European banks in two crisis-hit countries are trying to improve the appearance of their financial health by persuading their governments to change obscure accounting-related rules.

In Spain, where a deep recession has left some banks with thin capital cushions, bank executives are lobbying the government to transform potentially worthless tax assets into government-guaranteed tax credits that would bolster the banks' capital positions.

In Italy, where lenders hold ownership stakes in the country's central bank, top banking executives are pushing for a revaluation of the Bank of Italy that would translate into an accounting windfall for the banks and thereby inflate their capital levels.

The Spanish and Italian lobbying campaigns are the latest examples of banks in ailing European countries scrambling to find ways to make their financial conditions appear stronger, without relying entirely on costly initiatives such as issuing new shares or selling lucrative assets.

While banks in both countries already have made big strides at strengthening their capital buffers, critics say the requested changes are sleight-of-hand maneuvers that don't improve the banks' abilities to weather future losses. Such efforts, they say, could further sap public and investor confidence in the European banking industry.

"If capital adequacy measures can be manipulated to make banks appear better without really improving their financial health, the purpose of the [capital] regulation is undermined," said Anat Admati, a finance professor at Stanford University's business school. She described the Spanish effort in particular as "disturbing."

Spanish and Italian bank executives, as well as some public officials, say it is logical and fair for them to tinker with the current rules.

"I do not think this is a gimmick," Bank of Spain Governor Luis Linde said in an interview. "This is to apply rules that are already applied in other countries."

The issue in Spain involves so-called deferred tax assets. International accounting standards allow banks and other companies to book such assets when they report losses. If and when they report profits in the future, the companies then can deduct the prior losses from the tax expense on their financial statements.

Unprofitable Spanish banks have accumulated hefty deferred tax assets over the past few years. Analysts estimate the industry's total is roughly €50 billion, or about $66 billion.

Under new international capital rules, those deferred tax assets are unhelpful. Because there is no guarantee that they will ever be realized—that only happens if a bank earns a profit—their value gets deducted from a bank's capital base.

The industry's proposed solution is for the Spanish government to convert many of those assets into government-backed tax credits that wouldn't be deducted from the banks' capital calculations. In addition to the Bank of Spain, the Spanish finance ministry is on board with the plan, although it is encountering resistance from other quarters of the Spanish government, according to industry and public officials in Madrid.

The requested changes would have the effect of boosting Spanish banks' capital cushions by an average of one percentage point, according to a senior Spanish official involved in the negotiations. That is a significant impact, because banks' capital ratios rarely exceed 10% of their risk-adjusted assets. For banks such as Banco Sabadell...
SA and **Banco Santander** SA, the impact would be even greater, analysts say.

"Markets have quite a high tolerance level for bank recaps weighing on public debt if it genuinely cleans up the system," analysts at Exane BNP Paribas wrote in a recent research report. "We are less convinced about how accounting tricks would be perceived."

Spanish officials, including the finance ministry, say the changes would simplify the process of cleaning up the industry, because two nationalized lenders that Spain hopes to auction off are each sitting on about €5 billion of deferred tax assets.

In Italy, a long-standing proposal to revalue the stakes that several Italian banks have owned in the central bank for nearly 80 years recently has gained ground, getting support from prominent public officials.

In 1936, several banks, insurers and Italy’s social security system injected what was then 300 million lire into the Bank of Italy, which needed a recapitalization. The injection was converted into €156,000 when Italy entered the common-currency system.

Two banks—**UniCredit** SpA and **Intesa Sanpaolo** SpA—today hold about 60% of the Bank of Italy’s equity, which they have accumulated via a flurry of mergers with smaller lenders that also held stakes. Italy is one of the few European countries where lenders own stakes in the central bank.

The stakes are hard to value because they are never traded. Most banks are carrying them on their balance sheets at values that haven’t changed in decades.

Now the industry, including top bank CEOs and a trade association, is lobbying for the Bank of Italy to recalculate its current value. The move would allow the banks to adjust the values of their stakes. That would generate big on-paper profits for the banks, which would pad their capital cushions.

The banks’ campaign appears to be gaining momentum. Fabrizio Saccomanni, Italy’s economy minister who until recently was the Bank of Italy’s deputy governor, said in an interview that he supports an overhaul of the current system, which could benefit the capital positions of the banks holding the stakes.

Some critics, though, say that such a move would be purely cosmetic, partly because the stakes—regardless of their supposed value—aren’t actually able to be bought and sold. Any profits banks reap from the gain in the stakes’ values exist purely on paper, and won’t be of much use absorbing future losses.

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