MONEY

VALUE OF MORTGAGES APPROVED IN JULY
€1.16bn
(UP 25% YEAR ON YEAR)

AVERAGE APPROVED MORTGAGE IN JULY
€226,500
(UP 2.7% YEAR ON YEAR)

Take a risk for a roaring return

Unregulated investments offer thrills and spills for those looking for something less tame — but remember there's no safety net, writes *Eithne Dunne*

ERNIE LEYBA

Pablo Noel, who died in January aged 92, had an appetite for risk that could have made him as successful at investing in the unregulated sector as he was at taming lions in the circus

While the thought of putting money into anything with the word "unregulated" attached to it might strike fear into some, not so for Michael Houghton. The Limerick-based entrepreneur has made a beeline for unregulated investments in recent years and, apart from a few blips, it has worked well. So much so that he lives off his investment returns, many of which require minimal management.

However, his route has been high-risk all the way, and not only in the hope of making more money more quickly. His other big incentive is the fact that unregulated investments trump their regulated counterparts when it comes to tax treatment.

"If you do a regulated investment, you'll pay 41% exit tax every eight years even if you haven't sold a share. If you buy, say, bitcoin, you'll have a tax-free allowance and pay 33% capital gains tax," says Houghton.

An unregulated investment is anything not overseen by the Central Bank of Ireland. Providers are not subject to rules about directors or the safeguarding of client funds, and investors are not protected by compensation schemes or the financial services ombudsman. If you understand that and still want to veer off the beaten track, there are numerous places your money will be welcome. Here are a few.

Peer-to-peer loans

Peer-to-peer (P2P) lending involves lending money to SMEs at a mutually acceptable interest rate via an online platform. In general, repayments plus interest are made each month. Mintos is the biggest player in Europe, while Irish platforms include Linked Finance and Flender. Lending can start from as little as €50, and interest rates vary, but the average is 8%-11%.

There is also P2P lending for property. At Property Bridges, Irish customers can lend between €500 and €100,000 to the construction sector, with an average rate on these loans of 8%. Initiative Ireland has lent more than €33m to building projects, with investors earning passive income of 6%-8%.

Houghton, who has about 40% of his money in P2P investments, says that if you are going to lend for building, diversify your loans and, just as a bank would, keep an eye on the loan-to-value ratio.

"If you're giving a loan on a property, make sure it matches the value of the property so that, in the case of default, the property can be sold," he says.

With Property Bridges, the loan-to-value is capped at 70%.

P2P is not without risk. Linked Finance (alongside a pillar bank) lent to a golf tours company that shut its doors. Still, Linked's default rate at 1.27% is way below traditional SME lenders.

"P2P has not experienced a recession – it started only about 10 years ago. I'm curious to see what happens when recession hits," says Houghton.

His other advice for any type of P2P lending is to look for a buy-back guarantee, where the platform or the company guarantees that you will at least get your principle investment back.

Ralph Benson, co-founder of Moneycube, says P2P investment has its place in a portfolio of investments as long as people "know what they're getting into".

"[P2P] tends to be concentrated on a single asset category, and often a single asset, so you need to square that with your overall investment approach," he says.

Employment and investment incentive scheme

Any taxpayer investing in an approved indigenous company is entitled to a nice tax break via the employment and investment incentive scheme (EIIS). You can get as much as 40% of your investment back in the form of a tax rebate – 30% in the first year after you invest, and the remainder three years later.

You can opt to invest through a regulated or unregulated channel, as long as the company is EIIS-approved. The regulated route has numerous providers. For example, each year Davy runs an EIIS fund with BDO; this usually opens in October or November and closes at end December. Funds are invested in established, indigenous companies and previous ones have included Irish Breeze skincare and the Happy Pear healthy foods.

Goodbody and Baker Tilly will soon launch their latest EIIS fund. Past investees include Powerscourt Distillery and the refrigeration and logistics company McArdle Skeath.

Equity crowdfunding, which is also unregulated, differs from P2P investment in that you essentially take a stake in the company with the hopes of getting a return through the sale of shares – no interest rate is involved. Spark Crowdfunding is an Irish platform in this area.

Forestry and alternative energy

Despite recent jitters, Houghton still has about 40% of his investments in an Irish forestry company – another unregulated investment. While he hopes to diversify further, he still feels confident.

