



Dodd-Frank Act Stress Test (DFAST) Results June 2023

June 29, 2023

Exhibiting strength while remaining focused on regulatory change and challenging economic conditions

The Federal Reserve Board (FRB) released the results of the latest Dodd-Frank Stress Test (DFAST) on June 28, 2023.¹ All 23 banks subject to the stress test stayed above their minimum capital requirements in the stress scenario, even with aggregated projection of \$541 billion in losses under the hypothetical severe downturn where the banks had more than twice the amount of minimum capital required. While the banks remain strong under the stress scenario, it is important to note that banks should remain vigilant to the evolving economic conditions (e.g., commercial real estate (CRE) portfolio risks, interest rate volatility). Banks are expected to gauge capital actions based on their stress capital buffers and the expected impacts of new Basel III requirements.

2023 stress test scenarios

This year, stress tests evaluated the capital planning processes and adequacies of 23 large banks with total consolidated assets of more than \$250 billion. The stress scenario for this year includes severe global recession, with prolonged declines in both residential and commercial real estate prices, which spill over into the corporate sector and affect investment sentiment. Key components of the severely adverse stress scenario are noted below²:

- US unemployment rate rising to a peak of 10%
- Housing prices collapsing by 38%
- Commercial real estate prices declining by 40%
- Corporate bond spreads widening
- Equity prices collapsing by 45%
- Real gross domestic product (GDP) declining by 8.75% from Q4 2022 before recovering throughout 2023
- Consumer price index (CPI) inflation dipping by two percentage points

The FRB also conducted an exploratory market shock on the trading books of eight global systemically important banks (G-SIBs), testing them against greater inflationary pressures and rising interest rates.



Results at a glance

- Despite having a healthier economic baseline and challenging test scenario, all 23 banks did well in this year's tests
- Compared to 2022, the key variables had a higher degree of stress
- The results of the newly added exploratory market shock showed that all eight G-SIBs are resilient to the rising rate environment
- Banks are expected to share formal announcements on their capital actions post market close on Friday (June 30th)
- Banks are likely to gauge capital actions based on increased stress capital buffers, the expectation of new Basel III requirements, and possibilities of a recession³

Key highlights from the June 2023 stress test results⁴

Aggregate loan losses were lower relative to last year's scenario. Most of the hypothetical \$541 billion in losses came from \$424 billion in loan losses and \$94 billion in trading and counterparty losses.

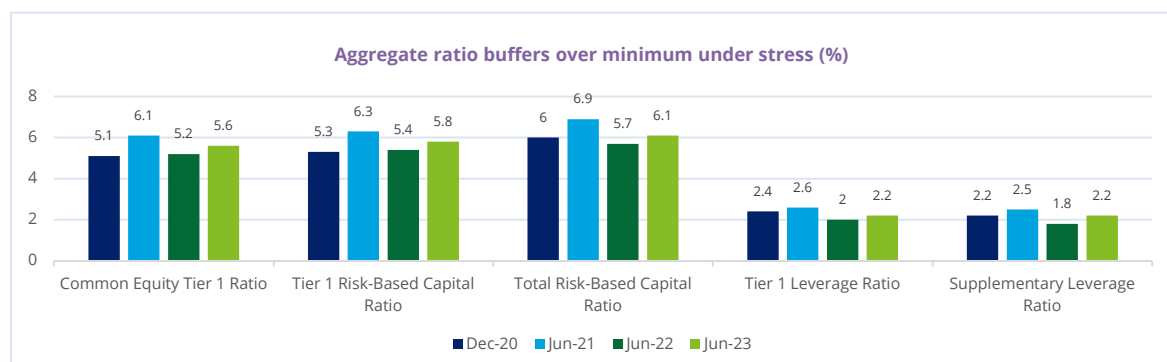
Overall, banks continued to show resilience, withstanding a tougher severely adverse scenario than 2022. On aggregate, the banks maintained a significant cushion against losses showing:

- A projected decline in aggregate Common Equity Tier 1 (CET1) ratio by 2.3 percentage points to a minimum of 10.1%, which is more than twice the minimum required of 4.5%, showing the ability for continued operations
- A reduction in aggregated total capital ratio by 2% to a minimum of 14.1%, which is comfortably above the minimum 8% required, suggesting banks are well capitalized
- The newly added exploratory shock test results demonstrated that the largest banks' trading books were resilient to the rising rate environment

Key ratios at an aggregated level

The June 2023 stress test results indicate that the banks, in aggregate, appeared adequately capitalized and able to absorb \$541 billion in losses. All key capital ratios—Common Equity Tier 1, Tier 1 Risk-Based Capital, Total Risk-Based Capital, Tier 1 Leverage, and Supplementary Leverage ratios—showed an increase compared to the June 2022 results.

Severely adverse scenario		Aggregate results and cushion over minimum (%)			
		Actual Q4 2022	Stress minimum	Minimum required	Cushion over minimum
Ratio	Common Equity Tier 1 (CET1)	12.4	10.1	4.5	5.6
	Tier 1 Risk-Based Capital	14.1	11.8	6	5.8
	Total Risk-Based Capital	16.1	14.1	8	6.1
	Tier 1 Leverage	7.5	6.2	4	2.2
	Supplementary Leverage	6.3	5.2	3	2.2



Although, this year's stress tests results have shown that the US banking industry is strong, banks should continue to evaluate evolving economic conditions including regional commercial real estate exposure affected by lingering office vacancies, rising interest rate environment, labor market and inflationary risks. Given the possibility of a recession and shifting regulatory expectations, banks should be thoughtful with respect to overall capital management and capital action plans. The potential impact from deteriorating CRE portfolios along with a somewhat adverse interest rate environment could make next year more challenging for the banks.

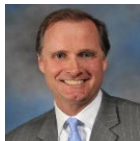
Endnotes

- 1 Board of Governors of the Federal Reserve System (FRB), "[Federal Reserve Board releases results of annual bank stress test, which demonstrates that large banks are well positioned to weather a severe recession and continue to lend to households and businesses even during a severe recession](#)" press release, June 28, 2023.
- 2 FRB, "[Federal Reserve Board releases hypothetical scenarios for its 2023 bank stress tests](#)," press release, February 09, 2023; and, FRB, "[2023 Stress Test Scenarios](#)," Dodd-Frank Act Stress Test Publications, February 22, 2023.
- 3 FRB, "[Why Bank Capital Matters](#)," speech by Vice Chair for Supervision Michael S. Barr, December 01, 2022.
- 4 FRB, "[2023 Federal Reserve Stress Test Results](#)," June 28, 2023.

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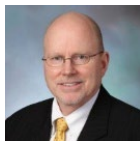
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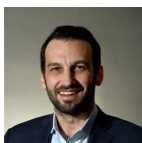
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