Most global banks are still unsafe, warns S&P

Standard & Poor's has given warning that nearly all of the world's big banks lack sufficient capital to cover trading and investment exposure, risking further downgrades over the next 18 months unless they move swiftly to beef up their defences.

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Every single bank in Japan, the US, Germany, Spain, and Italy included in S&P's list of 45 global lenders fails the 8pc safety level under the agency's risk-adjusted capital (RAC) ratio. Most fall woefully short.

The most vulnerable are Mizuho Financial (2.0), Citigroup (2.1), UBS (2.2), Sumitomo Mitsui (3.5), Mitsubishi (4.9), Allied Irish (5.0), DZ Deutsche Zentral (5.3), Danske Bank (5.4), BBVA (5.4), Bank of Ireland (6.2), Bank of America (5.8), Deutsche Bank (6.1), Caja de Ahorros Barcelona (6.2), and UniCredit (6.3).

While some banks may look healthy under normal Tier 1 and leverage targets, critics claim these measures can be highly misleading since they fail to discriminate between high-risk and low-risk uses of leverage. The system failed to pick up the danger signals before the financial crisis. The supposedly moderate leverage of US banks in 2007 proved to be a spectacularly useless indicator.

S&P has shifted to a tougher code. It is less tolerant of hybrid capital – a liability rather than an asset, and no defence in a crunch – and insists that banks must quadruple capital put aside to cover trading desks. Private equity exposure will be treated more harshly.

The Bank for International Settlements unveiled its own version in September. The regulatory framework worldwide is clearly shifting in this direction, a move that will hit some banks harder than others. "We expect banks to continue strengthening capital ratios over the next 18 months to meet more stringent requirements. Failure to achieve this could put renewed pressure on ratings," said Bernard de Longevialle, S&P's credit strategist.

Tougher rules at this juncture may prove "pro-cyclical", if banks respond by cutting loans. This may perpetuate the credit crunch for smaller borrowers unable to tap the bond markets. "There is a risk that the increase in regulatory capital requirements could weigh on banks' ability to finance recovery," said Mr de Longevialle.

The "safest" global bank is HSBC (9.2), followed by Dexia (9.0), ING (8.9) and Nordea (8.8). UK banks fare relatively well: Standard Chartered (8.1) is in the top quintile; Barclays (6.9) is in the middle. The study left out RBS and Lloyds because their status is unclear. Chinese banks – the world's largest – were excluded.

Many banks on the sick list are already cleaning up their books, mostly by disposing of assets or converting hybrids into common stock. Citigroup exchanged $64bn (£38.5bn) of hybrid equity in the third quarter. UBS has cut reliance on hybrids, still 80pc of its capital earlier this year.

Japanese banks score worst because they rely on hybrids and are major players on the stock exchange, buying equities at 12 times leverage. Equity portfolios make up more than 50pc of their capital. This could prove troublesome given Tokyo's bourse has fallen this year, missing out on the global rally.

German banks do poorly because they have large holdings of asset-backed securities (ABS), often toxic. US banks look healthy in terms of leverage, but look less pretty when this is adjusted for risk.

S&P said past focus on leverage alone had been a recipe for trouble. It encouraged banks to opt for dodgy products – treated as if equal to top-notch sovereign debt – and could be circumvented "off-books" in any case. Rules created the illusion of safety.

http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/6638922/Most-global-banks-are-still-unsafe-warns-SandP.html