Trepp, LLC

Four Predictions for CCAR 2016

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In the coming days, the Federal Reserve will release the results of its DFAST/CCAR[1] modeling. The results will focus on the impacts of the Severely Adverse supervisory scenario, and will include information about projected credit losses, capital ratio forecasts and whether the Fed has disapproved of any of the individual banks' submissions. The banks themselves will publish their results soon thereafter, by the first week of July. Capital plan information, such as planned dividend increases, will potentially be included with the banks' results.

The 2016 CCAR tests will include the 31 banks that were in CCAR 2015, as well as two additional banks new to CCAR this year, BancWest Corporation and TD Group US Holdings LLC. The timing of the exercise has also been changed. Beginning this year, forecasts will be based on the banks' fourth quarter regulatory filings as the starting point for the analysis, rather than the third quarter in previous rounds of CCAR.

Our key expectations for the results in CCAR 2016 are:

1) Stressed loan losses will increase by an estimated 10% compared to 2015.
2) Estimated losses will increase the most in the C&I, CRE and Credit Card loan categories; they will fall in the Residential loan types.
3) An estimated 20 to 22 firms will receive approval to raise their dividends. The average dividend increase will be in the $0.03 to $0.04 range.
4) At least one firm will receive an objection, most likely on qualitative grounds. Unfortunately, this will still mean that the bank will have to do additional work to satisfy regulators and any planned dividend increases by the bank will be postponed.

Trepp's own analysis relies on output from Trepp's T-CAST (Trepp Capital Adequacy Stress Test) platform for the Severely Adverse supervisory scenario. The T-CAST platform produces comprehensive scenario-based forecasts for DFAST submissions. It includes forecasts for individual bank balance sheets, income & expense, loan losses and capital impacts for banks and bank holding companies. It takes the same economic scenarios used by the Fed for DFAST/CCAR to produce an enterprise-wide picture of individual firms through a 9- or 13-quarter forecast horizon.

[1] DFAST (Dodd-Frank Act Stress Test) and CCAR (Comprehensive Capital Analysis and Review) were both mandated by the Dodd-Frank Act, although CCAR predates the Dodd-Frank Act. The terms refer to different parts of stress testing, though "CCAR" tends to be used more broadly and tends to be used to incorporate DFAST as well.

