-house' brokers.

- Brokers disclose to customers:
  - The list of lenders available to the customer via the broker's aggregator;
  - The number of lenders that a broker has used in the past year; and
  - The top 6 lenders and percentage of business directed to those lenders in the past year.
- Aggregators will disclose:
  - All lenders available on their panels and percentage written with each over the past year;
  - The spread of lenders being used by brokers; and
  - Weighted average commission rate percentage earned in the past year.
- Lenders will disclose to ASIC:
  - The weighted average pricing of home loans in the previous financial year across their different distribution channels using various standard scenarios (to be defined) alongside clearer disclosure of ownership structures.

Further, the CIF has proposed enhanced disclosures of ownership structures. NAB supports customer testing of disclosure formats and standards, once designed, to ensure clarity and maximum understanding.

IV.4 Financial advice

Draft Recommendation 12.1: Rename General Advice to Improve Consumer Understanding
General advice, as defined in the *Corporations Act 2001* (Cth), is misleading and should be renamed. The Commission supports consumer testing of alternative terminology to ensure that misinterpretation and excessive reliance on this type of promotional information is minimised. The term 'advice' should only be used in association with 'personal advice' that takes into consideration personal circumstances.

General advice or general information is the primary mechanism for the vast majority of Australians to access information. In line with our submission to the FSI, NAB is broadly supportive of the recommendation to re-label 'general advice'.

We note that general advice can be more than product related; it can be strategy related. Therefore, NAB believes that, when examining alternatives, consideration should be given to the purpose of the information – for example, 'product sales information' may not reflect the scope of information included; similarly, research opinions currently fall within the scope of general advice, and would need to be taken into account when formulating new terminology.

As well, consideration must be given to the timing of such change, given the significant number of document and system changes required, as well as training.[27]

Information request 12.1: Potential to increase the scope of financial advice to include some credit products
The Commission is considering recommending that ASIC-licensed financial advisers be able to provide advice on some credit products, in particular home loans, personal loans and credit cards. We seek views on: • the merits of such a proposal • which credit products should be included in this increased scope to provide advice • the nature of any duty advisers would have to their clients • different licensing approaches including the form of the licence • the regulatory costs and impact on the industry.

[27] See information request 12.2.

In relation to this information request, there are instances today of financial planners selling credit either via referral to a broker or banker or directly. NAB believes that simplifying the ability of customers to receive holistic financial advice is positive. Both the financial planning and mortgage broking industries are regulated, legislated and remunerated in different ways and these differences would need to be worked through.

IV.5 Transparency – insurance

NAB is neither an insurance brand nor insurer, but rather sells white labelled products underwritten by an insurer.

NAB supports greater transparency across financial products and services, including for insurance, and agrees that including the previous year's premium and percentage change would assist consumers when receiving their renewal notices.[28]

Insurance allows consumers to mitigate their risk, and NAB believes it is important that customers are encouraged and able to take up insurance which is appropriate and efficient. NAB agrees that the removal of distortionary taxes would ultimately benefit customers.[29]

Draft Recommendation 11.2: Transparency on Insurance Underwriting
On the same part of an insurance brand's website that contains the information about which insurer underwrites their product, a list of any other brands that are underwritten by the same insurer, for that particular form of insurance, should be included. Insurers should provide an up-to-date list of the brands they underwrite to the Australian Securities and Investments Commission (ASIC). ASIC should publish this information as a transparent list on its website.

NAB requests confirmation this draft recommendation does not encompass non-insurance companies selling white labelled products, but rather is intended to apply where an insurer sells product under different insurance brands that it owns.

If this recommendation is to be applicable to white label arrangements, NAB suggests the insurer to include white label partner brands on their website, but the non-insurer's (in this case, NAB's) disclosure and website to simply refer the customer to the insurer's website for an up to date list of other brands it underwrites. We note that white label non-insurer partners (such as NAB) have no control over other white labelling conducted by the insurer with other partners, and are typically not informed about other white label arrangements. Moreover, it would be impracticable for white label non-insurer partners to maintain and be responsible for such a list.

Noting the PC's comments regarding the difficulties of comparing products,[30] this recommendation may risk customers concluding that products are identical or very similar and therefore price should be the only factor to consider, which is not necessarily the case (particularly for white labelled products) and may result in poorer consumer outcomes.

[28] PC draft recommendation 11.1.
[29] PC draft recommendation 11.3.
[30] PC draft report, p14.

Draft Recommendation 14.1: Deferred Sales Model For Add-On Insurance
The Australian Securities and Investments Commission should proceed as soon as possible with its proposal to mandate a deferred sales model for all sales of add-on insurance by car dealerships. Following implementation, the Australian Government should establish a Treasury-led working group to extend the deferred sales model to all add-on insurance products in a practical timeframe.

