

Bank smart to make the best of less

Tighter regulation and reduced competition will hit borrowers and investors alike. Niall Brady examines the implications

HALIFAX shut its remaining branches on Wednesday and Postbank will begin pulling down the shutters in autumn — marking a retreat by institutions that once promised to break Ireland's banking cartel.

Customers will have to get used to less choice and higher charges, with some at risk of being squeezed out of the market, especially those on low pay or living in rural communities. The demise of Postbank contrasts with developments in Britain, where the post office is expanding the banking services — in partnership with Bank of Ireland.

Simon Moynihan of Bankers.ie, a price comparison website, said: "It makes no sense that an institution bailed out by Irish taxpayers is running a post office bank in Britain while post offices here are withdrawing general banking services. Postbank's closure is a huge loss, especially in rural areas where people rely on the post office to provide banking services."

The disappearance of competition has added to the problems of borrowers, who are confronted with a growing list of excuses for denying them a loan. Credit could become even more scarce if the Central Bank carries out its threat, announced last week, to limit the amount people can borrow.

Investors face a changed landscape too. Banks and insurance firms are being forced to come up with less risky alternatives following a decade of losses by their flagship-managed funds, which were supposed to provide a safe mix of equities, bonds and property. Reducing risk, though, could leave investors with little more than they would earn on deposit.

We examine the changed world of banking and advise you how to make the best of what is in store.

LESS COMPETITION

Halifax and Postbank are unlikely to be the last banks to quit Ireland. "I don't see how some banks can continue operating, [they are] fighting for the same pot of money," said Moynihan. "It looks like we'll be left with only four institutions: Allied Irish Banks, Bank of Ireland, Permanent TSB and Ulster Bank."

Decisions being taken by credit unions this weekend, though, could provide bank consumers with an alternative. They are voting on whether to invest in a new payments network, allowing them to provide electronic funds transfers, bill payments and debit cards. If approved, credit unions would be able to offer bank-style current accounts from the end

of 2012, although without overdrafts or cheques.

Mark Bailey, president of the Irish League of Credit Unions (ILCU), said: "It would give credit unions the opportunity to attract members and provide ethical financial services to those who have been alienated from banking services due to the current financial crisis."

The ILCU needs the support of 150 credit unions to go ahead with the payments network — 100 have signed up already and the boards of another 77 have recently voted on the proposal.

Bank customers, meanwhile, are being urged to make sure they get the best possible deals. All institutions still offer free banking, while Ulster Bank is the only one that does not pay interest on credit balances. You will not receive these perks, though, unless you ask for them.

TOUGHER REGULATION

The Central Bank suggested last week that it might seek to limit the amount people could borrow, in an effort to avoid the mistakes of the past. This could involve restricting the proportion of a house price you could borrow or capping mortgage amounts at a certain multiple of your take-home pay.

The Central Bank said: "Irish households have been able to accumulate liabilities more easily than consumers in countries where there is direct regulation of credit, for example in France or Germany. We anticipate that... we will be given broader regulatory powers which would include the ability to prescribe lending limits."



Flynn claims his system of investing beats the 'miserly' returns offered by some managed funds

Such limits are currently unnecessary, however, because banks have stopped lending. Karl Deeter of Irish Mortgage Brokers said: "Lenders are using every blunt instrument in the box to frustrate loan applications. One of my clients was turned down on the pre-text her employment wasn't secure. She works in reinsurance and, because of last year's record floods, her employer recorded a loss. It is part of a global reinsurance giant, though, that makes €3 billion a year. That's the type of stupidity that borrowers are dealing with."

First-time buyers must have at least a 10% deposit and a record of saving to back it up. "Banks aren't interested in parental gifts or guarantees," said Deeter. "They are interested in your ability to meet the repayments — not somebody else's. Make sure you pay your rent by standing order, not cash or cheque, so that lenders can see the money leaving your account on time each month."

SAFER INVESTING

Banks admit that their managed funds, which have made no money in the past 10 years, have failed investors. They tried to spread risk by investing

in different assets, only to find they all nose-dived when markets crashed in 2008 and 2009.

Pat O'Sullivan, the head of investment strategy at Irish Life Retail, said: "Managed funds used diversification to offer a healthy balance between risk and reward. That changed in 2008 and 2009 when equities and property performed similarly during the downturn."

In response, banks have launched less risky alternatives such as Irish Life's Core fund and the Elements fund from Bank of Ireland, which impose strict limits on equity exposure. Investors will pay for this caution, though, in lower returns.

Marc Westlake, the head of wealth management at Gold-Core, an adviser, said: "Returns are driven by risk — if you lower the risk, you have to accept lower returns. If you're trying to avoid short-term losses, don't hold risky assets over the short term."

