SPECTRUM
Asset Management

US Banks: Good Showing on CCAR

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All but one of the large US banks (which includes US-based foreign-owned banks) subject to the annual Comprehensive Capital Analysis and Review (CCAR) exam by the Federal Reserve passed. CCAR is the most important regulatory test for large US banks. **Spectrum views the CCAR results positively, as they signify the continued robustness of major US banks.** Deutsche Bank's US subsidiary is the one bank that failed to pass CCAR. It failed on qualitative grounds, based on "widespread and critical deficiencies across the firm's capital planning process," among other problems, including risk management and internal audit.

CCAR incorporates a quantitative test based on economic and similar stresses, and a qualitative test that focuses on risk controls and capital planning.

> *The quantitative test is based on the Dodd-Frank Act Stress Test – DFAST – which was run last week. This is the fourth consecutive year in which all tested banks passed DFAST. However, DFAST assumes that dividends do not change and there are no stock buybacks or issuances. Under CCAR, banks incorporate new dividend plans, as well as hoped-for net stock buybacks and business plan changes. Thus, CCAR governs capital returns for large banks.*

There was concern that Wells Fargo could experience some qualitative objections related to its retail sales practices difficulties, but that did not happen, which is encouraging.

That said, the Fed had issues with certain banks. The Fed issued a conditional non-objection to the capital plan of State Street, based on "management and analysis of its counterparty exposures under stress" and the bank will need to address these factors. Conditional non-objections were also issued to Goldman Sachs and Morgan Stanley on quantitative grounds, and these two banks will have to limit their capital distributions. In addition, under the severely adverse stress scenario, American Express, JPMorgan Chase, KeyCorp and M&T Bank Corporation all tripped at least one minimum capital ratio based on planned capital actions. The banks resubmitted reduced capital plans, and passed. This is known as "taking the Mulligan," and is common.

In summary, the 2018 CCAR results help confirm the strong capital bases and risk management faculties of the large US banks. Despite recent legislative changes [see Spectrum's May 25, 2018 report] that eased regulations for smaller US banks, Spectrum believes that the broad set of prudential standards imposed post-Crisis will remain, as will banks' own greater sensitivity to strong risk management. These factors should provide ongoing support for large US banks' creditworthiness.

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