The World's Safest Banks

Banking Rollup Review

We do not live in a static environment. So it's important to go back from time to time to validate our initial assumptions and basic premises to ensure that everything is still valid.

Banking is one area in particular that is extremely fluid. The regulatory environment is constantly changing, central bank policy is constantly changing, and macroeconomic conditions are constantly changing.

Think about it; the implementation of intergovernmental information sharing agreements from FATCA has caused many banks to simply fire their customers and increase their cost structures. Central bank monetary policy compels banks to hold certain types of assets (government bonds) over others (loans to small businesses).

All of this has a direct impact to bank balance sheets and their operations.

Granted, most banks don't care. The financial system provides huge incentives for banks to act recklessly with people's savings, and their focus is on trying to figure out where they can make the most money where they can squeeze out an additional basis point.

But there still are some conservative financial stewards out there. But it's becoming much, much harder.

In aggregate, central banks continue to conjure trillions of dollars each year, and there's an unprecedented amount of fiat money in the system now.

Prevailing interest rates fail to keep pace with inflation, and the assets which have traditionally been considered "risk free" such as government bonds are actually among the riskiest assets of all.

Given all of this, where does a conservative financial steward put his customer's money?

It's incredibly difficult work for bankers to find low-risk investments, which yield sufficient returns AND are liquid. And even if they succeed, there's going to be trillions more in the financial system next year that they'll have to manage. It never stops.

Candidly, this is a very compelling reason to own precious metals. Gold is one of the easiest ways to divorce at least a portion of your savings from this system and substantially reduce your counterparty risk.

Unfortunately, though, the world doesn't run on gold yet. It's difficult to walk into a Starbucks and buy a cup of coffee with a gold coin. One day I'm sure that infrastructure will exist to make precious metals, or their proxies, a more prevalent medium of exchange.

But for now, if we want to function in society, it's imperative to at least have some paper (electronic) money within the banking system.

It still begs the question—WHERE?

This is not a choice that should be taken lightly. The decision of who has the burden and responsibility of holding your savings is substantial. A bank in many ways is your silent financial partner. So it's important to undergo some sort of analysis.

Most people don't. We just plop our savings down in whichever institution has the cutest commercials, or the one that is closest to our house. But these factors are largely irrelevant.

In the Age of the Internet, modern transport and communications make geography practically irrelevant. It's possible to bank on the other side of the planet just as easily as it is to bank down the street.

The decision should ultimately come down to which is the BEST and SAFEST option for our individual circumstances.

My own analysis always starts with the jurisdiction. And I'll illustrate two examples to explain.

First, the United States.

Many of the largest banks in the United States are inadequately capitalized and they very publicly failed their Fed-mandated stress tests.

The FDIC, the primary regulatory body, which is supposed to insure the US banking system in the event of shocks and failures, is itself inadequately capitalized. The FDIC's insurance fund, in fact, fails to meet the minimum level of capitalization as required by law. Hello irony!

The US federal government, which backs up the FDIC, is itself insolvent to the tune of MINUS $17 trillion. And the US Federal Reserve, which supports the Federal government and the entire financial system, is nearly insolvent with a razor thin capital level and over $4 trillion in assets.

Bottom line, this is clearly not a risk-free banking system.

Very few people actually conduct this analysis, though. We're all bred to believe that banks are inherently safe. They exist in grand buildings and come with government guarantees so few people give any thought to putting their savings in these institutions.

Cyprus is another interesting example.

In March 2013, bank balance sheets in Cyprus had deteriorated to the point that they were largely insolvent.

People could still log on to a bank website and check their account balances. But just because people could see a number on a screen, it didn't mean the banks actually had the money.

It turns out they didn't. And people woke up one day to find out that their entire banking system was insolvent, and that they had been frozen out of their accounts.

The point with both of these examples is that it's imperative to first start with the macro view—start with the jurisdiction. If the country is bankrupt, or the central bank is practically insolvent, then it makes the entire banking system dangerous.

I prefer strong, financially sound jurisdictions with zero net debt and central banks with strong balance sheets.

From there, I analyze individual bank balance sheets. How much CASH do they have on hand as a percentage of total customer deposits? This is a measure of a bank's liquidity. The more liquid they are, the better.

