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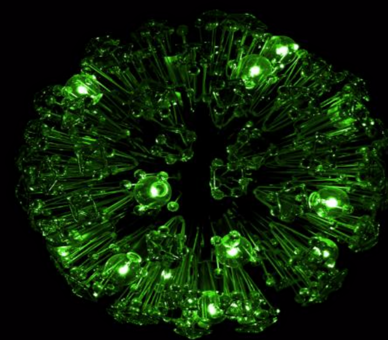
December 2020 Stress Test

Results summary and highlights



The June 2020 Comprehensive Capital Analysis and Review (CCAR) results published by the Federal Reserve Board (FRB) found that the 33 large firms subject to CCAR were well capitalized under a range of hypothetical adverse scenarios published by the FRB in February 2020[1]. Based on incremental sensitivity analysis several firms were found to be close to required minimum capital levels. Given this sensitivity and the ongoing pandemic the FRB promptly restricted certain capital actions and instructed firms to resubmit their capital plans by end of the year. The subsequent second round of stress tests incorporated two hypothetical adverse economic scenarios released in September 2020; a Severely Adverse scenario and an Alternate Severe scenario, which had a relatively less severe initial decline in global economic activity but a more sluggish recovery. Results for the most recent stress tests of the 33 CCAR firms were published by the FRB on December 18, 2020.

Key highlights from December 2020 Stress Tests

Overall, the results published by the FRB and their accompanying actions indicate they are attempting to find equilibrium between the results of the most recent analysis and the broader lack of clarity on the path of the pandemic and its impact on the overall economy:

Banks have demonstrated financial resilience. Banks maintained strong capital levels under both hypothetical scenarios covering severe stress in the post-COVID landscape in part due to pullback in dividends and the suspension of share repurchases. In addition, Q1 and Q2 of 2020 witnessed a significant increase in loan loss reserves, which served to offset higher losses under the December 2020 stress scenarios.

Capital restrictions have been extended and modified. The FRB extended limits on capital distribution until Q1 2021, however both dividends and share repurchase have been allowed for Q1 based on certain criteria[1].

Uncertainty remains on Stressed Capital Buffer. The FRB opted not to recalculate stress capital buffer requirements for the time being due to continuing economic uncertainty but have left open the possibility of future changes and will notify specific firms by March 31st, 2021 if requirements are to be recalculated.

FRB results and actions reflect a balance between current capital resiliency and continued caution in light of uncertainty

All 33 banks maintained strong capital levels under both Fed stress scenarios

FRB has modified and extended capital distribution restrictions through Q1 2021

FRB also extended the option to potentially recalculate stress capital buffer requirements through Q1 2021

[1] Provided the firm's capital ratio is above the total capital requirement, it can pay common stock dividends and make share repurchases that, in the aggregate, do not exceed average of the firm's net income for the preceding four calendar quarters (for ICHs, FBR references Q2,Q3,Q4 2020 and Q1 2021). The payout cannot be larger than the payout in Q2 2020. It can make share repurchases that equal the amount of share issuances related to expensed employee compensation as well as redeem and make scheduled payments on additional tier 1 and tier 2 capital instruments. (Source: December 2020 Stress Test Results)

While the firms cleared the stress tests, the FRB continues to exercise caution as the uncertain and rapidly evolving nature of the pandemic, and resulting impacts on the economy and banks' performance, makes it clear that the financial services industry is still in uncharted territory. Even with the development of vaccines, there continues to be uncertainty around distribution and adoption which could continue to impact the economy over the next several quarters. Looking forward to 2021, the FRB could consider including additional alternative pandemic-sensitive scenarios in the next round of stress tests that will allow the FRB to evaluate various stressors across different timelines. Depending on how the pandemic unfolds over the next several months, the FRB could possibly further tighten capital distribution or increase stress capital buffer to maintain stability.

Summary of results from FRB's severely adverse scenario

Key ratios at an aggregate level

The December 2020 stress test results indicate that despite starting from a recessionary period, the CCAR banks in aggregate appeared to be adequately capitalized to withstand additional stress in the economy, though some fared better than other in terms of the level of cushion above the regulatory minimums exhibited.

	Severely Adverse Scenario	Aggregate Results and Buffers over Minimum (%)			
		Actual Q2 2020	Stress Minimum	Minimum Required	Buffer Over Minimum
Ratio	Common Equity Tier 1 Ratio	12.20	9.60	4.50	5.10
	Tier 1 Risk-Based Capital Ratio	13.80	11.30	6.00	5.30
	Total Risk-Based Capital Ratio	16.40	14.00	8.00	6.00
	Tier 1 Leverage Ratio	7.90	6.40	4.00	2.40
	Supplementary Leverage Ratio	7.40	5.20	3.00	2.20

Source: Dodd-Frank Act Supervisory Stress Test Results, June 2020 and December 2020

The scenarios in December 2020 stress tests incorporated increased stress in the economy post COVID and this resulted in lower aggregate capital ratios compared to the June 2020 results. The decline was more pronounced in the leverage ratios compared to more risk sensitive capital ratios potentially indicative of banks shoring up their balance sheets with safer assets.

