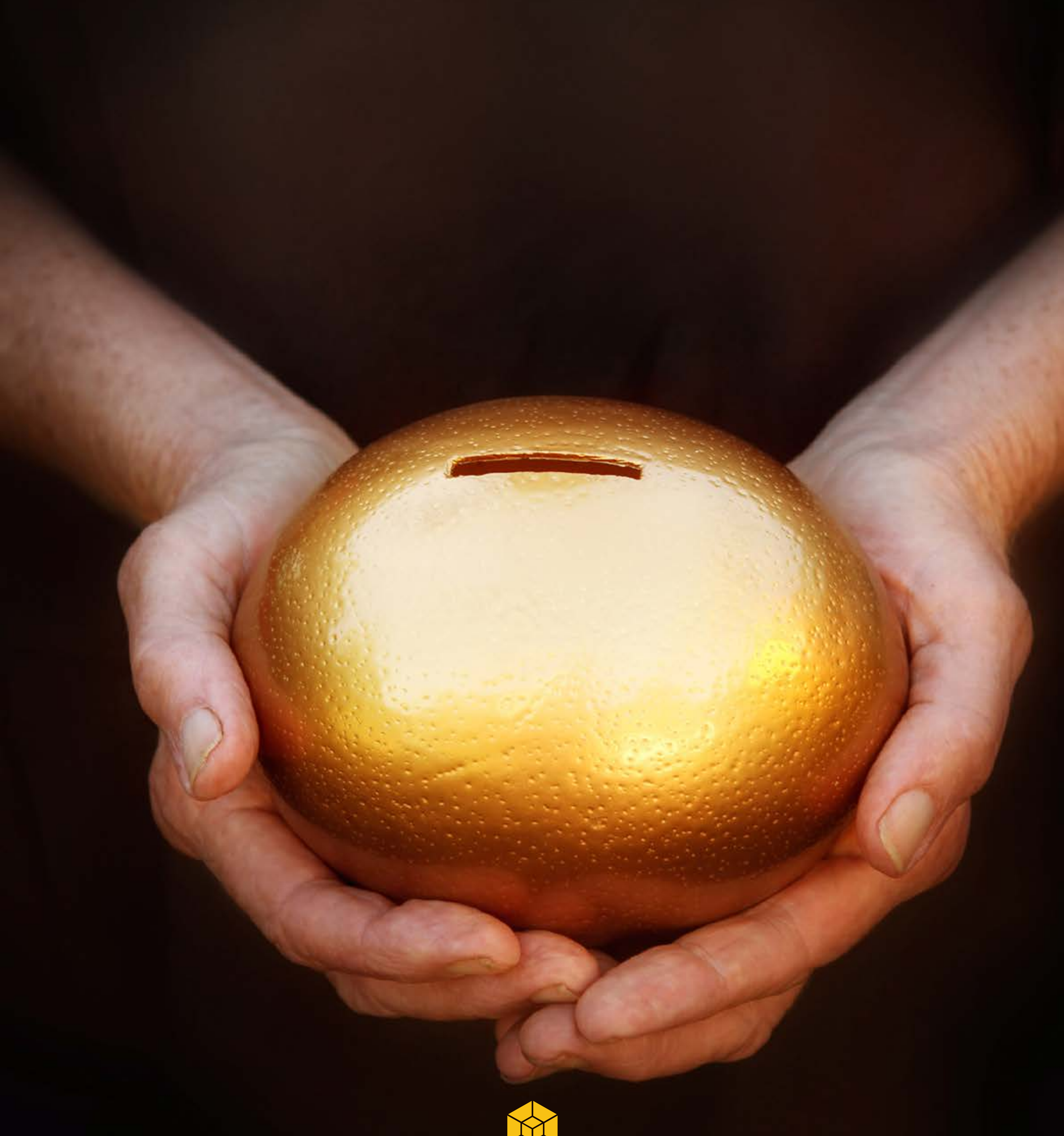
Protecting Your Savings In The Coming Bail-In Era



November 2013

GoldCore

TABLE OF CONTENTS

1 Why Bail-Ins Are Important

In June 2013, EU finance ministers agreed that bail-ins would be used going forward when banks fail. Ireland's Finance Minister, Michael Noonan, said, "Bail-in is now the rule." In other words, it is now the case that in the event of bank failure, the bank's depositors will incur losses.