1) Aggregate Credit Losses

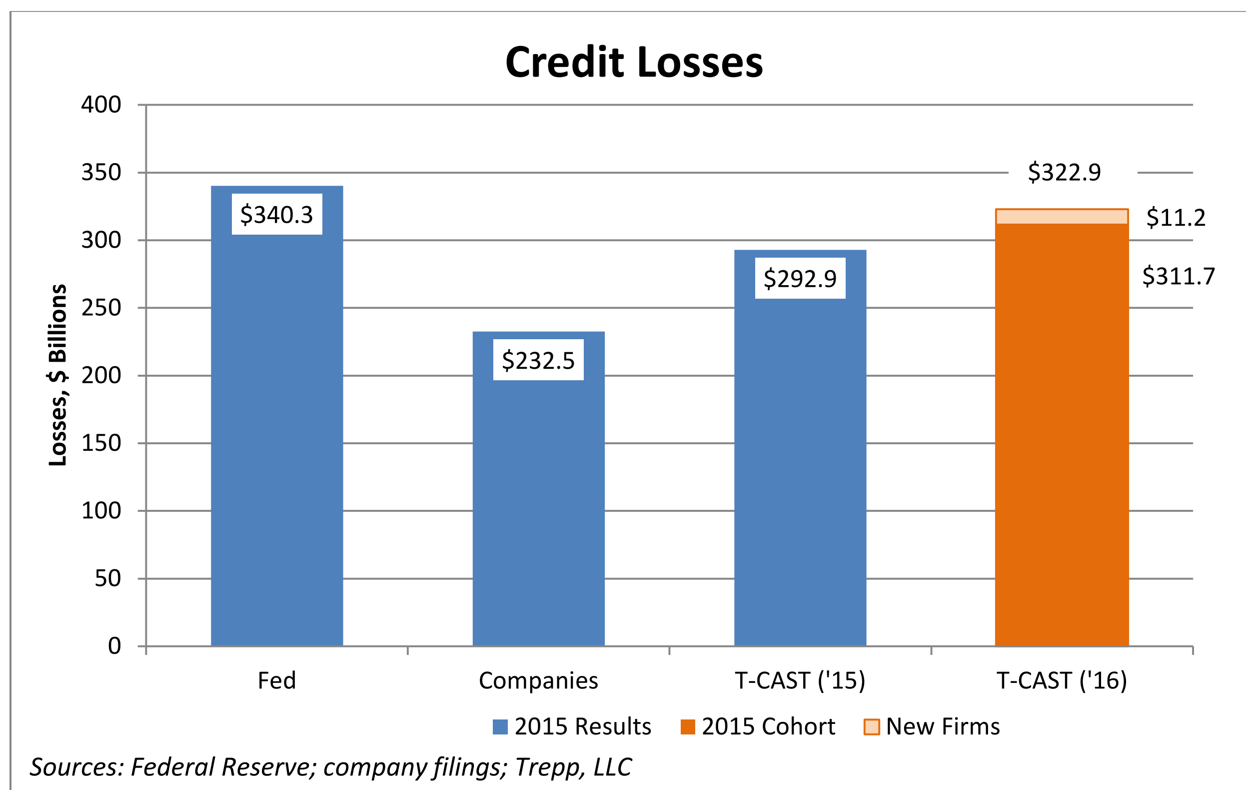
Aggregate loan losses will increase by 10% for the group overall, as compared to the 2015 CCAR results.

For the 33 firms that are part of CCAR this year, Trepp's T-CAST platform forecasts cumulative loan losses of $322.9 billion under the Severely Adverse supervisory scenario. That represents a $30 billion increase from the $292.9 billion in forecasted cumulative losses that T-CAST produced for the banks in the 2015 round of CCAR. After adjusting for the two firms that are new to CCAR this year, cumulative losses for the 31 banks that were part of CCAR last year are expected to increase by $18.8 billion, to $311.7 billion.

Last year, the T-CAST figures for CCAR 2015 fell about midway between the Fed's estimate of $340.3 billion and the companies' own estimates of $232.5 billion.[2]

Part of the increase in forecasted losses this year is due to the expansion in banks' loan portfolios, with total loans outstanding increasing by $322 billion since last year's CCAR exercise. Shifts in individual lenders' portfolios, especially growth in loan types with higher stressed loss rates, such as Credit Card loans, explain another part of the increase (see next section).

Among the 31 banks that were part of CCAR 2015, 25 experienced increases in forecasted losses, while 6 saw a decrease in projected losses. For the banks with increased losses, the average increase was 20.8% and the median increase was 12.5%. For the banks with decreases, the average change as -4.4% and the median was -2.9%.



Sources: Federal Reserve; company filings; Trepp, LLC

[2] For an analysis of CCAR 2015 and a comparison of Trepp's results to the Fed's and the companies', see "Comparison of the 2015 Comprehensive Capital Analysis and Review Stress Test Results by Model," Trepp, LLC; March 2015.

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2) Losses by Loan Type

Estimated losses will increase the most in the C&I, CRE and Credit Card loan categories; they will fall in the Residential loan types.

The largest increases in estimated losses will be in the C&I loan category, with forecasted losses expected to rise by $17.9 billion from the 2015 round of CCAR. This loan category experienced the most growth, with the CCAR banks adding $128 billion of C&I loans to their exposures since the last round of CCAR. The loss rate for C&I loans also increased, with the median loss rate increasing by 39 basis points from last year.

