INSIGHT

MARCH 2015

REGULATED SAVINGS IN BELGIUM

THE TOTAL COST OF REGULATED SAVINGS REMUNERATION FOR BELGIAN BANKS COULD HAVE DECREASED WITH € 1, 76 BILLION IN 4 YEARS, A 60% DECREASE.

Executive summary

Despite falling interest rates, outstanding amounts on regulated savings accounts have risen with almost 17,5% since 2011, to reach a record level of about € 250 billion end of 2014. At the same time, yields on regulated savings deposits have decreased significantly during the last 4 years.

Sia Partners analyzed those trends and estimated the cost savings for banks on interest expenses related to regulated savings deposits at € 1,76 billion over the last 4 years.

On the other side, falling interest rates are squeezing the net interest margin and consequently banks' net banking product. It seems to be particularly the smallest players, with business models based on high-yielding savings accounts that struggle the most to remain profitable and to defend their market shares.

A sharp drop of borrowing costs for Belgian banks

Since 2008, the total amount of regulated savings deposits[1] has been increasing, to reach record levels of € 250 billion end of 2014. While the growth in amount outstanding is still there, the growth rate starts to level off.

At the same time, the European economy has still not recovered from recent credit and sovereign debt crises. Inflation and ECB rates have been falling and still struggle to take off again, which has resulted in plummeting interest rates on savings deposits.

Sia Partners analyzed these trends and estimated the cost of regulated savings remuneration for Belgian banks to have dropped by about 60% or € 1, 76 billion in 4 years. This drop can be explained by a sharp decrease in average total interest rates on regulated savings deposits of around 100bp over the same period. At the same time, and despite the massive drop in interest rates, total deposits have grown with 17,47% to reach over € 255 billion end of 2014.

The Belgian savings landscape

Overview of bank deposits in Belgium

Belgians are known to be amongst the world's most fervent savers. A new record of more than € 600 billion in bank deposits was broken in the fourth trimester of 2014, a 100% growth in 15 years *(cf. Figure 1)*.

[1] **Regulated savings deposits** in Belgium are savings deposits with an *attractive taxation* *(cf. paragraph "Overview of bank deposits in Belgium" below)*, yielding a total interest rate which consists of a base rate and a *Fidelity Premium*. (*)

(*) **Fidelity Premium**: a bonus applicable in one of the following two cases: either the money stays in the bank for a period of 12 consecutive months, or the money stays in the bank for a period of 11 consecutive months in a same calendar year. The premium should be between 25.00% and 50.00% of the base rate

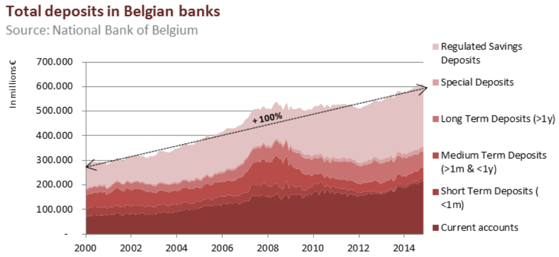

FIGURE 1 - TOTAL BANK DEPOSITS IN BELGIUM

This total amount consists mainly of current deposits (€217 billion) and regulated savings (€255 billion). The remaining € 128 billion is spread out over Short-Term and Long- and Medium Term deposits, as well as over other (non-regulated) deposits *(cf. figure 2)*. By way of comparison, the total financial patrimony of Belgian families is estimated at around €1.000 billion[2].