"This is a revolutionary change in the way banks are treated," Noonan added. Indeed, it is revolutionary; bank and financial institution bail-ins are one of the most important risks facing savers and deposit holders today. The "bail-in" in Cyprus was a financial rubicon; the investment and savings landscape has fundamentally changed.

> Bail-ins are a risk in the coming years and yet there is a lack of appreciation of this risk as there was a lack of appreciation of the risks posed by the Irish property bubble and the global debt crisis

"The era of bondholder bailouts is ending and that of depositor bail-ins is coming" as Dr Brian Lucey of TCD aptly warned in our research note 'From Bail-Outs to Bail-Ins: Risks and Ramifications.' [1]

The changing financial landscape post the Cyprus crisis poses challenges to savers and investors in Ireland. With over €152 billion in deposits in Irish banks and over €80 billion in Irish pension funds, it is important we consider how the national savings pool can be protected.

Bail-ins are a risk in the coming years and yet there is a lack of appreciation of this risk as there was a lack of appreciation of the risks posed by the Irish property bubble and the global debt crisis.

Preparations have been or are being put in place by the international monetary and financial authorities for bail-ins. The majority of the public are unaware of these developments, the risks and the ramifications. Depositors in Ireland and globally, both individual savers and SME and corporate deposits, may well be at risk as they were in Cyprus.

1. *Click here to download 'From Bail-Outs to Bail-Ins: Risks and Ramifications,' GoldCore's comprehensive report on bail-ins.*

2 What Are Bail-Ins?

A bail-in is when regulators or governments have statutory powers to restructure the liabilities of distressed banks and financial institutions, and impose losses on both bondholders and depositors.

Simply stated, a bank bail-in is an attempt to resolve and restructure a bank as a going concern, by creating additional bank capital (recapitalisation) via forced conversion of the bank's creditors' claims (potentially bonds and deposits) into newly created share capital (common shares of the bank).

This is really the crux of the Cyprus template - depositors internationally now have to think of their uninsured deposits as liable to potentially being confiscated and transformed into bank shares.

Bank depositors have traditionally viewed their bank deposits as one hundred percent secure, with an inalienable right to have their deposits returned in full. However, this has never been the case in legal terms, as a bank depositor is just an unsecured creditor of the bank.

> "A bail-in is when regulators or governments have statutory powers to restructure the liabilities of distressed banks and financial institutions and impose losses on both bondholders and depositors

In March 2013, the EU and IMF spearheaded the restructuring of the troubled Cypriot banking sector. Although the terminology of bank 'bail-ins' first entered public consciousness during the Cypriot financial crisis of at that time, the idea of bail-ins as a central bank rescue mechanism has been openly discussed for a number of years amongst international central bank policymakers.

Cyprus became the defining event since it revealed the preparations and planning of international banking regulators and governments at the highest levels.

The market's expectation was that Cyprus would be similar to previous Eurozone rescue packages applied to economies such as Greece, Ireland and Spain, where banks had their losses 'bailed-out' by governments, with the bail-out cost and risk transferred to the sovereign nation and funded by the taxpayer.

The important shift from bail-out to bail-in had not been signalled in a very public way.

Never before in the public's perception had bank deposits been countenanced as potential financing sources for the rescue of insolvent banks. The public was shocked by the freezing and confiscation of deposits and the use of them in a desperate attempt to prevent banks from failing.

Almost overnight, the sacrosanctity of bank deposits was shattered. This made many market participants and depositors nervous, especially in vulnerable EU countries. Until that point, there hadn't been a realisation that 'bail-ins' would become the template for future bank rescues.

After Cyprus, the term 'bail-in' became synonymous with possible deposit confiscation, where uninsured depositors were seen as unsecured creditors of the bank and liable to share bank restructuring costs.