Credit Card loss forecasts will increase by $7.6 billion, a result of both increased exposures, which rose by $44 billion, and loss rates, which rose by a median 10 basis points.

Forecasted CRE loan losses will increase by $7.1 billion. The banks' CRE loan exposures have risen by $74 billion since CCAR 2015 and the loss rate for CRE loans has also increased by a median 40 basis points.

Residential loan loss forecasts will decline. Forecasted losses for Residential Junior Lien Mortgages and HELOCs will fall by $7.5 billion, driven lower by a decline in loan exposures and a drop in the loss rate of 68 basis points. For Residential First Lien Mortgages, the $2.5 billion decline in forecasted losses will be the result of lower loss rates, with an 11 basis point decline from CCAR 2015. Residential First Lien Mortgages outstanding grew by $39 billion.

The changes in the loss rates – both up and down – are the result both of shifts in the scenarios and of credit quality changes during the past year. The Severely Adverse scenario for 2016 CCAR is somewhat harsher from an economic standpoint – for example, GDP declines are larger and the increase in the unemployment rate is greater. But two of the key drivers – home prices and commercial real estate prices – show roughly the same pattern as in the scenarios for CCAR 2015. Credit quality has changed during the last year and residential loan types have improved, with noncurrent loan rates falling by 130 basis points. Over the same period, oil sector woes have help drive C&I defaults higher by 20 basis points.

