

EU banks could shrink to hit capital rules

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Leading European banks say they would rather sell assets than raise expensive new capital to meet [compulsory demands from the European Union for higher capital ratios](#), threatening a further contraction of credit to the enfeebled eurozone economy.

This radical approach, led by French banks [BNP Paribas](#) and [Société Générale](#), would be copied by lenders across Italy, Spain and Germany, bankers said. “Why should we raise capital at these [depressed share price] levels?” said one eurozone bank boss. The average European bank’s equity is trading at only about 60 per cent of its book value.

Another top banker said: “It’s fundamentally wrong to increase capital at the moment. Deleveraging needs to happen.”

However, the banks’ “shrinkage” strategy is likely to prove controversial with politicians and regulators if it led to [bankers lending less money to customers](#), jeopardising the eurozone’s fragile recovery, analysts warned.

European companies rely on banks for as much as 80 per cent of their funding compared with only 30 per cent for US companies.

On Wednesday, José Manuel Barroso, president of the European Commission, outlined [the broad terms of a compulsory recapitalisation for Europe’s leading banks](#), requiring “a temporarily higher capital ratio”, with restrictions on dividends and banker bonus payments in the interim.

Mr Barroso stopped short of specifying the target ratio, but people close to the process told the Financial Times on Tuesday that the European Banking Authority, the regulator, is poised to set a higher bar than expected – a 9 per cent ratio of core tier one capital to risk-weighted assets – for banks across the continent. A deadline of six to nine months would be set for forceable recapitalisation by governments, if banks have not reached the ratio under their own steam.



Banks and their advisers said their scope to raise fresh capital from investors was all but non-existent. “I don’t think anyone has access to the markets now,” said one senior European investment banker. Investors are loath to commit to fresh equity injections, in the knowledge that the new money would simply be soaked up by sovereign debt writedowns, bankers said.

But by shrinking assets – the denominator of capital ratios – many banks believe they can reach the targets without resorting to government recapitalisation. In recent weeks, both BNP and SocGen have signalled plans to offload a combined €150bn of risk-weighted assets. Further businesses could now be sold. Italy’s [Unicredit](#) and Germany’s [Commerzbank](#) were likely to find themselves under most pressure to deleverage and divest assets, bankers said.

Many economists, however, support the European authorities’ efforts to recapitalise the banks quickly even if it results in lower lending levels.

Richard Reid, an economist at the International Centre for Financial Regulation, said that stress tests had to be credible with markets and “there is no alternative to a plan to take on board the obvious risks from sovereign debts” even if the action “could circumscribe the financial system’s ability to promote credit”.

It is unclear exactly how the 9 per cent ratio will be calculated, but several people involved in the process said it would be after taking sovereign writedowns but without the macro-economic stresses applied in the EBA’s July stress test.

There are wildly different estimates of [the economic impact of the Basel III regulatory reforms](#), which are in effect being accelerated by the European recapitalisation drive. An industry sponsored study by the Institute of International Finance predicted that borrowing costs would rise by 3.5 percentage points and global output would be reduced by 3.2 per cent, 10 times the estimate of regulators.