

U.S. Bank Exposure to Peripheral Europe: More Than Meets the Eye?

By Anil Lalchand

Co-Director, Credit Research, Global Developed Credit
DoubleLine Capital LP

July 5, 2011

Thanks to parliamentary passage of a €28.4 billion austerity package this week, Greece has fended off a default that also could have cascaded across the other periphery countries of Europe: Portugal, Ireland, Italy and Spain. Eurozone finance ministers will meet on July 11 at which time they are expected to approve the fifth tranche of €12 billion from last year's €110 billion euro bail-out package. This does not mean Greece is out of the woods. Europe and Greece have not resolved the Greek solvency crisis; they have only bought time – through September of this year. The finance ministers will need to structure a second, more significant package by addressing the longer term problems of Greece. As counterparties to banks and broker-dealers as well as managers of credit portfolios, U.S. asset managers need to monitor not only their European counterparties' country exposures but also the exposures of U.S. banks, direct and indirect, to the periphery countries. Here is our assessment of periphery country exposures of European banks and the five largest U.S. banks.

European Bank Exposure

Disclosure by individual European banks of country-specific exposures remains incomplete, a surprising shortcoming given the market's preoccupation with Greece for more than a year now. Most European banks' direct exposure to Greece is relatively small at less than 10% of Tier 1 Capital with the exception of those banks that have a commercial banking presence in the country and mainly participate in private sector loans (e.g., Dexia, Crédit Agricole, Société Générale, and Banco Comercial Português).

Within Europe, by far the most exposed banking systems are those of France (\$65 billion) and Germany (approximately \$40 billion). European banks in general have approximately \$162.4 billion of exposure.

Exposures to Defaulting Country				
As December 2010*				
(\$ Billions)				
	U.S.	France	Germany	UK
Greece	\$41.5	\$65.0	\$39.9	\$19.02
Ireland	105.0	56.0	159.1	194.5
Italy	269.1	472.3	215.9	100.1
Portugal	46.5	32.2	50.2	29.1
Spain	178.9	175.5	224.0	137.8
Total	\$640.8	\$801.1	\$689.2	\$480.5

Source: Bank for International Settlements

*These numbers include foreign claims (public sector, banks and non-bank private sector) plus other potential exposures (derivative contracts, guarantees and credit commitments).

The main threat for the European banks is possible contagion, especially if this were to lead to debt restructuring in bigger economies such as Spain.

U.S. Bank Exposure

The possibility of a Greek default has preoccupied the markets for about a year now. This long-developing situation has given the U.S. banks time to reduce their individual exposures via asset sales and/or hedges to more manageable levels.

According to the most recent statistics from the Bank for International Settlements (BIS), U.S. banks have \$41.5 billion in claims to Greece. We don't know how much of this exposure has been sold or hedged. The U.S. banks are not required to disclose their foreign country exposure unless it is greater than 0.75% of total assets; none of the major banks have made voluntary disclosure of this fact.

Top Five U.S. Banks Exposure to Greece, Portugal, Spain, Ireland and Italy

Bank of America As of First Quarter 2011

Bank of America disclosed that its total exposure to Greece stood at \$677 million as of the end of the first quarter. Its total exposure to peripheral Europe stood at \$16.9 billion, which represents approximately 0.75% of its total assets.

Bank of America			
\$ Billions			
	Total Exposure	As a % of Total Assets	Credit Default Protection
Greece	\$0.7	0.03%	\$0.03
Ireland	2.8	0.12%	0.02
Italy	7.1	0.31%	1.61
Portugal	0.7	0.03%	0.03
Spain	5.6	0.25%	0.06
Total	\$16.9	0.75%	\$1.75

Source: Bank of America, 10Q First Quarter 2011

JP Morgan
As of First Quarter 2011

JP Morgan doesn't report individual country exposures. Its first quarter 2011 10Q filing mentions that the aggregate exposure to the five countries is less than \$20 billion or 0.91% of total assets. JP Morgan also reports that sovereign exposure is less than half of the \$20 billion.

