Irish banks: deposit protection

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Section Business & Transport Section

This note sets out the issues behind recent concerns surrounding the safety of deposits made by UK residents in Irish banks. One important linkage between UK depositors and the Irish banking system is provided by the Post Office, which offers savings' bank accounts sourced with the Bank of Ireland.

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1 Introduction: the banking crisis in Ireland

Ireland, like much of the rest of the world has seen great turbulence in its banking sector. There are three main Irish banks: Anglo Irish Bank, Allied Irish Banks and Bank of Ireland. The Irish Government announced a generalised rescue package in December 2008.[1] An initial package was finalised in January 2009, and a further reorganisation and injection of funds was announced in March 2010 when a 'bad bank' was established to take on impaired lending. All three banks have experienced difficulties and have had various levels of government support, but of the three, it is Anglo Irish which is the most exposed.

1.1 Anglo Irish Bank (Anglo)

In the case of Anglo, adding to the woes of the 'credit crunch' have been instances of irregular loans made to its Chairman (who subsequently resigned) and other directors totalling €250 million. The bank is now 100% owned by the Irish government.

Anglo is not authorised by the Financial Services Authority (FSA), it is authorised by the Irish Financial Regulator. In January, the Irish Government put out a statement concerning the future of the bank which it intended to nationalise rather than simply recapitalise. It said:

> Anglo Irish Bank is a major financial institution whose viability is of systemic importance to Ireland. Anglo has a balance sheet of some €100bn with a substantial deposit base which the State is determined to safeguard. The Government has made clear that it will ensure its continued viability. Anglo Irish Bank will continue to trade normally as a going concern, with appropriate Government support as necessary. All Anglo employees remain employed by the company.
>
> The funding position of the bank has weakened and unacceptable practices that took place within it have caused serious reputational damage to the bank at a time when overall market sentiment towards it was negative. Accordingly the Government believes that the recapitalisation is not now the appropriate and effective means to secure its continued viability. Therefore the Government must move to the final and decisive step of public ownership.
>
> The Government believes that the prospects for the institution are solidly underpinned in the new structure, with the benefit of state ownership and a renewed management and Board. In the current circumstances the State is the only available potential owner.
>
> The recently appointed Chairman of the Board, Mr. Donal O'Connor, will stay on as Chairman. Anglo will be managed on an arms length basis as a commercial entity. A new Board will be appointed having regard to the need for appropriate continuity.[2]

Of interest to retail depositors, here and in Ireland is the concluding paragraph:

> All customers of Anglo Irish Bank can be assured that the full amount of their deposits and savings are further safeguarded by this action. They can also be assured that they can and should continue transacting with Anglo as normal and there is no need for customers to take any steps as a result of this announcement. Anglo Irish Bank will communicate directly with all customers in the coming days

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1 Irish Dept of Finance press notice, *Statement by the Government on the Recapitalisation of Credit Institutions*, 14 December 2008

2 Financial Regulator press notice, *Statement by Minister for Finance on Anglo Irish Bank*, 15 January 2009

Concerns over Anglo increased in February 2009 when it emerged that the bank had received a €4billion (later revised to €7.5 billion) deposit from Irish Life & Permanent on the last day of its financial year (thus appearing in its accounts and substantially improving its deposits to loans ratio). Later it emerged that Anglo had lent €451 million to "10 long standing clients" to buy its own shares. Anti-fraud investigators visited the bank's headquarters on 24 February 2009.[3] In April 2010, Anglo announced losses for the 15 months to December 2009 of £11.3 billion. On the back of these results, the Irish government announced a further aid package of €8.3 billion.

In September 2010 the Irish government split Anglo into 'good' and 'bad' banks.

1.2 Allied Irish Bank (AIB)

The recapitalisation support package announced in December 2008 was, after negotiation decided upon and announced on 11 February 2009. Under the "comprehensive recapitalisation" plan was announced by the Irish government:

> The Government will provide €3.5bn in Core Tier 1 capital for each [the terms applied to Bank of Ireland too] bank.
>
> In return for the overall investment the Minister will get preference shares with a fixed dividend of 8% payable in cash or ordinary shares in lieu. These preference shares can be repurchased at par up to the fifth anniversary of the issue and at 125% of face value thereafter.
>
> The Minister can appoint, in total, 25% of the directors to both banks.
>
> The Minister also gets 25% of total ordinary voting rights in respect of change of control and board appointments.
>
> Warrants attached to the Preference Shares give an option to purchase up to 25% of the ordinary share capital of each bank existing on the date of issue of the New Preference Shares. The strike price of the first 15% of the Warrants exercised by the State shall be €0.975 for AIB and €0.52 for BOI. The strike price of the balance of the Warrants shall be €0.375 for AIB and €0.20 for BOI.
>
> If the bank redeems up to €1.5bn of the State investment in New Preference Shares from privately sourced Core Tier 1 capital prior to 31 December 2009, then the Warrants will be reduced pro rata to that redemption to an amount representing not less than 15% of the ordinary shares of the bank.
>
> The recapitalisation programme will be funded from the National Pensions Reserve Fund. €4 billion will come from the Fund's current resources while €3 billion will be provided by means of a frontloading of the Exchequer contributions for 2009 and 2010. The necessary amending legislation to the National Pensions Reserve Fund Act will be introduced shortly.[4]

