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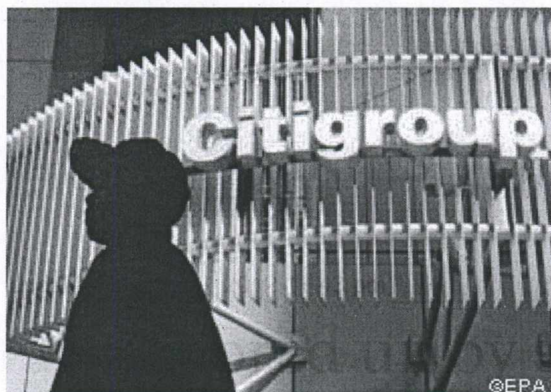
Banks shored up by stress test success

53

By Tom Braithwaite and Tracy Alloway in New York



Big US banks are set to return money to shareholders after the Federal Reserve released the results of "stress tests" on 19 financial groups showing that all but four – including Citigroup – had passed the exercise.

Results of the test, which were rushed out two days early after the Fed said it was concerned about information leaking, sparked a rally in US bank stocks. The S&P financials index rose 3.9 per cent and is now more than 18 per cent higher for the year, with JPMorgan Chase, Wells Fargo and Bank of America leading the way. Citigroup rose 6.3 per cent before the market close, but fell close to 4 per cent after hours as it became clear the bank had failed.

Tuesday's decision by the Fed is a disappointment to Citi, which had pledged to increase its dividend above a notional 1 cent a share for the first time since its near collapse during the financial crisis. "We intend to move forward with some force in 2012," Dick Parsons, Citi's chairman, had told the Financial Times on Friday. However, Citi said on Tuesday after narrowly failing the test that it planned to submit a new capital plan to the Fed, which could pave the way for later payouts.

Most of the 19 largest US banks were allowed to distribute more capital to shareholders in the form of dividends and share buybacks. JPMorgan announced on Tuesday it would buy back up to $15bn of its stock, more than analysts had expected, and increase its dividend. Wells Fargo announced its dividend would almost double.

Bank of America, which suffered reputational damage last year when its plan to pay a dividend was vetoed, passed the test but had not asked permission to increase its payout. Other than Citi, MetLife, SunTrust and Ally Financial could not demonstrate that their core tier one capital ratios would remain above the required 5 per cent of risk-weighted assets under a Fed "stress scenario".

The Fed told large banks to assess how their balance sheets would cope with a severe global recession, including a 13 per cent US unemployment rate, precipitous declines in stock markets

and house prices, and the sort of "market shock" that might be caused by a collapsing European bank.

Only if they showed that their core capital levels would remain above 5 per cent of risk-weighted assets were the banks allowed to increase their payouts to shareholders.

With many banks around the world concentrating on raising capital levels, the Fed's decision to allow a broader distribution from US groups is controversial. Some academics argue that dividends should not be increased until banks have reached the new tougher capital levels prescribed by the Basel III agreement of international regulators.

"Independent of these stress test results, the dividends are misguided, period," said Anat Admati, professor at Stanford University. "The banks want it but that's not enough justification."

But Fed officials believe that the tests are suitably stringent and that only healthy banks will be allowed to release capital to shareholders.

Both Goldman Sachs and Morgan Stanley, two of the more trading-focused banks included in the stress test group, said the Fed had approved their capital plans.

For Goldman the plans include repurchasing common stock and a "potential increase" in its quarterly dividend. For Morgan Stanley they include "the potential cash acquisition of an additional 14 per cent of Morgan Stanley Smith Barney", but no dividend increase or share buybacks.

Steven Kandarian, MetLife's chief executive, criticised the Fed for using "bank-centric methodologies" which he said were not appropriate for insurers. MetLife had requested approval for $2bn in stock repurchases and an increase in its annual dividend from 74 cents per share to $1.10.

The company said it "continues on track" to cease being a bank holding company in the second quarter.

The surge in financial stocks helped propel the S&P 500 1.8 per cent higher, its best one-day gain since the end of November.

With additional reporting by Michael Mackenzie and Telis Demos in New York.

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