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FRB and OCC Release 2023 Stress Test Scenarios

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The Federal Reserve Board ("FRB") and Office of the Comptroller of the Currency ("OCC") last week released their 2023 Dodd-Frank Act Stress Test ("DFAST") scenarios. As noted in the FRB's release, the "stress tests help ensure that large banks are able to lend to households and businesses even in a severe recession. The stress tests evaluate the financial resilience of large banks by estimating bank losses, revenues, expenses, and resulting capital levels – which provide a cushion against losses – under hypothetical recession scenarios into the future." The results of the DFAST tests help set large banking organizations' capital requirements, mainly through the stress capital buffer component of the regulatory capital requirements.

As has been the case for the DFAST over recent years, the regulators provide a severely adverse scenario and a base scenario. This year's severely adverse scenario incorporates a large increase in the unemployment rate to 10% in the third quarter of 2024, as well as sharp declines in economic activity and real estate prices. The DFAST also includes global market shock components for banking organizations with large trading operations. The regulators are quick to point out that these are not forecasts, but plausible stress scenarios.

This year's DFAST also includes an "exploratory market shock" component. This is the first year the FRB has added such a component, and it will only apply to the eight U.S. global systemically important banks ("G-SIBs"). However, the exploratory market shock will not impact the G-SIBs' capital requirements.