

ROUND TABLE DISCUSSION

Say what you will about the banking community but even in the aftermath of the crisis of confidence which has gripped the global economy, bankers remain a key part of the recovery process and the underlying commerce model. With this in mind, Ulster Business and Goldblatt McGuigan invited business bankers from the 'big four' Northern Ireland banks to an evening of topical discussion and debate, disguised behind a meal of local produce. Owing to bereavement, First Trust were unable to attend but Ulster Bank, Northern Bank and Bank of Ireland made a surprising revelation; they are keen to lend money...





Chair, Sir David Fell, Non-Executive Chairman at Goldblatt McGuigan



Michael Kidd, Head of Business Banking NI at Ulster Bank



Kevin Kingston, General Manager of Corporate Banking and Markets at Northern Bank



Henry Elvin, Head of Business Banking at Ulster Bank



Sam Goldblatt, Managing Partner at Goldblatt McGuigan

Banking on better times?



Sir David Fell – I should start by saying that suddenly everyone believes they know more about banking than they know about anything else in the world. There is no doubt the banking crisis led to the economic recession we find ourselves in and I think the general public, and the business community as a sub-set of the general public, are interested in what the current attitude of banks is to a variety of issues that affects their lives. We want to get into that tonight. I think we should start by acknowledging that the three banks around the table are different in structure from one another and therefore I am just going to start by asking each of you to give a brief description of your corporate structure, what your relationship to a parent is, where you are regulated and so forth.

Michael Kidd – We are part of the governing company Bank of Ireland. The business in Northern Ireland is part of that main parent company, we are not a subsidiary in any way and therefore Bank of Ireland Group is regulated both by the Irish regulator in Ireland and by the FSA in the UK operation. It is actually a very simplistic structure.

SDF – So when it comes to something like regulatory capital is it the Irish regulator who imposes that or the FSA?

MK – I suppose it is a mixture of both. Under the EU regulations, we have a passport

into the UK so the FSA takes an interest in everything we are doing - from a liquidity and capital perspective - but I suppose ultimately, the Irish regulator is the regulator for the Group as well.

Kevin Kingston – Northern Bank is a Northern Ireland bank led by a local management team in Belfast with a local Chief Executive. We are part of the Danske group, Danish banking, and regulated by the UK FSA as a UK bank.

Henry Elvin – Ulster Bank is a wholly-owned subsidiary of RBS and comes under full control of the FSA. Like Michael, for the part of the Ulster Bank that is in the South, the Irish regulator takes an interest in that part of it, but overall it is driven through the RBS relationship with the FSA and ultimately our relation with the FSA in terms of capital.

SDF – That sets the scene. Let's move on to how each of your banks has been affected by the banking crisis and by the recession.

HE – I suppose if you take a position and turn the clock back a year when this first impact of the recession, or credit crisis on Ulster Bank, ignoring RBS at this point in time, the full force would have been felt when the Irish Government came out and guaranteed the Irish banks. There is no doubt about that, it had an impact on anything



Jackie Smith, Partner at Goldblatt McGuigan



Michael Gibson, Partner at Goldblatt McGuigan



Tom Lenehan, Director of Corporate Finance at Goldblatt McGuigan

Also in attendance were Linda Beers, Inform Communications and David Elliott, Editor, Ulster Business



that wasn't guaranteed by the Irish banks. Kevin can speak for himself, but I assume anything that wasn't sitting in Anglo Bank, Bank of Ireland or First Trust would have felt a draught for sure, because there was a lot of nervousness around at that point in time. Now you could argue that is for the good, or the bad, for ourselves in terms of where RBS ended up, being that a high percentage of it is now owned by Her Majesty's Treasury. From our perspective, and in terms of liquidity and deposit gathering, all of that is much easier when you are sitting with 70%, and soon to be 84%, ownership by the UK government. Like every other bank, once you get past the funding side of it then you are into the actual running of the bank and the key thing would have been around the property position and the subsequent impairment lines that every bank has had to look at.

SDF – Once the wholesale market dried up what did the banks do about that?

HE – Well the wholesale markets to a certain degree gave the banks an easy way to fund themselves and it was relatively easy. It is harder to fund your balance-sheet by deposits from customers and so forth, but when the wholesale market closed up the next port of call was to go to customers and it takes a lot more time and effort to fund your balance-sheets through true customer deposits, whether that is corporate customers or individuals. But certainly you only have to look at the headline rates for any of the banks and clearly LIBOR and base rate are absolutely irrelevant in the market place. When people say we have moved from lending on base to lending on LIBOR it is still pretty irrelevant because the funding costs of banks aren't related to LIBOR any more than they are related just to the market position. And the market position is significantly in excess of that.

