Dividends are thorny issue for banks

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The momentum had been building. Before the order came last night, Britain's five big listed banking groups had been coming under mounting pressure not to make dividend payments that were due to their shareholders in the days and weeks to come.

With the impact of coronavirus set to impose considerable strain on their balance sheets, and with the memory of the devastation caused by the financial crisis still large in the public mind, the rationale was obvious. Banks needed to preserve capital, both to lend to businesses and consumers and to safeguard their financial reserves, and not dole out cash unnecessarily to shareholders.

Between them Barclays, HSBC, Lloyds Banking Group, Royal Bank of Scotland and Standard Chartered had been scheduled to make final and special dividend payments worth £7.49 billion before the end of next month after recently reporting full-year results.

UK banks: paying their dues

	Final dividend	Due date	Cost
Barclays	6p	April 3	£1.04bn
HSBC	21 cents	April 14	$4.27bn
Royal Bank of Scotland	8p (plus special)	May 4	£967m
Standard Chartered	20 cents	May 14	$632m
Lloyds Banking Group	2.25p	May 27	£1.58bn

Source: Company reports, Times research

The first, Barclays, was due to make its £1.04 billion payout on Friday, but expectations had been rising that the Prudential Regulation Authority, responsible for maintaining financial stability, would intervene to order it and other lenders to halt their plans.

All of the banks are mindful of their obligations to their shareholders, as well as their customers, and there was a view that if they suspended dividends under the regulator's orders, it would protect them against retaliatory legal action by angry investors. We also should bear in mind that most institutional shareholders had been assuming that dividend payments would be deferred and will be paid at a later date.

Obviously, no shareholder wants to be denied a due dividend, even if they are sympathetic to a heightened expectation being placed on institutions that perform an essential function in the economy in its hour of need. But is it necessary? And are bank shares a duff prospect, in any case?

Each of the Big Five has its own characteristics. Barclays, which dates back to 1690, offers the full range of banking and financial services across the globe. It avoided taking government money during the financial crisis, during which it also acquired the North American assets of Lehman Brothers, the collapsed Wall Street bank.

RBS was founded in Edinburgh in 1727 and remains 62 per cent-owned by the taxpayer after its £45.5 billion emergency bailout during the crisis. Previously a sprawling financial empire with a £2 trillion balance sheet, the lender has retrenched to concentrate on its UK corporate and consumer lending and is to rebrand as Natwest later in the year.

Lloyds was established in 1695 and was transformed in 2009 when it was merged with HBOS, a stricken rival, and the state injected £20.5 billion. It has since shed the government's stake and rebuilt itself as a mainstay British lender.

HSBC was set up in 1865 as the Hongkong and Shanghai Banking Corporation and still has an extensive presence in Asia, as well as in Europe, North America, the Middle East and north Africa.

Standard Chartered's history dates back almost 160 years, but it was created in its modern form in 1969 through a merger that brought together two banks that had been profiting from the growth in trade between Europe, Asia and Africa. It has no branches in the UK, but remains headquartered in the country, while prioritising lending in emerging markets.

In high-level terms, all the banks, with the exception of Standard Chartered, should benefit from the drive in Britain to ensure that all businesses receive the funds they need to survive, assuming that they are able to lend profitably.

Banks' net interest margin, effectively a measure of their profitability based on the difference between how much they pay to borrow and charge to lend, traditionally is wafer thin, at only 3.09 per cent for Barclays and 2.88 per cent at Lloyds, for example. At the same time, after the government encouraged home buyers to put property moves on hold, new mortgage lending is likely to dry up and it is highly probable that lenders will suffer a perceivable increase in bad loans as some customers are forced into default. Interest rates at a record low of 0.1 per cent and measures enabling borrowers to defer repayments for the next three months compound the problem.

To be a little more granular, while the total expected dividend payouts were not insubstantial, it's not clear that these lenders desperately needed to conserve capital.

Barclays' assets, weighted based on risk, stand at £295.1 billion, against which it holds £40.8 billion in easily available capital. The bank's tier one capital ratio, a measure of the amount of liquid reserves it holds to cover its exposures, was 13.8 per cent at the end of last year, vastly higher than it was during the financial crisis. As an illustration, at the end of 2008 the group's tier one capital ratio was a mere 5.6 per cent.

The same is true at the other lenders, among them RBS, with a tier one capital ratio of 18.5 per cent. Loosely, that means it has a little under a fifth of its exposures covered by capital that it can reach quickly. At the end of 2008, shortly before its rescue, the figure was 7 per cent.

Analysts at Numis yesterday published the results of stress tests that they carried out on RBS, Lloyds and Barclays using their own models. Applying severe-case tests, such as interest rates at 0.1 per cent for the next three years and a near-tenfold increase in loan impairment charges, would force the lenders into losses, but would not erode their capital strength beyond minimum regulatory requirements, Numis found.

Instinctively, the decision about bank dividends seemed to be more one of whether it felt appropriate for lenders to reward shareholders in the face of a looming economic crisis than a case of them needing to keep the money. Nevertheless, their direct exposure to an economic meltdown and the short-term pressures on their already meagre profitability do not make them attractive as shares in the present climate, particularly with interest rates near zero.

This is a shame in many ways, as all of the banks are trading at substantial discounts to the tangible net value of their assets. RBS's net assets were worth 268p a share at the end of last year, say, and the bank's stock was valued yesterday at 113p, down 4½p, or 3.8 per cent, on the day, a discount of 58 per cent. The shares yield an extraordinary 19.3 per cent based on last year's payout, which strongly suggests that the market predicted this year's dividend wouldn't come.

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