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The 10 cardinal banking questions

No one could accuse the Irish banks of basking in universal acclaim these days -- and there are still many questions hanging over their well-appointed boardrooms. Louise McBride has 10 of the best

Irish banks didn't have much to smile about last week. AIB reported its first ever annual loss. The number of homeowners struggling with their mortgages has doubled over the past year and a half. And with a new report showing that one in five homes are lying vacant, the prospect of a house-price recovery seems even remoter than ever. What are the biggest issues now facing the Irish banks?

How much money do the banks need? how will they get it?

THE top three Irish banks, AIB, Bank of Ireland (BoI) and Irish Life & Permanent (IL&P), could need almost €7bn between them to get back on their feet.

Analysts believe that AIB, which made a pre-tax loss of €2.65bn last year, needs about €4bn to bolster its capital reserves: money essentially held by banks to act as a cushion against any losses. AIB could raise that money in a number of ways, including offering a direct stake in the bank to the Government, restructuring debts, holding a rights issue, where the bank would raise money from existing shareholders, and selling overseas assets.

AIB would raise about €1.7bn by selling its Polish subsidiary, Bank Zachodni WBK, while the sale of its stake in the US bank, M&T, would raise about €900m, according to Stephen Lyons, bank analyst with Davy. Analysts believe the sale of its British banking business could generate a capital gain of €650m for AIB.

Mr Lyons believes that BoI needs €2bn to boost its capital reserves while IL&P, which has just reported a pre-tax loss of €319m for last year, needs €600m. Both of these banks could carry out a rights issue to raise some of that money.

Why can't we just shut DOWN Anglo Irish Bank?

THE Government has already poured €4bn of taxpayers' money into Anglo. With the bank expected to reveal losses of up to €11bn within the next few weeks, it looks like it will have to pour in billions more. Despite this, the Government is standing firmly by Anglo.

One of the reasons for this is that taxpayers, who effectively own the bank, could be forced to swallow further losses if the bank is shut down. With massive debts and little in the way of foreign assets, there is also unlikely to be much gained financially by shutting down Anglo.

"If you let Anglo go wallop, receivers would be appointed to the bank and they might then sell assets that the other banks have exposure to," said one bank analyst who did not wish to be named.

"A lot of the banks have the same customers so any fire sale of properties (by Anglo receivers) could have a domino effect. The losses the other banks are already facing could go higher."

Why HAS no banker been jailed?

NOT only have the Irish banks helped to bring our economy to its knees, two of them (Anglo and IL&P) have been at the centre of a criminal investigation for over a year. However, no criminal action has yet been taken against any former or current bankers.

"White-collar fraud is exceptionally difficult to prove so you wouldn't do anything to hurry an investigation," said Peter Oakes, managing director of Compliance Ireland and a former enforcement lawyer with the British financial regulator, the Financial Services Authority. "The gardai need to make sure they have a watertight and solid chain of evidence -- there would be massive public anger if a prosecution were made but the case fell through because of lack of evidence."

One of the reasons the Anglo investigation is taking so long is that the lack of whistleblower protection might leave employees feeling vulnerable if they were to bring their concerns to the relevant authorities.

Why shouldn't AIB and BoI be nationalised?

THOSE in favour of nationalisation argue that both banks would be in a better position to withstand any future losses or asset writedowns if they had the State behind them.

However, many investors run scared of nationalised banks. Furthermore, by taking over AIB and BoI, the Government could be taking on more bank debt than it can handle.

The State's bad bank, the National Asset Management Agency (Nama), has just been approved by the European Commission. "The purpose of Nama is to return the banking system back to health, and to suddenly nationalise the banks now would send confusing signals to the credit markets, which the Government relies on for its own funding needs," said Mr Lyons.

Why do so many people think Nama is a bad idea?

THE main gripe with Nama is its massive bill and unknowns. The taxpayer is paying about €54bn to the banks for property-related loans.