Since the announcement there have been no disclosures in the same vein as Anglo's and AIB was able to announce profits for the 2008 financial year of over €1 billion – albeit a reduction of 62 per cent on 2007. Following the April 2010 package AIB was required to increase its capital base by €7.4 billion. It is predicted that by the end of the year the bank may be 70% owned by the Irish government.

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3 *Financial Times* reports 12, 22 and 25 February.

4 Irish Dept of Finance press notice, *Government Announcement : Recapitalisation of Allied Irish Bank and Bank of Ireland*, 11 February 2009

AIB (GB) is authorised by the FSA, and hence in the event of its failure depositors would have recall to the Financial Services Compensation Scheme.

1.3 Bank of Ireland (BOI)

The BOI received assistance through the January recapitalisation packages on the same terms as the AIB (see above) and is. The BOI is the ultimate source of funding for the savings accounts currently being offered by the Post Office. Various parts of the BOI organisation are authorised and regulated direct by the FSA. However, the Post Office is regarded as an appointed representative of BOI Personal Finance Ltd. This means that the parent bank has assumed responsibility for the regulation of its representative and therefore, the Irish regulator is the lead regulator.

In November 2008, BOI revealed half year pre tax profits of €650 million, down from €951 million in the equivalent period in 2007, a 32 per cent fall. Under the 2010 recapitalisation plan, BOI was required to raise €2.7 billion and is likely to end up 40% government owned. BOI gained some notoriety in March 2009 when it was the victim of a €7.6 million bank robbery following the kidnapping of branch members and their families.

2 Depositor compensation levels

Customers with accounts in Irish banks and building societies are covered by the Irish Government's deposit guarantee scheme, which was extended in September 2008; details were given in a press notice issued by the Department of Finance:

> The Government has decided to increase the statutory limit for the deposit guarantee scheme for banks and building societies from €20,000 to €100,000 per depositor per institution. The cover will apply to 100% of each individual's deposit. This guarantee level will also apply to credit union savers.
>
> Announcing the decision, the Minister for Finance, Brian Lenihan TD, said "I want it to be known that the Government is confident about the strength and resilience of the Irish financial system. The Government is committed to the stability of our financial system, so that money placed with an Irish credit institution would not be at risk. As I said yesterday, the Irish Government wants to protect the whole financial system, secure its stability and ensure that all deposits in Irish financial institutions are safe."
>
> The Minister added "the Central Bank and Financial Regulator have stressed the soundness and stability of the Irish financial system. This measure provides additional reassurance to depositors in Ireland that their savings are safe. The new guarantee level is now among the highest in the EU."
>
> The Minister also commented that notwithstanding the uncertainty caused by the turbulence in international financial markets over the last week, it is encouraging that the banks have retained the confidence of their customers.

> This measure has been under consideration for some time, and the Minister believes that this is the appropriate time to make the announcement.[5]

This announcement was received poorly by the UK bank sector at the time, since it meant that Irish protection levels were significantly higher than those here, as one banker commented in a magazine article: 'The guarantee implicitly says that your money is safer in Irish banks.'[6] It was thought that this could lead to deposits being switched from UK based banks to Irish ones. The move also may have prompted the co-ordinated increase in deposit protection across the EU to, first, €50,000 and, by the end of the year €100,000. This was announced in October 2008.[7]

Recently however, as the scale of the problems in Ireland appears to have worsened, newspaper articles have suggested that UK consumer confidence in such deposits has reversed. Depositors are now looking to remove funds from Irish banks and repatriate them. A typical article from March 2009 reads:[8]

