How Safe Are Canada’s Big Banks?

Description

It seems that every day there are numerous articles about Canada’s overheated housing market, and if there were to be a correction, Canada’s banks would not be immune. Luckily the banks are all relatively secure.

Below is a table that shows the Tier 1 Capital Ratio and Common Equity Tier 1 (CET1) ratio for each of the big five. The CET1 ratio uses the strictest definition of capital (only common equity), and thus will always be the lowest number for any bank. The Tier 1 ratio allows for other forms of capital, but still is generally stricter than the ratios used before the financial crisis.

Bank	**Tier 1 Ratio**	**Common Equity Tier 1 (CET1) Ratio**
Royal Bank of Canada (TSX:RY)	11.7%	9.6%
Toronto Dominion Bank (TSX:TD)	11.0%	9.0%
Bank of Nova Scotia (TSX:BNS)	11.1%	9.1%
Bank of Montreal (TSX:BMO)	11.4%	9.9%
Canadian Imperial Bank of Commerce (TSX:CM)	11.4%	9.9%

The more useful capital ratio from an investor’s point of view is the CET1 ratio. Other forms of capital would help keep a bank solvent in the event of another crisis, which makes the Tier 1 Capital ratio more useful to a regulator than a common equity holder. This makes Bank of Montreal the best-capitalized bank from an investor’s point of view. But all of the banks are in a very narrow range, which is good news for both regulators and investors.

By practically any standard, all of the big five are very well-capitalized. The minimum Tier 1 and CET1 ratios will only be 9.5% and 8.0% respectively for the Canadian banks. And those minimums won’t go into effect until 2019. Until then, the banks have plenty of time to build up their capital while paying ever-increasing dividends.

The big five look especially secure when compared to smaller banks in Canada. For example, the CET1 ratio for **National Bank** (TSX:NA) is 8.7%. It is no coincidence that National has a price-to-earnings ratio below 10, making it cheaper than all the big five on that measure. **Laurentian Bank's** (TSX:LB) CET1 ratio of 7.6% is especially worrying since the bank is not as profitable as its larger peers.

Foolish bottom line

This has all become especially relevant as more people compare Canada's housing market to the one south of the border before it crashed. But with such strong capital ratios, Canada's banks should avoid such a comparison for the time being.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BMO (Bank Of Montreal)
2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:NA (National Bank of Canada)
5. TSX:RY (Royal Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

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