Europe's big-bank problem: too much capital trapped in the US

The conditional non-objection to Credit Suisse's US capital plan was the only (minor) glitch for European banks in recent US stress tests, which are now confronting a different issue: they are now materially over-capitalised in the US.

The 2019 US stress tests passed without much drama. The Fed's commentary was positively-toned; noting that since the first round of US stress tests in 2009, banks had more than doubled their common equity capital from around USD 300bn to roughly USD 800bn, and that the largest firms had made substantial progress in strengthening their capital-planning practices.

For the large European banks captured by them, the DFAST and CCAR tests were important, given the size of their US businesses. But only relatively so.

"While the US operations of each of the European banks stress-tested are material, their home markets and domestic supervisors are key and more important," noted Pauline Lambert, executive director in the banks team of Scope Ratings. "Stress tests are a useful exercise as supervisors and management teams are considering downside scenarios. Yet, they do not capture very real but more difficult-to-assess risks such as a cyber-attack or governance issues."

With regard to Credit Suisse, the Fed noted that while it did not object to its US capital plan, it had required the firm to address certain limited weaknesses in its capital-planning processes. "For Credit Suisse, the weakness was related to assumptions used to project stressed trading losses. Positively, the Fed felt that this could be resolved in the near term," Lambert added. The bank said it fully expects to remediate the issues by the October 27 deadline.

CS Holdings USA said it maintains capital levels and ratios above its post-stress capital goal and regulatory minima in the Company-Run Severely Adverse Scenario for all quarters across the planning horizon and all risk-based and leverage-based ratios.

Barclays, Deutsche Bank, HSBC and UBS received non-objections to their capital plans in CCAR. All the European banks demonstrated that their US operations were resilient under the stress scenarios although the projected impact on their capital varied. Meanwhile, their projected minimum capital positions compared well to US peers.

In fact, with regard to the projected minimum CET1 ratio under the severely adverse scenario, Credit Suisse, Deutsche Bank, Barclays and UBS (in that order) scored significantly higher than the large US bank holding companies and were all in the top five (the other being Canada's TD Bank). Of the European banks included in the US stress tests, HSBC was a downside outlier relative to its European peers across pretty much all metrics.

Deutsche Bank's US operation is expected to account for a large share of job losses and business-line cutbacks under CEO Christian Sewing's grand restructuring plan. There had been some prior comment about how the bank might fare in the stress tests, but the bank noted that it exceeded all minimum regulatory capital ratios and received no objections on its capital plan on either a quantitative or qualitative basis.

In the severely adverse economic scenario, DB noted that its CET1 capital would comfortably exceed the regulatory minimum of 4.5% and would not fall below 14.8% at any time over the nine-quarter planning horizon, adding its Tier 1 Leverage Ratio also remains well above the regulatory minimum of 4% and would not fall below 6.9%.

