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The Fed’s Bank Stress Tests Protect Americans’ Jobs and Homes: They Need to Be Stronger

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It’s largely forgotten now, but in early 2009, fear gripped the country as the financial crisis ignited by the collapse of Lehman Brothers and other megabanks continued to get worse, and as millions of Americans were losing their jobs, savings, and homes. Lending and economic activity were grinding to a halt because no one knew how big the losses were at the banks, which banks had enough capital to absorb their losses, or which were going to collapse next. For good reason, people were losing faith in the banking and financial systems, which was making everything worse. That downward cycle was stopped because the government imposed very strong tests on the banks to determine which ones would survive the economic downturn and which ones might not. The tests put stress on each of the banks’ various activities to ascertain the likely losses and evaluate whether the banks had enough capital to cover those losses (and remain viable) or not (and face bankruptcy or get a bailout).

Because those stress tests were independent, strong, and transparent, they had integrity. The publicly announced results restored faith in the banking system, which unlocked lending and economic activity (although at a relatively low level due to the recession caused by the crash). The value of imposing strong stress tests on banks to ensure they had enough capital to survive downturns and losses while continuing to lend to support economic activity was undeniable.

That’s why, done right, stress testing the biggest banks to gauge their resilience to adverse economic conditions and evaluate their ability to avoid failure and bailouts is one of the most important regulatory developments since the 2008 Financial Crisis (“2008 Crash”). Using strong stress tests to set bank capital buffers greatly reduces the chance of bank failures, crises, contagion, and taxpayer-funded bailouts of Wall Street’s biggest banks. Done wrong, however, stress tests give false comfort, make crashes and bailouts more likely, and endanger Main Street families, businesses, and community banks.

The lost jobs, homes, savings, retirements, and dreams of tens of millions of Americans due to the 2008 Crash provide a stark reminder of the importance of having strong banking regulations combined with effective supervisory oversight to ensure the largest banks are both financially sturdy and properly managed. Pre-2008 banking rules for the largest banks were grossly deficient, ineffective, and lacked robust stress testing. Weak standards for liquidity and capital, in particular, allowed Wall Street's biggest banks to take on too much risk, which ignited and fueled the crisis that devastated Main Street families and businesses as well as the financial system and entire economy.

Banks and regulators alike view the stress tests conducted directly following the 2008 Crash as a great success because they reaffirmed and restored confidence in the financial system at a time of severe uncertainty. Unfortunately, the Federal Reserve ("Fed") stress tests have been systematically and structurally weakened over time, leaving the future of the stress test in a lose-lose situation. The latest attack, launched by the banking industry and supported by the Fed in late 2024, threatens to further undermine and weaken the stress tests, leaving its future in a losing situation where the tests and the associated capital requirements have been so gutted that the results provide entirely false comfort and surely result in insufficient capital requirements.

This fact sheet details recent changes that are being considered for the Fed's stress tests relative to the factors that made the initial stress tests so successful, how the stress testing structure has already been severely weakened in recent years, and concludes with changes that the Fed should instead implement to actually strengthen the stress testing program and restore its value to the financial regulators, banking system, economy, and the American people.

Background

The Purpose of a Stress Test

Stress testing in any context should push a system to its breaking point so that weaknesses can be identified and remediated. This is done using reasonable scenarios to effectively gauge how strong the system is in response to pressure, uncertainty, or even unexpected challenges. In the context of the banking system, the American people rely on the Fed to develop a stress test that is sufficiently challenging to be an accurate indicator of the resilience of the largest banks in the face of a serious financial shock or economic downturn. This is necessary because it is taxpayer money on the line when such a shock or downturn does occur, banks fail, and require bailouts. It doesn't take a finance or banking expert to understand that strong testing protocols are necessary to receive reliable results.

Each year, the Fed develops a baseline scenario, with economic growth, inflation, labor market conditions, and interest rates that are consistent with economists' consensus forecasts and expectations for the economy. The Fed also develops a severely adverse scenario that includes things such as sharp increases in unemployment, declines in domestic and international economic growth, deterioration in equity and bond markets, and declines in house prices and commercial real estate prices.

