Are the Banks Really as Safe as We Think?

Description

It's quite remarkable when you think about it: When Canadians are looking for safe, reliable, dividend payers, they often turn to the banks. How would that sound to Americans, or Europeans for that matter, who watched many of their banks collapse less than 10 years ago? Are we crazy for believing that banking is one of the safest sectors for parking our money, especially given the frothy state of the Canadian housing market, or the high consumer debt levels?

Not necessarily. After all, there are numerous differences between Canadian banks and those of the rest of the world. Below we look at some of them.

1. High capital ratios

Any bank can make plenty of money during the good times by taking on too much risk. The sign of a truly strong financial institution, however, one that can stand the test of time, is the ability to earn high returns without levering up too much.

That is exactly what our banks are able to do. Take **Royal Bank of Canada** (TSX: RY)(NYSE: RY). The bank may be regarded as one of Canada's most aggressive — after all, it has massive capital markets and wealth management operations, and is always pursuing additional market share in these lines of business. But it still has a Common Equity Tier 1 ratio of 9.7%, a very strong number by international standards.

2. The right kind of diversification

You'll often hear executives talk about how their company is "diversified", simply because they do many different things. But there are two issues with this. First of all, the business can lack focus. Secondly, these different activities may be interrelated — so this diversification doesn't really reduce risk at all.

The Canadian banks are different, and the best example is **Bank of Nova Scotia** (TSX: BNS)(NYSE: BNS). This bank has operations in many countries, especially in Latin America. Meanwhile, only about half of net income comes from Canada, so it's not overly reliant on any one country, while at the same time continuing to do what it does best.

3. Less risk-taking

Perhaps most importantly, Canadian banks simply don't feel the need to take risks like their American counterparts did. Maybe this is a by-product of Canadian culture; we simply don't expect our banks to take over the world.

The best example of this is **Toronto Dominion Bank** (TSX: TD)(NYSE: TD), which in 2005 exited the subprime mortgage market. This was despite the fact that the bank had just entered the United States and was looking to gain market share. This move saved the bank billions of dollars, and helped show the world just how safe Canada's banks are.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:RY (Royal Bank of Canada)
3. NYSE:TD (The Toronto-Dominion Bank)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:RY (Royal Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

Category

1. Investing

Date
2025/07/26
Date Created
2014/06/26
Author
bensinclair