Charging negative rates on retail deposits is not without risk for banks

Corporate customers have been on the receiving end of negative deposit rates for years, but some European banks have recently started to charge individuals; a practice that carries a different set of commercial, reputational and legal risks.

We believe the current interest-rate environment is here to stay. The pandemic has further raised the levels of public debt in Europe, which will dampen the ECB's response function to near term inflationary pressures. Banks will continue to face charges for their excess liquidity and be limited in their ability to profit from maturity transformation in a flattish yield-curve environment.

The ECB is aware of the negative side-effects of a flat yield curve on banks, and while bank profitability is not a policy target, the possibility that low profitability becomes an impediment to monetary transmission is a concern.

We believe bank management teams have had time to get accustomed to the interest-rate environment, and for the most part are taking counter-measures. These include a continuous focus on cost efficiency and, where possible, cross selling of non-bank products to support the top line.

After some initial hesitation, several large European banks have moved to impose charges on large depositors, including institutions and high net worth individuals. Until very recently, retail customers have been shielded from this trend, although this appears to be changing.

In Denmark for example, policy rates have been negative for the best part of the past decade, so it is not surprising that Danish corporate customers have been facing negative rates on their deposits for several years now. But banks in Denmark have gone a step further, introducing negative interest rates on individual customers since late 2019, initially only applying to very large deposits. More recently the exemption thresholds have been lowered to as low as DKK 100,000 (c. EUR 13,500).

Figure 1: Euro Area deposit rates for corporations (new deposits)

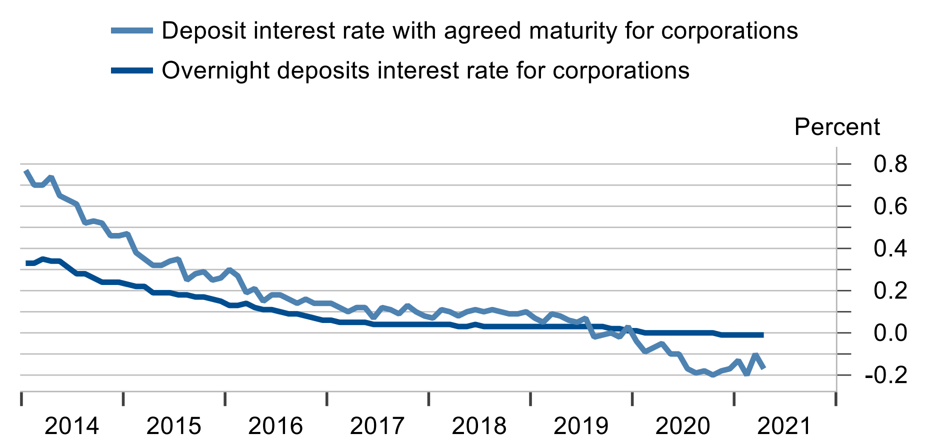

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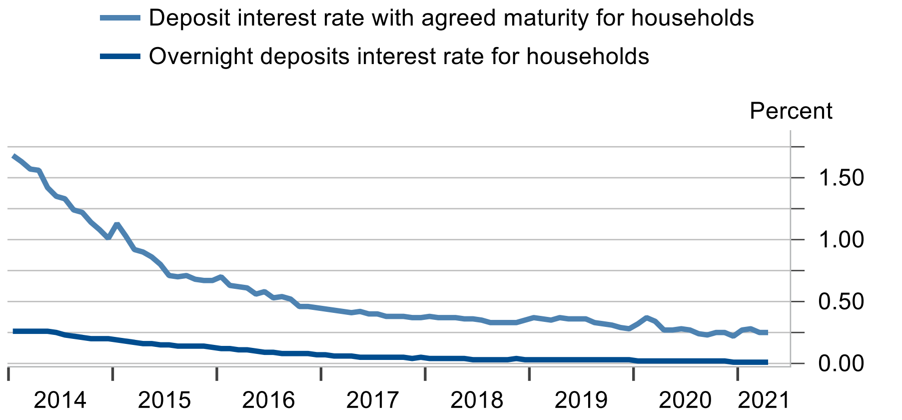
Figure 2: Euro Area deposit rates for households (new deposits)