SDF – Did any of the government sponsor schemes and the special liquidity scheme or

the government guarantee lines of credit help in any way?

HE – They helped, but it is such a big thing when you close off the wholesale market. All the banks would have been in a position where they were trying to move from a growth position to a more stable and a more sustainable funding position on the balance-sheets. So you have every bank facing quite a limited pool of deposits and causing the funding issue.

SDF – Kevin, just picking up on one of Henry's points that it is difficult to fund the balance-sheet by retail deposits, the Northern Bank had pretty well cracked that at one stage. Is that still the case?

KK – We are in a different position to the other banks around the table in that that we do have a relatively strong balance-sheet and we do have a fairly healthy product.

SDF – What is your retail ratio?

KK – 80 – 85%. Our deposits have not fallen over the last 12 months but are broadly flat which I think is a reflection of people's belief in our balance-sheet. That has certainly been a source of some comfort for us. In terms of the broader picture, I suppose it's worth just touching on our accounts. You may have seen we reported an operating profit of £15.5 million and impairment charges of £23 million in the last quarter. These impairment charges have continued to fall.

SDF – Is it largely property focused?

KK – It is still largely a property-led impairment issue. Actual losses though, year-to-date, are still pretty modest at about £5 million. We have been able to comfortably absorb those challenges





within our balance-sheet and haven't needed recourse. That continues to be the case. Our balance-sheet is strong enough to absorb those challenges and at this stage I think we can expect that to be the position through to the end of the financial crisis.

SDF – What about liquidity?

KK – I don't know where the other banks stand on conversations about liquidity. Our belief as far as the group is concerned is that the financial crisis is over to the extent that I don't think we will see any more banks going under at this point in time given the measures that have been taken and so on. From a group position we have continued to improve over the last nine months. Danske is now issuing five-year bonds into the market without government guarantees and I think that is probably the acid test in terms of the main position.

MK – From a liquidity perspective, the Irish Government was last September probably the first government in Europe to go down the deposit guarantee route. From a Bank of Ireland perspective, I think that to some degree you became tainted by being Irish. But it was also clear other governments around Europe and the UK were supportive of their banks as well. The public blames the local financial crisis on banks but I think there is a broader aspect to it than that. Banks are so varied; you have retail and relationship banks like ourselves, right down to a Lehman Brothers. The same term 'bank' applies to both but they are very different animals and there is no doubt that wholesale funding was so cheap and so available that

it drove a business model that everybody benefited from. Customers benefited from it; we benefited from it as banks; it made the availability of debt very easy and it was a very easy flow of money throughout the world.

SDF – Was there enough stress-testing of the model?

MK – Everybody felt there was strength in the global economy because when one economy went down you simply looked to another part of the world and that picked it up. I think maybe we all convinced ourselves there would be a soft landing.

SDF – Did any of the three of you have exposure to sub-prime mortgages or exotic derivatives?

MK – The sub prime debt was not a Northern Ireland issue and the banks around the table did not precipitate the crisis to that extent.

SDF – Did your parent companies go for them?

MK – Last summer we stopped our dividend around the time when other banks were still saying it was going to be OK. We gave an honest view and were very clear about our exposure to such things. Whenever I say minuscule, in the grand scheme of things it certainly has never been an issue.

HE – As Michael said, none of us were involved in the sub-prime market. In Ulster Bank we weren't and locally we are not involved in any of the exotic derivatives. Obviously RBS would have an exposure to those derivatives, and we don't need to repeat what happened there in terms of the very

significant change that they brought about, largely driven through the global market.

SDF – Was that proprietary trading for RBS?

HE – A lot of that would have been driven out of the slicing and dicing. The problem was we didn't have an asset to stress-test. It is very simple if you have an asset you can take a view but when you have a mixed bag it is very difficult.

The process fed the volume and the most disappointing thing is that the public, or the people in general, are not prepared to accept the fact that everybody benefited from that over a prolonged period of years. And the government benefited from it in terms of the level of public spending which it supported over these years. Whilst you can blame the bankers for a lot, you can't blame them for all of that.

SDF – We have identified wholesale funding and bad debts in the property sector as two of the major drivers. What have you done to tackle those two issues?

MK – If you look at what is going on at the moment, something that interests politicians is the level of mortgage re-possession, and understandably so because of how this impacts socially. Certainly the number of repossessions Bank of Ireland has taken you can count on the fingers of one hand. We have continued to work with our customers, continued to support them as best we can to find a way through. The best approach for Bank of Ireland to recover its money is to work with the borrowers to realise cash and repay the debt. I have got to say that we have found that approach to be pretty successful for us and we are very comfortable continuing with it.

