Stress Tests Buoy U.S. Banks

Most Big Firms Have Healthy Capital; Some Raise Dividends

By DAN FITZPATRICK and VICTORIA MCGRANE

Most of the biggest U.S. banks passed the latest round of "stress tests" administered by federal regulators—a milestone in the recovery from the financial crisis that clears the way for investors to receive tens of billions of dollars in increased bank dividends and share buybacks.

The Fed cleared the way for many of the nation's largest banks to raise dividends and buy back shares as it released the results of its latest round of "stress tests." Colin Barr and David Wessel have details on The News Hub. Photo: Getty Images

But in a major setback to Citigroup Inc.'s efforts to restore investor confidence, the Federal Reserve rejected the bank's request to raise its dividend and expand its buyback. Citigroup, the third-largest U.S. bank by assets, passed the stress test, but the Fed indicated it would fall short of some capital requirements if it boosted the payouts.

Stock prices reacted positively amid a spate of other upbeat economic news, including a robust retail-sales report and optimistic comments by Fed officials on the overall state of the U.S. economy. The Dow Jones Industrial Average ended the day up 1.7%, its highest close since December 2007. Asian markets opened trading on Wednesday higher, with Tokyo up 1.9%.

The Fed's stress tests were designed to see whether banks would have enough capital on hand to keep lending even if another deep economic slump or financial crisis were to strike. It's the third round of stress tests: The first took place in 2009, in the immediate aftermath of the financial crisis. At that time, banks fared much more poorly.

Banks Get Stronger

This time, the Fed said 18 of the 19 financial firms it tested retained a large enough capital buffer to continue lending in a steep downturn, defined in part as one in which housing prices and stock markets tumble sharply, and unemployment climbs to 13%. (Current unemployment is around 8.3%.)

However, the Fed said at least four of the 19—Citigroup, Ally Financial Inc., MetLife Inc. and SunTrust Banks Inc.—would have to resubmit their capital plans to the Fed, amounting to a de
facto rejection of their dividend or stock-buyback plans. Ally Financial was the sole institution to fall short of the test's capital requirements even without any proposed dividend payments or other capital distributions.

Citigroup, MetLife and SunTrust could get approval to return some capital to shareholders after revising their plans with the Fed.

No banks were forced to immediately raise capital, suggesting that banks in the U.S. are generally healthier than those in Europe, which have been shedding assets and pulling back from key businesses to shore up their balance sheets.

The increased leeway at 15 of the banks to boost their spending on dividends or stock buybacks amounts to a victory for bankers, who have been on a short leash with regulators and investors since receiving hundreds of billions of dollars in taxpayer rescue funds more than three years ago. Investors stand to receive nearly $32 billion over the next year in added share buybacks and dividend increases announced Tuesday, according to an analysis prepared by RBC Capital Markets.

The stress-test results—together with signs that bank lending is perking up in the U.S.—suggest the unpopular bailouts of 2008 and 2009 helped to stabilize the banking system during the financial crisis and put the economy on the path for recovery.

Several banks confirmed on Tuesday they would raise their dividends and expand buybacks. J.P. Morgan Chase & Co. said it would repurchase as much as $15 billion of stock over the next year, an announcement that sent bank stocks soaring. J.P. Morgan rose 7% and the KBW index of large commercial bank stocks added 4.6%. Others raising dividends and buying back shares include Wells Fargo & Co. and U.S. Bancorp.

Shares of Citigroup, MetLife and SunTrust declined 2% to 3% in after-hours trading.

In a contrast with the first round of stress tests in 2009, in which giant lenders were required to raise $75 billion, no banks were required following the latest tests to raise capital, a senior Fed official said. One bank, Regions Financial Corp. of Birmingham, Ala., said Tuesday it would sell $900 million of stock to repay government-bailout loans.

Citigroup stressed in a statement that it hit capital targets, assuming it didn't increase its dividend or share buybacks. "The Federal Reserve advised Citi that it objected to Citi's proposed return of capital to shareholders," Citigroup said in a statement Tuesday. "In light of the Federal Reserve's actions, Citi will submit a revised Capital Plan to the Federal Reserve later this year."

Bank of America Corp., which passed this year's test but didn't ask for any buyback or dividend increase, last year had a request for a dividend increase rejected by the Federal Reserve, a major embarrassment for the bank.
The Fed rejected MetLife's plan to raise its annual cash dividend to $1.10 a share from 74 cents and institute a $2 billion stock-repurchase program.

The chief executive of MetLife—the only insurance company among the firms stress-tested—blamed the Fed's "bank-centric" methodology for his company's shortfall, saying it isn't appropriate for insurers. CEO Steven Kandarian said measures used by state insurance regulators show MetLife to be financially strong.

MetLife became a bank holding company when it began operating a bank in 2001 offering services online. In December, MetLife announced the sale of its retail-deposit business to General Electric Co.'s finance arm. In the statement, MetLife said it "continues on track with its plan to cease being a bank holding company" by June 30.

Ally said the stress-test results made the company look weaker because they didn't count a large slug of U.S. aid that the company has yet to convert into capital, nor did the results account for the company's plans to shed its exposure to mortgages. SunTrust didn't return calls seeking comment.

The central bank said this week in releasing stress-test guidelines that the 19 biggest financial firms being tested have raised their "Tier 1 common capital"—an important measure of the funds a bank holds on reserve to absorb losses—by 81% since the eve of the first stress tests in 2009. The Fed also said the banks paid out as dividends less than half as much of net income last year as in 2006.

—Liz Rappaport contributed to this article.

**Corrections & Amplifications**
An earlier online version of this story incorrectly implied that J.P. Morgan's release of its stress-test results prompted the Federal Reserve to speed up publishing the stress-test results for all banks under scrutiny. The article also incorrectly said the Fed explained the change by citing banks' release of the information.

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