Bank Capital Analysis
June 30, 2020 Supplemental Information

kcFED

- Capital ratios grew across banking organizations following the 2007-08 Financial Crisis as reforms greatly strengthened capital requirements (Chart 1). In the early part of the recovery when profitability was improving, banks were retaining earnings to build capital. As the economic expansion continued over the last decade, capital ratios began flattening and in recent years have started to gradually decline for the largest banks, predominantly due to increased shareholder distributions. From 2017 to 2019 the U.S. Global Systemically Important Banks (GSIBs) distributed, on average, more than 100 percent of their earnings to shareholders.
- In the first half of 2020, as the impact of the COVID-19 pandemic drove unemployment rates to record highs and created widespread economic instability, the Federal Reserve took numerous emergency actions to support continued market functioning. As a result, bank balance sheets grew significantly placing pressure on capital ratios. This led federal regulatory agencies to relax certain capital requirements to promote continued financial market intermediation. One such measure was to temporarily exclude U.S. Treasury securities and deposits held at Federal Reserve Banks ("reserves") from the leverage exposure measure (the denominator) of the Supplementary Leverage Ratio (SLR).[1] While regulatory authorities have discussed the merit of making similar changes to the Tier 1 leverage ratio, which would require amending the Dodd-Frank Act, no such actions have taken place to date.[2]
- The Federal Reserve's response to the COVID-19 pandemic resulted in a $1.1 trillion aggregate increase in U.S. Treasury securities and reserves across the U.S. GSIBs at June 30, 2020 (using a 2017-2019 average starting point). The SLR exclusion of all U.S. Treasury securities and reserves collectively decreased leverage exposure by $2.1 trillion (14 percent) for U.S. GSIBs and $153 billion (6 percent) for other large banking organizations (LBO) required to report the SLR. All else constant, the GSIBs' weighted average SLR without the exclusion would have been 96 basis points lower at 6.05 percent as of June 30, 2020. If the rule had instead excluded the marginal increase in U.S. Treasuries and reserves that resulted from the pandemic ($1.1 trillion), GSIBs' weighted average SLR would have been 51 basis points lower at 6.5 percent at June 30, 2020.
- While balance sheets significantly expanded across all bank portfolio groups, the way in which the funds were deployed varied across groups (Chart 2). GSIBs and LBOs increased their U.S. Treasury security holdings by approximately 30 percent and reserves by approximately 92 percent, but loan growth was muted (0.5 percent). Community and regional banking organizations (CBOs and RBOs, respectively) were responsible for the majority of loan growth during the first half of the year, increasing total loans by approximately $350 billion (12 percent), 80 percent of which were PPP loans.
- The Federal Reserve has taken actions to limit shareholder distributions to conserve capital at the largest banks (assets over $100 billion) in light of the pandemic-induced downturn and relaxed capital requirements.[3] However, banking organizations within all size groups continued to distribute a significant portion of their income in the form of dividends in the second quarter despite the protracted downturn and prevailing economic uncertainty. As of June 30, 2020, dividend payout ratios were 76 percent, 95 percent, 570 percent and 52 percent at GSIBs, LBOs, RBOs and CBOs, respectively.[4]

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[1] See Board of Governors' April 14, 2020 Interim Final Rule available here: https://www.govinfo.gov/content/pkg/FR-2020-04-14/pdf/2020-07345.pdf

[2] See https://www.banking.senate.gov/imo/media/doc/Fed%20Response%20to%20Crapo%204.8.20%20Letter.pdf

[3] See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200930b.htm

[4] The RBO payout ratio is skewed by the inclusion of five RBOs that took significant goodwill impairments in the first quarter of 2020. When excluding these RBOs, the dividend payout ratio is 64 percent.

Chart 1: Historical leverage ratio trends by bank portfolio group

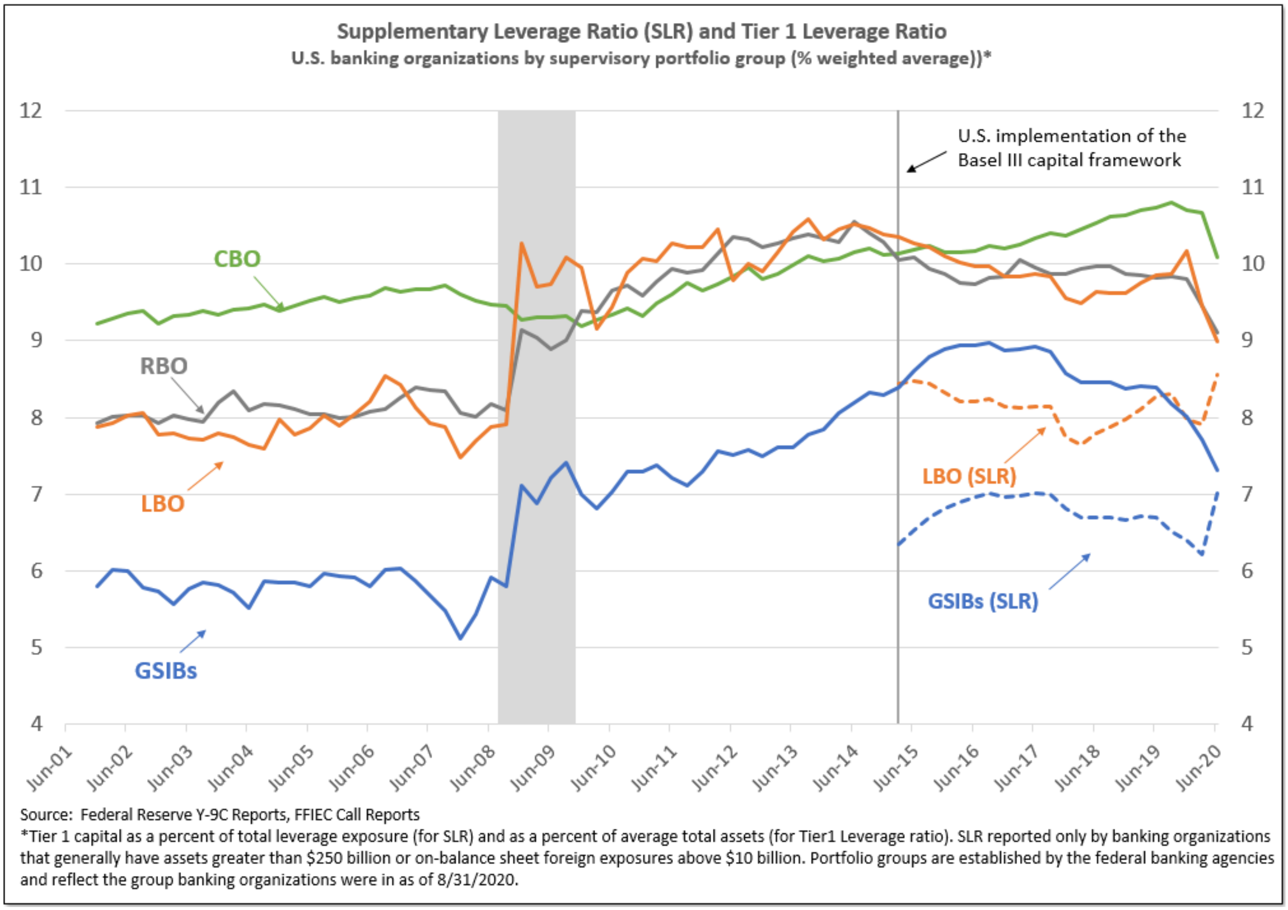

Chart 2: Asset utilization by bank portfolio group