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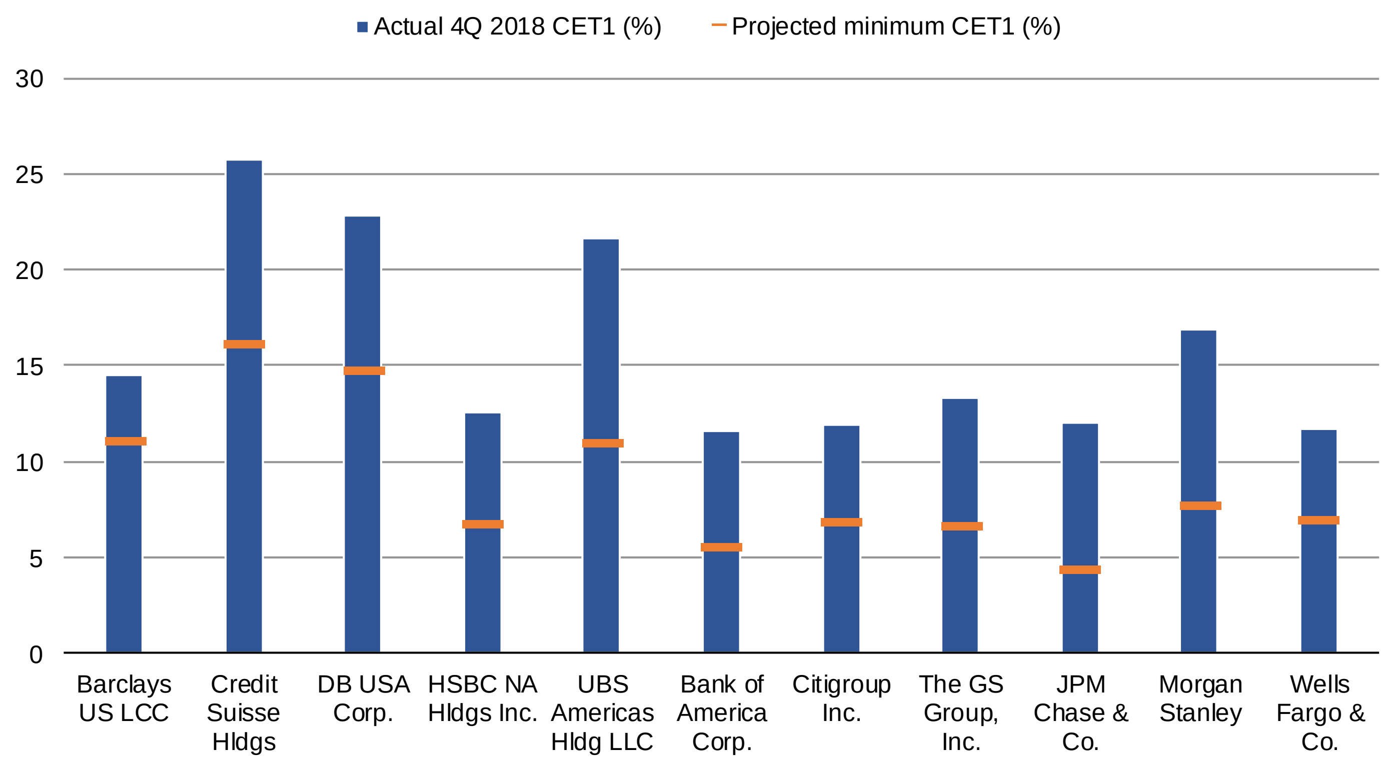
"The level of capital in Deutsche Bank's US businesses is reassuring on the one hand but raises questions on the other," said Dierk Brandenburg, team leader of the banks team at Scope Ratings. In a stress situation, the question is how easily capital can move to where it is needed. The concepts of internal MREL and TLAC aim to address this but they are still being implemented. As seen with HSBC, banks have not found it so simple to upstream capital from their US businesses to the group level. "Investors would appreciate more clarity from management about how their US operations need to be capitalised and at what levels," Brandenburg added.

Adversely-stressed capital ratios for Barclays, Credit Suisse, Deutsche Bank and UBS all came out at multiples of required minimums. The required CET1 capital ratio floor in CCAR in 2019 was 4.5%, for example. Under the severely adverse scenario, Credit Suisse Holdings USA Inc's CET1 capital ratio is projected to fall to 16.2% over the nine-quarter review horizon from 25.8% at Q4 2018. DB USA's Q4 2018 ratio is projected to fall to 14.8% from 22.9% at Q4 2018.

DB USA's Tier 1 capital ratio is projected to hit a minimum of 26.2% (from 34.4% at Q4 2018), while the projected minimum Tier 1 capital ratio for Credit Suisse is 17% (against 26.5%). At UBS the projected minimum is 16.6% (25.7% in Q4 2018). Those numbers provide huge margins over the required 6% minimum Tier 1 capital ratio. Excesses of similar magnitude were found in Tier 1 leverage ratios, too.

Figure 1: CET1 capital ratios under the severely stressed scenario



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