# MacKay ON MONEY (AND OTHER THINGS)

**BY AUTHORISED FINANCIAL ADVISER CHRIS MACKAY**

Haircut day. In the sixties as a kid, this signalled the end of the holidays and meant a trip to Moera and a visit to our local barber, Mr Prangley – Ted to his mates. When it was my turn, Ted (possibly the inspiration for Edward Scissorhands) would place a well-worn wooden plank on the arms of his antique barber's chair to make it high enough for a seven-year-old to sit on. Half a century later, being a bit germ-a-phobic, I really hope the towel he would then stuff into my shirt collar was a clean one – every time. I'll give him the benefit of the doubt, Ted would then proceed to do his magic with a combination of flashing scissors and a buzzing razor.

Twenty minutes later, he would allow me to admire the clean lines of the back of my neck via his large two handed mirror. I would then be mesmerised by watching Ted douse his hands with the legendary "bay rum" – they used to drink it during prohibition in the States – which he then ran through my now well-coiffed crown. My unruly curls had been tamed. The savage of the summer was vanquished. My haircut was complete. I could resume my studies and be tidy and presentable for the annual Waiwhetu Primary School photos soon to be taken by the ubiquitous Mr L. C. Scott.

You might recall another haircut day – but this one was on the international stage.

The Cypriot banking system was delivered a massive "haircut" in 2013.

In March of that year, a 10 billion euros international bailout by Eurogroup, the European Commission, The European Central Bank and the International Monetary Fund was arranged.

What was the deal? In return for the bailout, Cyprus agreed to close their second largest bank, the Cyprus Popular Bank after imposing a onetime bank deposit levy - a "haircut" – on all uninsured deposits. Like the UK, Europe, USA and Australia, Cyprus had some form of deposit insurance – in their case – covering up to the first 100,000 euros of a deposit. NZ doesn't have this. The Reserve Bank and the NZ government rightly or wrongly reckons we are better off without it.

In the Bank of Cyprus's case – the second bank involved – if you had more than 100,000 euros in your account, you took a "haircut" on about 47.5 per cent of the excess.

So by way of example, if you had 500,000 euros on deposit the day before, the next morning would see you with a severely reduced balance of 310,000. You would have had a 190,000 euros "haircut".

Normally the government would have financed the whole bail out (using borrowed money from overseas) but having depositors stump up almost half in order to recapitalise the bank was suggested by the four lenders.

The Cypriot politicians leapt at the idea after the lenders reckoned Cyprus wouldn't have been able to repay the larger debt anyway. It meant the government wasn't liable for the bill.

We are told half the depositors were wealthy foreigners, especially Russians, who were using Cyprus as a tax haven. The other half, the locals who were customers of those two banks weren't happy at all. Not sure about the Russian oligarchs who happened to be the rich foreigners involved, but then, I'm picking they could afford it. Is this just a good guess? Not really. According to *The Independent* in October 2013, 110 oligarchs own a staggering 35 per cent of household wealth in Russia. The article went on to suggest that after the fall of communism in 1989, Russia's most prized assets were sold off [some say at bargain basement prices] to businessmen later to become known as oligarchs. Another article from *the Business Insider* of March 2013, reported that the Russian economy had been in disarray and the government wanted to distribute badly managed State-owned companies in an effort to move towards capitalism. Sort of full circle back to pre-October 1917 revolution days you could surmise but this time with oligarchs owning the loot instead of Princes, Counts and Barons; not to mention Tsars and Tsarinas.

Anyway, some of these rich dudes apparently got badly shorn in Cyprus back in March 2013. For them it was probably loose change. For the local mums and dads, it was real money.

So now we're going to come back to little old NZ.

Some of you will remember some of our own bailouts over the years.