SDF – Do you believe the approach in terms of lesser repossessions and fewer bankruptcies is going to benefit the bank. Is this something you have learned from the current recession, because in past recessions maybe a harsher approach had been adopted?

MK – Quite possibly, we're in relatively unique times. One thing I have got to say about our experience of Northern Ireland business, if you take property away from it, is that actually it has been remarkably resilient. The relatively low number of business customers we have in distress is pleasantly surprising. That's not saying there aren't businesses in trouble, but it is remarkably low given the recessionary times that we live in., the economic times, it is actually remarkably low, and we have spoken about this and tried

to understand why that is the case, you would love to be able to put your finger on it. Our house prices in Northern Ireland seem to drive a lot of people's demeanour in business and beyond. When they started falling in July 2007, business started looking hard at itself through the back half of 2007, before the real economic crisis kicked in, and took hard decisions early which helped stop the rot.

KK – In terms of our approach, we realised when we saw issues around the property market our focus would be on supporting our existing customers through the crisis and that is the policy we pursued. So in terms of reaction to that situation, our focus was on getting as many of our customers through this crisis as we possibly could.

SDF – What about valuation and the extent to which there is a market out there for key assets?

HE – In terms of valuations and the approach of the bank, I think you probably have to agree the general economy is actually in decent shape. On the other hand, property is the driver of a lot of the stresses. You probably have to split it into two parts where you have a blue-chip asset and as an investment-type product, be that an office block in Belfast or a shopping centre where the valuation may well have gone down by 20% - 30%. To some degree, and I think from a banking perspective, it is not that relevant to the current economic position given most of those assets are actually quite good income generators. The key thing from that is whether the economy in the UK comes out of the recession in the next quarter or the next six months because that will determine some of the stress tests for banks. If it doesn't come out of recession then some of that actual cash

flow, in terms of rental, could come under pressure and that would then put that part of the property sector into a slightly different perspective. Ironically, you could have a market recovery in value and have a problem from a debt service point of view. The other side then is really the whole development side, whether that is residential development, or whether that is commercial development projects. I think the approach the banks have taken thus far is that the way out of this is actually to work with the customer. We have used a route that has been tried and tested with RBS. During the last recession in the early 90s they set up a global re-structuring group. They work with the customer and there is an element of sharing the risk and sharing the reward. The best person to drive that through in many cases is the individual, not the bank, not anybody else, so we work with the customer. But the reward has to be recognised, you have to get a two-way process there. RBS have been in it, we (Ulster Bank) have been in it, and we have set up our own team now and have had that going for 18 months.

SDF – Given the securitisation market dried up and the bond market dried up, what have you been able to do to access wholesale sources of funding? To what extent have you depended on government sponsored schemes or access to government finance or regulatory interventions?

HE – I think it now has settled down and there is beginning to be the first signs of a bit more movement within the wholesale market. From our perspective the change in shareholding structure has had an impact on RBS's ability to fund in the market and indeed get into the wholesale market. That has now given us a window of opportunity to

go out there and raise funding - and that is now quite evident - as well as our deposit base.

KK – You are correct in saying we are in a different position in terms of our balance-sheet and we have been able to manage the situation over the course of the last year, without recourse to government schemes.

MK – From a funding perspective we have recently issued a five year bond as well, but that didn't benefit from a guarantee because of its tenor. Funding is opening up and our results last week showed a 4% increase on our customer deposits as well. We are very comfortable with the funding position; it's much improved for every bank and I think every bank has benefited with the support of its government. I think people also need to remember, NAMA (National Asset Management Agency) hasn't happened yet.

SDF – It must be very hard to envisage the detailed terms and conditions of how NAMA will operate until it is enshrined in statute?

MK – It is similar to things that have happened elsewhere in the world previously - there are similarities to the Government Asset Protection Scheme in the UK - but it is different as well. It is going to be set up for exactly the right purposes, it will take a long term view and its intention is to create stability and allow the property market to take a long-term view.

KK – I am comforted by Michael's points around NAMA taking a long-term perspective but I think in terms of the context of Northern Ireland, I wouldn't underestimate the scale of what is being done. If we were holding this dinner in a year's time we would need another chair at this table because there would effectively be one heck of a big property bank sitting here as well.

SDF – What figures can you guys offer to demonstrate that banks indeed are lending or have restarted lending, or whatever way you want to put it?

KK – Our balance-sheet was up in the last quarter, we reported a climb of 1% year-on-year, with mortgages up 11% year-on-year. If we are going to look at mortgages I think we have to predicate the discussion by considering just who we have around the table. Our mortgage share, Ulster Bank's mortgage share, Bank of Ireland's mortgage share and if you added First



Trust in there, is less than 20% of the Northern Ireland mortgage market.

