

Eoghan Gavigan

Banks hold all the cards – but savers may have an ace up their sleeves



I wrote an article in The Sunday Times almost four years ago (“Stick a fork in banking competition – it’s done”), which made the case that the banking sector was heading for a purple patch of profitability due to a lack of competition in the sector after the global financial crisis, culminating in the exits in quick succession of Ulster Bank and KBC.

Since that article, the combined operating profits of our two main banks have climbed by a factor of five, from under €900 million in 2020 to €4.5 billion last year. To quote an old Danish quip sometimes attributed to the Nobel laureate Niels Bohr, “prediction is very difficult, especially if it’s about the future”, so I may as well claim this small victory even if, as a consumer of banking services, it feels like anything but.

This was not rocket science. Operating without any real competition is a profitable pursuit in any sector, and very profitable for a deposit taker in a market without a culture of investment. As the European Central Bank began raising interest rates from 2022, the main-street lenders retained most of the increases as margin rather than passing them on to depositors.

In most countries this would cause funds to flow out of deposits into equity-based investments, but the 41 per cent tax on investment gains from unit-linked funds and the fact that tax must be paid every eight years on unrealised or notional gains are both disincentives to investment.

Generating interest income from the €155 billion parked in low-interest deposit accounts was like shooting fish in a barrel for Irish banks.

But the deposit business is boring and unimaginative. Every activity by a bank requires some level of competence or involves risk, but not deposit-taking.

Many years ago, when I worked in a bank, a colleague tried to explain to me the profitability of our international deposit desk. “It’s not us,” he said modestly, “it’s the position we find ourselves in.” To put it bluntly, success at deposit taking is no recommendation.

Another factor that has enhanced bank profitability is the rationalisation of the branch network, which is understandably unpopular with the public. Before the advent of the electric light a night-time game of cards had to be played by candlelight. The candles cost a lot of money so if a game of cards were particularly poor it might be discontinued, hence the saying “the game wasn’t worth the candle”.

When a bank seeks to close its only branch in a town, it will cite increased migration to digital channels, but this is a stratagem. What it is really saying is that the game isn’t worth the candle, that it doesn’t believe that the level of economic activity in the area is worth keeping the lights on.

If you doubt what I say about digital migration, consider the United States where, after years of consolidation, JPMorgan Chase and Bank of America are opening new branches. Where? In cities that are experiencing population growth and rising wealth, where the population is technologically literate and where broadband is ubiquitous. In other words, cities where fintechs should thrive.

While there has, of course, been an increase in business being transacted digitally, physical bank branches are critical to services such as business banking and wealth management, and to cross-sell other services. Having a presence matters.

Banks have had it easy for the past four years. In a contracting sector you don’t have to be innovative, you can rationalise your way to a lower cost-to-income ratio while living off interest income. Of course, as a strategy it suffers from the law of diminishing returns – you can’t close your way to success.

So where to now? Given the reversal in interest rates since last year, the model that has been so profitable over the past few years isn’t sustainable. Irish consumer behaviour is often influenced by developments in America, so my hope would be that consumers of the future will realise that they need to protect their wealth by investing in equity markets. Current market weakness means there has seldom been a better time to start.

Now that the government has offloaded most of its shareholding in the pillar banks, it could stop artificially protecting their deposit base and align life assurance exit tax with capital gains tax rules. If this happened, maybe banks – which, if they play their cards right, actually have some advantages over fintechs – would find more innovative ways to turn a profit.

Eoghan Gavigan is a certified financial planner and owner of Highfield Financial Planning; hfp.ie