3 Timeline - 100 Years of Boom and Bust

- December 23, 1913 - Federal Reserve Created
- October 29, 1929 - Black Tuesday Stock Market Crash Followed By Great Depression
- April 5, 1933 - U.S. President Roosevelt Forbids Private Ownership Of Gold
- June 5, 1933 - President Roosevelt Takes U.S. Off Gold Standard
- January 30, 1934 - Gold Reserve Act Outlaws Private Possession of Bullion
- 1938 – 74 U.S. Banks Fail – The Most Since The Great Depression Started
- 1939-1945 – World War II – U.S. Starts Recovery, Europe In Depression
- August 15, 1971 - Nixon Takes America Off The Gold Exchange Standard
- October 1973 – March 1974 – 1st Oil Crisis; OPEC Embargo Sees Oil Prices Soar
- January, 1979 – 1981 – 2nd Oil Crisis; Iranian Revolution Sees Exports Suspended
- 1980's – Savings and Loan Crisis – Over 1,000 U.S. Banks Collapse
- October 19, 1987 - Black Monday Stock Market Crash
- 1989 – 534 U.S. Banks Fail In One Year – A New Record
- March, 2000 – Nasdaq Stock Market Bubble Starts To Burst
- August 2007 - U.S. Housing Bubble Bursts and Subprime Crisis
- Sept 13, 2007 - Northern Rock Sees First Run On Bank In UK In A Century
- 14 March, 2008 - Bear Stearns Biggest Casualty Of Crisis So Far - Bought By JP Morgan
- September 14, 2008 - Lehman Brothers Bankrupt – 1st Major U.S. Bank To Collapse
- 30 September 2008 – Irish Government Underwrite Debts Of Entire Banking System
- 7-8 October 2008 - Iceland's Three Biggest Commercial Banks Collapse
- 13 October 2008 - British Government Bails Out Royal Bank of Scotland, Lloyds TSB & HBOS
- 2 May, 2010 - Bond Holder Bail Outs Begin In Greece
- 28 November 2010 - Bond Holder Bail Outs Worth €85 Billion In Ireland
- May 5, 2011 - Bond Holder Bail Outs In Portugal
- March, 2013 - Cyprus Bail-Ins
- June 27, 2013 - EU Finance Ministers Agree Cyprus Bail-In Template - Era of Bail-Ins Has Begun

4 How Likely Are Bail-Ins?

There are differing opinions as to the severity of the on-going financial crisis, and whether it has turned a corner. There are two very broad 'schools of thought'.

The first school believes that the U.S. Federal Reserve, along with partner central banks internationally, has successfully stabilised the global financial system through low interest rates and quantitative easing, while the EU has managed to help recapitalise banks, avoid bank insolvencies in the European Union, and the breakup of the European Monetary Union (EMU).

The second school is more skeptical of this view and believes that many banks globally remain vulnerable to insolvency because they are being kept on life-support due to extremely accommodating central bank measures including near zero percent interest rates and quantitative easing. Banks are also being supported through the use of almost fictional, though internationally endorsed, accounting treatment for their asset books, such as mark-to-model valuations for their over-the-counter (OTC) derivatives exposures and by failing to have realistic valuations on problematic property loan portfolios.

> "Depositors with deposits in certain banks, or planning to place deposits, must look at the likelihood of and how likely that bank is to get bailed in

Many sovereigns nations remain vulnerable to sovereign debt crises. The Eurozone debt crisis and other sovereign debt crises have been solved for the moment through various forms of ultra loose monetary policies, quantitative easing or debt monetisation.

All short term panaceas have not addressed the root cause of the global debt crisis - too much debt in the financial sector and at all levels of western society.

Indeed, the concern is that the solution of socialising the debt and transferring it to the western sovereigns and taxpayers has simply bought some time. It may make the crisis much worse in the long term.

We believe the second school will be proved correct in the coming months and years.

Therefore, depositors with deposits in certain banks, or planning to place deposits, must look at how likely that bank is to get bailed in.

5 Where Are Bail-Ins Likely?

Bail-ins are likely to happen to banks that are close to failure in countries that have adopted bail-in conventions and or do not have financial resources or will to bail-out their banks. Thus, deposits in failing banks in G20 nations who have adopted bail-in conventions are likely to be subject to bail-ins.

