Federal Reserve Corrects Dodd-Frank Stress Test
Even Afterwards, Test Show Big Bank Strength

A SNL Financial Feature

Even after the Federal Reserve tweaked the results to address errors, Dodd-Frank Act stress tests revealed what most on the Street anticipated: Robust capital remains not just a priority but an established strength that should help the nation's top lenders, as a group, weather another economic downturn.

The Fed on March 20 released the initial results of annual Dodd-Frank stress tests of bank holding companies with $50 billion or more in assets. Results showed that the vast majority of the industry's big players could withstand the shock of another steep recession — one in which unemployment spikes to above 11%, housing prices fall 25% and equity prices plunge nearly 50%. That was the worst-case scenario under which 30 large banking companies conducted stress tests, 12 more than in 2013.

On March 21, the Fed issued a correction to those results, noting changes to some banks' minimum, post-stress Tier 1 common capital ratios in the severely adverse scenario. The Fed followed this with a fully corrected version of the results on March 24.

Among other changes, the Fed said the 30 companies subject to the stress test would see their cumulative Tier 1 capital fall $283 billion, compared to the initially reported $286 billion, under its nine-quarter severely adverse scenario beginning in the fourth quarter of 2013. The Fed also made a "minor technical correction" to Tier 2 capital.

The results show that all but one of the 30 banks— Zions Bancorp. — would have ample capital to survive the exceptionally poor economic conditions and continue to lend. Banks needed to show that even under the hypothetical worst-case conditions outlined by the Fed they would have a Tier 1 common capital ratio above 5%. Over the course of the severely adverse scenario the 30 banking companies would collectively suffer $366 billion in total loan losses. The aggregate Tier 1 common capital ratio would drop from the actual 11.5% in the third quarter of 2013 to a low of 7.6% in the hypothetical scenario. That is well above the 30 firms' actual tier 1 common ratio of 5.5% at the start of 2009, the Fed noted.

"Regulators threw every economic calamity they could think of at our nation's largest banks, and these institutions once again proved their ability to handle even the most extreme financial distress," Frank Keating, president and CEO of the American Bankers Association, said in a statement following the release of the results. "This should allow more institutions to proceed with their business plans, paying dividends, attracting investor capital and expanding services to their customers and communities."

Full Story with Charts:
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