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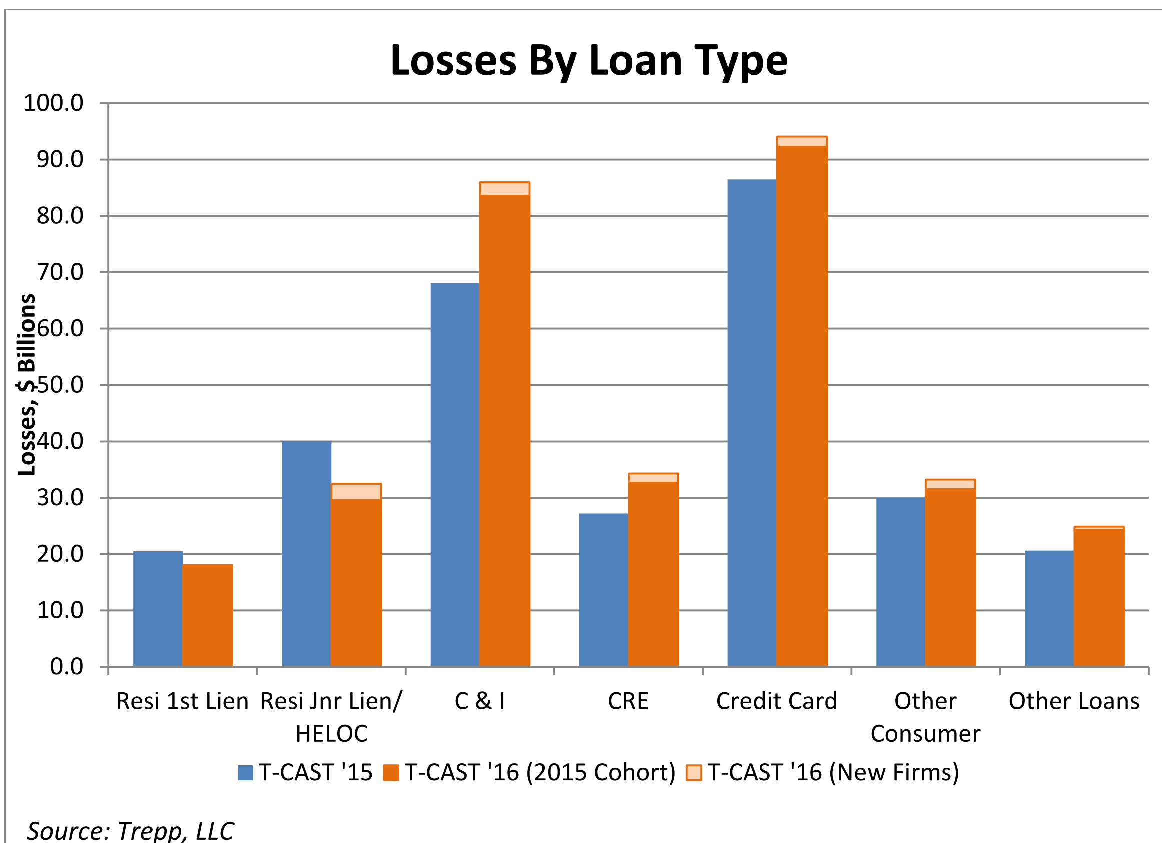
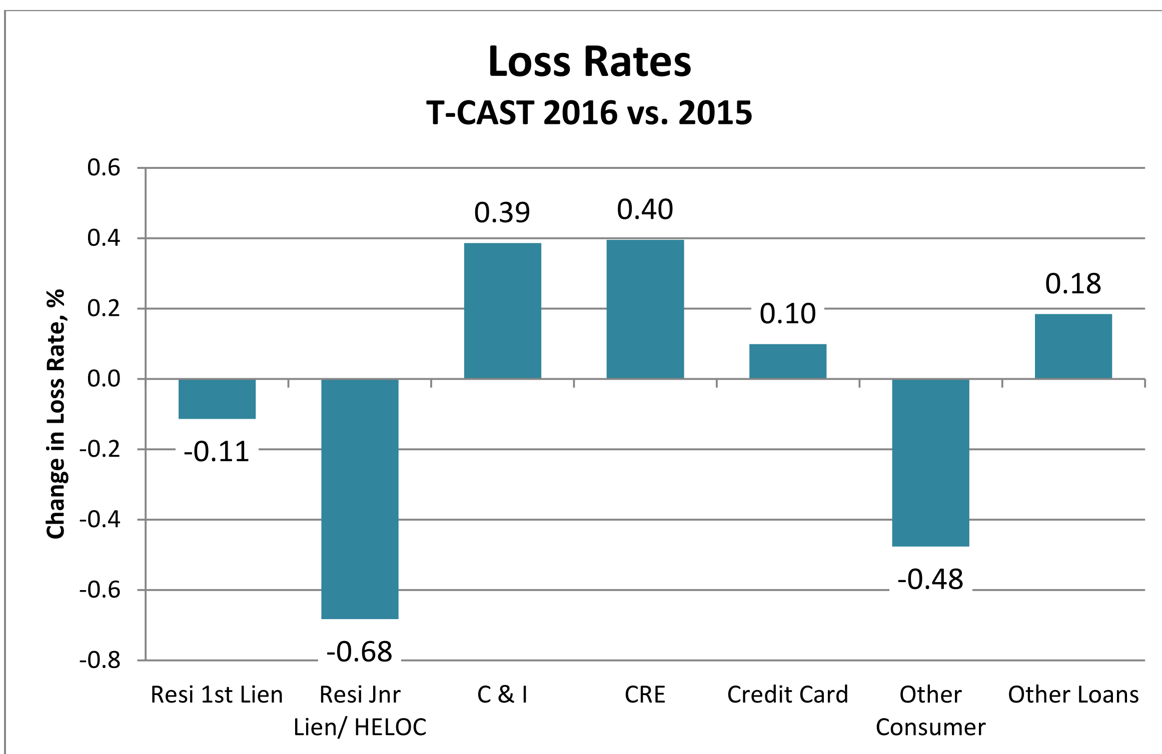

Losses By Loan Type
Losses, $ Billions
100.0
90.0
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Resi 1st Lien
Resi Jnr Lien/ HELOC
C & I
CRE
Credit Card
Other Consumer
Other Loans
T-CAST '15
T-CAST '16 (2015 Cohort)
T-CAST '16 (New Firms)
Source: Trepp, LLC


Loss Rates
T-CAST 2016 vs. 2015
Change in Loss Rate, %
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
-0.8
-0.11
-0.68
0.39
0.40
0.10
-0.48
0.18
Resi 1st Lien
Resi Jnr Lien/ HELOC
C & I
CRE
Credit Card
Other Consumer
Other Loans

3) Dividend Increases

Approximately 20 to 22 (61% to 67%) of the banks will receive approval to raise their dividends.