"I found out who the directors are, who else has invested with them and whether they got their money back," says Houghton.

Many other Irish forestry investors have been disappointed after getting caught up in early hype about the sector, with promised high returns never materialising.

Nick Charalambous, managing director of Alpha Wealth, cites several scams in these sectors – such as one involving Arden Forestry Management – as reasons to be circumspect.

The announcement by the infrastructure giant John Laing of considerably lower than expected yields at wind farms in Ireland and Germany will also give alternative investors reason to pause.

Alcohol

Some investors like to put their money into wine or whiskey. The Whiskey & Wealth Club channels investors' money into Irish cask whiskey and says returns are 10%-20% a year. The business claims that putting money into whiskey in bonded warehouses has "relatively little risk", but critics would argue that any investment with these kinds of returns is inherently high-risk.

Houghton points out that investors must be careful when it comes to unregulated investment in very early-stage companies. The Whiskey & Wealth Club was founded last year.

"If someone asked me about investing in an 18-month-old company, the first thing I'd ask is whether they really want to invest in a company that hasn't sold any whiskey yet. Even if it's unregulated, at least if it's 10 years old there is some history there," says Houghton.

Craft brewer Blacks of Kinsale is offering casks of whiskey – 397 bottles – in its initial batch for €6,500, with a buy-back option after five years at an agreed return of 4% per annum.

Regulated alternatives

Not all alternative investments are unregulated. For example, there is an opportunity to invest in an office property at CIT House in Blackrock, Co Dublin, via BlackBee. The minimum investment is €25,000 and the expected term is two-and-a-half years, with a projected return of 17.5%.

The potentially huge returns in the BlackBee investment are contingent on an appetite for risk, of course. This and similar investments occupy the top spot on the seven-point ESMA risk scale, indicating high volatility, and are not for the faint of heart.

> **Diversify as much as possible — and have the attitude that whatever you put in, you can afford to lose**

Under BlackBee's plan, investors will advance €11m to a special purpose vehicle aimed at "aggressively letting vacant space". The return is contingent on a sale or refinancing of the property in two-and-a-half years.

BlackBee has also recently announced plans to raise €250m for a nursing home fund, and has raised €40m for iNua, a regional hotel operator.

No compensation

Investors in unregulated products have no safety net. With regulated investments, such as the above BlackBee Blackrock Office Bond II, the investor compensation scheme will pay compensation – subject to limits – if the investment firm or broker goes out of business. The most you will get is 90% of your loss, or €20,000.

However, if you put your money in a regulated investment but lose it because of poor advice or management or bad performance, you are on your own.

Houghton says that anyone determined to go down the unregulated route should diversify as much as possible across investments and platforms.

"And you have to have the attitude that whatever you put in, you can afford to lose," he adds.

Steven Barrett, managing director of Bluewater Financial Planning, says he would not recommend any form of unregulated investment.

"I don't think taking a punt is ever good financial advice," he says. "If your money grows slowly over the years, it won't make you a millionaire, but at least it won't go to zero – which is where [many unregulated investments] can go."

€? QUESTION OF MONEY

I'm 41 years old with two children (aged seven and four). We have about €185,000 left to pay on our mortgage over 15 years on a variable interest rate of 3.15%. My partner and I both have pensions (PRSAs) but have only been paying the maximum tax-free amount into them for the past five years, and they are at about €120,000 in total. Between us we earn about €80,000 a year. I now have a lump sum of €180,000. Should I use this to more or less clear the mortgage or should I put some or all of it towards our pensions? If so, how do we do this? We are already paying the maximum tax-free amount, so can we put in extra and get any investment returns but just not get the tax relief?

A Walsh

Pension funding

The general advice in relation to pension planning is to ensure that you are getting tax relief on contributions, as you will pay some tax on the income you draw down from the pension. If you are both paying the maximum amount that you can receive tax relief on, I would not suggest you make contributions above this limit.

Emergency fund

Ensure you have a "rainy day" fund put aside. A good rule of thumb is to have six months' net income available should it be required.

Educational funding

If you think your children will likely progress to third-level education, it would be prudent to consider making provisions now to pay the costs of this in the future. According to a 2018 study by Zurich, the average cost of third-level education, excluding accommodation, is just over €5,000 per annum.

