

## **Excessive bank dividends drain the system of essential capital**

Text of letter by Anat R. Admati, published in *Financial Times*, January 28, 2011

Mr. Shyam Amladi (“Stopping bank dividends is only a symbolic step,” January 25) agrees with my assessment (“Dividends Can Wait until Banks are Stronger,” January 19) that banks are excessively leveraged. However, he cites the fact that the three largest US banks paid little in dividends recently to argue that stopping dividends would only be a symbolic step in reducing leverage.

The reason some banks paid little in dividends to common equity recently is that the US government, which received preferred equity in exchange for funds under the troubled assets relief program, pressed banks since 2009 to reduce dividends and pay it off first. The issue right now is not whether banks should stop paying these small dividends, but whether they should be allowed to increase dividends substantially, to levels as high as they used to pay up through the financial crisis. These levels are far from symbolic.

Acharya, Gujral and Shin (in a working paper entitled “Dividends and Bank Capital in the Financial Crisis of 2007-2009”) report that twenty one large banks in the US, UK and Europe paid around \$500 billion, a third of their total value at the end of 2007, as dividends during 2000-2008, including \$130 billion distributed during 2007-2008. Bank leverage consistently increased during this period by any measure. While 61 firms in the S&P 500 cut dividends during 2008, most banks in US, including those receiving funds from the government, paid normal dividends at least through early 2009.

According to analysts, if allowed, JPMorgan would restore a dividend that could equal \$1.50 a share annually this year, resulting in a dividend yield of about 3.3 per cent. Wells Fargo Bank told investors it would like to reach a payout ratio of 30 per cent of earnings. For 2011, this would mean an annual dividend well above \$3 billion.

Raising new equity or selling assets, as Mr. Amaldi suggests, would clearly be helpful in reducing leverage. But it makes no sense to pay large dividends and then try to raise new equity to partly recover the funds paid out. And buyers are not lined up to pay good prices for banks’ illiquid assets. Paying dividends drains banks of essential capital. It is in direct conflict with the interests of creditors and taxpayers, who may have to pick up the pieces if trouble arises.

Anat R. Admati  
George G.C. Parker Professor of Finance and Economics  
Stanford University