The Relationship Between Stress Tests and Bank Capital

Banks fund their operations in two ways: with their own money (capital) and with other people's money (customer deposits and other debt). Put differently, capital is the bank's own "skin-in-the-game" to protect against potential losses, before other people's money takes a loss or, worse, the bank fails and has to be bailed out with taxpayers' money.

The Fed uses stress tests to assess how stressful economic events could affect the largest banks. The Fed uses the results of the stress test to set capital requirements for those banks and also provide transparency for the public to see how the largest banks could be affected by stressful economic or financial events and, importantly, how much capital is needed to absorb the losses expected from such stressful events.

There is an inherent tension between banks—that want lower capital requirements so they can pay more dividends, conduct share buybacks, and pay larger executive bonuses—and the public—that needs banks to have sufficiently high capital requirements so that they can withstand financial losses through periods of economic and financial stress, avoid failure, and continue to lend and support the real economy.

During the 2008 Crash, for example, many large banks simply did not have enough capital and, as a result, could not absorb the losses from their profit-maximizing activities. While other companies would collapse into bankruptcy, banks are vital to the economy, and many fear that letting them fail like other firms would result in a failure of the financial system and greatly impair the economy, maybe even causing a second Great Depression. Consequently, the government bails them out by providing the banks with enough capital to prevent their collapse. This is why the megabanks are referred to as "too-big-to-fail."

These facts are key to understanding and evaluating the Fed's current stress tests and proposed changes. While the stress tests do not need to, and realistically cannot, predict every potential bad outcome, they must be sufficiently severe to assess whether banks have enough capital to withstand a range of severe outcomes, including those that the Fed and banks may not have even conceived. If they are not sufficiently severe, then the banks passing them provides false comfort at best, misleading the public into thinking the banks are stronger than they are. Worse, it means that the banks probably do not have enough capital to absorb their own losses and keep lending, meaning that economic downturns will be worse and the banks will need taxpayer funded bailouts.

The Fed Is on Track to Weaken and Damage the Stress Tests, Putting Banks, the Financial System, and Main Street at Risk

On December 23, 2024, the Fed announced a series of changes that will severely erode the integrity and usefulness of the stress tests. The following day, on December 24, 2024, Wall Street bank lobbyists, banks, and business groups sued the Fed, claiming that stress tests violate the law. The banking industry claimed, without evidence, that uncertainty in the stress tests resulted in difficulties in planning and managing capital levels, leading to higher borrowing costs for customers. On May 23, 2025, the banking industry notched another victory, and the public took another loss, when the Fed agreed, as part of the agreement to pause ongoing litigation, to begin the rulemaking process to disclose the stress test models and open the scenarios up to public comment.

On April 17, 2025, the Fed issued the first of two proposals that would implement major changes to make the stress tests weaker, less responsive to changes in bank conditions, and less able to protect Main Street Americans and the financial system from bank failures and bailouts. Fed Governor Barr wisely objected to the proposal, listing five reasons why the proposal will result in a weaker and less credible test:

1. It will create an incentive for bank commenters to object to various aspects of the Federal Reserve's models that result in higher capital requirements, and not to highlight the areas in which the models underestimate downside risk, creating a one-way ratchet that weakens capital requirements.
2. Banks are likely to game the capital requirements once they know the details of the stress test.
3. Banks are likely to invest less in their own risk management if the test becomes too predictable.
4. Disclosure of the Fed's models may encourage concentration across the system in assets that receive comparably lighter treatment in the test, which could create risks to financial stability.
5. Banks are likely to reduce their capital cushion above the required levels, which will lead to greater risks of breaching the minimums and regulatory buffers when a significant risk event happens.

Unfortunately, none of the other Fed Governors objected to putting the proposal out for public comment, which is the first step in its approval.