- Air New Zealand required $885m from the Government in January 2002.
- In late 2008, at the height of the Global Financial Crisis (GFC), when the world's banking systems froze up, the Government brought in a deposit guarantee scheme to maintain confidence in our banking and non-banking system. It is estimated to have subsequently cost us all about $1.8b.
- AMI cost taxpayers $500m in April 2011 after the Christchurch earthquake.
- The first time BNZ was bailed out was in the 1890s when King Dick chucked in a 500,000 pounds cash injection and a two million pounds guarantee.
- The second time BNZ was thrown a lifeline was in 1990 when it almost went broke again. Bolger's government and Fay Richwhite through Capital Market Equities Ltd, injected $250 million directly into the BNZ. They subsequently sold it to the National Australia Bank (NAB) who still own it.

So what's the chance of a government/taxpayer bailout of a New Zealand bank going belly up today? Forget it! The rules changed back in July 2013.

In the event of a NZ bank failure, there is now a Reserve Bank policy aimed at allowing a distressed bank to be kept open for business, while placing the cost of a bank failure on the bank's shareholders and creditors (including depositors), rather than the taxpayer (you and me).

It's called Open Bank Resolution (OBR).

What is OBR?

Well folks, it's a "haircut".

Check out the Reserve Bank website: www.rbnz.govt.nz/faqs/open-bank-resolution-policy-faqs

I'll extract the important parts for you –

What happens to depositors' funds during the OBR process?

"The first stage of the process, is to freeze all access channels to the bank and establish the balance of each account at the point at which the bank was placed under statutory management. A high-level assessment of the bank's losses will then be undertaken, and a conservative portion of account balances frozen. [This is the "haircut" people! If the assessment indicated the bank was short say $5b, and if depositors' funds totalled say $10b, they could shave 50 per cent off every account. So if you had a term deposit of say $50,000, overnight it would drop to $25,000.]

The frozen funds are then set aside to cover any losses beyond what the bank's capital position could absorb. The frozen funds are not cancelled or written off, and the depositors and creditors continue to hold a legal claim to these funds. To the extent that all or some of these funds remain available after all its losses have been covered, they will be returned to depositors and creditors."

How soon will depositors be able to access their funds?

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*"My haircut was complete. I could resume my studies and be tidy and presentable for the annual Waiwhetu Primary School photos soon to be taken by the ubiquitous Mr L. C. Scott."*

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"The bank will re-open for ordinary transaction business on the next business day after it is placed under Statutory Management. At this point, depositors will have full access to the unfrozen portion of their accounts. These [unfrozen remaining] funds will be subject to a Government guarantee.

The full assessment of the condition of the bank and the identification of the appropriate long-term solution to the failure are likely to take a number of days or even months to work through. Additional frozen funds may be periodically released to depositors during this time, to the extent it becomes clear they will not be required to cover the losses that have been incurred."

Is a major NZ bank failure likely? Not very, according to most commentators, even if Auckland property prices fell 20 per cent. But nothing is impossible. The OBR policy will ensure that the banking system will keep working no matter what, despite some of your hard earned bank deposit paying for it.

This may make you feel slightly nervous.

You may have previously believed you couldn't go wrong with all your nest egg stuck in the bank, wrongly believing Steven Joyce will come riding on his trusty steed to your rescue if it all turns to custard.

One prudent alternative is owning a diversified international portfolio including Fixed Interest investments (Government & Corporate Bonds), Property and Shares. Diversification over 100 or more underlying securities is a wonderful method to minimise risk.

Here's hoping future haircuts are all in the salon and not in the bank!

I couldn't source what it cost in the sixties to get but here's some stats from the fifties:

Sixty five years ago, in the December 1951 quarter, a woman's haircut would have set you back about 3 shillings in Auckland or Wellington. That's roughly $9 in today's terms, after allowing for general CPI inflation from the December 1951 quarter to the December 2016 quarter. A man's haircut, on the other hand, would have cost about 2 shillings in 1951 or $6 in today's terms. If you were getting a hair set or a perm in Wellington, they would have cost 5 shillings and sixpence or £1 and 15 shillings respectively – about $16 and $102 in today's dollars.

*These are generalised comments only and should not be taken as personalised advice. Disclosure Statements are available on request and free of charge.*

## CROSSWORD SOLUTION

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