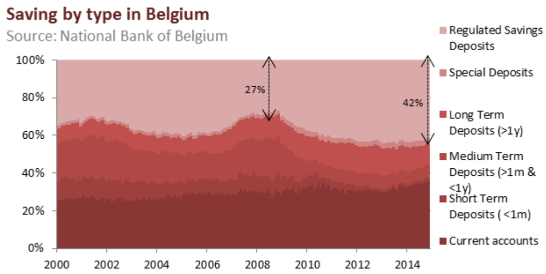

FIGURE 2 – DEPOSITS BY TYPE IN BELGIUM

The popularity of regulated savings accounts is flagrant and can be explained by various factors, especially:

- **Safety**: money can be withdrawn at every moment and a state guarantee applies on the first € 100.000 per person per bank[3]
- **Accessibility**: full accessibility of deposited funds, that can be withdrawn costless at any time

[2] http://www.lesoir.be/294174/article/economie/2013-08-06/245-milliards-nouveau-record-sur-comptes-d-epargne-en-belgique

[3] This applies to the whole Banking Union (European Directive on the Deposit Guarantee Scheme which entered into force in July 2014 and must be transposed into national law by 3 July 2015)

- **Advantageous taxation**: the first € 1.880 (figure for 2015) in interests earned on regulated deposits are free of taxes. Beyond that amount, a withholding tax on deposits of 15% is applied

Focus on Regulated Savings: an all-time high outstanding despite floor rates

The steady growth in deposits, maintained since 2001, has only been disturbed once, during 2006-2009 when the credit crunch was raging.

2007-2008: At the dawn of the financial crisis, we observe a drop in regulated savings deposits in Belgium *(cf. figure 3)*. Part of the amounts outstanding in regulated savings accounts flew towards medium / long-term deposits which, during the early crisis period 2007-2008 were safer than equity but still lucrative thanks to high interest rates *(cf. figure 4)*.

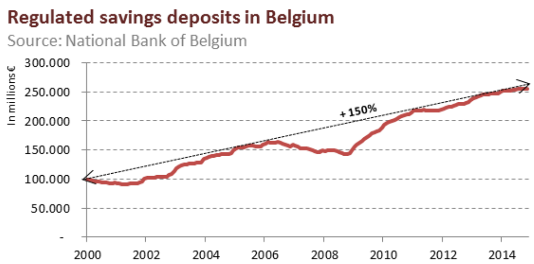

FIGURE 3 – 15Y EVOLUTION OF REGULATED SAVINGS DEPOSITS

2008-2010: However, since the end of 2009 ECB key rates fell dramatically *(cf. Figure 5).* This did not translate into a retreat from financial savings. On the contrary, households drastically increased their savings in that period to compensate for their patrimonial erosion conceded during the financial crisis due to, amongst others, falling house-prices[4]. The sovereign debt crisis does not allow Europe to recover properly from the crisis and households prefer to increase their savings.

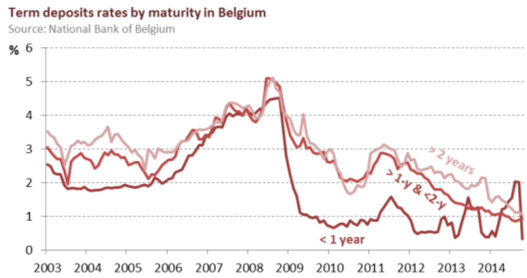

FIGURE 4 – EVOLUTION OF TERM DEPOSITS RATES

2011-today: The failure to achieve target inflation rates in Europe is accompanied by historically low interest rates as shown in Figure 5. After the interest rate crash in the period starting in the fourth trimester of 2008, rates have been almost flat for around two years, before starting a decline in 2011 that has still not stopped today. Despite the floor interest rates on regulated savings accounts *(cf. Figure 6)*, the threshold of 250 € billion in deposits was achieved in 2014. As the inflation rate turned negative in December 2014, the ECB announced the launch of a Quantitative Easing ('QE') program in Europe, based on a securities buyback of mainly securitized loans and sovereign debt.