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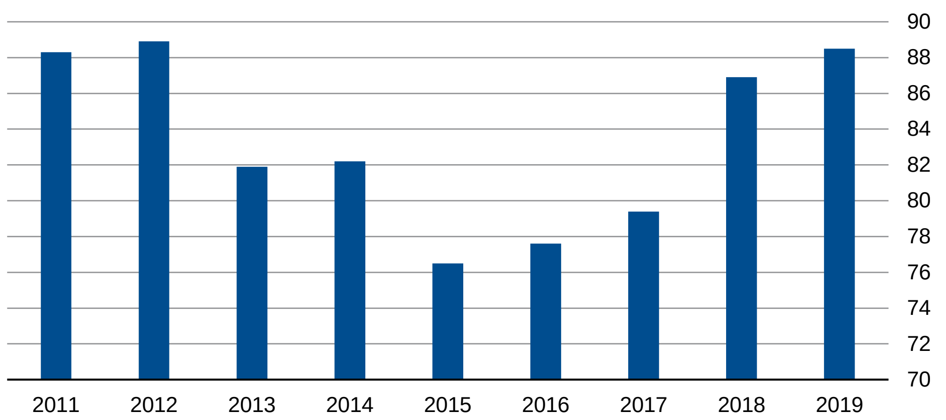
In the Euro Area (EA), business customers are often charged custody fees or excess liquidity fees, but the exemption thresholds for small business deposits are also declining, with a greater proportion of corporate deposits now in negative territory. ECB data collection on interest rates for new deposits shows that the average rate on term deposits in the EA went negative in 2020.

Cheap TLTRO funding diminishes value of deposits

The success of cheap ECB TLTRO3 funding lines has supported revenues in 2020 but also further diminished the value of deposits for banks – including retail deposits. EA banks have so far been cautious about charging for retail customers' liquidity, especially on current accounts, but there is evidence of current account fees for retail also increasing in the past couple of years.

The Bank of Italy conducts an annual survey on the cost of bank accounts in Italy. This shows that the average cost of a current account in Italy in 2019 stood at EUR 88.5, up from EUR 86.9 in 2018 and EUR 79.4 in 2017. Evidence suggests the cost keeps rising.

Figure 3: Current account costs in Italy



Source: Bank of Italy, Scope Ratings

Strategies to keep active and valuable customers

Banks' strategies typically involve setting a high price for basic accounts, and discounting deeply for certain customers; typically those that use accounts as their primary accounts. This allows banks to discourage customers that only park excess liquidity (hence are unprofitable), while not alienating the most active, and valuable, customers. The practice of offering zero-fee accounts to transactional customers remains market practice in Spain, though non-discounted accounts typically face costs of over EUR 100.

Since late 2020, we have noticed an acceleration in the number of banks explicitly charging individual customers. In Germany, the majority of banks already charge corporate customers negative rates and either charge or are in the process of introducing negative rate charges to individual customers, although with exemption thresholds that vary depending on the institution, the type of account as well as the vintage, with newly opened accounts being the most penalized via lower thresholds.

This negative pricing of customer liquidity is not confined to any particular pillar of the German system; it is common practice irrespective of the type of institution. On June 2, Deutsche Postbank announced that it will soon start charging customers fees to compensate for the cost of excess liquidity, with an exemption threshold set as low as EUR 25,000 for savings accounts.

Negative rates on retail deposits presents pitfallls …

In our view, charging negative rates (or equivalent fees) to retail customers presents a number of pitfalls. From a business perspective, banks have to balance the immediate cost of the unwanted excess liquidity with the risk of losing a liquidity-rich customer. While this may not seem like a huge immediate loss, it would deprive the bank of revenue potential as well as future funding optionality, including in the context of regulatory compliance for the day when stable funding sources become scarcer.

Unless renewed, the latest TLTRO funding lines will expire in 2023/2024, which could lead to greater demand for retail stable funding – also in the context of the Net Stable Funding Ratio requirement coming into full force in June 2021. It was not too long ago that banks had to offer teaser rates and other perks to acquire new customers.

… and potential legal challenges

We also highlight the potential risk that negative rates on existing retail deposits are challenged from a legal perspective. Indeed, while a corporate deposit is typically an arm’s length negotiated agreement between two sophisticated parties, retail products are often based on standard terms and conditions, and the imposition of negative rate charges may be challenged in courts as abusive, especially if they are introduced through unilateral changes to terms and conditions.

In April 2021, the German Federal Court of Justice (BGH) ruled that new clauses or changes in in banks' general terms and conditions (AGB Banken) are void unless the customer explicitly accepts the changes.

Finally, we note the reputational risk associated with the decision to impose negative rates, especially for first movers. As exemption thresholds are lowered and the charges apply to an increasing number of customers (which are also, crucially, voters), the appeal for politicians to come out vocally against the charges also increases. This in turn amplifies the media mileage of coverage of the topic.

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