The Fed's proposed changes, combined with the industry's new posture of pursuing litigation, put the future of the Fed's stress testing program in a lose-lose situation. If the stress test remains as a key component of the capital requirement framework, the industry's lawsuit to force the models and methodology to be put out for public comment, if won, would allow banks and their lobbyists to use the public comment process to chip away at the assumptions and model parameters, making the tests weaker and keeping capital requirements lower than they need to be. Alternatively, the Fed and other regulators could require more capital through the supervisory process. But the industry has already weakened the supervisory process by attacking supervisory guidance, and it has indicated that it will challenge the determinations that are reached through the supervisory process, which would include any supervisory capital add-ons.

The Fed's Stress Tests Were Vital to Restoring Confidence in the Banking System After the 2008 Crash

The lost jobs, homes, savings, retirements, and dreams of tens of millions of Americans in the 2008 Crash highlight the imperative of having strong banking regulations combined with effective supervisory oversight to ensure the largest banks are both financially sturdy and properly managed. Pre-2008 banking rules for the largest banks were grossly deficient, ineffective, and lacked robust stress testing. Weak standards for liquidity and capital, in particular, allowed Wall Street's biggest banks to take on too much risk, which ignited and fueled the crisis that had devastating effects on Main Street families and businesses as well as the financial system and entire economy. At the same time, banking supervision—the day-to-day oversight of these firms that should complement and fill in potential gaps in rules to ensure banks are not dangerously run—failed dramatically. Combined with weakened rules, this created a particularly fragile banking system that was a ticking time bomb in the 2000s—until it blew up with disastrous consequences.

While the post-2008 Crash reforms have not come close to removing Wall Street's too-big-to-fail banks problem, they did substantially strengthen the U.S. banking system by ratcheting up the regulation and oversight of the largest banks. Indeed, post-2008 banking sector reforms are the key reason the largest banks entered the COVID-19 pandemic in relatively strong financial condition. Remarkably, all this was done while bank lending increased, and bank profits skyrocketed. Financial reform proved to be a win-win.

Nevertheless, regulation remains under attack by the banking industry, and history has clearly shown the dangers that deregulation brings.

Post-2008 Crash Stress Test Implementation

As the catastrophic effects of the 2008 Crash were unfolding, the public had entirely lost confidence in the viability of the largest banks, as they had taken massive losses and were unable to provide any certainty about their financial positions. To provide some assurance around their financial positions, the Fed and the U.S. Treasury executed the first robust, coordinated stress test of the largest banks, known as the Supervisory Capital Assessment Program ("SCAP").

This exercise achieved its goal of restoring public confidence in the financial system and the government's ability to size and remediate the problem. For example, the then-President and COO of Goldman Sachs, Gary Cohn, sang the praises of stress tests and capital:

> [US banks were] subject to enormously robust stress tests here in the United States, and I give the Fed enormous credit for what they've done in stress testing the major banks here in the United States.

Former Fed Governor Daniel Tarullo, in his final official speech before he departed from the Fed in 2017, said, stress tests are regarded as "the key innovation in capital regulation and supervision," making other reforms, such as enhanced capital standards, "more effective."

Former Fed Vice Chairman for Supervision Michael Barr agreed:

> In the winter of 2008–09, markets had lost confidence in banks amid wide uncertainty about the future path of the economy and the losses banks could face. This prompted the Federal Reserve and Treasury to conduct a stress test to determine the health of the 19 largest banks under a severely adverse economic scenario and to publish the findings. The release of the results provided transparency about the status of the largest banks, made it easier for firms to re-capitalize themselves, and restarted the provision of credit to the economy that began the process of recovery.

The 2008 Crash proved that large bank resiliency and public confidence, rooted in strong capital positions, are critical to the stability of the financial sector and that problems at large banks can lead to significant market disruption, spread rapidly throughout the financial system, cause a credit crunch, and precipitate economic downturns. As such, in 2010, the Dodd-Frank Act established stress testing requirements for bank holding companies and nonbank financial institutions ("covered companies"). These tests, conducted by the Fed, were intended to discover whether covered companies "have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions."