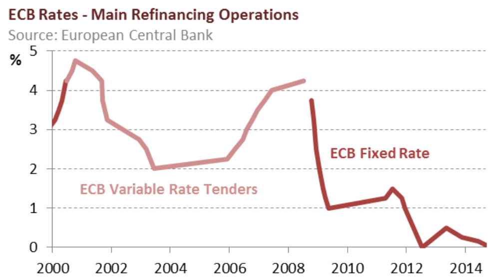

FIGURE 5 – ECB KEY RATES

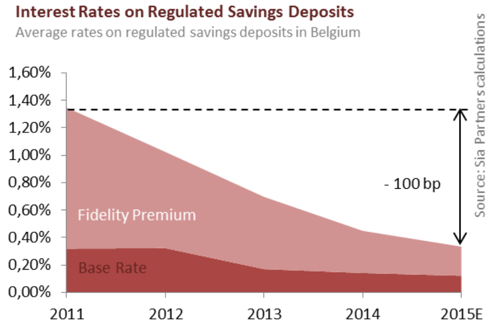

FIGURE 6 – INTEREST RATES ON REGULATED SAVINGS

[4] http://economic-research.bnpparibas.com/

What about 2015?

It is yet unclear what impact the new QE program will have on the European economy in 2015. Moreover, there are other factors affecting the European economy of which we cannot currently determine the outcome, such as the phantom of a 'Grexit' and the Ukrainian crisis. Based on historical growth rates of Belgian banks' regulated savings deposits, on ECB key rates and with adjustments for unknown variables from macro-economic trends as mentioned above, Sia Partners estimates the regulated savings outstanding end of 2015 at around € 262,4 billion or a 2,1 % growth compared to 2014.

Cost of Regulated Savings Deposits for Belgian banks

A significant fall in interest expenses despite growing deposits

In the paragraphs above we looked back on the financial savings behavior of Belgian households and commented on the impressive growth of regulated savings deposits in Belgium (150% in 15 years, cf. figure 3).

We also mentioned the falling interest rates, which have characterized latest years. Since April 2011, ECB Fixed Rate Tenders have fallen from 1,25% to 0,05% with effect from 10 September 2014 and rates on Deposit facility are already negative (-0,20%) since 11 June 2014[5].

Sia Partners analyzed the effect of falling interest rates on Belgian banks such as to estimate the total impact on the cost of regulated savings deposits, which represents a major part of Belgian banks' funding.

Based on analysis of base rates and fidelity premiums[6] on regulated savings deposits of the top-15 biggest banks[7] operating in Belgium, the total cost saving is estimated at € 1,76 billion over the last 4 years[8]. This represents a saving of 61,2% of the 2011 interest costs. The annual cost savings are distributed in a relatively linear way over the 4 years with cost savings of € 0,54 billion between 2011 and 2012, a high of € 0,64 billion in 2012-2013 and another € 0,58 billion in 2013-2014.

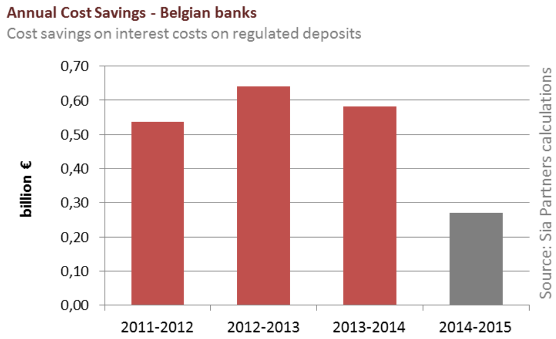

FIGURE 7 – ANNUAL COST SAVINGS

It is doubtful however that this trend will persist in 2015 and thereafter, given the floor-interest rates of today and the ECB's efforts to boost the European economy by a European QE program. Sia Partners estimates an additional cost decrease in 2015 of around € 0,27 billion, based on growth projections of outstanding amount and actual or projected interest rates on regulated savings deposits for 2015.

Method and hypotheses

Total yearly cost savings are based on the product of low[9] regulated savings interest rates and amounts outstanding on regulated savings deposits for each bank.

