Ratings Cut for Giant Banks

Moody's Downgrades Hit Five of Six Largest U.S. Banks, Add to Market Jitters

By ROBIN SIDEL And AARON LUCCHETTI

Moody's Investors Service dealt a fresh blow to the financial sector, downgrading more than a dozen global banks to reflect declining profitability in an industry being rocked by soft economic growth, tougher regulations and nervous investors.

The move hit five of the six biggest U.S. banks by assets, including Morgan Stanley, MS -1.72% which had mounted a campaign to persuade Moody's not to cut its rating by three notches. It was downgraded instead by two.

The lower ratings are likely to raise the companies' borrowing costs and affect how they raise capital, and could deprive some banks of trading revenue. The higher costs for banks could be passed on to customers such as municipalities, corporations and others who get loans from banks.

"All of the banks affected by today's actions have significant exposure to the volatility and risk of outsized losses inherent to capital-markets activities," said Greg Bauer, a managing director of global banking at Moody's, in a statement. Although some of the banks' other businesses can provide "shock absorbers," Mr. Bauer said, they "also provide unique risks and challenges."

"We conducted an extremely thorough process of analyzing the banks and we feel comfortable with our ratings," said Johannes Wassenberg, Moody's managing director for European banks in an interview Friday. "It was clear that government support is less forthcoming than before." The main issue is not so much ensuring that banks have access to liquidity but ensuring that their capital bases are maintained, Mr. Wassenberg added.

Investors have been bracing for the downgrades since February, when the Moody's Corp. unit said it would review the ratings of more than 100 banks around the world. U.S. bank stocks rose in after-hours trading Thursday, after Moody's announced the downgrades. The gains followed a broad-based selloff that saw the Dow Jones Industrial Average fall 250.82 points to 12573.57.

Still, it is the first time that Moody's has imposed a sweeping downgrade of banks since 2007. The downgrades target banks with big trading operations, some of which—like Bank of America and J.P. Morgan—also deal directly with consumers.

Rating Europe's Banks
Moody's Investors Service has been reviewing the credit ratings of more than 100 European banks for possible downgrade. Track Moody's long-term debt ratings for the largest of these banks.

**Riskier Business: Ratings Since the Crisis**

Five big U.S. banks have seen their ratings fall since the financial crisis, as investors and rating companies have reassessed the soundness of giant financial companies with big trading arms.

The downgrades come as unease plagues global markets. Many investors have been skeptical of banks' capacity to withstand an economic downturn or market shock tied to the European debt crisis.

Concerns like these have widened in recent weeks amid signs that Greece may exit the euro zone and that economic growth is slowing in the U.S. and China.

The banks have spent the past couple of months playing down the potential effect of a downgrade. They have said they are more robustly capitalized and have more cash on hand than they did in the financial crisis of 2008.

Policy makers also have moved to minimize any funding-market impact.

A liquidity program announced last week by the Bank of England was in part an effort to make sure U.K. banks would continue to have access to funding.

In addition to cutting Morgan Stanley's long-term rating by two notches, Moody's also reduced long-term ratings by two levels at Goldman Sachs Group Inc., GS -2.74% J.P. Morgan Chase & Co. and Citigroup Inc. C -3.70%
Moody's Investors Service cut Morgan Stanley's long-term debt rating by two notches.

"While Moody's revised ratings are better than its initial guidance of up to three notches, we believe the ratings still do not fully reflect the key strategic actions we have taken," Morgan Stanley said in a statement. Despite the two-notch cut, Morgan Stanley kept a higher rating than Bank of America and Citigroup.

Citigroup said it "strongly disagrees with Moody's analysis of the banking industry and firmly believes its downgrade of Citi is arbitrary and completely unwarranted."

The New York-based bank also said Moody's hadn't taken into account the company's recent improvements, calling the rating firm's approach "backward-looking."

Bank of America Corp.'s long-term debt was downgraded by one notch. Ratings at Wells Fargo WFC -1.43% & Co., which has a smaller investment-banking operation, weren't reviewed.

In a statement, Bank of America said, "We have significant liquidity and resources to serve clients and customers."

A spokesman for J.P. Morgan declined to comment on the move.

Goldman didn't comment specifically on the downgrade, saying "we believe our strong credit profile and unique mix of attractive, high-return businesses with an institutional client focus will continue to serve our shareholders, creditors and clients well."

Moody's previously downgraded lenders in Spain, Italy and Germany.

On Thursday, it also cut the ratings of giant European banks with substantial trading operations, specifically Deutsche Bank AG, Barclays BCS -4.02% PLC, HSBC Holdings HBC -2.52% PLC, Credit Suisse Group AG, Royal Bank of Scotland Group PLC, BNP Paribas, Credit Agricole SA, ACA.FR +1.59% Société Générale and UBS UBS -3.16% AG. Moody's also downgraded Royal Bank of Canada RY -4.15%.

Credit Suisse was alone in having its rating cut by three notches. Credit Suisse said in a statement the downgrade would have "no material impact on the bank's liquidity and funding planning."
Credit Suisse and UBS both said Friday the downgrades would have no "material impact" on their liquidity and funding planning. In the U.K. Lloyds Banking Group LYG -3.09% PLC said that its one notch downgrade would have limited impact on the bank's funding costs and market capacity.

Shares of big banks have been rattled this year by questions about their outlook along with self-inflicted wounds such as J.P. Morgan's $2-billion-plus trading loss that was disclosed in May.

Each of the five big U.S. financial firms hit in Thursday's downgrade has shed at least 10% of its market value over the past year and trades at a fraction of its reported book value, or net worth.

The cost of protecting debt issued by the top U.S. banks against default via insurance-like contracts called credit-default swaps has more than doubled since February 2011, showing that investors perceive significantly higher risk in lending to these companies.

Revenue at the five large U.S. financial firms hit by the downgrades tumbled 11% in 2011 from a year earlier, to $330.26 billion. Net income at the firms rose 2.1% over the same period, to $40.61 billion.

The prospect of downgrades prompted a lobbying campaign by banks seeking to persuade Moody's that their finances are sufficiently strong to justify their current grades. The companies have publicly estimated some direct costs of a downgrade, measured in additional collateral they would have to post or termination payments they would make.

Morgan Stanley said in its first-quarter report to regulators that a downgrade by major ratings firms to the level where Moody's moved the debt on Thursday could cost $6.7 billion in various one-time collateral and termination payments to trading partners, while Goldman Sachs said its costs could hit $2.2 billion for a two-notch reduction.

Bank of America said a one-notch downgrade could deliver a $2.7 billion hit.
But the biggest effect of the downgrade could be to deprive some firms of trading revenue. Trading partners are expected to seek out higher-rated banks because of their perceived safety.

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A version of this article appeared June 22, 2012, on page A1 in the U.S. edition of The Wall Street Journal, with the headline: Ratings Cut for Giant Banks.