UK FINANCE

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Rt Hon Mel Stride MP
Chair
Treasury Committee

Email: treascom@parliament.uk

2 February 2021

Dear Mr Stride,

National Savings and Investments

I read with interest your concern regarding the poor customer experience customers have received as a result of National Savings and Investments' (NS&I) approach to pricing recently and, having recently reviewed NS&I's letter dated 18th January 2021, felt I should make some observations on the wider impacts of NS&I's approach across the savings market.

Whilst the focus of your concerns has rightly been for customers, this has also been an ongoing issue for our mutual, mid-sized and specialist members who both share your concerns and find themselves competing for deposits in an increasingly volatile market as a consequence of NS&I's actions. The specialist banking sector has been most affected, as it tends to be more active in *time deposit* markets alongside NS&I. This matters for consumers: The diversity of providers in the sector gives increased choice through competition, as firms exploit niche markets and drive innovation.

To illustrate the extent of the difficulties created by NS&I's approach to pricing, I attach for your information a series of slides that has been prepared by one of my members. At one point during 2020, NS&I attracted almost three quarters of new deposit flows (compared to more normal single-digit levels), which naturally significantly impacted pricing.

When this aggressive liquidity strategy subsequently unwound, alongside the market wide impact on pricing, customer service levels were impacted as firms witnessed a sudden and unforeseeable migration away from NS&I, causing a sharp increase in customer delays and subsequent complaints – in effect, the same issue as faced by NS&I themselves. For NS&I to be building up operational centres appears to be tackling the symptom (service levels) not the cause (pricing policy) and infers that similar stresses on services levels may well be seen again if NS&I applies the same modus operandi in future.

Our members recognise and accept the need to compete for savings, but when such a large, government sponsored competitor behaves in the manner recently witnessed, it runs the risk of heightened volatility in liquidity levels alongside pressure on customer service standards.

I would be happy to discuss this matter further with you, if you would find that to be helpful. The chair of the UK Finance Specialist Firms Strategic Advisory Committee, Nigel Terrington, Group CEO, Paragon Group PLC would also be happy to talk through this issue with you.

A copy of this letter is being sent to John Glen, Economic Secretary to HM Treasury and Gwyneth Nurse, Director, Financial Services at HM Treasury

Yours sincerely

David Postings
Chief Executive Officer

Enc.