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[5] https://www.ecb.europa.eu/stats/monetary/rates/html/index.en.html

[6] Hypothesis: Fidelity Premium applies on 90% of regulated savings deposits *(impact of fidelity premium quite low: if hypothesis of a Fidelity Premium applying on, for example, 50% of deposits, the estimated cost savings would be adjusted downwards by only 10-15%), according to Sia Partners calculations.*

[7] Those account for > 97% of total outstanding on regulated savings deposits in 2014

[8] From 2011 till 2014

[9] Most banks offer higher yield online savings accounts. Those higher interest rates were not used, which did not significantly impact our estimation in absolute figures, as explained in the text below *(paragraph "Method and hypotheses").*

To determine the amount outstanding on regulated savings deposits for past years for each bank operating in Belgium, NBB figures are used. Interest rates on regulated savings are the interest rates provided on banks' websites, of which the rates of the lowest yielding products are used. Hence, estimated interest costs (and cost savings) from regulated savings deposits, are based on each bank's lowest yielding regulated savings products. In absolute terms, using the highest yielding interest rates does not significantly impact our estimation (€ 1,70 bn in costs savings instead of € 1,76 bn). However, it does in relative terms (38,2% less interest costs end of 2014 compared to 2011 rather than 61,2% when using low yielding products). The explanation is that in a context of higher interest rates and with a stable relative gap between high and low yielding savings accounts, the impact of decreasing rates, and thus cost savings, is smaller in relative terms.

Which banks benefit from those cost savings on interest expenses?

Above-mentioned costs savings are distributed depending on banks' market shares and offered interest rates. However, both sides of the balance sheet are affected by decreasing interest rates. Figures 8 and 9 show that, in a context of low interest rates, a 'scale economy' phenomenon seems to be at play, which may be beneficial to larger banks. The reason is that the room to lower interest rates on regulated savings deposits – a business model often used by smaller "internet-banks" – gets extremely small, which improves strong players' position to the detriment of the smallest banks.

Figure 9 shows that a critical mass might be necessary to stay competitive in Belgium. Small banks with aggressive high-interest accounts cannot benefit from cost savings arising from falling interest rates to the same extent as larger banks because their volumes are not as high.

The squeeze in net interest margin resulting from falling rates is thus more problematic for smaller banks, which causes the weakest players (non-top 15) to exit the market or lose market share to stronger players, as shown in Figure 9. Between 2011 and 2014, market shares of non-top 2015 players dropped from 5,8% in 2011 to 1,9% in 2014, even down from 9,0% in 2010. The lost market shares conceded by the smallest players over the period 2011-2014 (minus 67%) benefits to medium-sized "challengers" to some extent (+4,5%) but mainly to "small players" which are still Top 15 (+21,4%).

Hence, the observed trend is that a pressure on interest rates pushes the smallest players out of the market. Small (but still Top 15) players take over most of this lost market share, sharing only a bit from this market share increase with the "challengers" or

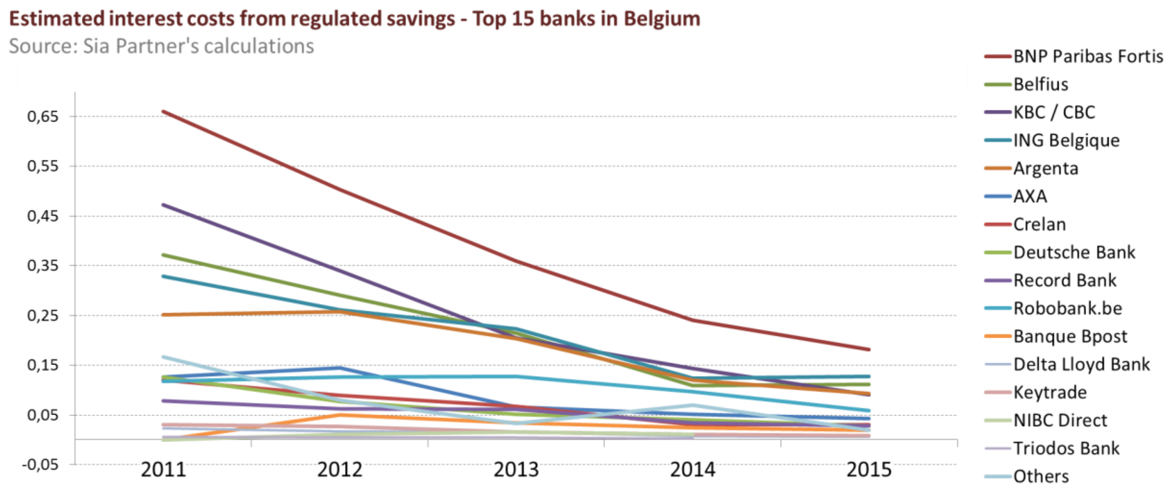
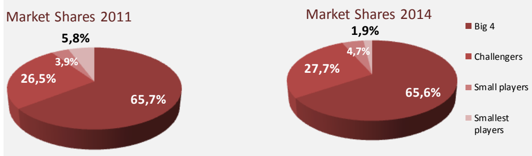


