How Oily Is Royal Bank of Canada?

Description

For about a year and a half the big Canadian banks have avoided any serious fallout from the plunge in oil prices. But the banks can only avoid the pain for so long.

Royal Bank of Canada (TSX:RY)(NYSE:RY) provided a perfect illustration while reporting its first-quarter results on Wednesday. The bank raised its provision for credit losses to $410 million, nearly a 50% increase over the previous quarter, largely due to the decline in oil prices.

As a percentage of total loans, RBC's annualized provisions clocked in at 31 basis points, which is roughly in line with historical averages. But it's much higher than the 23 basis points reported in the previous quarter.

In response, RBC's shares dropped by as much as 6% the following morning. Investors are clearly worried. So that raises the obvious question: Just how oily is RBC?

A closer look

On the surface, RBC does not seem overly exposed to oil and gas. Drawn loans to the sector total just $8.4 billion, which is just 1.6% of total loans. And 18% of those loans are made to refining and marketing companies, which are actually benefiting from the downturn in oil prices.

But there's a lot more to the story. As of the end of last year, RBC had an additional $13.3 billion in "undrawn commitments" (i.e., unused lines of credit) to oil and gas firms. And we've already started to see these commitments turn into actual loans as energy companies draw further from their credit lines.

It doesn't stop there. RBC's results in wealth management are largely tied to the stock market, and stock prices have become very correlated with oil prices. Furthermore, energy is a specialty of RBC Capital Markets, so a broad downturn could lead to problems in that division.

Finally, one has to look at RBC's exposure to Alberta. According to the most recent annual report, the Prairies account for 19% of RBC's total loans, which is not a small number at all. And many theseloans could turn into problems if Alberta's economy continues to suffer.

A look at TD

Just to put RBC's issues into context, let's take a look at **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD).

TD's total loans to the oil and gas sector total just $6.1 billion, or less than 1% of the overall loan portfolio. Furthermore, TD has less exposure to corporate loans and less exposure to the capital markets business.

It gets better. TD's loans in the Prairie provinces comprise less than 12% of the total, thanks mainly to the bank's exposure in Ontario and the United States. So if you're looking to avoid any energy fallout, then TD is certainly a better choice than RBC, even though the stock is a little bit more expensive.

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