Learn how to feed off a zombie bank

Desperate financial institutions are giving ruinous rates on loans and savings, writes **Niall Brady**

CUSTOMERS are being urged to take advantage of a rare opportunity to beat banks at their own game by earning more interest on their savings than they pay on borrowings.

Zombie institutions such as Anglo Irish Bank are desperate for deposits as they cannot get funding elsewhere — forcing up rates across the board. Mortgage rates at Irish-owned banks and building societies, meanwhile, are artificially low thanks to the considerable political pressure they face after being bailed out by taxpayers.

Colm Doherty, the managing director of Allied Irish Banks, has described retail banking as "dysfunctional", warning that the pricing anomaly cannot continue. It contributed to a 25% slump in operating profits at AIB's Irish division last year, with massive bad debts pushing the final result to a record loss of €3.6 billion before tax.

Customers can profit at the expense of the banks — if they act quickly. Homeowners can borrow from AIB at 2.8% fixed for two years, but earn 3.4% a year from Nationwide UK (Ireland) on a two-year fixed deposit. Borrowing to save has the potential to pay a risk-free return of €1,200 on a loan of €100,000 over two years — if you qualify for credit.

Doherty warned that cheap mortgages would not be available for much longer, even though the European Central Bank is not expected to raise interest rates until later this year or in 2011. AIB is set to follow the lead of Permanent TSB by hiking mortgage rates before the summer.

Rory Gillen, the founder of InvestRCentre.com, which provides investment training and advice, said: "The barrage of criticism that came AIB's way for announcing higher borrowing costs missed the point. Banks have been paying higher borrowing costs for some time.

"AIB, like Permanent TSB before it, is simply passing on those costs with a lag. Savers are gaining by earning deposit rates way above the current ECB rate of 1%."

We find the best ways to gain from the banks' pain.

MORTGAGE RATE FIX

Homeowners can beat higher variable rates by fixing their mortgages now. This will increase your repayments initially because fixed rates are higher than most of the current variable deals. Fixing should pay off over time, though, as variable rates rise.

Karl Deeter of Irish Mortgage Brokers expects they will increase by 1.5 percentage points on average by 2011, sending AIB's standard variable mortgage from 2.25% to 3.75%. This is higher than all of its current fixed deals, except those for five and 10 years.

Other lenders penalise their loyal customers, charging them more to fix than new borrowers. Permanent TSB is the worst culprit. It has a five-year fix at 3.7%, the best on the market, but charges 5.75% to existing customers — an extra €10,620 in interest over five years on a mortgage of €150,000.

You should try switching if you have equity in your home and your lender does not have good fixed deals. KBC Homeloans pays €1,000 towards the legal costs of switching and charges 3.29% fixed for two years, or 3.69% fixed for three. It will refinance your existing home loan, plus up to €40,000 of other debt, provided the new mortgage does not exceed 80% of the value of your home.

MORTGAGE RATE CAP

Fixing leaves you at the mercy of your lender when the fixed term ends, with no assurances about what you will be charged for the rest of the mortgage.

Capping the interest rate might be a better option, especially if you are lucky enough to have a low-rate tracker mortgage, where the rate is pegged to the ECB rate for life. With capping, you can keep your tracker but have a form of insurance that will cover the extra payments if interest rates rise above a certain level.

Ian Lawlor of Optima Strategies, which helps investors to renegotiate their debts, said it was possible to buy interest rate caps on loans over €1m. The cap would cover the extra payments if the Euribor, the rate at which banks lend to each other, rises above 3.5% — from 0.65% currently. It would cost €23,000 to cap the rate on a €1m mortgage for five years, with the possibility of knowing exactly the cost by topping up your mortgage.

"We've advised some clients to buy cover for the peace of mind of knowing that, whatever happens to the Euribor, their rate is capped at 3.5%," he said. "Other clients, though, will be in trouble if the Euribor hits 2%, so there's no point capping the rate at 3.5%."