> *Cash: Irish pledges fail to calm fears for UK savers: Despite guarantees on their bank accounts, many readers have lost faith in Dublin and want their cash back in Britain.* Margaret Dibben reports
>
> No amount of reassuring words from Irish banks and the Irish government about the economy in the past week has satisfied readers - many retired - that their money is safe in Irish bank accounts.
>
> Dozens of people contacted us after an article in last week's Cash (Ireland looks to quash talk of crisis as savers get the jitters), asking us to find out if there is some way to retrieve their money.
>
> Many opened accounts in Ireland on the promise of high interest rates but often, overwhelmingly, because they had the security of both the UK and Irish compensation schemes written into the terms and conditions of the account. Nothing in the terms suggested this situation might change.
>
> But now they have only Irish protection. This is, in fact, better than the UK's Financial Services Compensation Scheme (FSCS), which protects savings up to £50,000, because the Irish government has guaranteed all money in Irish bank accounts until September 2010 and, even after that, up to euros 100,000 (£88,000) is guaranteed.
>
> There is one exception. AIB Group (Allied Irish Banks) is a fully FSA authorised UK subsidiary, so AIB customers still have first call on the UK compensation scheme.
>
> Even though the Irish scheme offers 100% protection, that holds good only as long as the Irish government can pay out if banks collapse. If it got to the point that the Irish government could not compensate depositors, UK savers could not now revert to the UK scheme because the Irish banks (importantly for UK savers, Bank of Ireland and Anglo Irish Bank) are not directly UK authorised.
>
> The problem is that, despite this increased protection, many readers say that they have lost confidence in the Irish economy.

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5 Irish Dept of Finance press notice, *Government Increases Deposit Guarantee Limit to €100,000 per depositor*, 30 September 2008. Further details are set out in Irish Dept of Finance, *Credit Institutions (Financial Support) Scheme 2008 - Frequently Asked Questions*, 16 December 2008

6 *City & Corporate: Banks fight against Irish pledge*; PR Weekly, 10 October 2008

7 See Europa Rapid press release 15 October 2008

8 Observer 1 March 2009

> […]
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> Because of the uncertainty, some of them want to abandon the high interest rates they locked into and are even prepared to pay a penalty to withdraw their savings. But those with fixed-rate, fixed-term products have found they can't get out.
>
> However, there appears to be hope. Some savers are having success in getting money out, so long as they have a good reason - which does not include being worried about the bank's future.
>
> When reader Tony Tucker learned the terms had changed, he tried to get his money out of Anglo Irish but discovered that, although its FAQs told him withdrawals were allowed at a penalty and in an emergency, the terms and conditions added " . . . and if permitted by us".
>
> "The bank's reply said I had 'not provided a satisfactory reason for us to action this transfer'," he wrote in an email to Cash last week. "I am extremely worried by the present situation. This money is critical to my retirement and can never be replaced or earned again."
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> […]
>
> Tucker appealed to the bank, explaining that his son and daughter were likely to lose their jobs and he needed the money to support them. Last week, Anglo Irish agreed to refund his money without penalty "as a one-off goodwill exception".
>
> The Observer has learned of other savers having similar success. However, the bank does say it will consider all withdrawal requests on a case-by-case basis, so there is no guarantee that persistence will pay off. The bank also insists customers are protected by nationalisation.
>
> Thousands of Post Office savers, whose money is with Bank of Ireland, will find it easier to access their money. They are allowed to cash in their fixed-term bonds and are unlikely to pay what the Post Office calls a breakage charge, because interest rates have fallen so far. But this also means savers cannot earn nearly as much in a new account.

An article in the Sunday Mail appears to have caused the latest round of concerns:

> SAVERS with Post Office accounts - provided by the Bank of Ireland - are growing increasingly anxious about the safety of their money as the economic and banking crisis in Dublin worsens.
>
> Post Office savers are not protected under the UK's Financial Services Compensation Scheme. Instead they are forced to rely on a scheme underwritten by the Irish government.
>
> If the Irish economy collapses or requires rescue, it is unclear what would come of pledges made by the authorities in Dublin to refund UK savers' money.
>
> The Irish protection scheme has no money set aside for such an emergency. There is no requirement for UK authorities to step in.
>
> Post Office boss Alan Cook is thought to have held secret talks with Whitehall officials on the matter. He refuses to talk to Financial Mail.

> While the Post Office, Bank of Ireland and Anglo Irish Bank all still offer savers attractive deals, they are not for the faint-hearted.[9]

The unnamed article, does not say who these anxious savers were, but has certainly caused many to become worried. Neither does the article make clear why it was not warning its readers of the perils of this account before the Irish government raised its protection levels. Before, the FSCS would only have paid a proportion of the deposit, whatever the Irish government had done, and why it misleads people into thinking that protection, and regulation, has somehow switched from London to Dublin. It should be remembered that Ireland is not the only country in the position of offering greater protection than the UK. The following institutions are all covered by home regulators providing greater protection than the UK FSCS scheme: Belgium - Fortis Bank SA/NV; Ireland - Anglo Irish Bank Corporation plc Bank of Ireland, Merrill Lynch International Bank Limited; Netherlands - AKbank, ING Direct NV; TD Waterhouse Bank NV, Triodos Bank NV

