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Activists Back Away From Bank Surgery

The conspicuous absence of an activist investor in Europe's banks is a warning to other investors that the industry is still toxic to shareholders -- years after the credit crisis.

SHARES DROP

Yet bank boards are more in need than ever of the sort of pressure activists bring to implement the kind of surgery that could improve sentiment.

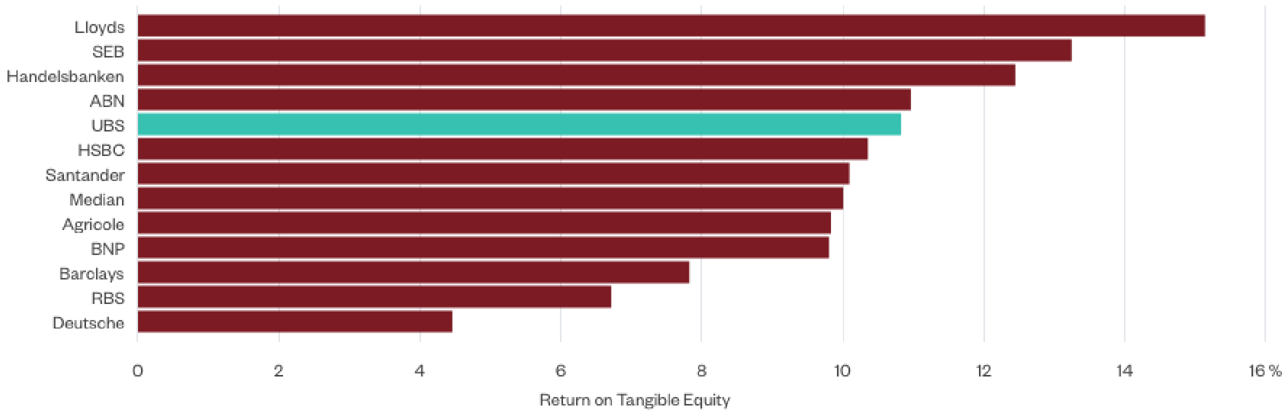
Eric Knight said yesterday his firm sold its stake in Swiss lender UBS at the end of last year. Knight Vinke spent almost three years pushing UBS's managers to spin off its ailing investment bank. But the idea gained little traction from other shareholders -- and other banks have been reluctant to implement the idea themselves.

There have been plenty of calls from other quarters for mergers or restructuring -- Sanford C. Bernstein analysts this month wrote an open letter calling on Barclays's CEO to spin off its investment-bank -- but concerted activist campaigns have been thin on the ground and now clearly getting thinner.

Granted, UBS hasn't sat still since 2013: the bank took the bold and early decision to pare back its fixed-income operation and shift more capital to its wealth management operation. And Knight is unlikely to see his campaign as a failure after exiting his position at "approximately double" the price his firm paid. After all, activist funds have clients to think about; a battle half-won is better than a Pyrrhic victory.