For example, let's say there are two banks. Each has $100 in deposits. Bank A keeps just $1 in cash and $99 in loans. Bank B keeps $50 in cash and $50 in loans. Which of these banks do you think would be better able to withstand a major financial shock, like a bank run? Obviously Bank B, the one with more cash.

Secondly, I look at how much EQUITY (or capital) a bank has as a percentage of total assets. This is a measure of the bank's solvency (or capitalization). It gives us a very strong idea of their margin of safety.

Again, let's assume Banks C and D each have $100 in total assets—cash, bonds, loans, etc.

Bank C has $99 in liabilities—customer deposits, debt, etc. So its net equity is just $1, or 1% of its assets.

Bank D has $90 in liabilities, so its net equity is $10, or 10% of assets.

This tells us that Bank D has a much higher margin of safety. If the market value of Bank C's assets falls by just 1%, Bank C is insolvent and out of business. Bank D, on the other hand, has enough capital to withstand a 10% drop in its asset valuations. Generally speaking, this makes Bank D much safer.

The idea is to find highly liquid, well-capitalized banks in jurisdictions that have low (or zero) debt, supported by well-capitalized central banks.

Again, though, because things do change frequently, I felt it was important to review some of our banking recommendations and re-assess their balance sheets.

UNITED STATES: POOR

I want to start with the United States as a control given that it is the largest banking system in the world.

Government net position: Net DEBTOR, $17 trillion (over 100% of GDP)

The federal government's net position (i.e. total assets minus liabilities) is minus $17 trillion, which is far in excess of US GDP. This means that the US government lacks the financial wherewithal to credibly bail out its banking system or support depositors.

US Federal Reserve capital ratio: 1.30%

The Fed is showing a massive, long-term deterioration in its margin of safety. The Fed's capital is just 1.30% of its assets, which is a razor thin level of capital. Just a month ago it was 1.32%. A year ago it was 1.66%. Two years ago it was 1.90%. Five years ago it was 2.27%.

So the trend is clearly a continued erosion in the Fed's balance sheet.

Bank liquidity: 2.05%

I selected JP Morgan as an example, which currently has $26.3 billion in cash equivalents to support $1.28 trillion in customer deposits. That's a liquidity ratio of just 2.05%. Pitifully small. And JP Morgan is supposed to be a 'healthy' bank.

Bank solvency: 8.87%

Again, JP Morgan is currently posting total capital of $219 billion, or roughly 8.87% of its total assets of $2.47 trillion.

Ordinarily this would be an acceptable margin of safety. Single high digit margins of safety are sufficient, so long as the bank has substantial liquidity. But if a bank has very little liquidity (like JP Morgan's 2%), then I want to see a MUCH higher margin of safety.

Think about it like this—if just 2% of JP Morgan's customers want to withdraw their funds, then JP Morgan is out of money.

Ordinarily this wouldn't happen. But in serious financial shocks, bank runs do occur so it would seem likely that they would far surpass this 2% threshold.

If that happens, JP Morgan would have to sell some of its assets in order to raise cash. The problem with this is that in a financial shock, the sale of assets does not happen in an orderly way.

Asset sales in a financial shock are more like fire sales. Asset values are plummeting. You don't get reasonable market value. You get distress prices.

So with a margin of safety of just 8.87%, it's possible that JP Morgan's assets could deteriorate far beyond that level in a financial shock.

Bottom line, they don't have enough cash to meet basic liquidity needs. And if they needed to liquidate assets to raise cash, they don't have a sufficient margin of safety to ensure solvency in a fire sale.

All of these factors—low bank solvency, low bank liquidity, low central bank solvency, government insolvency— suggest that the US is not an appropriate place to hold the preponderance of yours savings. Hence a score of "C-"

AUSTRALIA: ADEQUATE

Australia is still an adequate place to bank, though both the government and central bank have had gradually deteriorating balance sheets. While the fundamentals are still solid, the trend is negative.

Government net position: Excellent. Australia's net debt is equivalent to 12% of GDP. While this number has been rising, it is a very solid figure on a comparative basis.

