Economic Review

How Did Banks and Investors Respond to the 2020 Stress Test Results?

by: W. Blake Marsh

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Supervisory actions in 2020 helped build capital levels at large banks but may have indirectly hampered stock price returns.

In June 2020, the Board of Governors of the Federal Reserve System took steps to preserve capital at large banks by capping dividend payments to shareholders and prohibiting common stock repurchases outright for some time. In doing so, supervisors looked to prevent behavior that could threaten large banks' survival during the COVID-19 pandemic crisis.

W. Blake Marsh investigates how the announcement of the 2020 payout restrictions influenced bank capital levels and stock prices. First, he finds that surprisingly strong income growth combined with the payout restrictions raised bank capital to near record levels. Second, although payout restrictions had only a minimal effect on stock prices for most banks, the threat of increased supervisory stringency appears to have lowered stock price returns for directly affected banks and those near the supervisory threshold. His results provide justification for supervisory restrictions during times of crisis, as restrictions may have mitigated market pressure on banks to reduce capital levels.

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Author

W. Blake Marsh

Senior Economist

Blake Marsh is a senior economist at the Federal Reserve Bank of Kansas City. He joined the Banking Research department in July 2016. His research areas are commercial bank regulation and financial intermediation. His current research examines commercial real estate lending, syndicated corporate lending, and financial innovation. Mr. Marsh holds a B.A. in economics from The George Washington University and M.A. and Ph.D. degrees from American University. He previously held positions at the Board of Governors of the Federal Reserve System and in the mortgage industry.