A new ball game for buyers of U.S. banks

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Canadian banks are likely to take a pass on participating in the U.S. financial-sector aid package because the terms are too onerous, although the plan to take troubled assets off the balance sheets of lenders may open the way to acquisition opportunities.

The aid proposal, hammered out in marathon congressional talks over the weekend, calls for banks to be able to sell as much as $700-billion (U.S.) of problem loans and money-losing real-estate securities to the U.S. government. In return, the government is extracting limits on executive compensation and may be able to take ownership stakes in participants. The plan may go to the U.S. Congress for approval this week.

Toronto-Dominion Bank, **Royal Bank of Canada** and **Bank of Montreal** all have U.S. banking operations with loans that are in rough shape because of the housing crisis, but not to the extent of U.S. rivals which are desperate for balance-sheet relief.

While Canadian banks may not want to use the program directly, they may take advantage of the ability to shed bad assets as they look for U.S. acquisitions.

U.S. banks that do use the program may have to take further writedowns, and in current markets, finding capital to replace the lost money is difficult.

That may lead to more banks seeking buyers. Canadian banks could also use the program to hive off bad assets from any acquisitions.

"With the risk removed [Canadian banks] are foolish not to pull the trigger in this opportunity of a generation," said John Aiken, a bank analyst at Dundee Securities Corp.

There is talk that a Canadian bank such as RBC or TD could take a run at Charlotte, N.C.-based **Wachovia Corp.**, a huge but troubled lender that's seeking a buyer.

RBC's U.S. operations share a similar footprint to Wachovia's home base in the U.S. southeast, while TD has been mentioned as a possible suitor because it had a look at Seattle-based Washington Mutual Savings Bank before that lender failed last week. A spokesman for TD declined to comment on reports that Wachovia had reached out to inquire about a merger.

However, any acquisitions are likely to be smaller than Wachovia, which is the fourth-largest U.S. bank, analysts and executives said.

Wachovia has a market capitalization of $21.6-billion after an 80-per-cent plunge in its stock price in the past year, making the lender less than half the size of RBC or TD by that measure.

Wachovia's balance sheet, though, is still much larger. It had $812-billion of assets as of June 30, compared with RBC's $637-billion (Canadian) and TD's $609-billion, as of their most recent results. That makes a purchase unwieldy and potentially risky for either of the Canadian banks, especially if they end up bidding against other giant suitors that include Citigroup Inc. of New York and, potentially, Wells Fargo & Co. of San Francisco.

Smaller regional banks with balance sheets that are easier to manage may present more appealing targets.

"There will be a tremendous feeding frenzy at some point, but it's still early days," said one senior Canadian banking executive, adding that he "wouldn't be surprised if in two years the Canadian banks like RBC and TD are twice the size they are now."

In the meantime, while TD, RBC and BMO all have U.S. banking operations, the problems on their books are relatively minor and are unlikely to warrant turning to the U.S. government for help. RBC, for example, does have some troublesome loans in the United States, particularly a portfolio of loans to home builders worth about $3-billion, but believes it can work out the problems and limit losses.

"Though the Canadian banks that are on-the-ground lenders in the U.S. may be eligible for inclusion, their issues do not appear significant enough to offset the 'quid pro quo' that will likely accompany the [proposal's] implementation," said Merrill Lynch bank analyst Sumit Malhotra.

RBC, for example, would be "highly unlikely" to participate, Morten Friis, the company's chief risk officer, said at a conference Friday. "It's early days and we don't know the terms of the setup, but I would be very surprised if that is a vehicle that we are eligible for or that makes sense for us."

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In a nutshell

THE DESIGN: As much as $700-billion (U.S.) of taxpayers' money would be used to purchase banks' worst mortgage-related investments, with the ultimate goal of reviving lending on Wall Street and Main Street.

SIGNS TO WATCH: If the plan works, interest rates on short-term Treasury securities backed by the full faith and credit of the U.S. government should rise, signalling banks are more willing to take on riskier types of debt - including new mortgages and student loans.

NO QUICK FIX: Rising unemployment and falling real estate values are not expected to disappear overnight, and a recession is still possible. Economists say it could be late 2009 before home prices stop falling.

Associated Press

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The winners

Wall Street

Wall Street and the banking industry are perhaps the biggest winners. Scores of banks and other financial institutions faced with going under stand to gain a lifeline that should allow them to start making loans again.

Borrowers

Anyone soon trying to borrow money - for cars, student loans, even to open new credit card accounts.

Treasury Secretary Henry Paulson

and Fed chairman Ben Bernanke

In just a few months, the pair has remade Wall Street. If the plan helps to get the U.S. economy moving again, they may be remembered for having kept the financial crisis from spreading throughout the economy.

The losers

Top executives at battered financial institutions

The proposal would limit their compensation and rules out "golden parachutes."

Troubled homeowners

Those faced with foreclosure or those who have lost their homes get little help from the agreement. Nor will it help people whose houses are worth less than what they owe get refinancing or take out equity loans.

U.S. Taxpayers

Nothing that potentially adds $700-billion to the national debt - already surging toward the $10-trillion mark - can be considered a winner for those who foot the bills. The package may make money for taxpayers, but only if the loans and interest on them are repaid in full. Few expect that provision to be a winning proposition, however.