The market value of the assets on which these loans are secured has been estimated at €47bn -- with the property market in stalemate; however, this €47bn estimate could be way over the mark. This would mean that the Government is paying billions more for these loans than it should.

For Nama to make money, property prices must recover -- if they continue to collapse, Nama could be in the red by the time it is wound up. And it's not looking good. Almost one in five of all housing in Ireland is lying vacant, according to a report just published by UCD -- oversupply of that level is bound to push property prices down further.

Why are the banks not lending money?

THE recession has turned our once-flush banks into cautious lenders. Although unemployment last month fell for the first time since last September, the number of people losing their jobs has hit all-time highs over the last year.

By the end of last year, 28,603 borrowers were struggling to repay their mortgage -- about twice that of June 2008. Many of these are in negative equity, which means they've borrowed more than their house is worth. Banks simply aren't prepared to take on risks like this.

The credit crunch -- which erupted in August 2007 as banks worldwide tightened their belts to protect themselves from a mortgage crisis in the US -- has also played its part. The credit crunch made it harder and more expensive for banks to raise money to lend to customers.

The explosion in the number of businesses going to the wall hasn't helped either.

"In contrast to the strong-growth years when most loan applications were for investment capital for businesses that were viable and trading well, today most applications are for working capital and cashflow," said a spokesman for the Irish Banking Federation (IBF). "Some businesses are finding it difficult to remain viable because of the decline in economic and trading conditions."

Will Nama free up credit?

IF Nama does its job and stabilises the Irish banks, they should eventually start to lend a bit more. But Nama will be only one part of the recovery jigsaw -- lower unemployment and higher consumer confidence and spending will also encourage the banks to lend more.

At a Dail committee meeting before Christmas, former AIB chief executive, Eugene Sheehy, said: "Nama has had a hugely positive impact in terms of stabilising the banking system and, in time, helping to reduce funding costs. It is not a panacea, however."

Central Bank governor Patrick Honohan has also warned people to be realistic in their expectations that the work of Nama would start to free up credit coming from the banks.

Will the 'Third Force' work?

With local banks like AIB and BoI now dominating the market, a third force in Irish banking is deemed vital for competition.

This third force is expected to include EBS, Irish Nationwide and Permanent TSB -- as well as a business lender. Critics, however, believe it will be impossible to put two or three banks together, particularly since a merger of that scale would inevitably trigger cost-cutting and job losses. The third force sounds good in theory but it may never get off the ground.

What does the new banking landscape mean for customers?

THE recent exodus of Halifax and Postbank from Ireland will erode choice and competition in the banking sector. Mortgages and loans will become more expensive, higher bank charges will sneak in, banks will feel less compelled to offer sweeteners in a bid to hold on to, or win, customers, and the interest paid on savings is also likely to be slashed.

"Ultimately, all of the guaranteed banks are losing out from paying high deposit rates and this is not sustainable at a time when they need to protect their earnings to rebuild capital," said Mr Lyons.

Last week, AIB warned that it planned to raise its mortgage rates by 0.5 per cent before the summer.

This increase could be the first of many. BoI and EBS are also expected to increase their standard variable rates soon. Permanent TSB has already increased its rate twice over the last year.

If, as expected, the ECB pushes up its interest rates over the next year, mortgage interest rates could double over the next year and a half.

What's the ultimate impact of the banking problems for the taxpayer and infrastructure?

THE Government has already put €11bn of taxpayers' money into BoI, AIB and Anglo -- and this bill is likely to run higher. It has also gambled about €54bn on Nama.

If Nama fails -- and the Irish banks don't clean up their balance sheets -- it will be a disaster for our economy. Without a stable banking system, the Irish economy is unlikely to emerge from the dire straits it is currently in.

Were it not for the Irish banks though, the billions of euro in the State coffers could have been used to kickstart state infrastructure projects -- which would, in turn, generate employment and spending.

Instead, infrastructure projects have been stalled, workers have been hit with tax hikes and pay cuts, and there has been a raft of state cutbacks.

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