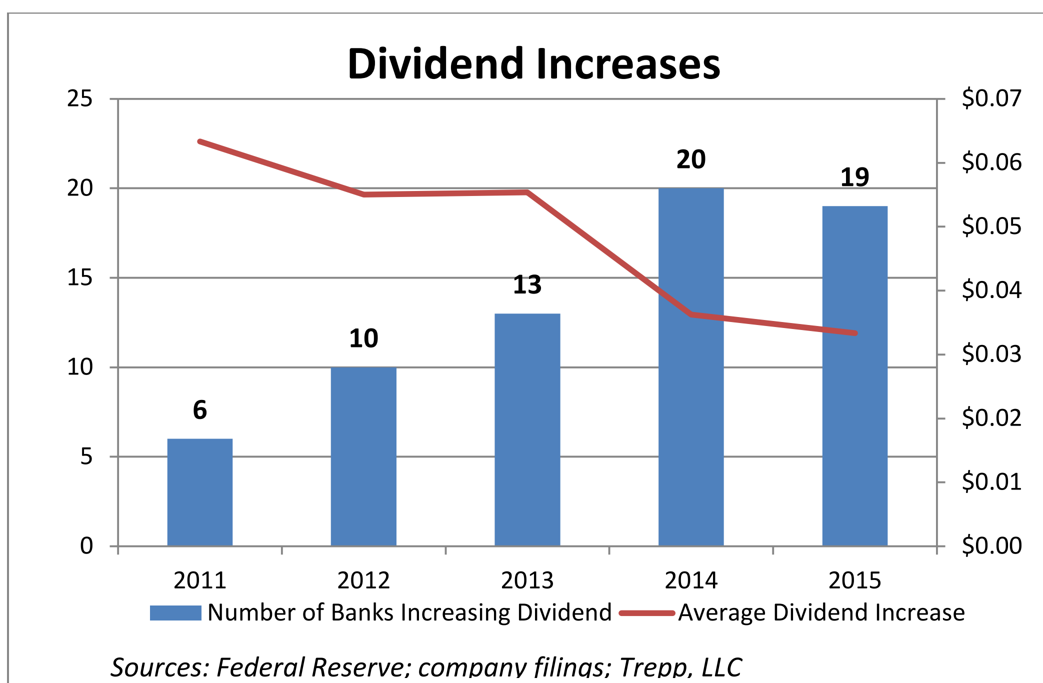
From the banks' perspective, the review of the capital plan and potential dividend increase is one of the most important aspects of the CCAR exercise.[3] For the CCAR banks, dividend increases require the Fed's approval, which is conditional on the CCAR results.

The number of CCAR banks receiving approval to boost dividends jumped to 20 in 2014, the same year that CCAR was expanded to include 30 institutions, an increase of 12 from the prior year. But the proportion actually dropped from 72% to 67%.

In 2015, the number of banks increasing their dividend dipped slightly to 19. With the addition of 1 firm to CCAR that year, the proportion of banks able to grow their dividend slipped to 61%.

This year, we expect 20 to 22 of the banks to receive approval for dividend increases. There are 20 banks with modest payout ratios less than 30%, and 22 banks with payout ratios with still modest payout ratios below 32%.[4]

For firms receiving approval to boost dividends, the average increase will likely be in the $0.03 to $0.04 per share range. The average increase was 3.6 cents per share in 2014 and 3.3 cents per share in 2015. With moderate payout ratios, the banks should have ample room to increase the dividend. However, stressed capital ratios from this year's CCAR exercise will temper the potential increases. Furthermore, expectations for higher capital requirements for the largest banks will also provide a potential drag on dividend increases.