Greater security is all about options

FUND managers claim to be investment experts but Kevin Flynn believes he can do better, minimising risk by using strategies that are ignored by managed funds.

He concentrates on blue-chip stocks, buying the household names favoured by fund managers. Flynn limits the downside, though, by using trading options — buying the right to sell his shares at an agreed price in the future. Options also allow him to generate an income while he holds the shares by renting them to others.

"These are rock-solid shares with great potential and, by using options as a form of insurance, I can get rid of the downside," said Flynn, from Kinnegad in

Co Westmeath. "It lets me exceed the miserly returns that many people received from managed funds."

In July last year, for example, he bought General Electric at \$11.72 (€9.57), paying an extra \$6.73 for an option to sell the stock at \$17.50 after two years. From a total outlay of \$18.45 a share, therefore, he could be certain of getting back at least \$17.50. "The most I had at risk was 95c a share, compared with a downside of 100% if I hadn't bought the insurance," he said.

Three months later, he sold his GE shares at \$16.72. Taking account of the additional revenue from options — rent of \$1.48 plus \$3.65 from selling the option

to buy at \$17.50 — Flynn received \$21.85 per share in total. This represented a return of \$3.40 or 18% on his investment of \$18.45.

Similar trades last year allowed him to make 23% on Starbucks and 16% on Oracle, the software company. The insurance provided by options limits the downside, he says.

"It removes the risk for retail investors while giving them total control."

After running his own portfolio for many years, Flynn has recently set up Iseinvest.com, which teaches skills to people seeking a hands-on approach to investing.

Niall Brady

Maximum mortgage	AIB	ICS	Irish Nationwide
Individual earning €55,000	€308,000	€288,750	€320,000
Couple (one income €70,000, the other €40,000)	€630,000	€550,000	€710,000
Couple (one income €65,000, the other €55,000)	€654,000	€600,000	€755,000

SOURCE: Irish Mortgage Brokers

Let's rein in lenders but avoid a stampede towards regulation

It looks like "intrusive" banking regulations are here to stay — well, at least until society decides they need to be bent a little, then twisted and finally, because they have become discredited, discarded.

Generally, that is what happens to heavy-handed regulatory regimes that have been instituted by governments overreacting to the problems they caused initially. The shake-up of the Irish banking sector proposed by Matthew Elderfield, the Financial Regulator, and his team is a good example of this.

Light-touch regulation was a shambles. An almighty mess has been left behind by the people entrusted by shareholders and customers to run the banks, and by the supervisors and regulators who were entrusted by the state to keep an eye on those bankers. During the boom years, both sides failed miserably in their single most important responsibility: not to lose our money.

The new Central Bank regulators need to get our banking industry back in working order, but is micromanagement part of their role?

Do the proposed restrictions really have to be statute-based? Will they apply to all banks or just to the ones owned by the Irish state and regulated by sheriff Elderfield and his deputies, assistant directors general Jonathan McMahon and Patrick Brady?

The tone of regulators' pronouncements to those ornery bankers has certainly turned more combative. This is what Brady said recently: "The level of engagement that you have with us will be dictated by your score. Your behaviour will play a significant part in where you are on the score sheet..."

Elderfield was even more direct: "Where we don't see risks being managed, we will intervene. In the most serious situations, we will stop you doing business."

Meanwhile deputy McMahon, unhappy that the banks still haven't addressed their weaknesses to his satisfaction, was quoted as saying: "We find ourselves having to hold their feet to the fire in ways that are surprising to me."

I expect many think this is the least

JILL KERBY COMMENT



the bankers deserve. And maybe it is. But all this "regulation" comes at a price.

Another 300 people are to be added to the hundreds employed at the Central Bank, most of whom clearly were not doing their jobs when the banks were running amok on their watch. They should have been sacked.

That won't happen now, however. Instead, we are going to be paying all their salaries long after this great banking emergency is over and sheriff Elderfield has turned in his badge.

Pension risks unchecked

How's this for déjà vu. At the launch of the 2008 Pensions Board report last year, Brendan Kennedy, the chief executive declared that he was very unhappy with the investment risks that defined-contribution pension schemes were taking with members' money.

Last week, exactly one year later, he said that he is still very unhappy with the investment risks being taken by defined-contribution pension schemes.

The board has been the supervisor and regulator of the occupational pension fund industry for 20 years. So you have to wonder how it has permitted the level of investment risk being taken to continue. Pension fund losses amount to about €25-€30 billion of the €90 billion originally under investment, and 75% of all defined-benefit pension schemes remain in deficit, Kennedy admitted.

Aside from extending the deadline for pension schemes to return to solvency

and reminding trustees and administrators that they have a legal obligation to have due regard "to the nature and duration of the expected liabilities of the scheme", the Pensions Board has no plan to force trustees and fund administrators to adjust their current asset allocation and reduce investment risk.

