MarketWatch

June 10, 2011, 4:39 p.m. EDT

Big banks may need Fed OK for dividends, buybacks

Central bank proposal seeks to 'institutionalize' bank stress tests

By Ronald D. Orol, MarketWatch

WASHINGTON (MarketWatch) — The Federal Reserve on Friday proposed making annual decisions on whether the country's largest banks can pay dividends or repurchase stock.

The Fed proposes to have big banks with at least $50 billion in assets submit annual capital plans for review by the central bank. The Fed would evaluate the plan of each institution's capital distribution plans and in situations where the Fed rejects a bank's capital plans, the institution would need to receive approval from the central bank before issuing dividends or making conducting stock buy-backs.

Jamie Dimon to Bernanke: Have things gone too far?

JP Morgan Chase executive officer Jamie Dimon asks Federal Reserve Chairman Ben Bernanke if reining in the banking system is slowing down economic growth. Video courtesy of Fox News. Photo: Associated Press.

The capital review builds on and seeks to "institutionalize" the stress tests on capital levels U.S. banks have been required to undertake in the wake of the financial crisis of 2008. Read about big banks being permitted to hike dividends after stress tests.

William Poole,a former president of the Federal Reserve Bank of St. Louis, said banks have become so resistant to holding more capital that they have now opened themselves up to more detailed influence by Washington regulators.

"There is enormous regulatory discretion and this will promote a lot of lobbying and regulatory pressure back and forth," said Poole, now a fellow at the Cato Institute. "We're building into a situation where we're going to be operating a financial sector based on central planning principals and I know lots of cases where central planning has failed and I know of no case of shining successes."

The news comes as tensions between regulators and the industry are rising due to a mountain of new rules. J.P. Morgan Chase CEO Jamie Dimon earlier this week directly confronted Federal Reserve Chairman Ben Bernanke, asking whether the cumulative impact of new regulation has been studied. See Dave Kansas's take on Dimon outburst.

The stocks of big U.S. banks rose late in the trading day on a CNBC report that these large institutions may have to hold extra capital of between 2% and 2.5%, rather than the 3% that many Federal Reserve officials and global regulators were reported to be considering. See David Callaway's take on Dimon outburst.

Key banks that would be subject to the annual review include Citigroup Inc. (NYSE:C) , Wells Fargo & Co. (NYSE:WFC) , Bank of America Corp. (NYSE:BAC) , J.P. Morgan Chase & Co., (NYSE:JPM) Goldman Sachs Group Inc. (NYSE:GS) and Morgan Stanley (NYSE:MS) .

Under this new proposal, the Fed said appropriate bank plans will assess the institution's sources of capital over a nine-month forward looking period that takes into account the bank's size and complexity. Banks will need to examine how their capital would fare in both expected and stressful scenarios.

The report would vary depending on what kind of investments the bank makes. For example, the Fed said, a bank with extensive credit exposures to commercial real estate, but very limited trading activities, would need to have strong systems in place to identify and monitor its commercial real estate exposures.

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The report notes that 35 banks have assets of at least $50 billion as of March 31. The Fed hopes to adopt the proposal later this year so that reviews would take place in 2012.

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The agency said the proposed capital plans would complement a number of aspects of the Dodd-Frank Act, which was written in response to the crisis. The statute requires companies to conduct internal bank-run stress tests, and the Fed said in its release that these would serve as one component of the capital plans submitted to the agency.