So are worries justified? A 'government' is normally more credit worthy than any private institution and there is little to suggest that this has changed since the measures taken in January to support the banking sector. The only evidence one has so far is that when small countries become 'insolvent' there are support mechanisms in place. Iceland for example, was able to negotiate a substantial loan from the IMF in order to meet its much worse public finance difficulties. Part of that loan was to settle outstanding claims on its now nationalised banking system.[10]

Another strand of support is being suggested by the Chancellor in advance of a G20 meeting in April 2009. This was outlined by the Chancellor speaking on the *Today* radio programme on 10 March. The Chancellor's interview is reported below:

> Alistair Darling is calling on the EU's richest countries to step up help for more fragile member states, saying all nations are "dependent" on one another. By acting together, the EU could make a "real difference" to help those of its members with the most serious economic problems, the UK's chancellor said. Wealthy nations must also give more resources to the International Monetary Fund to combat global poverty, he said.
>
> The chancellor says some newer EU countries, in Eastern and Central Europe, face funding gaps that must be addressed by combined action before their position becomes too "acute".
>
> The European Central Bank's emergency 25bn euros (£22.9bn) fund available to support countries in difficulties should be topped up, he told the BBC.
>
> "In Europe we can do more to help those countries that may be getting into difficulties," he said, adding that all EU members must do their bit to offer a "broad shoulder" of support.
>
> They may not be acute yet but there are certainly difficulties that if you don't sort out will come back to bite the rest of us." It was in the interest of all member states to do their bit as they were dependent on each other for trade in the same way as Europe was dependent on other areas of the world.
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> […] BBC political correspondent Iain Watson said Mr Darling was calling for a substantial increase in resources for the IMF, which has identified 26 countries that are particularly vulnerable to the financial crisis.

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[9] Sunday Mail 15 March 2009

[10] For further details on the Icelandic banking problems see standard note 4864, *Icelandic Bank Default*

> Mr Darling has not said how much more money is needed to support EU countries, in particular, but has indicated that central and eastern European economies face a $100bn "financing gap" this year.
>
> World Bank head Robert Zoellick has proposed a "vulnerability fund" to help developing countries, financed by 0.7% of the money the richest countries are spending on their economic bail-outs.[11]

Lastly, the Irish government has introduced a package of public expenditure cuts designed to improve public finances. A 'Stability Programme' was introduced in October 2008. In January 2009, it was updated to reflect worsening economic crisis. An updated statement outlined the overall aims of the plan:

> The Government has agreed to put in place a five year plan to restore balance to the public finances by 2013. This will include as a priority the elimination of the current budget deficit by 2013, that is to stop borrowing for day-to-day spending, and in that period to also bring the General Government deficit to below 3 per cent of GDP, while maintaining a high level of capital expenditure.[12]

As part of this programme, the *Financial Emergency Measures in the Public Interest Bill* was introduced on 17 February 2009 and included cuts in public service pension expenditure and reductions in public sector fees for professional services.

There are differences between the three main Irish banks. Anglo and BOI are protected by the higher value Irish deposit scheme, Anglo is fully nationalised whereas BOI is simply in receipt of government capital support. AIB is also in receipt of government support but its UK operations are covered by the FSCS. The particular position of UK depositors with Post Office accounts sourced with the BOI was the subject of a recent Lords PQ:

> **Asked by Lord Lawson of Blaby:** To ask Her Majesty's Government in the event of a partial or total default by the Irish Deposit Protection Scheme, what recourse United Kingdom Post Office depositors have to the Government. [HL905]
>
> **The Financial Services Secretary to the Treasury (Lord Myners):** Some savings accounts at the Post Office are provided through a joint venture with the Bank of Ireland Group. Those deposits are covered up to a level of €100,000 by the Irish Deposit Guarantee Scheme, under the terms of the deposit guarantee schemes directive. In addition to the protection of the Irish Deposit Guarantee Scheme, the Irish Government announced on 30 September 2008 that they would guarantee certain deposits with Irish banks, including all retail deposits, until 29 September 2010. Other savings accounts are provided by FSA-authorised firms and are guaranteed by the Financial Services Compensation Scheme. Depositors have been informed about the guarantee arrangements.[13]

In a move that is unlikely to reassure nervous investors, on 30 March 2009 the credit agency Standard & Poor's downgraded the Irish government from triple A status to AA+.

Ultimately, it is for depositors to come to their own conclusions about the soundness of the institutions they invest in and this clearly will include the profitability and soundness of the institution itself and the security of support behind such institutions.

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[11] Reported BBC News website 10 March 2009
[12] Irish Department of Finance statement January 2009
[13] HL Deb 11 March 2009 cWA261