Banks face £25bn loan default bill

Huge uncertainty over scale of pandemic losses

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The Bank of England is encouraging the UK's biggest banks to look beyond the current crisis and assume that the economy will bounce back strongly

Britain's biggest banks are on course to report up to £25 billion of loan losses this year because of a blowout in borrower defaults, a leading credit rating agency has warned.

Fitch suggested that the surge in expected credit losses to £7 billion, reported last week by the five biggest banks for the first quarter of the year, would be repeated in future quarters.

It estimated that total expected credit losses this year for HSBC, Barclays, Lloyds, Royal Bank of Scotland and Santander UK would be at least £17 billion. "Based on indications by some of the banks in their first-quarter 2020 results announcements, we expect that full-year provisions could be 2.4 to 3.6 times higher than the first quarter, which would amount to £17 billion to £25 billion for all five issuers," Fitch said in a research note. That would compare with £6.1 billion of loan losses for the Big Five in 2019.

The pandemic is expected to lead to a surge in defaults by businesses going bust and by people losing their jobs or suffering income cuts. There is uncertainty about the scale of the losses, however, both because of the unprecedented splurge of government support to companies and households and because of the flexibility on how banks choose to estimate future loan losses.

While the newly implemented IFRS9 accounting standard is intended to push banks into writing off loans earlier than previously, guidance from the Bank of England has partly offset this. Its Prudential Regulation Authority recently told banks to “look through” the present downturn and assume a sharp bounce in the economy once restrictions are lifted.

Last week Lloyds was able to assign only a 30 per cent probability to the base case of macroeconomic assumptions on which it based its loan losses. HSBC came closest last week to indicating future loan losses, saying that they could amount to $7 billion to $11 billion for the full year. Barclays suggested that it might have to set aside another £1 billion in each of the remaining three quarters.

The banks are well capitalised and look able to absorb losses on this scale without resorting to emergency fundraisings. However, the losses could delay the speed at which they would be allowed to resume dividend payments.

The warning on loan losses came as Virgin Money set aside £232 million for expected loan losses and announced that 100,000 of its customers had been put on payment holidays.

Fitch put HSBC, RBS, Lloyds and Santander UK on “negative outlook” on April 1, while Barclays was assigned a “negative watch” rating as it could be vulnerable to shorter-term pressures.

The warning came as Lord Blackwell, chairman of Lloyds Banking Group, said that a plan needed to be devised to help companies that survive the crisis but become saddled with state-backed debt. Commercial banks are issuing government-guaranteed loans but those debts may have to be converted to equity or an equity-type security once the crisis has passed, he said.