Impact of NS&I on Savings

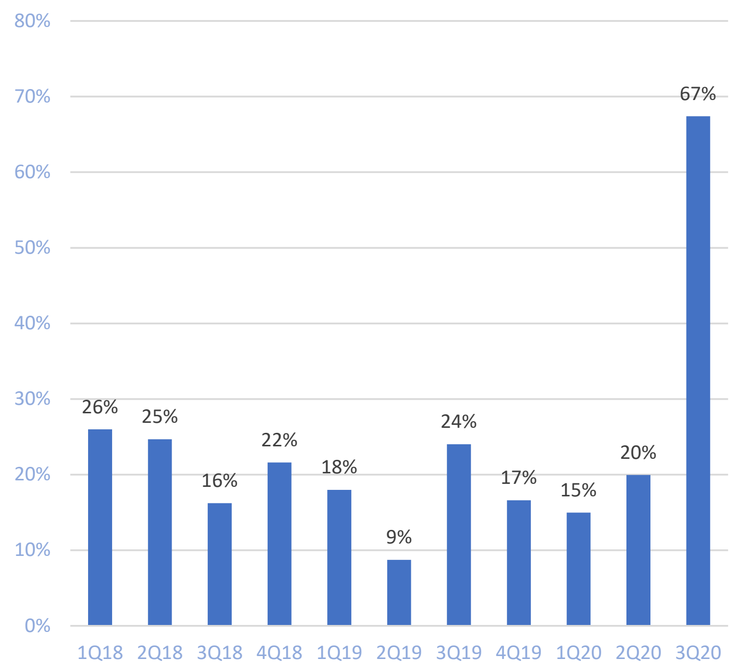
January 2021

Executive summary

NS&I actions resulted in unprecedented market and customer dislocation

- NS&I's pricing actions in late spring and again in late summer resulted in huge market disruption
- In response to a higher funding target NS&I held pricing after BoE cut rates by 65bp. Operating with a 100% Government guarantee, this resulted in significant market share gains and record volumes in a very short period
- Effectively sucking deposits out of the system over the summer months, Specialist Banks and Building Societies were forced to react to defend liquidity
- After causing disruption as NS&I gathered deposits, the decision to cut rates (to as low as 0.01%) caused significant disruption again as customers looked to switch out of NS&I in the hunt for higher rates
- Equivalent of a "hokey-cokey" in deposit land, NS&I's pricing actions disrupted Specialist Bank and Building Society operations when platforms were already under Covid-19 strain, while reportedly putting unprecedented strain on their own operations
- Customers could have suffered from the disruption and may have suffered financially, as they abandoned higher yielding deposits to switch to NS&I, only for the rug to be pulled in late September

NS&I market share of net new household deposits*



Source: Bank of England (* assumes all NS&I balances are deposits)

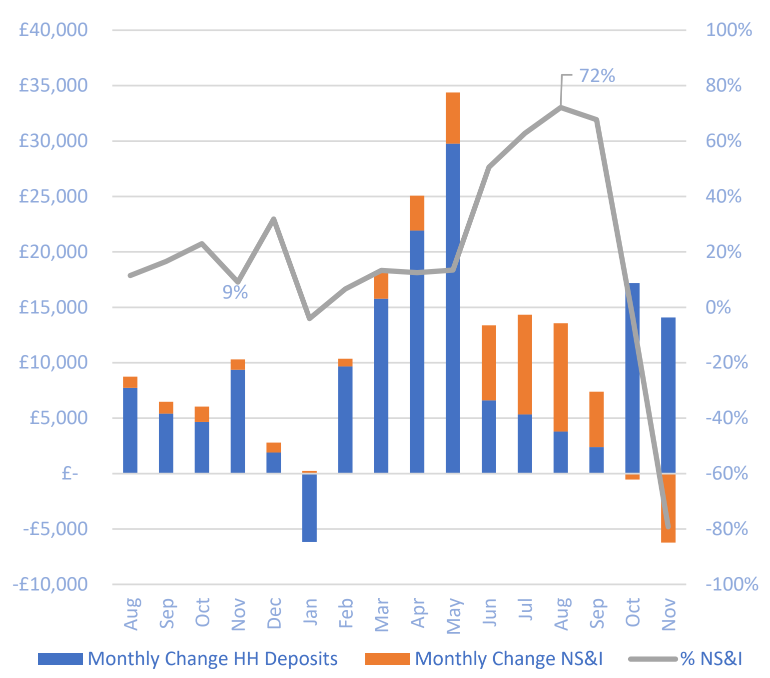
Impact felt disproportionately by Smaller Banks and Building Societies

NS&I's impact at system level

NS&I took c72% share of new deposits in August

- Household deposit growth (inc NS&I*) in 2020 was exceptional at £155bn to November (+2.4x v 2019)
- In July 2020 NS&I announced a net funding target of £35bn for twelve months from March 2020. £38bn delivered by end of September
- Proportion of growth in NS&I in comparison to all other providers of household savings jumped materially from May-September
- Coincided with a 6.1% (£10bn) contraction in Term Deposits May-Sept as price led savers switched to NS&I. Also, Cash ISAs fell by 1.2% (£3bn)
- Rate reductions from NS&I announced on 21 September, effective 24 November
- Following slides summarise impact on three categories of savings providers which combine to cover c 82% of household deposits outside of a Personal Current Account (PCA)
- Non interest bearing deposits, not included in following slides and primarily held with large high street clearing Banks ("the Clearers"), benefitted from system wide growth in 2020 to November of £40bn