NAB acknowledges the concerns related to consumer credit insurance (CCI) sold by banks. NAB (in partnership with its insurance product providers) will continuously work to improve both product features and constructs, as well as the purchase methods we offer for customers.

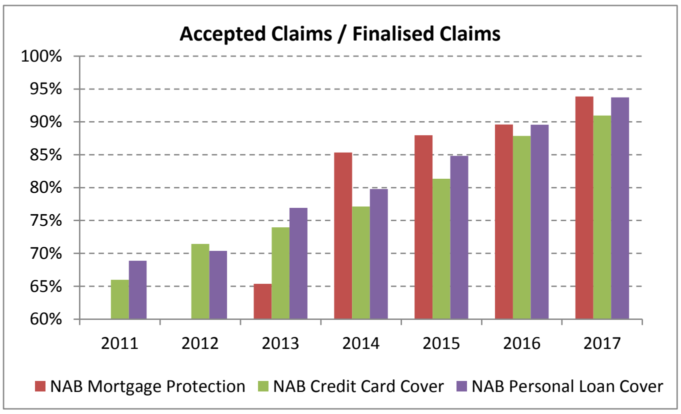
NAB is supportive of a Treasury-led working group to work collaboratively to address the concerns raised in respect of CCI sold by banks. However, NAB believes these concerns are best addressed directly rather than via mandating a sales approach that is not directly linked to the issue at hand. In this way, the Treasury-led working group should determine an optimal approach going forward, rather than establishing a working group with a pre-defined solution.

The concern regarding a low payout ratio is directly related to the quality of CCI products and their value to consumers; clearly this would best be addressed by improving the quality/value of the products. An appropriate solution here would be for insurers to lift payout ratios (by either wider benefits and/or lower premiums). On this front, NAB and MLC Limited (NAB's life insurance provider) are collectively taking steps. An example of this is the update of NAB Mortgage Protect (NMP) product in December 2017, with enhancements such as limiting the Pre-Existing Condition (PEC) exclusion to the past 12 months, extending the involuntary benefit to six months, removing waiting periods for disability and involuntary unemployment benefit, and passing these benefits back to existing policy holders.

In relation to the PC's statement that:

> '*only 85% of consumer credit insurance claims are accepted. This is well below the average rate for retail insurance policies of 96%...*'[31]

NAB and MLC Limited have recognised this issue and collectively have been taking steps over the past several years to increase consumers' awareness about the benefits, limitations and exclusions of CCI products. Various product improvements have also been made. For instance, in July 2016 the NAB Credit Card Cover (NCCC) product was upgraded to limit the PEC exclusion to the past 12 months, and various qualifying and waiting periods were reduced. As a result, there has been a substantial increase in the percentage of claims accepted, to the extent that in 2017 the claims acceptance rate for NCCC was circa 93 per cent. The figure below illustrates the improvement in claims acceptance rates across NAB's three CCI products since 2011.



[31] PC draft report, p399.

In relation to the PC's statement that:

> *'consumers do not actively seek out add on insurance, and they are often poorly informed of its value when they purchase it…'*[32]

NAB believes this is best addressed by increasing consumers' understanding of these products, through increased and better delivered disclosure at the point of sale and on an ongoing basis throughout the life of the policy. For example, for the NMP and Personal Loan Cover, customers will receive multiple forms of communication in the first 30 days following purchase of the product (a welcome pack, text message and phone call).

Regarding the PC's concern with customers purchasing CCI and not being able to assess other options (thereby limiting the scope for competition), it should be noted there is a 30 day cooling off period. This allows customers to protect themselves from the outset of the debt, which then provides further time to consider alternative options (for example, retail insurance provided by Financial Adviser through personal advice; noting this often takes several months to put in place, which could leave the customer exposed). The CCI product can be cancelled during the cooling off period, in which case the customer receives a full refund of the premium paid. Moreover, the CCI product can be cancelled any time after the cooling off period, in which case the customers receive a pro-rata refund.

[32] Ibid.

V. CONCLUSION

NAB strongly believes that the Australian financial system is highly competitive, and is only becoming more so; this is supported by a number of indicators such as NIM, ROE and flow-based market share data.

NAB believes the existing financial system has the elements of workable competition, as identified by the PC.[33] The system however continues to be refined and improved; for example through reforms to improve customer access to their data, to facilitate further switching, and those that will enable banks to offer more appropriate and competitively priced products. Work is also underway to reduce regulatory barriers.[34] In addition to these changes, innovation and the increasing number of new entrants means that customer outcomes will continue to be at the centre of banking, leading to better and more transparent product and service propositions.

In addition, prudential regulation continues to evolve as global and domestic dynamics change. Accordingly, NAB supports ongoing assessment and calibration to ensure there is an appropriate balance between consumer cost and financial stability.

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[33] PC draft finding 2.1.
[34] PC draft report pp124 – 127.