Better Returns

UBS's return on tangible equity is better than most of its peers

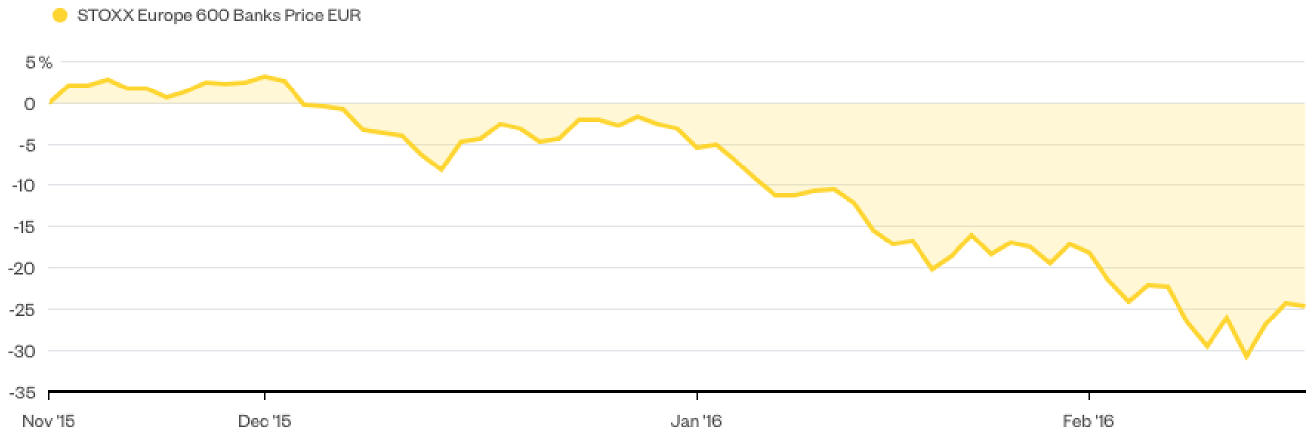


Source: Bloomberg Intelligence

But the exit, along with Knight's reiteration of its concerns about UBS's continued exposure to investment banking, underlines just how challenging it will be to get Europe's banking industry to make radical change -- even in an environment where market jitters are mounting.

Banks Battered

Shares of European lenders have dropped 23% in the past three months



Source: Bloomberg

So why aren't more activists picking on Europe's banks?

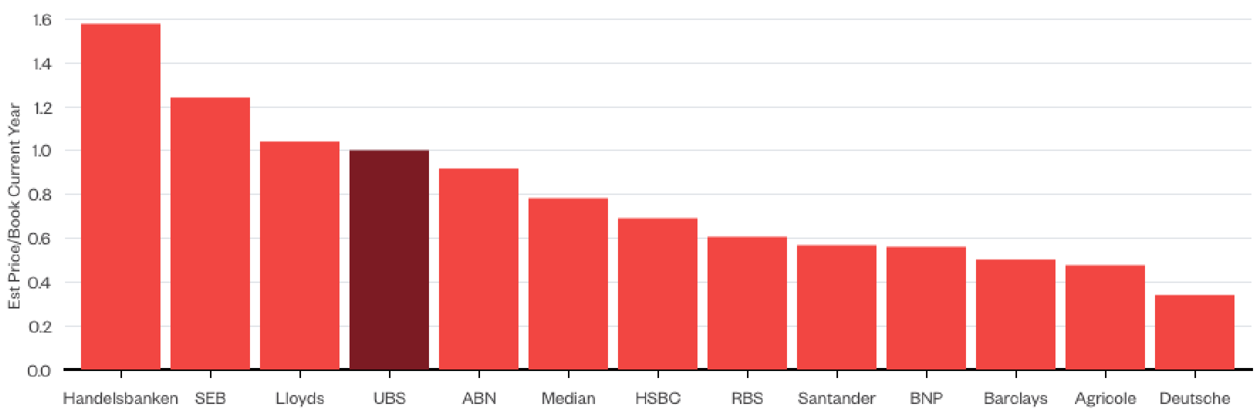
The first problem is that it's not really clear who is in control of the Europe's financial industry -- is it directors, shareholders, national regulators, governments or the European Central Bank? Even if you write the most convincing letter to the board of directors, the final sign-off on any big restructuring or strategy change will have to come from the regulator.

Even if your proposals get traction, any gains from the stock could be wiped out by economic factors beyond your control that disproportionately hit banks. The recent battering European banks took is a good example of why Knight's exit was shrewdly timed. Is the sell-off a re-pricing of risk after years of artificially inflated asset values? Is it fear of an implosion of loan quality to the oil and gas sector? Is it just a natural response to the prospect of recession? In any case, Knight was right not to stick around to find out whether the sell-off was justified.

For any activist, the biggest issue when investing in a bank is their sheer complexity. As an investor, can you be sure about the valuation of a bank? Most European ones trade below book value, a sign shareholders most certainly aren't.

Below Book

Most European banks trade for less than their book value



Source: Bloomberg Intelligence

It will take radical surgery to help get European banks out of their rut. There will be pain. Activists clearly recognize the risks and complexity of the procedure are too great -- even for them. That should be a warning for other investors.

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