The Fed took this a step further by ensuring the stress tests not only provided public awareness on large bank capital positions but also effectively required large banks to maintain minimum levels of capital that could absorb the amount of stressed losses estimated in the stress tests. This was done by including the Fed's stress test in its annual Comprehensive Capital Analysis and Review ("CCAR") program, in which the Fed assesses the ability of large banks to manage and plan their capital positions effectively. Importantly, in the original version of this program, the Fed's Board could limit or even stop capital actions based on the results of its stress test (i.e., quantitative grounds) or based on significant deficiencies found in the examination of a bank's practices (i.e., qualitative grounds).

Key Changes in Stress Tests Since Dodd-Frank

Several key changes in the stress test structure and protocols have severely weakened the stress tests since they were first introduced and proven to be so effective. The net effect of these changes is a reduction in the amount of capital that large banks must maintain. These changes make these banks, the financial system, and the economy more vulnerable. They also erode our confidence that the banking system is resilient enough to withstand a severely stressful period without requiring another taxpayer-supported bailout. Better Markets opposed many of these changes, detailing why they were misguided and unwise. The most impactful of the changes in eroding the stress test are shown in the table and discussed in more detail below.

Key Changes in the Fed Stress Tests

	Initial Stress Test	Current Stress Test
Size of Banks Subject to the Stress Test	All banks with ***$50 billion or more*** in total consolidated assets	The minimum size of banks subject to the test increased to ***$100 billion***. Banks with between ***$100 billion and $250 billion*** in assets are tested every other year. Banks with ***more than $250 billion*** in total assets are tested every year.
Growth and Dividend Assumptions	Banks are ***assumed to grow, pay dividends, and execute share buybacks*** throughout the stress test time horizon (9 quarters), which increases the capital needed to maintain operations and reflects the reality of bank behavior in stress.	Banks are ***assumed to pay dividends in only four of nine quarters and not grow their balance sheets***, which is inconsistent with reality and reduces post-stress capital needs.
Minimum Leverage Ratio Requirement	Banks were ***required*** to meet minimum leverage ratio standards.	Banks are ***no longer required*** to meet minimum leverage ratio standards.
Qualitative Assessment by the Fed	The Fed ***could limit or stop bank capital actions*** for supervisory findings of serious deficiencies in bank practices that would be ***described publicly***.	The Fed ***no longer limits or stops capital actions based on supervisory factors, and descriptions of those factors are no longer made public***.
Disclosure of Stress Test Models and Methods	Only the ***broad framework*** of the stress test was disclosed to banks and the public.	***Stress testing model details are disclosed***, which allows banks to reverse-engineer the models and do less of their own independent modeling.
Planning of Capital Actions	Banks submitted capital plans based on their internal stress tests, and banks ***could not reduce the capital in those plans*** unless approved by the Fed Board, even if the Fed stress tests had lower capital.	***Banks can make any changes to their capital plans*** as long as the capital in their plan remains above the Fed stress test.

The Size of Banks that Are Subject to the Stress Tests Was Increased

The Dodd-Frank Act directed the Fed to conduct annual stress tests for all banks with $50 billion or more in total consolidated assets. However, the regional banks lobbied for looser regulation, arguing that these tests imposed an undue strain on their financial and human resources. As a result, the minimum size of banks subject to the Fed stress tests was increased to $100 billion in total assets.

The stress testing framework was further weakened by allowing the Fed to set the testing frequency for covered companies with total assets between $100 billion and $250 billion. The Fed determined that firms with $100 billion to $250 billion in total assets would only be subject to stress tests every other year.

Without question, conditions in the banking system as a whole and at individual companies change very rapidly. The spring 2023 bank failures proved that the condition and viability of banks can deteriorate to critical levels in a matter of days. It also proved that banks in the $100 billion to $250 billion asset size range do indeed present systemic risks to the financial system as a whole. Therefore, it is clear that changes to the size of banks subject to the stress tests and the testing frequency were mistakes.