Central bank solvency: Low. The Reserve Bank of Australia has experienced an astounding deterioration of its balance sheet over the past 18-months. Back in 2010, the RBA's capital was nearly 9% of its total assets. And it held near that level for years. Today it's just 1.9%, a low it hasn't seen since 1997.

Banking system liquidity: Low. Typical liquidity ratios in Australia are roughly 6%. St. George's bank, for example, has cash equivalents equal to 5.82% of its customer deposits.

Banking system solvency: Adequate. The entire banking system shows capital of roughly 9.20% of total banking assets. Given the level of liquidity in the banking system and the government's net financial position, however, this is an adequate level of capitalization.

CHILE: GOOD

Chile's banking system scores well overall despite some trouble with the central bank's balance sheet, and a medium term slowdown in the economy.

The main challenge to banking in Chile is that banks (like most everything in Chile) operate in a very insular manner. They are not accustomed to dealing with foreigners; to them it's like dealing with space aliens.

And there have been so many changes in Chile just in the last 12-months, much of which is related to the IGA model 2 FATCA implementation that banks have been very slow to adapt. We have been working very diligently with a number of banks, including their general counsel in some cases, to resolve this issue.

Government net position: Excellent. Chile has ZERO net debt, and the government generally maintains a breakeven budget.

Central bank solvency: Low. As I have written to you before, the Chilean central bank actually has NEGATIVE capital. It is insolvent.

Under normal circumstances, this would cause a massive currency crisis. The reason it hasn't is because the central bank falls under a charter issued by the government of Chile. If the central bank actually did fall on hard times, it would be the responsibility of the government to bail it out.

Given the government's solid financial position, this is not an issue.

The central bank's balance sheet as of March 31, 2014 totaled $45.4 billion in assets. Net equity is MINUS $6.9 billion. But this only constitutes 2.2% of GDP.

The central government's current NET debt load is -5.7% of GDP. In other words, the government's net assets total 5.7% of GDP (as opposed to the US which is in a net liability position beyond 100% of GDP).

This means that the Chilean government could recapitalize the central bank, and then some, and still have ZERO net debt. So this is overall a fairly stable system.

It certainly begs the question—why is the central bank insolvent? Easy. They have been losing billions each year trying to keep the Chilean peso artificially low against the US dollar.

I told you about this in the summer of 2013 (see the SMC July 2013 teleconference), that there would likely be short-term peso weakness, but long-term we would see a much stronger peso. So far that has happened—the peso has weakened against the dollar. And it's possible it could go lower.

Long term, though, the central bank is not going to be able to continue maintaining this charade, and the peso will have to rise.

Banking system liquidity: Excellent. The Q4/2013 annual report for Santander Chile (just the Chilean operations) showed a cash balance that constitutes a whopping 27.96% of customer deposits.

Banking system solvency: Good. Santander's most recent report shows net equity of roughly 8.71% of total assets. Given the strong liquidity in the system, plus the bank's total lack of exposure to foreign toxic assets, this is a solid level of capitalization.

COOK ISLANDS: GOOD

I have mentioned the Cook Islands in the past numerous times as an asset protection jurisdiction. No doubt, some of the best asset protection law in the world is in the Cook Islands.

And that alone is a great reason to consider banking there.

Funds held in the Cook Islands have a tremendous amount of legal protection supporting them and banks have even stood up to US government agencies to defend their customers' funds.

Capital Security Bank in the Cook Islands is a private, independent bank that was started by Southpac Trust Company. There is no minimum deposit, and the company has a very strong balance sheet since it makes no customer loans.

The majority of the funds are held outside of the Cook Islands at stronger banks abroad in Hong Kong and Singapore. This makes Capital Security Bank an excellent proxy, especially for individuals who are only looking to move smaller sums.

Bear in mind, CSB charges an annual fee for maintaining an account. This is, in a way, the price customers pay for the bank being able to maintain a solid balance sheet.

Government net position: Good. The Cooks Islands government has a net debt position of about 15% of GDP. This is a very reasonable figure.

Central bank solvency: N/A. The Cook Islands dollar is pegged to the New Zealand dollar, so there is no independent monetary policy. That being said, very little of CSB's funds are actually denominated in Cook or NZ dollars, or kept on the island.

