ANALYST QUICK NOTES

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Federal Reserve Announces Results of 2017 Bank Stress Tests
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Bank Stress Test Results for 2017:

- On June 22, the Federal Reserve announced the results of the 2017 Bank Stress Tests conducted under the Dodd-Frank Act. The stress testing is a quantitative evaluation of the impact of stressful economic and financial market conditions on the capital of bank holding companies. After incorporating banks planned capital actions, including for dividends and share buybacks, the stress test are also used for the quantitative assessment in the Comprehensive Capital Analysis and Review (CCAR). Bank holding companies with $50 billion or more in total assets are subject to Dodd-Frank stress testing.
- The severe adverse scenario used in this year's stress test included a global recession in which the U.S. unemployment rate more than doubles to 10%, accompanied by a "period of heightened stress in corporate loan markets and commercial real estate markets." Other criteria included consumer price inflation falling to 1.25%, the 10-year Treasury yield declining to 0.75%, equity prices dropping 50%, and residential home prices falling 25%.
- According to the Fed, the 34 bank holding companies subject to the test would experience losses projected at $493 billion under the severe scenario, but in the aggregate could continue lending to businesses and households, which the Fed attributed to the capital buffer built following the 2008/9 financial crisis. Losses included those from loan portfolios, credit impairment on securities held in investment portfolios, and trading/counterparty credit losses from a global market shock.
- For the third year in a row, all banks subject to the stress tests met the Fed's requirements for maintaining capital levels under the parameters, which have become stricter each year.

- With the stress tests rules first adopted in 2012, banks have become better at understanding the rules as well as forecasting potential losses, while also building substantial capital buffers.
- We believe the stress test results bode well for the capital return portion of the Fed’s annual review, which will be announced the week of June 26 and include approvals for dividend and share buyback plans.
- We expect healthy capital return increases for Buy-rated JPMorgan Chase (JPM), Bank of America (BAC), Morgan Stanley (MS), BB&T Corp. (BBT), Capital One Financial (COF), Discover Financial (DFS), and PNC Financial (PNC).
- The favorable results may also provide more support for financial deregulation being advocated by the Trump administration.
- A peaking of capital level requirements and slower growth in regulatory/compliance costs would free capital for lending and allow a greater amount of revenue gains to flow to earnings.