ARE BANK DEPOSITS SAFE IN THE ISLE OF MAN?

Northern Rock, Bear Sterns, Fannie Mae, Freddie Mac and Merrills all rescued. Lehman Brothers failed. Who is next? Yesterday[1], the Financial Times' Lex column said:

> 'Banks deemed to be potentially short of capital – Barclays, HBOS and UBS for example – will be judged vulnerable.'

The problem causing the current crisis is not losses on the assets side of banks' balance sheets, but the withdrawal of commercial funding on the liabilities side. UK banks were highly leveraged in 2007 and never less liquid. In the 1960s, it was typical for UK banks to hold as much as 30% of their assets in liquid form. Congdon (2007) reports that the ratio of liquid assets to total assets has fallen to 0.5% in recent years. The Bank of England's April 2008 Financial Stability Report confirms the general trend that the liquid asset holdings of UK banks have undergone very large falls in recent decades[2]. The deleveraging of 2008 is painful and potentially fatal for some banks.

High leverage, low liquidity is an accident waiting to happen. It is picking off the vulnerable one by one. It may only be a matter of time before there is a victim in the Isle of Man.

The lesson of Lehman Brothers is that not all banks will be saved. The US Treasury recognised it cannot rescue every bank. At the same time, signals are emerging from the Federal Reserve and the European Central Bank ('ECB') that the liquidity tap may not be as free flowing in future.

So how safe are banks in the Isle of Man. Let's start with the position of the Financial Supervision Commission ('FSC'):

> 'It is a fundamental principle that anyone making a deposit with a bank should first consider carefully the risks involved. No financial transaction is without some risk.[3]'
>
> '.. the important element is that depositors must use their own judgement in assessing institutions where they place their deposits.[4]'

Not very encouraging, but it gets worse:-

> 'I would reaffirm that it is not the role of the Commission to prevent failure.'

The FSC is clear that if things go wrong, they are not to blame: blame the directors of the bank and yourself because you did not first 'consider carefully the risks involved'.

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[1] September 16, 2008.
[2] Source: Morris & Shin www.brookings.edu/economics/bpea.aspx
[3] John Aspden Chief Executive Financial Supervision Commission - 3 January 2008
[4] Rosemary Penn Chairman Financial Supervision Commission - 25 February 2008

Let's carefully consider the position in relation to Isle of Man banks[5] and building societies[6]. The locally incorporated banks can muster only two credit ratings between them: Lloyds TSB Offshore Limited[7] and Barclays Private Bank & Trust (Isle of Man) Limited[8]. A number of UK incorporated banks have local licences and all have credit ratings. Most of the locally incorporated banks are deposit gathering operations for overseas parent banks. In many cases, they lend the substantial proportion of what they collect back to their parent company, so their stability depends on their parent company's ability to repay. What does the FSC know about the parent's ability to repay?

We asked the FSC this very question suggesting in our question that the FSC did not have full information from the parent regulators. Our understanding of their reply was that they did not have full information from the parent regulators about the ability to repay. It would help if the FSC published what information they get from parent regulators, so we all know what they know and what they take on trust. There is a risk that the FSC does not really know whether certain parent banks can repay their local subsidiaries. We should be told. We should also be told which local banks have restrictions on their ability to send deposits back to their parent bank – are there any? If so, how many and who are they – we want to avoid those banks.

What can you do?

1. Get a copy of the local bank's and its parent company's accounts. The local bank's accounts are reasonably easy to read, but will tell you that it is all bound up in the parent bank's solvency. The parent bank accounts are impenetrable and if you fully understand them, please can the writer work for you.

2. Ask if they have a credit rating. If they do, don't take that on trust as it is no measure of liquidity and it is a failure to maintain liquidity (when highly leveraged) that got the banks into the mess in the first place.

3. Compare the interest rates offered by local banks generally[9]. The riskier the bank the higher the rate they are forced to offer.

4. Look at the press clippings for the banks. The more negative press on that bank the higher is the risk.

5. Ring the FSC and ask them which local banks have restrictions on placing deposits with their parent organisation. When they refuse to tell you lodge a complaint with the FSC and copy it to your MHK.

6. Ring the local directors and ask them. In particular, ask them (a) if it is sensible for them at a time of crisis to put all their eggs in the parent bank's basket

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[5] There were on September 17 2008 42 licensed banks and 3 licensed building societies.
[6] The Cheshire Building Society is being taken over in a nil premium merger by the Nationwide after incurring losses – read into that what you will.
[7] Aa2 Moodys
[8] AA- Standard & Poors
[9] Make sure you compare interest products like with like.

and (b) if the parent bank goes down can you have their house? When they refuse to tell you lodge a complaint with the FSC and copy it to your MHK.

Decide that you really don't know what to do. If you must have bank deposits place them with HSBC Bank plc or Lloyds TSB Bank plc. In our judgement, if all banks fail they should be among the last banks standing. The alternative is short dated government paper (preferably index linked). It is now pricey, but it is safer.

Finally, complain to your local MHK and say that if they don't sort this out fast, you will write to complain to the International Monetary Fund. That will get everyone's attention!

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