[3] Note: 7 CCAR firms do not currently pay a dividend.

[4] Though it is not stated as a specific criterion for dividend increases, the Fed cited a payout ratio of 30% in its discussion of CCAR bank dividends and room for increases in 2011. See "Comprehensive Capital Analysis and Review: Objectives and Overview," Federal Reserve, March 18, 2011.

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4) Objections and Transparency

We expect at least one firm will receive an objection to its CCAR submission.

The good news is that the objection(s) will likely be on a qualitative (or process) rather than a quantitative (or capital ratio) basis. The bad news is that it will still constitute an objection, which will require the bank to redo and resubmit its results and capital plan. An objection would also delay any dividend increase, if the bank(s) had requested an increase as part of its submitted capital plan.

Regulators have been giving more transparency about the process and results each year since the first round of CCAR in 2011. When the Fed published summary results of CCAR in 2011, it did not give much detail about the results, including whether any banks had failed the tests. Beginning in 2012, it gave more information, including specifics on which banks had passed or failed on a quantitative basis. In 2013, the Fed's disclosure expanded to include whether banks passed or failed on a qualitative basis.

The regulators' objections have shifted from primarily quantitative (i.e., meeting minimum stressed capital ratio thresholds) to primarily qualitative. Quantitative objections have declined from four in 2012 to one in both 2013 and 2014 to none in 2015. Over the same period, qualitative objections have been present each year since they were first released in 2013. Furthermore, qualified passes have increased, with four of the passes in 2015 still requiring additional work or resubmission. In most of these cases, the banks were asking for larger dividend increases than the regulators would approve, so they had to re-submit their capital plans.

The regulators have been giving increasing amounts of transparency since the inception of CCAR in 2011, and the Fed's published results have become more voluminous. Some milestones in the development of CCAR are summarized here:

5) 2011 – First round of CCAR, no firm-specific details.
6) 2012 – Details provided on individual firms.
7) 2013 – Results split into two components: DFAST and CCAR.
8) 2014 & 2015 – Firm-level results for the additional adverse scenario included.

CCAR Results Summary

2011-2015

		Passed		Objections		
Year	Number of Institutions	Total	with Changes / Comment	Total	Quantitative	Qualitative
2011	19	---	---	---	---	---
2012	19	15	---	4	4	---
2013	18	16	2	2	1	2
2014	30	25	2	5	1	4
2015	31	29	4	2	---	2

Source: Federal Reserve; Trepp, LLC

Looking Ahead

When the Fed and the CCAR banks publish their results, Trepp will revisit the predictions made here, along with further analysis of results. Prior to releasing summary results, the Fed will be giving each bank detailed feedback on both the qualitative and quantitative aspects of its CCAR submission. The feedback will have a significant impact on what each bank prioritizes in preparing for CCAR 2017.

It is quite likely that the regulators will direct banks to continue to focus efforts to improve in areas such as data infrastructure and modeling integrity as well as governance and integration of stress testing within the banks' on-going business planning.

It is also possible that the regulators will give banks somewhat of a breather, allowing them to consolidate gains already made. [5] In any case, the DFAST/CCAR process will remain a key component of the regulators' efforts to maintain the viability and stability of the banking system overall, and in overseeing capital planning at the largest banks in particular.

For additional information on Trepp's latest banking products and services, please contact us at press@trepp.com or 212-754-1010.

[5] See "The Regulatory Onslaught for Regional Banks May Have Peaked," Trepp LLC, June 8, 2016. http://info.trepp.com/trepptalk/regulatory-onslaught-for-regional-banks-may-have-peaked

About Trepp, LLC

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