Dividend and Growth Assumptions in the Stress Tests Were Weakened, and the Leverage Ratio Requirement was Removed

Like in any model, the assumptions used in the stress test matter a great deal to the final results. In the bank stress tests, key assumptions have been materially weakened by the Fed. Consequently, not only are the recent test results not comparable with prior test results, but the current results are also less viable, informative, and trustworthy. As Better Markets has detailed, several changes have eroded the stress test's value and increased the post-stress capital ratios with overstatement of the strength of the banks being tested, including:

1. Banks are assumed to only pay dividends in four of the nine quarters that make up the stress test horizon; and
2. Banks' balance sheets are not assumed to grow during stress periods.

With regard to the dividend assumption, prior to 2020, the stress test included banks' actual planned common stock dividends and share buybacks for the full 9 quarters of the stress scenario timeframe. In addition to lowering the amount of capital that banks are required to have, this change weakens the forward-looking nature of the stress test and undermines the countercyclical approach of requiring banks to build capital during good times in preparation for an extended downturn.

The change to the assumption that large banks will cease growth during periods of stress is inaccurate and not consistent with actual bank behavior. For example, during the COVID-19 pandemic, many of the large banks continued to grow.

Furthermore, the post-stress leverage ratio requirement was removed. The leverage ratio was intended to serve as a backstop to risk-adjusted capital requirements since it does not weight assets. Such a backstop is vital, especially during times of stress when financial conditions and bank positions are changing rapidly.

The Qualitative Assessment—a Critical Component of the Overall Stress Testing Program—Was Effectively Eliminated

Together with the quantitative and scenario-based portion of the stress tests, the Fed's broader program for assessing bank resilience under stress originally included a qualitative portion. This qualitative portion has been wrongly eliminated. As Better Markets' expert Tim P. Clark explains,

> ***The qualitative assessment focuses on practices that support banks' ability to run their businesses safely, to identify and assess risks, and to make informed decisions about the capital needed to survive another economic meltdown***. Importantly, it also supports the Fed's quantitative assessment. Weaknesses in bank practices that are reviewed during the qualitative assessment, particularly those supporting risk measurement and data integrity, can undermine the Fed's supervisory stress test because the Fed uses information it receives from the banks as inputs. . . .
>
> The Fed could object to the bank's planned capital payouts under the qualitative assessment. This was known as the "qualitative objection," which was publicly disclosed in an annual announcement that outlined the reasons for the objection and could lead to temporary restrictions on a bank's ability to make capital distributions to investors, restrictions that could remain in place until the bank fixed its weak practices.
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> ***In announcing the decision to scuttle the qualitative objection, the Fed assured us a similar, but not publicly disclosed, qualitative assessment will remain a key part of its supervision of the largest banks. Nonetheless, this decision all but guarantees the banks won't put as much effort into maintaining or strengthening their practices as they have over the past nine years. It also indicates the Fed Board shares the banks' desire to return to more "traditional" pre-crisis supervision, which was less transparent to the public, less restrictive on the banks and, not coincidentally, far less effective.***
>
> The qualitative objection has been used sparingly. The process never *required* the Fed to object to a bank's planned capital distributions on qualitative grounds; it allowed for an objection when Fed bank supervisors found it warranted and the Board of Governors agreed. ***The Fed has now given away this valuable option seemingly in exchange for nothing more than bankers' appreciation. This raises concerns about what might be given away next.***

Stress Test Models Were Made More Transparent and Thus More Vulnerable to Gaming

Changes the Fed made in 2019—billed as an effort to make the stress test ***more transparent*** by providing more detailed information to banks and the public about the modeling the Fed uses in its stress tests— actually undermine the value of the stress test in multiple ways.

First, giving the banks too much information on how the Fed estimates losses allows banks to reverse engineer the test and, as a result, makes it less effective at capturing the banks' risks. In other words, banks may design products or structure their balance sheets in ways that carry the same risks they did before but are less likely to be identified as risky by the stress test. This would allow banks to have less capital without reducing their risks.

