

US Bank Stress Test 2021

Strength Across the Board

June 25, 2021

All 23 large US banks that underwent the Federal Reserve’s annual stress test “remained well above their risk-based minimum capital requirements,” according to the Fed. Given these strong results, the Fed is lifting its COVID-era restrictions on these banks’ capital returns, which had been limited to the average level of net income over the prior four quarters. They are now subject to the normal restrictions of the Fed’s prudential capital framework.

"Over the past year, the Federal Reserve has run three stress tests with several different hypothetical recessions and all have confirmed that the banking system is strongly positioned to support the ongoing recovery," says the Fed’s Vice Chair for Supervision Randal K. Quarles.

Under the 2021 stress test – known as DFAST, or the Dodd-Frank Act Stress Test – the 23 large banks tested would, in aggregate, lose more than \$470 billion, with around one-third of that loss stemming from bad commercial real estate and corporate loans. However, even with such losses, their common equity tier 1 (CET1) capital ratios would decline 2.4% to a still healthy 10.6%, which is more than double their minimum requirements under the Fed’s rules.

The DFAST Stress Test is a key determinant of these banks’ Stress Capital Buffer (SCB) – an important input in the Fed’s ongoing prudential capital supervision of US banks. It works this way. The banks have a minimum CET1 capital requirement of 4.5%. Added to this is a 2.5% Capital Conservation Buffer, and a Countercyclical Capital Buffer – now set at 0%, but regulators can change this as their judgment dictates. In addition, Systemically Important Financial Institutions (SIFIs) have an additional capital requirement that varies by bank and is adjusted periodically. Added to these capital requirements is the SCB, which is calculated as the difference between a bank’s YE20 CET1 capital level and the projected minimum CET1 level under the DFAST stress test, less an estimate of four quarters of dividends as a percentage of risk-weighted assets. The minimum SCB level is 2.5% but can be higher depending on each bank’s calculation.

Spectrum is encouraged by these strong stress test results, which confirm our view that the large US banks remain in excellent condition, and are well placed to continue to service their preferred dividends and support the US economy.

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