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Canada banks prove envy of the world

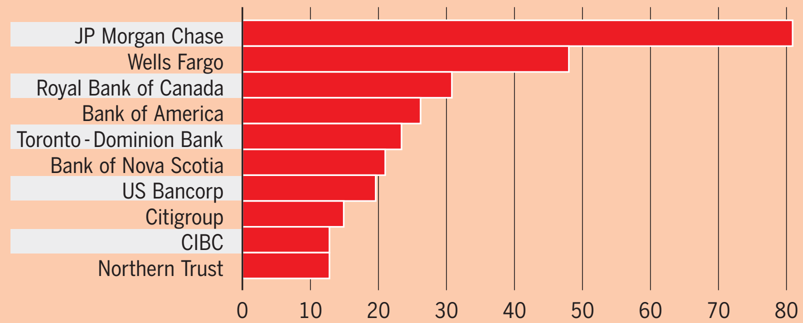
News analysis

Old-style policies are yielding results while other lenders suffer, report **Christopher Mason** and **Bernard Simon**

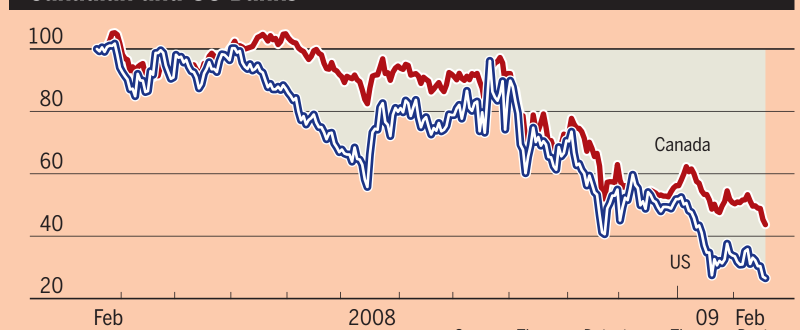
	Royal Bank of Canada	Toronto-Dominion Bank	Bank of Nova Scotia	Bank of Montreal	Canadian Imperial Bank of Commerce
Share price (% change over one year)	45.28 ▼	46.71 ▼	44.66 ▼	49.24 ▼	35.45 ▼
Net profit (Canadian $)	C$4.6bn	C$3.8bn	C$3.1bn	C$2.0bn	C$2.1bn loss
Total assets (Canadian $)	C$723.9bn	C$563.2bn	C$507.6bn	C$416.0bn	C$353.9bn
Tier 1 capital ratio	9.0%	9.8%	9.3%	9.8%	10.5%
Moody's ratings:	Aaa	Aaa	Aa1	Aa1	Aa2

Profit, assets and capital ratio figures at year-end Oct 2008

Top 10 North American banks Market value ($bn)



Canadian and US Banks FTSE World indices rebased



Sources: Thomson Datastream; Thomson Reuters

Banks are usually not on the agenda when US presidents visit Canada. But before setting off on his first foreign trip as president, Barack Obama said the performance of Canadian banks – alone among those of the Group of Seven nations in not receiving a government bail-out – was “striking”.

“Canada has shown itself to be a pretty good manager of the financial system in ways that we haven’t always been here in the United States,” Mr Obama told a Canadian broadcaster.

The president spent yesterday in Ottawa meeting Stephen Harper, Canada’s prime minister, to discuss the economy, trade and the environment, in addition to any talk surrounding the strength of Canada’s banks.

> ‘What I’m arguing for looks more like Canada’s system than the US one’
> **Paul Volcker**
> **Former Fed chief**

In large part because of their conservative culture, one that depends heavily on a vast and stable retail branch network, and a clubby working relationship, Canada’s banks have remained the strongest in the G7 and, according to an October report by the World Economic Forum, the soundest in the world.

“In Canada they do it the old-fashioned way, where when you need money you go to the bank and they review your file and they will lend you no more than 75 per cent of the value of your house,” said Laurence Booth, a finance professor at the University of Toronto. “Canada is a more conservative place and, as much as it limits growth in good times, that approach pays off when others begin a race to the bottom.”

In Canada, five banks – the Royal Bank of Canada, Toronto-Dominion Bank, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and the Bank of Montreal – largely control the market through thousands of branches across the country, forcing geographic diversification and efficiencies of scale generally not found in the US.

Canadian investment banks, as part of commercial banks, are more tightly regulated and kept in check by the main institutions, which would pay a price for unwise investing. Canada’s independent stockbrokers were bought by the big banks in the late 1980s, thus putting investment banking under the same regulatory umbrella as commercial banking.

In the US recently, investment banking companies such as Merrill Lynch have been brought under the wing of commercial banks. With moves such as this, the US is moving towards a Canadian model.

Meanwhile, the government re-regulates its banks every eight to 12 years, compared with the US system of decentralised regulation.

Canadian banks have not been immune from the turmoil, but their value has fallen less than that of their US counterparts. The banks have all taken hefty writedowns on their exposure to toxic securities and analysts expect the slowing Canadian economy to push up loan losses. But among North American banks, all five big Canadian banks rank in the top 15 in market value. One, Toronto-Dominion, has risen from 30th two years ago to sixth today.

Toronto-Dominion and RBC are among only seven banks worldwide that still carry a Moody’s triple-A credit rating. Since October, Canada’s five biggest banks have bolstered their balance sheets by raising C$9bn (US$7.2bn, €5.7bn, £5bn) in common equity and preferred shares.

These distinctions have cast growing attention on Canada’s system, especially from the US.

Paul Volcker, the former US Federal Reserve chairman and a close adviser to Mr Obama, is pushing for a regulatory regime similar to Canada’s model. “It’s interesting that what I’m arguing for looks more like the Canadian system than the American system,” Mr Volcker said last week.

Canada’s banks have not escaped the downturn entirely. A debate has erupted on whether the banks might be forced to cut dividends – something not done since the 1930s.

Their dividend yields are currently about 7 per cent, their highest level in 24 years, suggesting that investors are braced for dividend cuts. The banks paid out 76 per cent of their earnings in dividends last year, compared with an average of 42 per cent over the previous decade. The picture may become clearer next week when the banks begin reporting earnings for the quarter ended January 31.

Peter Rozenberg, an analyst at UBS in Toronto, said last week the risk was “not zero”. “An extended period of very low earnings and/or unexpected government intrusion could negatively impact dividends.”

Government support has so far consisted mainly of providing liquidity through regular auctions for high-quality mortgages held by the banks and other mortgage lenders. The authorities have also raised the limit for preferred shares qualifying as tier one capital.

But the government is amending banking legislation to allow it to inject capital into troubled institutions, if necessary. The banks have so far resisted help.