Second, increased disclosure on modeling increases the risk that banks will simply use the Fed's models rather than focusing on developing their own independent and robust measurement techniques specifically designed to capture their own idiosyncratic risks. This makes the entire banking system riskier because the Fed and the banks are all focusing on the same measurement techniques. It also makes it more likely that dangerous risks will be overlooked or unnoticed in the same way and at the same time. A diversity of modeling approaches is best, and more disclosure of Fed modeling techniques risks reducing that diversity.

The Fed's stated desire for greater transparency is, at best, unevenly applied and, at worst, appears to be driven by industry interests rather than the public interest. For example, regarding the qualitative objection discussed earlier, the Fed has made the stress testing program ***less transparent*** to the public by changing the qualitative assessment process in a way that reduces public disclosure of information about risk management and capital planning weaknesses at specific banks. However, as discussed here, ***the Fed did the exact opposite regarding the steps to increase modeling transparency in ways that could make the stress test both easier for banks and less effective at promoting resiliency***. What is the common theme? The biggest banks lobbied relentlessly for both changes.

The Capital Planning Process Was Gutted

Before changes to the stress tests, banks had to submit capital plans (such as dividends and stock buybacks) that were based on their own internal models. It was those plans that the Fed Board considered when objecting or not objecting. If those plans (based on the banks' internal models) had higher capital levels than were implied by the Fed's stress test, then banks had to stick to those capital plans, despite the higher capital levels, unless approved by the Fed Board.

Now, banks don't need approval to change their capital plans as long as they are above the stress capital buffer ("SCB"). This matters because the original framework put the emphasis on banks' ability to manage their own risks and capital, but the new framework shifts the focus to the Fed's estimate of capital. In other words, the importance and relevance of the banks' internal models have been eliminated.

Changes to the Stress Testing Program Were Premature and Unnecessary

The American people depend on the Fed and other banking regulators to properly oversee banks to protect their life savings and avoid taxpayer-funded bailouts. Better Markets has detailed several reasons that the stress testing framework prior to the changes discussed above worked well and why the changes that were made were "an unforced error" by the Fed.

- **Before the Changes, Banks Were Safer Than Ever:** By all accounts, U.S. banks are more resilient than ever and much better able to withstand stress than before the financial crisis. In fact, 2018 was the first year since the financial crisis, and only the third year since 1933, in which ***not a single bank failed***. While zero bank failures is not the goal, it is certainly a metric that is consistent with a strong and stable banking system. Credible stress testing has been key to this success. As Fed Governor Brainard observed, "One key benefit of our stress testing program is that it promotes a dynamic forward-looking assessment of a bank's capital adequacy in the face of severe stress." Weakening regulations that have been so successful in making the financial system safer should only be considered if there is a substantial countervailing data-driven basis.

- **Before the Changes, Banks Were More Profitable than Ever:** The Fed should not be swayed by the banks' pleas to reduce "unnecessary" or "needless" compliance costs. In the first instance, the important role of **annual** stress tests fully justifies their costs. Moreover, those costs are plainly not unduly burdensome: not only has the current regulatory framework made banks more resilient, it has done so while allowing them to make record profits. If, under the current framework, banks are having no trouble making massive, if not historic profits, even as they are safer, what justification could there be for weakening the framework? There is none.

- **The Fed's and Other Banking Regulators' "Experience" with Stress Tests Is Insufficient:** The Fed does not have sufficient experience to determine whether it is safe and appropriate to reduce the frequency of stress tests. As Fed Governor Brainard explained, it is imperative to "wait until we have tested how the new framework performs through a full cycle before we make judgments about its performance." Until such time, at a minimum, the Fed cannot reasonably assert that it can weaken the regulatory framework while still fulfilling its statutory obligation under Dodd-Frank to protect the public from another $20 trillion crisis.