Household deposit growth in comparison with NS&I*



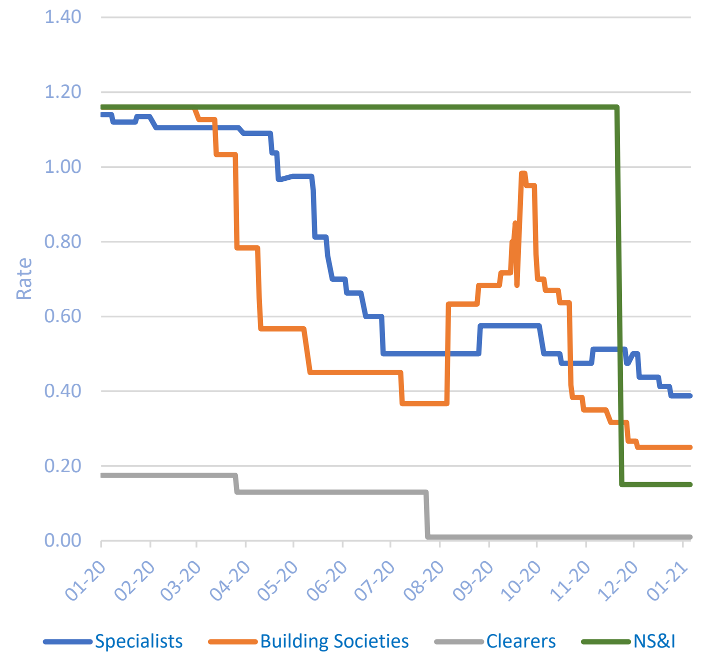
Source: Bank of England (* assumes all NS&I balances are deposits)

NS&I's impact on easy access non-ISA pricing

NS&I's actions caused big disruption to Building Societies in Easy Access …

- Planned rate reductions to NS&I savings products due to apply in May were cancelled in April
- Cancellation meant NS&I took top three slots on Best Buy tables, through to September
- Between April and September Household Time & ISA net deposits held by banks fell by £14bn – this is a good proxy for the minimum disruption caused by NS&I's market position over that period and likely understates it
- Existence of TFSME and strong market growth offset these pressures initially, however as liquidity was sucked out, the market reacted strongly in September
- In late August/early September two large Building Societies reacted, pushing pricing in stages up to 1.20% - highlighted that without FSCS limits to encourage spreading of deposits by wealthy depositors, price points below market leading rates were ineffective
- Announcement of rate reductions by NS&I on 21 September quickly reversed reaction by banks and building societies with offered rates returning to the pre-disruption trend
- It is notable that over the disruption period the average rates offered from the Clearers reduced

Easy Access (non-ISA) Indicative Market Pricing



Specialists: Average of top rate available from Paragon, Charter Savings, Aldermore and Shawbrook

Building Societies: Average of top rate available from Coventry, Principality and Skipton

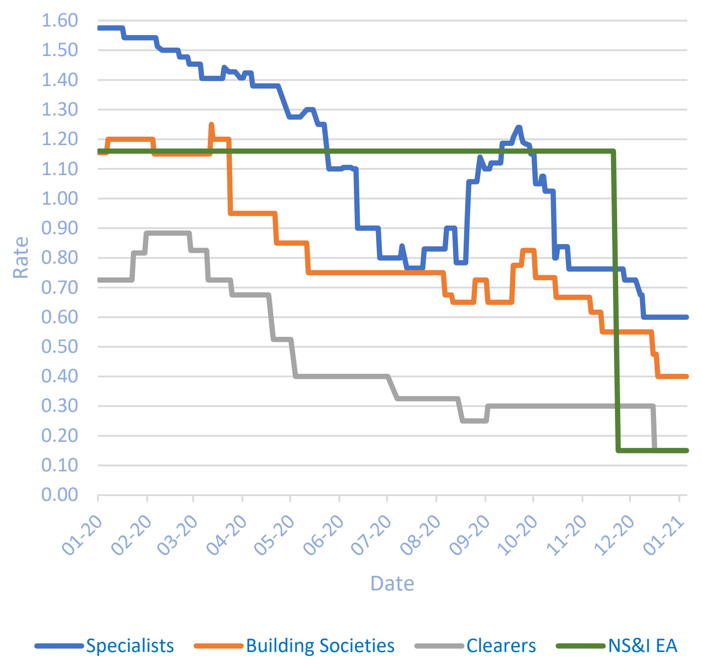
Clearers: Average of top rate available from Barclays, Lloyds and NatWest