Setting up a regular savings plan is one way to gradually accumulate the funding required to support your children's education. A monthly savings amount of €232, reducing to €102 when your first child starts college, should be sufficient to meet these costs, subject to assumptions such as the investment growth achieved. Alternatively, investing €32,125 of your lump sum now would achieve the same objective, assuming a 3% annual return on the investment after charges.

Mortgage repayment

Clearing your mortgage will have a positive impact on your overall financial position, but the benefits of doing this need to be weighed against the loss of the lump sum and the security it provides. Contact your mortgage provider (and other providers if switching is an option) to see if you could get a better interest rate if you pay off part of the balance and reduce the LTV ratio. Once you have clarity on this, you can make a decision whether you opt to reduce the term on the mortgage or the monthly repayments.

Advice

Finally, seek advice from an impartial financial adviser. This is a significant lump sum and the decision as to how best to put it to work is one that should be considered carefully.

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Send your personal finance or consumer-related questions to money@sunday-times.ie

Eoghan Gavigan

Ban on initial commissions will put a premium on good advice

Financial advisers in Ireland are required to disclose in writing any conflict of interest to clients before arranging a financial product and obtain a written statement from the client that they still wish to proceed.

Yet in circumstances when the adviser receives higher commission for selling financial products with higher charges, isn't there always a conflict of interest?

The remuneration structure that best serves the interest of the client is fee-based advice, where the consumer writes a cheque to the adviser each year. A close second is trail commission, where a percentage of the value of funds under administration goes to the adviser. A very poor third is initial commission, where the adviser receives payment from the life assurance company for selling its product; this structure is widely used in Ireland.

The conflict is at its most extreme when a client is moving a pension or investment from one company to another. If the contract on your new product allows for a large upfront payment to the adviser, with no ongoing trail commission, then the adviser will be paid up front by the life assurance company.

As the adage goes, if there is no charge for the product, it is because you are the product. The adviser is not being paid for work done; he or she is being paid to steer you to the life assurance company. This is not financial advice, it is sales.

Furthermore, if the client wants to move to another provider soon afterwards, an exit fee will generally be applied. Essentially, the client is stuck with the adviser and product provider for up to five years, regardless of the performance of either.

When a consumer pays an annual fee to their adviser, any financial products should have lower charges, which may offset the fee.

An adviser paid by the consumer instead of by the company selling the product makes an agent of the life assurance company an agent of the consumer. Yet many consumers in Ireland apparently do not favour paying fees for financial advice.

There is middle ground, where the adviser is remunerated by trail commission paid monthly over the life of the product. Under this structure, there is an incentive for the adviser to manage the product in the client's best interest. If he doesn't, the client can transfer to another adviser. If the value of the pension or investment increases, so does the adviser's commission.

The remuneration structure as it stands creates a testing climate for advisers, particularly for forward-thinking advisers who have done their homework to promote pension take-up.

Only competent advisers will favour setting up your pension with trail commission. Yet when that same product has accumulated a significant value, another adviser can come and take that product over by offering a product without trail commission.

He or she will receive a large initial commission essentially for harvesting the crop sown by the first adviser. There are many advisers who have built businesses on the back of this practice. It is not surprising: commissions for establishing a new pension are extremely low, and any adviser who makes this their main focus would surely fail.

So advisers concentrate on taking over existing pensions rather than promoting pension take-up. An adviser who focuses exclusively on taking over existing pensions is remunerated handsomely, despite the fact that he has arguably added no value for anyone. On the contrary, by sucking commissions out of product providers, he is essentially increasing the cost of these products for all consumers.

All of this creates problematic trust issues between the consumers of financial products and advisers.

It has been argued that, rather than having to pay fees, consumers prefer advisers to be remunerated through commissions from the product provider. Yet this misses the point that consumers do pay for these initial commissions through higher product charges.

It is also posited that if initial commissions are banned, less well-off people won't have access to independent financial advice.

However, the advice being doled out under the current system is anything but independent. If advice isn't independent, then it isn't advice. A ban on initial commissions might result in consumers finally being able to trust their own adviser.

Can this really be such a radical idea?

Eoghan Gavigan is a certified financial planner and is the owner of Highfield Financial Planning and chief executive at RAM Capital