KPMG

Single Easy Access Rate (SEAR)

What will it mean for firms?

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1. Introduction

The FCA recently published a Consultation Paper (CP20/01) on retail deposits, proposing a single interest rate for all easy access savings accounts provided by a deposit-taking institution (the 'SEAR') and another one for all easy access ISAs. The proposal is designed to ensure new and longstanding savers benefit from competition.

Under the proposal, Banks and Building Societies will have to set a single interest rate for all easy access accounts. Banks and building societies will still be able to offer introductory rates for up to 12 months, but after this period the rates must return to the bank's own single easy access rate.

Easy access savings and easy access ISAs represent around 50% and 15% respectively of the total UK cash savings market. We anticipate that this proposal will have a significant impact on many banks and building societies' margins as these two savings products make up significant proportions of their balance sheets and many have large legacy books of easy access savings accounts currently paying low interest rates.

This is one of the number of factors currently impacting domestic lenders, including the impact of MREL, the end of FLS/TFS, the continuing impact from the implementation of ring-fencing on price competition in mortgages and cost pressures. In combination, these factors drive a need for banks and building societies to assess their strategy and balance sheet composition to generate sustainable and acceptable returns. With the FCA's focus on 'Fairer Pricing in Financial Services', the SEAR consultation may be a pre-cursor to future action on mortgages.

We believe there are a number of potential scenarios on how the market may be impacted by the SEAR proposals and how they may respond.

2. Scenarios: Possible market impacts and responses

Scenario 1: Neutral impact	Scenario 2: Net Interest Margin (NIM) impact	Scenario 3: Liquidity impact
— Firms' cost of funds broadly remain the same as they are able to reduce their savings rates to offset the increase from the introduction of the SEAR to longstanding customers. Assumes: – Reduction in savings rate has no material impact on savings inflows or retention rates (price insensitive customers) – Moderate differential between front book (12month+) rates and longstanding savings rates.	— Firms' cost of funds increase as they are unable to offset the increase from the introduction of the SEARs to longstanding customers as a result of the need to maintain new and front book rates to achieve required inflows. Assumes: – Reduction in savings rate has negative impact on savings inflows and outflows (price sensitive customers) – Large differential between new savings rates and longstanding savings rates — In response, firms increase their new business mortgage lending rates to restore net interest margin. Assumes: – Increase in new business lending rate does not materially impact competitiveness of new business lending. This would require mortgage repricing activity to be led by the price	— Firms' longstanding easy access deposits become less 'sticky' resulting in the need for increased liquidity buffers (NSFR) as a result of the SEAR proposals (coupled with the emergence of open banking savings marketplace trends) increasing consumer awareness of savings rate differentials and increases switching behaviour. Assumes: – The SEAR proposals will increase consumer awareness – Easy access deposit-holders are price sensitive.

Scenario 1: Neutral impact	Scenario 2: Net Interest Margin (NIM) impact	Scenario 3: Liquidity impact
— Firms' cost of funds broadly remain the same as they use repricing activity to reduce excess liquidity. Assumes: – Firm has excess liquidity – Customers are price sensitive enough to switch.	setters and followed by others to create a market-wide rate adjustment — Alternatively, firms increase emphasis on higher yield lending segments. Assumes: – Firm has risk appetite and capability to operate in these segments – Higher yield lending segments are large enough to offset NIM reduction	— In response, firms may shift product focus away from easy access to short term notice accounts (30/45/60 day) and fixed term savings. — Alternatively, firms may increase longer fixed term mortgage lending (10-20 year terms) to reduce dependency on shorter term liquid deposits

3. Impact and response by market segment:

While the proposal will affect the whole banking sector, the impact and potential responses are likely to differ by market segment as shown in the table below. The larger high street banks may be able to absorb the impact of the proposal more easily than some of the smaller banks and building societies, leading to an unintended impact on broader competition within the UK banking sector.

		High Street Banks	Building Societies	Small & Medium-Sized Banks
Impact of Exposure	**Proportion of balance sheet in easy access products**	H	M	M
	Potential interest rate differential (new to longstanding)	L	M	H
Ability to Respond	**Current customer price elasticity**	L	M	H
	Ease of passing on through lending activity	H	L	M

Source: KPMG analysis

The high street banks

— High street banks with large legacy books have the largest exposure to easy access accounts and easy access ISAs. These two products make up 55% and 15% of their total retail savings books respectively.

— However, their front book savings rates are typically very low (~20-30bps) as a result of their personal current account relationships with customers. Thus, it is likely that the interest rate differential (in bps) between longstanding deposits and 12 month+ accounts will be minimal. A large proportion of their customer base is also likely to be relatively price insensitive given they could already achieve up to 100bps more by switching to best buy providers.

— As a result, the larger high street banks may be able to minimise the impact by rebalancing front and back-book savings rates while the broader interest rate environment remains benign.

— The ring-fenced banks and mortgage price setters may also be able to respond by using the rate rebalancing to reduce excess liquidity and potentially increase new business mortgage rates to improve NIM.

The building societies

- The building societies have a slightly lower exposure to easy access accounts and easy access ISAs as a result of their greater focus on fixed term savings accounts. These two products make up 38% and 12% of their total retail funding respectively.
- The building societies typically offer higher front book savings rates than the high street banks (~50-110bps) for easy access savings. However, there is a range of approaches across the sector to pricing back-book savings, resulting in a spread of interest rate differentials (in bps) between long-standing deposits and 12 month+ accounts. Those with large legacy books on low interest rates could be significantly impacted by the SEAR proposal.
- With relatively price sensitive customers and a 'price taker' position on mortgage lending, repricing initiatives on savings and mortgages may be limited, therefore requiring a potential re-think of strategy and balance sheet composition to drive sustainable and acceptable returns will be essential.

Small and medium-sized banks

- The smaller banks also have a slightly lower exposure to easy access accounts and easy access ISAs as a result of their focus on notice and fixed term saving accounts. These two products make up 42% and 8% of their total retail funding respectively.
- As a number of these banks don't have current accounts or branches, they are more dependent on 'best buy tables' to achieve required savings inflows, offering front book saving rates up to 130bps on easy access products. Similar to the building societies, there are contrasting approaches across the sector to pricing back-book savings and retaining relatively price sensitive customers. However, those with legacy books on interest low-interest rates have the potential to be significantly impacted by the proposal.
- As a number of these participants are dependent on offering attractive savings rates to build their deposit bases, opportunities to rebalance front and back book savings rates may be limited, albeit this may be helped by higher volumes of switcher looking for better rates as a result in increased consumer awareness.
- For those with capability in non-standard lending segments, there may be an opportunity to increase mortgage rates with limited impact on new lending. Those without this capability may be required to review their product and pricing strategy and balance sheet composition.

Next steps:

Firms have until April 9 to provide comments on this consultation paper to the FCA. As a priority, firms should identify and assess a range of scenarios, including competitive dynamics and to understand the potential impact of the proposal, including the 'unintended consequences' for the market.

Further insights:

We would welcome the opportunity to discuss the potential impact of the SEAR proposals with you including scenarios around the broader strategic implications and the potential actions you may need to consider.

If you have any questions or would like to discuss the implications of this important regulatory development, please contact:

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