

# Banking on bad times for lenders

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Fri, Mar 05, 2010

**ANALYSIS:** Retail banking faces another tough year, with Irish institutions paying more for their money than they are charging customers

ALLIED IRISH Banks managing director Colm Doherty made a bold but refreshingly honest statement for a banker at AIB's annual results when he said that only three players in the market were actually lending on mortgages and all three were domestic banks.

"None of the foreign banks are lending, they have priced themselves out of the market," he said on Tuesday.

The lenders he was referring to are his own bank; Bank of Ireland, which is claiming in adverts to be approving 100 new mortgages a day, and EBS Building Society, which is writing more than double its usual share of new mortgages.

The lack of competition does not bode well for consumers.

Permanent TSB, once the leader in the mortgage market, said this week that the bank provided €800 million in lending in 2009, with just €300 million of this on new mortgages. The rest was top-ups to existing customers.

This compares with €8 billion in new mortgage loans in one year at the peak of the property boom.

Doherty said AIB was now covering 40 per cent of new mortgages, well above its traditional 17 per cent share of the market.

Doherty said that retail banking was "dysfunctional", with Irish institutions paying more for their money than they are charging customers. The consequent squeeze on the net interest margin cost the bank €420 million last year.

It's little wonder then that Lloyds Banking Group and French bank Paribas have abandoned Irish retail banking with the respective closures of their Halifax and Postbank businesses.

The increased cost of customer deposits shaved 0.42 per cent off the net interest margin, which was only partially offset by a 0.18 per cent gain on high lending margins.

Despite this AIB is still lending, though Doherty said that the bank's standard variable rate would rise by a half point over "the next couple of months" to the same level offered by many peers.

As the State's largest bank moves, other lenders will follow to where Permanent TSB was forced to much earlier due to its heavy reliance on outside funding.

The difficulty for AIB is not just the charges it makes on future loans but with the bank's €27.8 billion Irish mortgage book.

Doherty said that 60 per cent of these mortgages were on tracker rates. Most are likely to be on lossmaking margins above the European Central Bank rate.

Resolving this will take some time – possibly as long as the duration of the loans – given that many customers have very favourable rates and will be reluctant to move in the short term when they are enjoying margins as low as 0.6 per cent above the ECB rate.

The scale of the problem explains why AIB said this week that it will no longer take switcher mortgages to focus on first-time buyers and home movers. Mortgages are bad business in Ireland.

Doherty pointed out that he did not see any value for the economy in facilitating switchers as the bank's "primary emphasis is on support property transactions and thus the broader property market".

Doherty didn't hold back when assigning blame for the problems with retail banking and the heavy concentration in land and development which is costing AIB so dearly and "imperilled" the bank.

As a former head of the capital markets division of the bank in the IFSC on the northside of the river, he pointed to the problems at the retail bank at AIB Bankcentre on the southside in Ballsbridge.

The bank had operated as "a siloed business" adopting different credit and risk standards across the bank which had led to the problems in the over-exposure to developers and land speculators.

Doherty defended his track record as a director, saying that he had raised his concerns at board meetings about the retail bank. "My views are well-known at the board in relation to the concentration of risks that were built up in the retail portfolio," he said.

If Doherty pointed out the problems with retail banking on Tuesday, Irish Life & Permanent (IL&P) confirmed them the following day with its 2009 results.

Permanent TSB, a mortgage lender, posted an operating loss of €270 million after writing off €376 million on bad loans. IL&P finance director David McCarthy said the net interest income fell 21 per cent to €375 million as higher deposit rates and increase funding costs squeezed the net interest margin.

It's all about funding at IL&P this year as well as raising up to €600 million as a dowry to recapitalise Permanent TSB before marrying it off into any unions that arise from the expected consolidation across the banking sector.

While awaiting the future shape of the sector following the loan transfers to the National Asset Management Agency (Nama), IL&P must try at least to fix Permanent TSB's operating model.

The mountain it must climb is the €3.5 billion in funding that matures before the blanket guarantee ends in September.

The extended Government guarantee scheme will cost the bank up to €130 million this year, almost five times the blanket guarantee cost the company last year, so this, coupled with higher deposit rates will continue to eat into operating profits before loan loss charges.

Kevin Murphy, chief executive of IL&P, said he expected banks to stop paying up for deposits once Nama injected liquidity and improved bank funding generally.

Michael Cummins, a director at Dublin firm Glas Securities, which specialises in fixed-income markets, said that life will remain difficult in Irish retail banking "until confidence is fully restored in the Irish banks and the marketplace".

"The cost of the new Government guarantee, significantly higher costs of funding outside the guarantee and increased competition for deposits will weigh negatively on earnings in 2010."

Retail banking in Ireland faces another tough year as the Nama transfers have yet to begin and as a result it will be some time before the banks' capital requirements are crystallised. Until then, high-street banking will remain tricky.

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