



## Could This Be the End of Big Bank Profits?

### Description

Banks have a special place in many Canadians' investment portfolio. It's easy to see why. On average, the stock price of Canada's five largest banks rose 121% over the past five years. And they provide exceptional income, with the **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)) offering a dividend yield at 4.2%. Even the lowest dividend rate, from **Toronto Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)), is still a very respectable 3.7%.

Financial services is also considered one of the better managed, more profitable sectors of the Canadian economy. According to Thomson Reuters, the average net margin for the big five Canadian banks is over 20%, with the **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) leading the group at 23.3%.

### Nothing lasts forever

But can this level of profitability, and the exceptional capital gains and dividend income it makes possible, last forever?

Last week, while waiting in line at my local bank to buy American money for a U.S. vacation, I overheard a conversation between another customer and the branch teller. He was exchanging U.S. for Canadian dollars, cashing in on the recent decline in the loonie. I wondered to myself what was stopping he and I from completing our transactions with each other, bypassing the bank, and obtaining better rates in the process. Apparently nothing.

One does not need to look very far to find examples of peer-to-peer platforms that have disrupted stable, mature and highly profitable industries. Skype transformed the way we communicate, **eBay** altered how we buy and sell goods, and Airbnb improved how we find a place to stay while on vacation.

### **The growth of peer-to-peer lending**

Peer-to-peer lending takes place without the assistance of a traditional financial intermediary, matching savers with borrowers through an online platform, and providing superior rates. The companies that offer the electronic platforms to facilitate this process are for profit, but thanks to automation, sophisticated algorithms and low overhead, provide their services more cheaply and efficiently than traditional financial institutions.

Peer-to-peer lending has not made significant inroads into Canada, but the industry is growing by leaps and bounds in the U.K, and the U.S.

U.K.-based Zopa, one of the first to establish a peer-to-peer lending platform, has over 50,000 active savers and 80,000 borrowers. It has lent nearly \$925 million since being established in 2005, and claim a bad debt rate of just 0.19% over the past five years. Closer to home, the top two U.S. firms, Google-backed Lending Club, and Prosper, have originated loans worth an estimated \$4.5 billion. And Lending Club said that from June 2007 to mid-2013, lenders earned an average annualized return of 9.5%.

### **Making money the old-fashioned way**

Banks make their money in many ways — from insurance and wealth management to helping corporate clients raise money and retail investors save for retirement. But the vast majority of their earnings come from personal and commercial banking. Paying depositors rates close to zero, and lending that same money for three to four percentage points higher, is where Canadian banks make most of their money. In fact, it accounts for well over 50% of profits at each of the big five banks. And at **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)), it accounted for nearly 70% of earnings in 2013.

### **Foolish bottom line**

The peer-to-peer trend that's revolutionized many industries may just be the one that hurts the profitability of Canadian banks — but probably not anytime soon. Today, Canadians are unable to access, either as lenders or borrowers, peer-to-peer financial platforms in the U.S. or the UK.

Until that day comes, or domestic platforms are established to serve the local market, investors will continue to benefit from the highly profitable banking sector. And lenders and borrowers will, of course, continue to receive too little for their savings, and pay too much for their next loan. But Canadians wishing to benefit from the exploding growth of peer-to-peer financing may just be in luck — Lending Club's much anticipated initial public offering is expected to come to market later this year.

### **CATEGORY**

1. Investing

### **TICKERS GLOBAL**

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

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