So, who will? Or is this a sector of the financial-services industry where light-touch regulation still reigns?

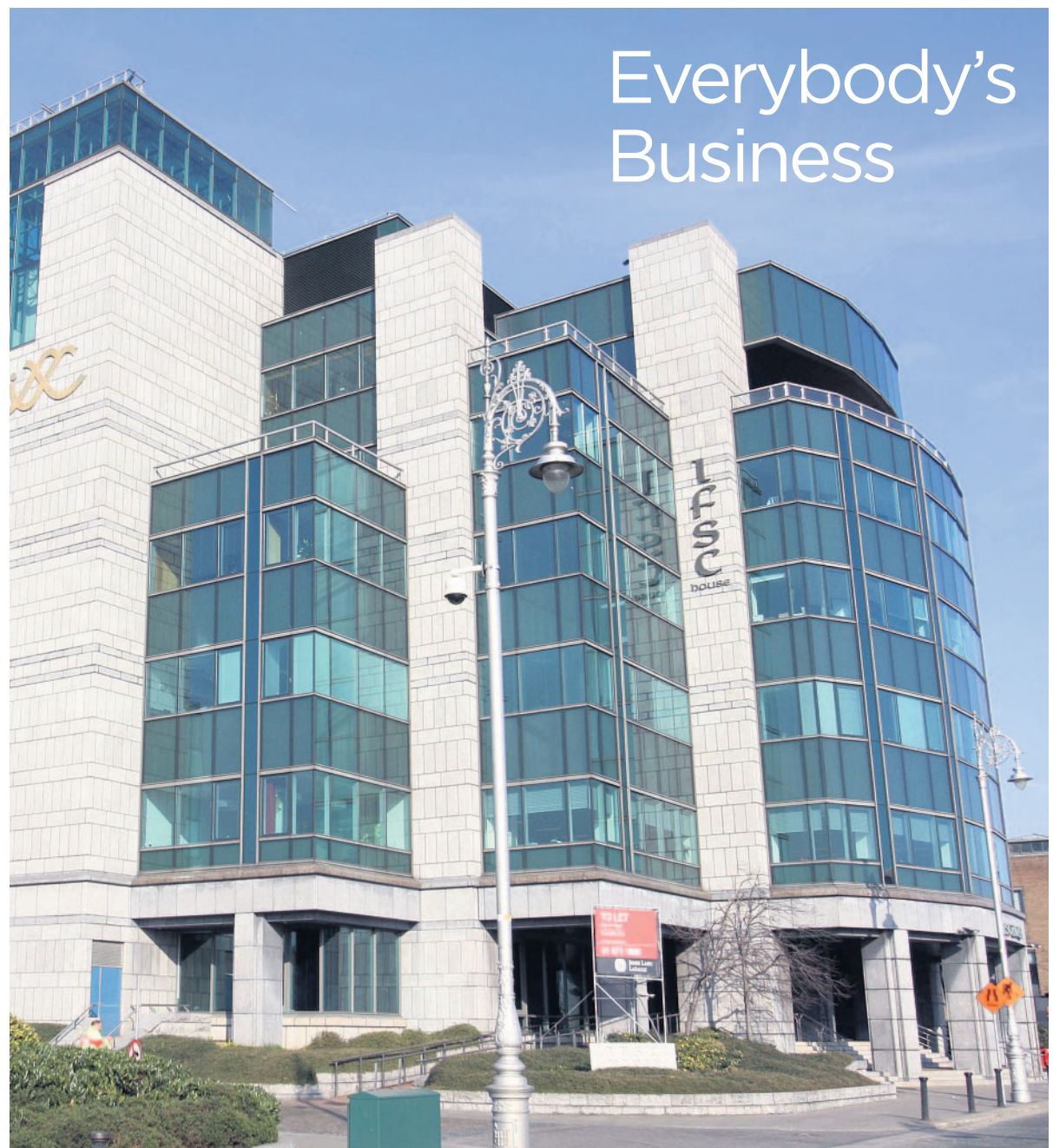
Struck by an Apple idea

Mine is an Apple i-family. Our computers, music players and now our mobile phones are all Apples.

I am still kicking myself for not following through with a very sensible suggestion that my then 11-year-old made in 2004, which was to use a generous money gift he had received that year to buy Apple shares.

Since 2003, they have gained more than 3,800%, and the maker of iPhones, iPods and iPads is now the second-biggest company in America. However, as a few commentators have also reported, Apple's rise has been very much at the expense of Nokia, the Finnish telecoms company whose share price has collapsed from a 2007 high of €29 to just €7.

There are two lessons here, says Brian Hunt of the DailyWealth newsletter. First, "when you find a great growth story, go ahead and buy it." Second, look for the most uncool phone (or computer or oil) company "to bet against" on its way down.



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