- **Credible Stress Tests Are Critical to Financial Stability:** As shown by prior experience, stress tests are an essential component in the regulatory toolbox for preventing or mitigating financial crises. After the 2008 Crash, stressed if not panicky markets were reassured when the government published stress test results demonstrating the resiliency of the largest banks. Indeed, many consider these tests and the related disclosure to be the turning point of the crisis. However, stress tests are only useful if they are credible and viewed as such. Yet in rapidly changing economic conditions during a period of market distress, tests conducted up to two years earlier are not sufficiently current and are unlikely to be considered credible. As one expert observer cautioned:

Doing stress tests less frequently, such as only once every two years, would not be frequent enough to meaningfully promote financial stability. First, firms make choices about dividends and share repurchases at least once a year. Capital planning which should incorporate projected capital positions and risks to those positions should not be done less frequently than decisions about shareholder payouts.

- **Stress Test Weaknesses Are Amplified by Other Deregulatory Actions**: The effects of reducing the frequency and strength of stress tests cannot be considered in isolation. Instead, the potential effects must be considered in light of the other deregulatory actions that were taken between 2016 and 2020, including a series of regulatory changes to weaken capital and liquidity requirements for banks.

The Stress Testing Program Needs Change, But Not the Changes That Have Been Proposed

As detailed earlier, stress testing done right pushes a system to its breaking point. The American people rely on the Fed to develop a stress testing protocol that is sufficiently challenging and one that will be an accurate indicator of the resilience of the largest banks in the face of a serious shock or economic downturn because it is taxpayer money on the line if such a shock or downturn does occur and banks fail.

As mentioned earlier, the current stress tests are grounded in scenarios and economic projections that are rooted in past recessions. Therefore, by definition, they are not stressful enough to represent a plausible scenario in which banks are standing on their own, without government or taxpayer support.

In other words, stress tests have gone from confidence builders to "capital ejection mechanisms." Some have noted that what was originally thought of as a process to create a capital floor has become a capital ceiling, and one that is falling with each deregulatory move.

Finally, recent evidence has proven how banks have been gaming other regulatory tests that directly affect capital levels, as the Fed's stress tests also do. Therefore, it is reasonable to expect that the banks are doing everything they can to work around the stress tests using the plethora of information that the Fed has provided to maximize profits, without concern for the array of negative consequences for this behavior for financial stability or Main Street Americans. As Better Markets detailed, research from the Basel Committee and the Fed shows:

> [C]lear evidence. . .that the biggest global banks that pose the gravest risks to the financial system and economies of the world have been systemically, knowingly, and intentionally cheating on critical regulatory tests for many years. Worse, they are cheating so that their highest risk activities will be under-regulated, that they

can increase short term profits and bonuses, and shift the costs of losses and failures to society.

We therefore recommend several changes that would move in the right direction toward strengthening the stress testing framework.

The Fed Should Reinvigorate and Strengthen the Stress Tests

Key elements of the stress testing framework that were altered during the recent deregulatory effort must be returned to their original form to strengthen the stress testing program and its results.

- It should be assumed that banks will continue to make dividend payouts for the full nine-quarter duration of the stress test. It is not realistic that banks will discontinue dividends to shareholders, and assuming that they will only inflate the amount of capital that they will have through the test period.
- It should be assumed that banks can and will continue to grow during periods of stress. Assuming that banks will not grow makes their capital levels appear larger than they would otherwise be, which inflates the test results.
- The Fed should reinstate the qualitative objection, which had become a powerful tool to ensure that bank risk managers were not becoming complacent.

The Fed Should Expand the Stress Tests to Include More Scenarios with Capital Implications

The Fed has recently ventured into broadening the scope of its stress testing framework. According to the Fed, the exploratory scenarios complement the rest of the stress testing framework with a different set of risks and provide information on how banks' losses are affected by different risks. In the 2023 stress test, the Fed included for the first time an additional exploratory market shock that was only applied to the eight U.S. GSIBs. The Fed built on its success and included exploratory macroeconomic scenarios and exploratory market shocks in the 2024 stress test. However, in neither test period did the additional scenarios have a direct tie to capital requirements. Capital implications must be added to ensure accountability for banks.

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Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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