NS&I's impact on easy access 1 year FRB pricing

… and big disruption to Specialist Banks in Term deposits

- Specialist banks tend to be more active in Time or term deposit markets, for example, with up to75% of deposits typically term in nature. Behaviour noted in EA non ISA market therefore visible in the term market via the Specialist Banks
- After a temporary period utilising liquidity resources, Specialists forced to react with term deposit pricing to reinstate an access versus rate trade off for customers using NS&I's EA price as a collar
- Banks' experienced low retention of term deposits as market rates offered could not compete with NS&I easy access offers, which came with a 100% Government backing. This was an incentive for savers to aggregate previously spread-out FSCS covered deposits with NS&I
- Building Society rates were largely unchanged reflecting their preference for EA products
- Clearers moved further away from price led offers
- These offer rates generally translate to re-pricing existing customers over the disruption period. Offer rates 21 September-23 November were 28bps higher than the average rate in December 2020
- Retaining balances acquired during the disruption period may create a secondary impact as fixed terms come to an end in 2021/22

1 year FRB (non-ISA) Indicative Market Pricing



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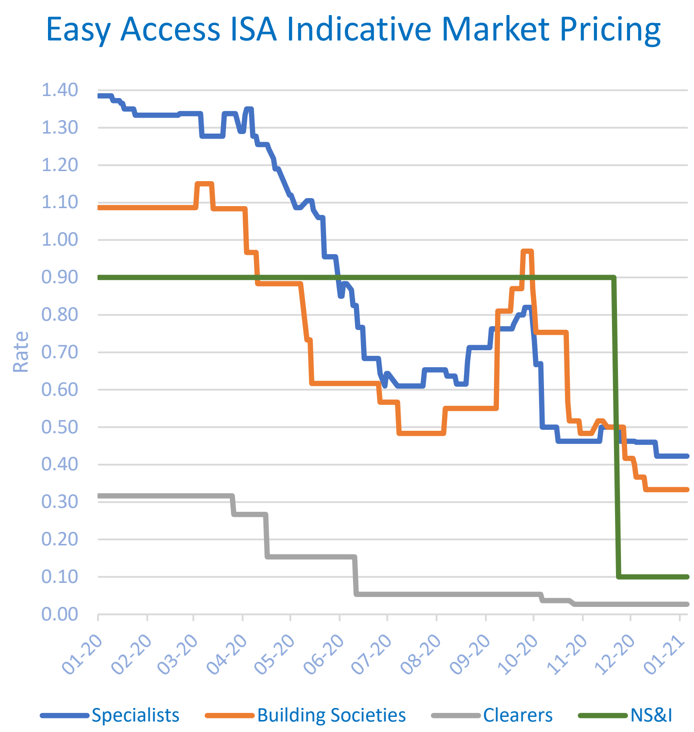
NS&I's impact on easy access ISA

… both segments disrupted in ISA market – the big banks were untouched

- Planned rate reductions to NS&I savings products due to apply in May were cancelled in April
- Given the wide utilisation of cash ISA's the disruption caused a market response in both Specialists and Building Societies given the providers are more aligned
- A large Building Society launched at 0.96% on 8 September after previously trying, alongside a smaller Challenger Bank, to match NS&I's 0.90% rate
- Other banks launched products to no apparent success at price points that would have been successful at previously proven capability and capacity, reflecting NS&I's government backing



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NS&I's actions led to material operational disruption

- In normal times banks manage operational strain and service levels to customers through product availability and pricing
- Initial phase of the pandemic caused unprecedented new deposit flows/demand at a system level. This combined with operational disruption at banks and building societies as business models were adapted to cope with the constraints of social distancing and working from home
- NS&I's price strategy change led to a sharp reduction in new deposits, which eased operational strain from the pandemic, but led to higher withdrawals at an industry level, which was notable across the specialist banks and building societies
- NS&I's announcement to reprice in September led to a surge in activity as customers switched out of NS&I throughout September to November. Whilst banks reacted by withdrawing products quickly to limit flows, the sheer magnitude of balances that had been sucked into NS&I and looked to switch out on the announcement, led to some of our members experiencing record operational strain, leaving customers disappointed
- When the actual rate reduction from NS&I came through the operational impact was less disruptive as banks were more prepared and pricing had been accommodated
- Alongside operational frustrations, customers may have suffered financially, as they abandoned higher yielding deposits to switch to NS&I, only for the rug to be pulled in late September.