

Bank dividend bans: Three market implications

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Equity investors might suffer from the knock-on consequences of a dividend ban, but it's not necessarily negative for all bank capital providers.

Regulators in the UK and Europe have introduced a de-facto ban on bank dividends.

The rationale for this is that banks provide a critical part of the monetary transmission mechanism. Regulators want to ensure that banks don't compromise their ability to carry out their role in enacting monetary policy by weakening their capital positions through dividend pay-outs to shareholders.

Additionally, if bank profitability indirectly benefits from the unprecedented support being provided to the real economy, increasing shareholder pay-outs could be viewed as profiteering, which the authorities want to avoid.

We believe anything more than a temporary ban on dividend distributions could have negative implications for markets.

Why?

1. It disrupts the allocation of capital by discriminating against those banks that have emphasised capital strength and conservative management (typically ['national champion banks'](#)) to maintain income flows to their investors, while being more favourable towards institutions that have been run with more aggressive capital management policies.
2. It damages the ability of the banking sector to raise further capital from private investors in the future, if this is required, as the appeal of a regular and consistent dividend payment is called into question.
3. Uncertainty over dividend policies is likely to increase the cost of capital required to invest in these institutions going forward.

While the ban on cash dividends has been damaging for equity investors, retaining the would-be dividend within banks is positive for AT1 and bond investors as this retained capital increases the institutions' buffers and the amounts available to pay coupons on these securities.

So, although equity investors may suffer from the knock-on consequences of a dividend ban, it's not necessarily negative for all bank capital providers.

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