Citigroup
As of First Quarter 2011

Of the five countries, only Italy exposure was greater than 0.75% with a total exposure of \$31.1 billion or 1.6% (including cross-border plus commitments.) At year-end, Citigroup's total sovereign exposure was approximately \$265 billion, 94% in investment grade countries and 6% in non-investment grade countries.

On a separate note, total exposure to France was 4.4%, and total exposure to Germany was 3.4%.

Goldman Sachs
As of First Quarter 2011

Of the five countries, only exposure to Ireland was greater than 0.75% with total exposure of \$8.3 billion or 0.90% (including cross-border plus commitments).

Morgan Stanley
As of Fourth Quarter 2010

Morgan Stanley discloses exposures that exceed 1% of the company's assets or 20% of the company's total capital, whichever is less. Of the five countries, only exposure to Italy was disclosed at \$4.6 billion or 0.57% of assets and approximately 2% of total capital.

Second-Derivative Effects: Peripheries to European Banks to U.S. Banks

Yet the story of U.S. banks' exposure to Europe's periphery does not end with direct exposures. The top five U.S. banks have exposures to Germany and France, the largest bank lenders to Greece. The interconnectedness of the U.S. and European banking systems can hardly be lost on markets and policymakers post-bailout of American International Group (AIG). The periphery countries of course represent a much smaller systemic risk to the U.S. than did AIG. Nonetheless, in light of U.S. banks indirect as well direct exposures to the periphery, President Obama's comments on June 7 with respect to U.S. willingness to participate in the Greek bailout take on greater significance.

Top Five U.S. Banks Exposures to Germany and France					
As of First Quarter 2011, \$ Billions					
	BAC	CITI	JPM***	GS	MS**
Germany	N/A*	\$39.8	N/A	\$18.6	\$17.7
France	25.0	49.7	N/A	38.1	44.8
Total	Greater than \$25.0	\$89.5	\$124.1	\$56.8	\$62.4

* Less than 1% of total assets

** Data as of December 31, 2010

*** Total Europe, Middle East and Africa

Source: Company filings 10Qs and 10K

Exposures to Defaulting Country	
As of December 2010*	
(\$ Billions)	
	U.S.
Germany	\$601.4
France	629.9
Total	\$1,231.3

Source: Bank for International Settlements

*These numbers include foreign claims (public sector, banks and non-bank private sector) plus other potential exposures (derivative contracts, guarantees and credit commitments).

Conclusion

Based on the U.S. banks' own disclosures, U.S. bank exposures to Greece appear to be manageable. However, collectively the five banks do have considerable direct exposure to the periphery countries. Furthermore, the U.S. banks have significant exposures to large European countries such as Germany and France, which themselves have considerable exposure to the periphery countries. Therefore, the U.S. banks could have additional indirect exposures (beyond what is disclosed) via cross-guarantees or holdings of other banks that may have exposure to these troubled countries. There may be more than meets the eye in terms of aggregate U.S. bank exposure to Greece as well as Spain, Ireland, Italy and Portugal.

DoubleLine has no obligation to provide revised assessments in the event of changed circumstances. While DoubleLine gathered the information from sources believed to be reliable in preparing information for this report, DoubleLine cannot guarantee the accuracy of the information provided. Investments discussed are not recommendations and are presented as examples of issue selection or portfolio management processes. They have been picked for comparison or illustration purposes only. No investment or security presented within this report is either offered for sale or purchase. The mention of specific banks within this paper is neither an offer to sell nor a solicitation of an offer to sell the securities of those banks, nor is DoubleLine intending to make any investment recommendation regarding these banks in reporting its analysis of the situation described within this document. DoubleLine reserves the right to change its investment perspective and outlook without notice as market conditions dictate or as additional information becomes available.

The views and forecasts expressed in this material are as of the date indicated, are subject to change without notice, may not come to pass and do not represent a recommendation or offer of any particular security, strategy, or investment. Past performance is no guarantee of future results.

DoubleLine® is a registered trademark of DoubleLine Capital, LP.