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Negative interests and the private law of professional and private accounts

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Bloomberg, 2016:

‘...if negative rates will either mark the start of a new era for the world’s central banks, or finally expose the limit of their powers.’

‘Situation where borrowers get paid and savers penalized is upside-down world’



Negative interest and monetary policy

Investopedia:

'Negative interest rate policy is an unconventional monetary policy tool whereby nominal target interest rates are set with negative value, below the theoretical lower bound of zero percent.'

- Governments - mostly no reactions
- Consumer organization – rare reactions
- Rare court judgments



Legal nature of interest rate

- Interest - payment from a borrower or deposit-taking financial institution to a lender or depositor of an amount above repayment of the principal sum expressed as annual percentage rate
- Economically, interest is charged by lenders as compensation for the loss of the asset's use
- In commercial contracts the obligation to pay for services and goods is presumed
- in consumer contracts the right to interest and method of accounting interest rate shall be agreed before conclusion of the contract
- As a rule, law does not regulate the lowest rate of interest

Is negative interest still interest?

	Positive interest	Negative interest
Calculated on the bases of regular payments	+	-
Payments during contract or after expiration	+	-
No payments during contract or after expiration	-	+
Calculation is based on the principal amount of the loan balance, or its balance	+	+
Obligation to repay agreed sum+ interest	+	-
Obligation to repay agreed sum - interest	-	+
Limitations in the law	+	-

Qualification problems



- Deposit/bailment contract - obligation of payment of interest is on the bank - loan-reverse-transaction
- Qualification under national law
- **Deposit with negative interest rate** – rare court practice on qualification

- Bailment?
- Loan?
-?



Problem of the equal treatment

- Do we have to treat businesses (professionals) and individuals (consumers) differently?
- Aristotle's division of justice into distributive and corrective justice?
- **What does mean principle of equal treatment in applying negative interest rate, which kind of justice has to be applied?**
- **Should the same principles apply to the calculation of interests?**
- Does it mean that the most advantageous solution shall apply to both of them?

Some possible discussion points:

- Consumer; no agreement with respect to the negative interest rates; contract with variable interest calculation; concluded before the reference rate turning into negative

Solution: deposit rate has to be equalized to zero

Why zero?

Possible set off situation: application of rules on deposit contract, even if the interest rate will be negative, bank is still obliged as depositary upon return of the deposited money transfer the profit received.

If the bank will earn no profit from using deposited money, there will be no set-off situation. Fair outcome - zero deposit rate. Then the client will lose the right to charge interest and bank has no obligation to return earned profit.

Some possible discussion points:

Most advantages for the creditor is the real negative interest rate and, for the depositary, the variable interest rate limit.

If real negative interest rate could be applied to the bank as depositary, the client will have to pay for the depositing money.

If we apply to both parties to the contract the most favorable method - variable interest rate limit to depositary, there is a possibility that the bank must pay more for lending money out than the depositary should pay for deposit. Coming to this point, the principle of equal treatment by using most favorable method of calculating interest rate might not be the best solution.

- Possible hidden negative interest rate



Agreed application of the negative interest rate

As long as there is no provision in the law prohibiting negative interest on loans or accounts, the parties are generally free to agree to such charges.

- 1) As individually agreed term – who has to prove?
- 2) As standard term – possibility of qualification as unfair?

Interpretation of contract – new rules?



Private law remedies in case of reference interest rate turning into negative

- **Reserved right to change unilaterally the contract terms**
- **Agreed restrictions on interest fall e.g. interest rate floor terms**
- **Concepts of impossibility, hardship or change of circumstances**
- **Avoidance due to the mistake**
- **Nullity of the transaction or a term**



Conclusions

- Economic arguments which may not be valid in private law
- Uncertainty concerning the qualification
- Uncertainty in applicable principles
- No court practice, no legal regulation
- Private law concepts need to be revised

Thank you for the attention!