The EU, UK, the U.S., Canada, Australia and New Zealand all have plans for bail-ins in the event of banks and other large financial institutions getting into difficulty.

The total debt to GDP ratios including household, corporate, financial and sovereign debt, in Japan, the UK and the U.S. are all at very high levels. All three major economies have banks whose outlook is far from positive.

> “ The EU, UK, the U.S., Canada, Australia and New Zealand all have plans for bail-ins in the event of banks and other large financial institutions getting into difficulty.

Many analysts warn that many Wall Street and City of London banks are bigger now than they were prior to the collapse of Lehman. The Eurozone debt crisis has abated in recent months but many analysts and economists are concerned that it is only a matter of time before the debt crisis returns.

European banks have been recapitalised but should the sovereign debt crisis return or a new global systemic crisis happen, akin to Lehman Brothers, individual banks may again face capital shortages.

Greece, Cyprus, Spain, Italy, Portugal and Ireland all remain vulnerable. However, other countries in the EU also have risks, including the UK, the Netherlands, Switzerland, Denmark and France.

6 Bail-In Warnings

Many economists and financial experts have all warned of bail-ins and the risks they pose to Irish deposit holders.

Dr Brian Lucey:

"Bail-ins are a risk in the coming years and yet there is a lack of appreciation of this risk as there was a lack of appreciation of the risks posed by the Irish property bubble and the global debt crisis.

In that context a move to increased allocation of savings to alternative investments, including a prudent allocation of some 5% to 10% to precious metals, is a sensible policy."

Dr Brian Lucey is Professor of Finance at the School of Business at Trinity College Dublin. He studied at graduate level in Canada, Ireland and Scotland, and holds a PhD from the University of Stirling. His research interests include international asset market integration and contagion; financial market efficiency, particularly as measured by calendar anomalies and the psychology of economics.

His research on gold has established that gold is important as a long term diversification due to gold's "unique properties as simultaneously a hedge instrument and a safe haven."

Dr Constantin Gurdgiev:

"Changes in the regulatory and policy responses to the financial crises, established in response to the Cypriot banking crisis, including bail-ins, warrant longer-term re-weighting of optimal gold and other precious metals' shares in defensive portfolios."

Dr Constantin Gurdgiev lectures in Finance in Trinity College, Dublin and in the Smurfit School of Business, UCD. He serves as the Chairman of Ireland Russia Business Association. In the past, he served as non-executive member on the Investment Committee of GoldCore.

Cormac Lucey:

"In November 2012, it was reported by RTÉ's David Murphy that CRH "was mandated by its board not to leave cash in a bank in the euro zone during any weekend.

The logic of CRH's stance only became fully clear after weekend decisions taken by Eurozone finance ministers had a severe and adverse effect on the financial claims of depositors in Cypriot banks in March 2013.

If there is a significant possibility, even small, of capital loss, depositors should ask themselves the same question that corporate treasurers regularly ask themselves: am I being adequately compensated by the deposit rate for the risk I am now exposing my money to?"

Cormac Lucey is a chartered accountant, financial analyst & lecturer at the Irish Management Institute (IMI). He was special advisor to Michael McDowell from 2003 to 2007. He is a commentator on economics and politics.

Jim Power:

"For investors, bank diversification is essential, but more broadly, asset diversification has to be the priority for anybody with any wealth. We still live in very dangerous and uncertain times and investors should do whatever it takes to manage risk and ensure that all of their eggs are not in a single basket that may be badly holed."

Jim Power is a graduate of University College Dublin with a BA in Economics & Politics, and a Master of Economic Science Degree. He is Chief Economist at Friends First Group, a wholly owned subsidiary of Eureko, one of Europe's largest insurance groups. He teaches Finance and Economics on the Local Government MBA at Dublin City University, and Business Economics on the Executive MBA at the Michael Smurfit Graduate School of Business, University College Dublin.

7 9 Key Considerations To Protect your Savings

Depositors internationally should examine the financial health of their existing bank or banks. Overall, diversification of deposits now has to be considered. However, it is vitally important that those tasked with diversifying deposits do not jump out of the frying pan and into the fire. This means diversification across financial institutions and across countries or jurisdictions globally.