Banking system liquidity: Excellent. The 2013 annual report shows cash equivalents equal to roughly 56% of customer deposits. The rest of the funds are maintained in very short-term securities. Most accountants would consider these cash equivalents, meaning CSB's liquidity ratio is essentially 100%.

Bear in mind, most of the cash balances are held in foreign banks, specifically in Hong Kong and Singapore.

While I am not at liberty to disclose the names of the banks where CSB holds its funds, I can tell you that CSB has been very judicious in making those selections.

The typical bank in Hong Kong, for example, has a liquidity ratio of 37%, and 11.7% capital solvency.

Banking system solvency: Low. CSB maintains net equity of roughly 1.53%. At first glance, this is critically low. But bear in mind that the bank essentially maintains nearly total liquidity; thus, the level of capitalization is much less relevant.

GEORGIA: GOOD

Whenever I talk about banking in Georgia, people typically do a double take. Why would anyone bank in Georgia? It's shocking to even suggest something so strange.

But the facts certainly support the assertion.

Georgia has steadily climbed atop the rankings to be among the world's best places to do business. The country's economy has grown dramatically, and the financial system is well capitalized.

Right now there is a lot of concern that Georgia will somehow get caught up in the Ukraine situation because it too is a former Soviet republic.

Frankly the two issues are completely unrelated. But it is worth pointing out that when Russia invaded Georgia in 2008, the Georgian banking system was able to sustain the panic that ensued, and pay out every single customer who demanded a withdrawal.

Georgia is clearly not a developed nation. So there is some additional risk, or at least perception of risk. That being said, the return is much higher. It's possible to park money in Georgia and make 8% to 10% on your money, just holding it in a bank.

Government net position: Adequate. Georgia's public debt is 34.8% of GDP. I would prefer to see a much lower debt level (Chile's or Australia's, for example), but this figure is not anywhere near the danger zone.

Central bank solvency: Low. The National Bank of Georgia's most recent statistics show a critically low equity level of just 0.48% of total assets. I will need to reassess once the 2013 figures are released. This is less of a concern to me, however, because:

(a) I am not suggesting that you hold your funds in local currency. Banks pay 8%+ on US dollar deposits. So the exposure to the central bank is limited.

(b) Georgia's central bank has a growing, favorable net foreign asset position. So the trend is improving. Again, I will validate this conclusion once they release the 2013 annual report.

(c) The individual banks have excellent liquidity and capitalization, some of the best in the world right now.

Banking system liquidity: Excellent. TBC's most recent annual report shows cash equivalents equal to 23.76% of customer deposits. This is a very strong, healthy figure.

Banking system solvency: Excellent. The entire Georgian banking system has a net equity equal to 16.59% of total assets. TBC Bank is right at that level at 16.09%.

HONG KONG: EXCELLENT

Hong Kong receives top marks from me as one of the best places in the world to bank. The central bank is one of the best capitalized in the world, and the banking system is extremely liquid.

Opening a bank account in Hong Kong requires a personal visit. As we published several months ago, Hang Seng is opening accounts for walk-in customers at any of their branches.

Remember, owning Hong Kong dollars is a great idea if you're a US dollar investor. The HK dollar is pegged to the US dollar, so if the US dollar surges, so will the HK dollar. If the US dollar plummets, the Hong Kong Monetary Authority will simply revalue the peg to a different level, covering your downside risk. Government net position: Excellent. Hong Kong's cumulative debt load is negligible, about 2% of GDP.

And despite having some of the lowest tax rates in the world, Hong Kong almost always runs a budget surplus.

Central bank solvency: Excellent. The Hong Kong Monetary Authority is one of the highest capitalized central banks in the world, and its exchange fund current has net equity equal to 21.56% of assets. This is even higher than last year.

Banking system liquidity: Excellent. HSBC Hong Kong's most recent annual report shows cash equivalents equal to 26.62% of customer deposits. This is an excellent ratio.

Banking system solvency: Adequate. HSBC Hong Kong's net equity is equal to 8.11% of total assets. Given how high the bank's liquidity is, this is a more than reasonable figure.

NORWAY: EXCELLENT

Norway always receives top marks from me given how liquid the banking system is, and the government's financial position.