SAVINGS DEALS

The top easy-access accounts pay more than 3% interest. Fixed-rate bonds pay even more, and offer the security of knowing exactly what your money will earn until maturity.

Investec pays 3.6% for 12 months for online deposits over €20,000, with Anglo Irish Bank and Irish Nationwide paying 3.5%. Nationwide UK has good deals for longer-term savings — 3.6% annually for three-year deposits and 3.4% annually for a two-year account.

Before making their decision, savers should wait until the government launches the national solidarity bond. It will encourage them to save for the long term, paying a tax-free bonus after seven or 10 years, although it will be possible to cash in the bond at any time.

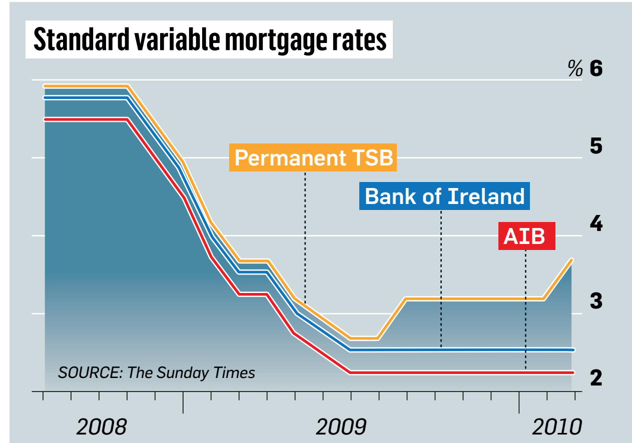
Vincent Digby of Impartial.ie, a financial adviser, said: "Provided you have emergency funds that are easily accessible, you should consider fixing your savings at 3.5% for 12-18 months. Hold your fire on fixing for longer because of the risk of missing out as interest rates rise."

FREE BANKING

The departure of Halifax and Postbank will make it harder to qualify for free banking. AIB and Bank of Ireland impose strict conditions, but it makes sense to obey the rules to avoid fees of 28c per transaction.

AIB requires that you use a debit card and make one payment by phone or internet banking every quarter to avoid fees. Bank of Ireland requires three phone or internet payments a quarter, or a minimum balance of €500 at all times.

Deeter said: "Free banking will be a thing of the past soon, or it will be heavily restricted. After Halifax and Postbank have shut down, the remaining incumbents have no need to extend free banking. Customers will choose banks for reasons such as proximity of local branches, quality of online service or availability of credit and overdrafts — not free banking."



BRYAN MEADE

Fitzgerald moved her savings to Rabodirect when the financial crisis struck and she is willing to trade the lower interest rate for peace of mind

Security is the key to making a switch

BANKERS' claims that current deposit rates are unsustainable cut no ice with Celine Fitzgerald, 47, who moved her personal savings to Rabodirect because of its rock-solid credit rating.

Fitzgerald, the chief executive of Rigney Dolphin, a call centre company in Waterford, said: "I find it intriguing that any business would tell its customers they are getting too much. If deposit rates fall, savers will resort to other options such as the post office, where their money has an unlimited state guarantee. It's not the customers' problem if banks are losing money. They need our cash and they shouldn't forget that money is mobile."

Security is Fitzgerald's top priority, leading her to switch to Rabodirect when the global crisis engulfed Irish banks and building societies in 2008. She earns 2% interest on Rabodirect's on-demand account — less than returns elsewhere.

Anglo Irish Bank and Irish Nationwide, the two institutions with the biggest financial problems, pay more than 3% interest on easy-access savings.

"I'm very conscious of the stability of the institution where I put my money," she said. "I'm willing to trade a lower rate of interest for security."

Another reason for switching is that other banks quickly drop their headline rates after customers have signed up. "They never tell you when the interest they are paying drops to almost nothing," said Fitzgerald. "They should be more up-front about what they offer."