Financial institutions should be chosen on the basis of the strength of the institution. Jurisdictions should be chosen on the basis of political and economic stability. A culture and tradition of respecting private property and property rights is also important.

9 Key Considerations To Protect your Savings

1	Diversify savings across banks and in different countries.
2	Consider counterparty risk and the health of the deposit-taking bank.
3	Attempt to own assets outright and reduce risk to custodians and trustees.
4	Own physical gold in allocated accounts with outright legal ownership.
5	Avoid investments where there is significant counterparty risk, such as exchange traded funds and many structured products.
6	Avoid banks with large derivative books and large mortgage books.
7	Monitor banks' and institutions' financial stability.
8	Monitor government policy pertaining to banks and bank deposits.
9	Monitor deposit and savings accounts' terms and conditions.

8 Conclusion

"*Bail-in is now the rule*," admitted the Irish finance minister Michael Noonan. Yet depositors both in the EU and internationally have yet to appreciate the ramifications and risks of this important development and the stealth bail-in regimes developing globally.

In the same way that there were a few voices who asked hard questions about the property bubble and helped protect many Irish people from the consequences of the property crash, so today there are a few voices asking questions about the risks and ramifications of bail-ins in Ireland, the EU and internationally.

> Cyprus and the real risk of bail-ins in many countries in the coming years shows that even bank deposits are no longer completely safe

We have outlined in this document that there are plans internationally for so called 'bail-ins' or deposit confiscation in banks, should they get into trouble.

Today, the majority of G20 nations have or are adopting legislation that will allow for bail-ins in the event of banks getting into difficulty. Depositors internationally now have to think of their uninsured deposits as liable to potentially being confiscated.

Cyprus and the real risk of bail-ins in many countries in the coming years shows that even bank deposits are no longer completely safe.

The fundamental tenet of investment theory is diversification and the importance of owning a broad range of assets, or eggs in different baskets. Today, diversification remains vitally important to investors internationally; now savers and those with large deposits in banks need to also to diversify and not allow themselves to be overly exposed to any one institution.

This diversification should take into account the financial health and standing of the bank and the bank's country. Return of capital, rather than simply return on capital needs to be considered. This means that the financial stability and long term outlook of deposit taking banks needs to be evaluated once again.

We have long advocated that depositors hold a portion of their assets in precious metals. Our investment rationale for holding gold is as a portfolio diversifier, a store of value and hedge against inflation, a hedge against currency and systemic risk and hence as a safe haven asset. We can now add bail-ins and deposit confiscation as another reason to have an allocation to gold.

However, the key insight from Cyprus and the coming move from bail-out regimes to bail-in regimes, is that a precedent has now been created in terms of deposit confiscation. Therefore, simply having deposits in a bank is no longer the safest way to save, protect capital and conservatively grow wealth.

> We can now add bail-ins and deposit confiscation as another reason to have an allocation to gold

Conservative wealth management, asset diversification and wealth preservation will again become important and gold will again have an important role to play in order to protect, preserve and grow wealth in the coming bail-in era.

Written By
Mark O' Byrne

Mark O'Byrne is the founder of GoldCore and is the Head of Research and Executive Director. Mark studied at University College Dublin where he graduated with a BA in History (focus on economic and monetary history). Mark is an acknowledged expert on gold and gold's role in a portfolio as diversification, and is frequently quoted and interviewed on Dow Jones Newswires, Reuters, FT, Wall Street Journal, CNBC, Bloomberg and other regional media outlets.

About GoldCore

GoldCore are respected international bullion dealers who are experts in the execution and logistics of the highly specialised precious metals market.

GoldCore have been providing precious metal investment solutions for an international client base since 2003. Today, our team of experts service all investor classes from private individuals to companies and institutional investors. Whether you are a small or large investor looking to take delivery or arrange for secure, trusted insured storage, GoldCore has a solution to suit your needs.

Contact GoldCore

Ireland

GoldCore Ltd
14 Fitzwilliam Square
Dublin 2
Ireland

Ireland Phone:
+353 1 632 5010

England

No. 1 Cornhill
London EC3V 3ND
England

UK Phone:
+44 (0) 203 086 9200

USA

USA Phone: +1 302 635 1160