Like Hong Kong, the central bank is THE most well capitalized in the world, meaning that the Norwegian kroner is the cockroach of fiat currencies. It will be able to withstand even a nuclear shock to the financial system.

They require a 100,000 euro minimum ($138,500) to open an account, which will be converted to Norwegian kroner.

I don't recommend you hold kroner in an operating account, i.e. to pay the electric bill. This is truly a savings account—rainy day money, not funds you would need to tap frequently.

Government net position: Excellent. Norway is so wealthy that its net financial position is well over 100% of GDP. All of this is tucked away in a rainy day fund.

Central bank solvency: Excellent. Again, the Norwegian central bank is prodigiously capitalized Its March 2014 balance sheet showed net equity equal to 31.6%. Remember, the US Federal Reserve's is 1.3%. It's an astounding difference.

Banking system liquidity: Excellent. DNB Norway most recent financials (Q4/2013) showed cash equivalents equal to 25.02% of customer deposits.

Banking system solvency: Adequate. DNB Norway's net equity has dropped to 6.28% of total assets. Much of this difference was due to certain dividend payouts to reduce overall capital, plus the paying down of certain debts that will be reflected in future financials.

DNB is partly owned by the cash-rich Norwegian government, so the likelihood of a failure is minimal. Not to mention, DNB runs a very conservative portfolio with zero exposure to any toxic US or European assets.

SINGAPORE: EXCELLENT

Like Hong Kong, Singapore has an incredibly well developed financial system that has become one of the most important in the world. And I am frequently discussing the benefits of banking in the city-state.

The last year, however, has presented some difficulties.

For the first time in decades, Singapore experienced social unrest. People actually rioted and lit police cars on fire. There are certain elements of society that are becoming unglued.

Singapore is beginning to experience vast income inequality. There are more millionaires per capita in Singapore than anywhere else in the world. Yet much of the population can barely make ends meet. Subsidized government apartments are now selling for nearly S$1 million!

Inflation is rising, and balance sheets of both the central bank and commercial banks in Singapore have showed clear signs of deterioration in the last year, and the last six months in particular.

Moreover, the banking environment is being scrutinized right now. There's an international microscope hovering over Singaporean banks. Countries from the US to India to China are all looking at Singapore, demanding that the banking system help stamp out tax fraud.

Compliance is such a huge concern in the banking system right now, the standard answer for just about anything at banks these days is NO. No one wants to do business. They just want to survive. Bureaucrats, auditors, and inspectors are running amok, and many banks are starting to cull accounts that may arouse suspicion.

This is not a cause for concern. I have numerous funds in Singapore, and our publishing division holds a substantial portion of its funds in Singapore. I have no intention of moving those funds.

Overall, Singapore is still a very solid place to do business and bank. If you already have funds in Singapore, I see no reason to move them. If you are looking to establish a new account somewhere, I would look in Hong Kong. The compliance requirements are just too severe in Singapore right now.

Government net position: Excellent. Like Norway and Chile, Singapore has no net debt.

Central bank solvency: Adequate. Like Chile, the Monetary Authority of Singapore has lost billions over the years trying to keep its currency artificially depressed against the US dollar. It's not working.

Net central bank capital last year fell to roughly 6% of total assets. 2013 figures have yet to be released, but based on the central bank's monthly updates, I expect it will be roughly the same this year.

6% is not spectacular. But given the strength of Singapore's economy and the government's net surplus, it's more than adequate.

Banking system liquidity: Excellent. DBS in Singapore recently posted cash equivalents equal to roughly 16% of total customer deposits.

Banking system solvency: Adequate. DBS's net equity constitutes nearly 10% of its total assets. Given the bank's liquidity level, this is a solid figure.

BANKING REVIEW

	Government net position	Central bank solvency	Banking system liquidity	Banking system solvency	Overall banking environment
Australia	Excellent	Low	Low	Adequate	Adequate
Chile	Excellent	Low	Excellent	Good	Good
Cook Islands	Good	N/A	Excellent	Low	Good
Georgia	Adequate	Low	Excellent	Excellent	Good
Hong Kong	Excellent	Excellent	Excellent	Adequate	Excellent
Norway	Excellent	Excellent	Excellent	Adequate	Excellent
Singapore	Excellent	Adequate	Excellent	Adequate	Excellent