SDF – The market leaders being?

KK – The building societies, the Nationwide, the Abbeyes, the Halifax. The people you have sitting around the table today are not the drivers of the mortgage market. We are a conservative lender focused on affordability but the figures show that we have continued to support the customer, and from what I know I think all the banks around the table can report figures of growth within their mortgage book as well.

In terms of repossessions, the Northern Bank has not initiated a single repossession in the last couple of years and we don't foresee ourselves needing to. I think it is very similar figures for each of the other two banks here.

SDF – Have you changed your lending policies at all?

MK – Yes we did. We are now back to a 90% loan-to-value mortgage and we wouldn't have been there this time last year. In fact we have a 95% loan-to-value mortgage for first time buyers.

SDF – Does that imply you believe the housing market has bottomed out?

MK – I think it might be a tool to help the housing market not go down much further.

HE – In terms of our mortgage offering, we are very much open for mortgages. We have given commitments, in terms of RBS, to business growth and also to put £500 million additional out into the mortgage market by early 2010.

SDF – As recently as today the Governor of the Bank of England said that bank lending to the SME sector wouldn't get back to its previous levels for another couple of years. Is he right?

HE – Our experience is that we are seeing customers deleveraging, we are seeing them taking prudent and sensitive decisions in the context of the economic environment that we find ourselves in. What that means is investment decisions are being deferred and that has a consequence in terms of business lending. Part of the answer to that is what is happening in terms of demand and I think our experience is that customers are being very careful and as a result we are not seeing the same scale of demand

for business lending as we would have seen eighteen months ago.

SDF – Are you taking a harsher view with those who do seek lending or not?

KK – We are turning down very little on the business front. We are working with customers to see about how those loans should be structured, what tests should be applied to those business plans.

SDF – Have you tightened on restrictive covenants?

KK – Yes, to a degree. I think covenants have a purpose in terms of identifying risk, in terms of making sure everybody understands what is expected on all sides of the table and that is only sensible and prudent.

MK – I know we are lending new money to businesses and I know we would like to lend more money. Banks are potentially easy to blame but do we ask more questions? Probably yes.

SDF – Do you have more frequent reviews of customer accounts for example than you would have had before?

MK – No. And our credit policy per se has not changed; I genuinely mean that. But we are living in different economic times and I know customers are taking longer to make the decision to come to the bank to look for new money. In the same way we will be exploring that in greater depth. I think they expect it and probably take comfort if we make sure it is a viable proposition and is well thought through. It won't be for the lack of capital or the lack of liquidity that our customer will not get the funding.

HE – I concur with what Mike was saying. I mean the money is there. We are probably under even more scrutiny than any bank in the sense that we have to do returns into the UKFI (UK Financial Investments Limited, the organisation which manages the government's investments in UK banks) under the RBS umbrella. RBS is committed to lending an extra £3 billion into the small firm sector. We have a share of that of £250 million that is measured on a monthly basis.

It has to be out by the end of early next year, early 2010. We are struggling to get it out but we believe we will make the target. It is fair to say the level of activity dipped around July and August, but since September there has been a reasonable pick-up and I am confident that we will achieve that target in early 2010.

SDF – The three of you are sending out a very positive message here, that you are open for business, that you are encouraging both retail customers and SME customers to come and talk to you, that there are no particular prohibitions on lending, that in many ways you all want to lend more and that you have the cash to do so. What I want to ask you now is will you address the question as to why the public believes the opposite?

HE – All I can say is in the business area the level of approvals has not dipped. It is running at 85% approval, so the 15% that doesn't get approved clearly can make a significant noise. Looking at what the other banks are doing, and we are still very competitive in the market place against each other, so I don't for one minute believe that it has significantly changed. There is very strong competition.

SDF – You say there is around an 85% approval rate and the question has been raised in relation to the public perception. Is your 85% approval rate largely due to the fact that people don't even go to you because the perception is so bad?

HE – I don't accept that at all because I have to look at the number of applications that are coming through and they are growing. You have some very good trading businesses in Northern Ireland but the one thing that is a little depressing for a banker is that many of them moved into property. Some of the problem cases that you see now are actually good trading businesses that diversified into property business.

SDF – I think that two messages that have come out are: there is probably a case for the banks either individually or collectively to improve their communications and you can't generalise when it comes to referring to the banks.

An evening of discussion such as this throws up a number of interesting topics but unfortunately it's difficult to reproduce everything. Additional subjects covered included the competition for deposits, increased costs of regulation, the challenges faced increasing lending while meeting regulatory capital requirements, bank charges and bank bonuses.