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Asset Management

US Bank Stress Tests: Continued Good Health

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The recently released annual Dodd-Frank Act Stress Test (DFAST) and Comprehensive Capital Analysis and Review (CCAR), which stress test large US banks' controls, credit and markets risks, and capital bases, once again demonstrated that these institutions are robustly positioned and capitalized. The CCAR test is the more important of the two, as it incorporates banks' requested dividends and stock buybacks over the coming four quarters, and determines the banks' permitted levels of equity payouts. Of the 34 banks subject to CCAR, only one (Capital One) had a conditional non-objection from regulators. While its capital plan was approved, the bank "exhibited material weaknesses in its capital planning practices" and it will need to resubmit its capital plan before the end of 2017. All banks with greater than $50 billion in assets are subject to the DFAST and CCAR quantitative stress test, which puts them through a Depression-like scenario, though only banks with greater than $250 billion in assets are subject to a qualitative review under CCAR.

Spectrum notes that Capital One and American Express had to take a "mulligan", under which they were able to resubmit and reduce their capital plans before final results were issued. We further note that these two firms, plus Ally Financial, had some of the lowest (albeit still fully compliant) stressed common equity tier 1 (CET1) capital ratios of the banks tested. This likely reflects their relatively non-diversified (credit cards for American Express and Capital One, auto loans for Ally) business models. Furthermore, Morgan Stanley and Goldman Sachs experienced the largest relative declines in their stressed CET1 ratios of the banks tested, likely reflecting their investment banking and securities trading focus.

Total approved payouts – dividends and stock repurchases – for the coming four quarters average 100%, with some banks' payouts being substantially over 100% of expected earnings. This average payout level is above last year's, which was in the ~mid-80%. Spectrum does not see this high payout level as a concern, given the banks' continued solid post-stress-test capital bases, and overall healthy earnings.

Spectrum views the DFAST and CCAR stress test results as confirming the strength of the large US banks. We also expect this strength to be maintained, though credit costs will likely rise as the credit cycle normalizes.

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