Her mortgage, which has six years to run, is on a variable rate and is likely to rise in the coming months as lenders seek to increase profit margins. "I'll consider using my savings to pay off the mortgage if the rate of interest increases," she said.

Niall Brady

Eircom example shows how to tackle the pension problem

JILL KERBY

COMMENT

The government has spent six years trying to sort out Ireland's serious pension problem: half the working population has no pension and the pensions of the other half are inadequate.

The time bomb is ticking loudest for state and public sector pensions, which are largely funded from the public purse on a pay-as-you-go basis. The government has to fight these problems in the midst of a massive debt crisis.

The outlook isn't much better in the private sector where the majority of defined-benefit pension schemes are in deficit.

Eircom decided to face its pension crisis head-on last summer. Its pension scheme has 18,000 current, deferred and retired members and a €400m deficit.

Its solution, in the end, is remarkably simple. Despite there being just one active member for every 2.3 deferred or pensioned members in the scheme, nobody will be forced to delay retirement or pay more into the fund. Nobody will suffer a reduction in pension income or benefits. Eircom says it will clear its deficit and sustain the scheme until the last member departs this world by 2085.

Eircom's pension problem centred on liabilities growing relentlessly as members lived longer, while investment growth could not be guaranteed to meet those liabilities. The solution involves a limit on the company's contribution to the scheme for the next three years. Pensions will be frozen too until 2013 — and capped thereafter.

A strict but flexible formula has been agreed for the growth of pensionable pay from 2014 onwards.

Later this month, after a long process of consultations with trustees and unions, the unique and sustainable solution they agreed on is expected to be approved by members.

One of the big differences between Eircom and this government is that the company is under a legal obligation to sort out its pension deficit. The government can — theoretically — keep putting off its pension problems. Eircom can't.

Eircom also has the advantage of a workforce which, because it owns 15% of the company through an employee share ownership plan, was prepared to accept that the current scheme, and how it was funded, was not sustainable and risked the business's viability.

That's something that neither this government nor many of its citizens is willing to accept about funding pensions.

There are still important investment decisions for the Eircom trustees to make, but the terms and conditions under which this important occupational scheme will operate will be realistic, affordable and sustainable.

It's a template the government pension planners should have looked at before they wasted so much time on the deeply flawed national pensions framework, published 10 days ago.

Not sold on one-stop shop

There's a game of personal finance musical chairs happening at present, but I can't see too many winners.

Last week, the National Consumer Agency was given the consumer information and education function of the Financial Regulator. The agency heralded this as a victory for consumers, claiming they will have "a single body to represent their interests on consumer issues including personal finance . . . an independent, one-stop shop for consumer rights and personal finance information".

"Hopefully," this will lead to "lower costs and more savings on everything from groceries and electricity to investment products and loans," said Ann Fitzgerald, the NCA's chief executive.

That, I think, is a miscalculation of the power of either of these agencies to have anything other than a minor impact on market forces.

The cost of keeping two state agencies stocked with highly paid officials, their pensions, office overheads and €562,000 paid to a public relations company (in the case of the NCA) is partly what causes the high cost of living in this country.

I just can't see how shifting the financial information function from the regulator — which has actually done a pretty good job and has all its systems already in place — to the agency, which specialises in chasing down incorrect grocery pricing, somehow produces anything resembling a one-stop shop.

Anybody who fears they have been mis-sold a financial product or has a grievance against a financial institution isn't going to find comfort from the National Consumer Agency. Instead they will have to go back to the Financial Regulator.

Complaining about the loss of tens of thousands of euros from a mis-sold or inappropriate investment policy or mortgage is not the same as a complaint about a mispriced or faulty electrical appliance or a service contract with the management company of your apartment — two of the areas of NCA responsibility.

Consumers of financial products were supposed to have a one-stop shop when the Financial Regulator was set up.

Breaking up its functions and hiving them off to other quangos that look dangerously close to their own sell-by date doesn't seem to make much sense.

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