FIGURE 8 – COST OF REGULATED SAVINGS DEPOSITS

medium-sized competitors, while total market share of the "Big 4" stabilizes around two third of the total market.

Market Shares Regulated Savings - Top 15 banks in Belgium
Source: NBB & Colmpany Websites

			2010	2011	2012	2013	2014
Top 15	Big 4	BNP Paribas Fortis	25,1%	24,6%	24,5%	24,4%	24,0%
		Belfius	15,7%	13,9%	14,2%	14,5%	14,8%
		KBC / CBC	15,8%	14,9%	14,8%	14,0%	14,5%
		ING Belgique	11,5%	12,3%	11,4%	12,3%	12,3%
	Challengers	Argenta	7,6%	7,7%	8,0%	7,9%	8,1%
		AXA	0,0%	4,3%	4,4%	4,5%	4,6%
		Crelan	4,3%	4,5%	4,4%	4,3%	4,2%
		Deutsche Bank	4,4%	4,7%	4,5%	4,3%	4,1%
		Record Bank	2,8%	2,9%	3,2%	3,4%	3,5%
		Robobank.be	1,8%	2,4%	3,0%	3,3%	3,2%
	Small players	Banque Bpost	0,0%	1,9%	2,1%	2,4%	2,5%
		Delta Lloyd Bank	1,2%	1,1%	1,0%	0,9%	0,9%
		Keytrade	0,7%	0,7%	0,7%	0,7%	0,7%
		NIBC Direct	0,0%	0,0%	0,2%	0,4%	0,4%
		Triodos Bank	0,0%	0,2%	0,3%	0,3%	0,3%
Others	Smallest	Others (PSA, Evi, MoneyYou)	9,0%	5,8%	3,4%	2,0%	1,9%



		2011	2014	Delta
Top 15	Big 4	65,7%	65,6%	0,0%
	Challengers	26,5%	27,7%	4,5%
	Small players	3,9%	4,7%	21,4%
Others	Smallest players	5,8%	1,9%	-67,2%

FIGURE 9 – MARKET SHARE REGULATED SAVINGS DEPOSITS – TOP 15 BANKS IN BELGIUM

Conclusion

Despite falling interest rates, outstanding amounts on regulated savings accounts have risen with almost 17,5% since 2011, to reach a record level of about € 250 billion end of 2014. Although this growth is likely to level off, there are no signs yet of a reversal of this trend. However, macro-economic and geopolitical factors such as the outcome of the European 'QE' and the Greek and Ukrainian crises will undoubtedly affect Belgian households' savings-behavior.

Sia Partners estimated total savings in interest expenses from regulated savings deposits for Belgian banks at around € 1,76 billion over the last 4 years and projects an additional (but probably final) € 0,27 billion in cost savings in 2015.

Main benefiters of last years' interest cost savings seem to be the smaller / medium-sized players of Top 15 Belgian banks. Those were able to take over 67% of non-Top 15 players in the Belgian market, while the status quo was maintained for the "Big 4" in the Belgian banking sector. The reason is that lower rates not only cause cost savings but affect both sides of the income statement and thus cause a squeeze in banks' net interest margin. This effect might be more pronounced with smaller banks, especially with those using high-yield savings accounts to compete with bigger players. Indeed, floor interest rates are making their business model less viable. Consequently, a consolidation phenomenon occurs beneath the Top 15 banks in the Belgian banking sector, causing non-Top 15 banks to struggle for viable market share.

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