	Severely Adverse Scenario	Capital Ratios (%)		
		June 2020	December 2020	Change
Ratio	Common Equity Tier 1 Ratio	9.90	9.60	(0.30)
	Tier 1 Risk-Based Capital Ratio	11.40	11.30	(0.10)
	Total Risk-Based Capital Ratio	14.10	14.00	(0.10)
	Tier 1 Leverage Ratio	7.10	6.40	(0.70)
	Supplementary Leverage Ratio	5.60	5.20	(0.40)

Source: Dodd-Frank Act Supervisory Stress Test Results, June 2020 and December 2020

Severely adverse scenario

December 2020 Severely adverse scenario includes severe decline in economic activity as evidenced by decline in GDP growth rates and spike in unemployment rates followed by financial market stress. Over the duration of the scenario, short term interest rates are lower. The scenario includes a larger amount of stress in the economy compared to the June 2020 scenario to factor in the impact of the pandemic.

	Severely Adverse Scenario	Peak/Trough Stressed Scenario (%)			
		June 2020		December 2020	
		Peak	Trough	Peak	Trough
Metric	Real GDP Growth	4.7	-9.9	24	-5.9
	Unemployment Rate	10	4.5	12.5	7.6
	U.S. Market Volatility Index	70	20	70	26.5
	U.S.BBB Corporate Yield	6.6	3.7	6.1	2.1
	House Price Index	205	153	220	161

Source: Dodd-Frank Act Supervisory Stress Test Scenarios, February 2020 and September 2020

Loan loss rates

Loan loss rates for the banks generally increased for the December 2020 scenarios as compared to June 2020 scenarios. C&I loans and credit cards form the largest loss categories in dollar terms, and the stress may reflect high correlation with credit spreads and unemployment rates

Severely Adverse Scenario		Loan Loss Percentage (%)		
		June 2020	December 2020	Change
Loan Type	Total Loan Losses	6.30	7.70	1.40
	First Lien Mortgages	1.50	2.10	0.60
	Junior Liens and HELOC	3.10	3.10	0.00
	C&I	7.20	7.50	0.30
	CRE	6.30	12.60	6.30
	Credit Cards	17.10	22.30	5.20
	Other Consumer	6.50	6.40	(0.10)
	Other Loans	3.60	4.00	0.40

Source: Dodd-Frank Act Supervisory Stress Test Results, June 2020 and December 2020

Pre-Provision Net Revenue (PPNR)

The reduction of PPNR compared to the June results is partly attributed to the flatter yield curve, resulting in reduced net interest margins. The impact levels to PPNR varied widely across firms, with a handful of firms showing improvements.

	June 2020	December 2020	Change
PPNR as % of Average Assets in Severely Adverse Scenario	2.60	2.00	(0.60)

Source: Dodd-Frank Act Supervisory Stress Test Results, June 2020 and December 2020

Global market shock and counterparty losses

Global Market Shock applied to the 11 firms with large trading and equity positions, and largest counterparty default scenario applied to 13 firms resulted in losses ranging from $0.9Bn to $23Bn[Error! Bookmark not defined.1]

	June 2020	December 2020	Change
Losses in Severely Adverse Scenario (in $ Billions)	83.20	95.10	11.90

Source: Dodd-Frank Act Supervisory Stress Test Results, June 2020 and December 2020

Growth in forecasted risk-weighted assets (RWAs) moderated, reducing pressure on ratios

Marginal increase in the risk-weighted assets, coupled with timely access to capital markets have allowed banks to maintain their stressed capital ratios well over regulatory minimums

	June 2020	December 2020	Change
Projected RWAs in Severely Adverse Scenario (in $ Billions)	10,256	10,272	16

Source: Dodd-Frank Act Supervisory Stress Test Results, June 2020 and December 2020

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Sources of data utilized within this document from the Board of Governors of the Federal Reserve System and FFIEC are listed below.

1. December 2020 Stress Test Results: https://www.federalreserve.gov/publications/files/2020-dec-stress-test-results-20201218.pdf
2. Dodd-Frank Act Stress Test 2020: Supervisory Stress Test Results, June 2020: https://www.federalreserve.gov/publications/files/2020-dfast-results-20200625.pdf
3. Assessment of Bank Capital during the Recent Coronavirus Event, June 2020: https://www.federalreserve.gov/publications/files/2020-sensitivity-analysis-20200625.pdf
4. Supervisory Scenarios for the Resubmission of Capital Plans in the Fourth Quarter of 2020, September 2020: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200917a1.pdf
5. 2020 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule, February 2020: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200206a1.pdf