June 23, 2025

Ann Misback, Secretary
Attn: Docket R-1866; RIN 7100 AG92
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement; RIN: 7100-AG92; Docket Number R-1866; Document Number 2025-06863; 90 Fed. Reg. 16843 (Apr. 22, 2025)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on a notice of proposed rulemaking ("Proposal") from the Federal Reserve ("Fed") that would fundamentally and structurally undermine the value of the stress testing framework for the largest, most complex banks that pose the greatest threat to financial stability.[2] It is important to note that the Fed has recently discussed several potential changes to the stress testing framework,[3] but this Proposal contains only a portion of those changes. We look forward to seeing additional proposals on this topic and responding to them.

The Proposal would make two unnecessary and dangerous changes that would make the Fed's stress tests less valuable:

1. <u>Average each firm's maximum common equity tier 1 capital decline in the current year and the prior year's stress test, instead of using results from the stress test for each individual year, to determine the firm's current year's stress capital buffer requirement</u>.[4]

---

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement; RIN: 7100-AG92; Docket Number R-1866; Document Number 2025-06863; 90 Fed. Reg. 16843 (Apr. 22, 2025), https://www.federalregister.gov/documents/2025/04/22/2025-06863/modifications-to-the-capital-plan-rule-and-stress-capital-buffer-requirement.

3 Press Release, Board of Governors of the Federal Reserve System, *Due to Evolving Legal Landscape & Changes in the Framework of Administrative Law, Federal Reserve Board Will Soon Seek Public Comment on Significant Changes to Improve Transparency of Bank Stress Tests & Reduce Volatility Of Resulting Capital Requirements* (Dec. 23, 2024), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20241223a.htm.

4 Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, *supra* note 2 at 16843.

This would make the stress tests less sensitive to actual real-time deterioration—and the hypothetical deterioration as measured by the stress test—in the financial condition and resilience of the largest, systemically important banks in our financial system.

2. Extend the time that firms have to comply with the stress capital buffer requirement by one quarter, from October 1 of the year in which the stress test was conducted, to January 1 of the year after the stress test was conducted.[5] This would slow the process by which banks are expected to rectify weak capital positions.

The only thing standing between a failing bank, a financial crisis, a taxpayer bailout, and economic and human catastrophe is bank capital. If a bank has enough capital to absorb its own losses, then it won't fail, be the proximate cause of a crisis, or require a bailout, which is nothing more than taxpayers providing the necessary capital after a crash when a bank should have had enough capital to prevent the crash in the first place. Banks having adequate capital would have prevented the 2008 Financial Crisis ("2008 Crash") and the 2023 Banking Crisis. Likewise, banks having enough capital now will prevent future crashes. Unfortunately, stressless stress tests—made worse by this Proposal—will lead to banks having less capital than they need to avoid future failures, crashes, and bailouts. A fundamental part of ensuring a bank has enough capital is that the amount of its capital funding must reflect its current activities.

No part of this Proposal makes the Fed's stress tests ***stronger*** or ***more responsive*** to deterioration in bank conditions that could lead to a failure or a banking crisis. While it is true that if a bank's prior year stress test results were worse than its current year results, the averaging calculation would lead to its capital requirement being higher than it would be based on just the current year results, that is not a good or desirable outcome. The key point is that the Proposal would make the tests ***less responsive*** to real changes in economic conditions and individual banks' financial strength. This undermines the stress test's value for effectively measuring current large bank—and banking system—resiliency to stress events. In other words, the Proposal would make the largest banks and the financial system ***more vulnerable*** to a crisis.

The banking industry and the Fed support and justify the Proposal by saying that it will reduce volatility, increase transparency, and increase the predictability of banks' stress capital buffers.[6] They also say that it will decrease the regulatory reporting burden for banks and enable more lending by banks by avoiding huge and painful swings in capital requirements.[7] As explained more fully below, these claims are unpersuasive. The proposed averaging calculations would clearly ***decrease*** transparency and generate less precise, less meaningful, and much less useful measures of capital needs based on stress testing results. Moreover, as to predictability, the banks already can and should be evaluating and maintaining prudent capital levels that minimize volatility and maximize resilience under a wide range of possible stressful events. The financial system is defined by unpredictability. This should not and cannot be assumed away simply to help minimize the amount of capital a systemically important bank is required to have to keep the

[5] *Id*.

[6] *Id*. at 16847.

[7] *Id*. at 16843.

banking system and taxpayers relatively safe. The regulatory burden under the current regime is comparatively modest for large banks and, in any event, vastly outweighed by the benefits of maintaining a more effective stress testing framework and a more resilient financial system. Finally, as we have explained in other advocacy related to capital requirements for the largest banks, stronger capital requirements lead to more lending, while lower capital requirements only enable banks to increase disbursements to shareholders, such as dividends and stock buybacks.[8]

Meanwhile, a critically important issue that the Fed does not address is that banks should not be solely relying on this stress test and the stress capital buffer as the determinant and primary driver of their capital levels. The Fed's stress tests determine regulatory ***minimum*** capital levels, but banks have come to regard them as maximums instead of minimums. Banks should be running their own stress tests to evaluate their capital needs and levels on an ongoing basis. ***If banks seek more predictable or less volatile capital levels, achieving those is completely within their control and does not require any rule changes.*** The bottom line is that banks should not be relying on the results of the Fed's stress tests as the key determinant of their capital levels. Therefore, it is disingenuous and misleading to justify this Proposal by saying that it will confer benefits that the banks already have at their disposal and under their control.

Furthermore, the Fed has been clear on the fact that ***reducing the volatility of results is not and should not be the goal of stress testing***. The Fed is not and should not be helping with a capital plan that is the responsibility of each of the banks to create for themselves; instead, the Fed should work to identify risks and the minimum capital to protect against those risks. Moreover, ***volatility is expected and occurs all the time. Making banks more resilient in a volatile and uncertain world is a critical goal and component of the stress tests***:

> Some degree of volatility is inherent to risk-based capital requirements, including those determined by stress testing, as such requirements are sensitive to changes in a firm's activities, exposures and changes to macroeconomic conditions. In addition, some volatility in stress test results is to be expected because the stress test is designed to capture a firm's vulnerability to plausible and salient risks to the U.S. financial system.[9]

---

[8] *See, e.g.*, Better Markets Comment Letter, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity* (May 16, 2024), https://bettermarkets.org/wp-content/uploads/2024/05/Better-Markets-Supplemental-Comment-Letter-Regulatory-Capital-Rule.pdf; Better Markets Comment Letter, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity* (Jan. 16, 2024), https://bettermarkets.org/wp-content/uploads/2024/01/Better-Markets-Comment-Letter-Regulatory-Capital-Rule-1-16-24.pdf.

[9] Regulations Q, Y, and YY: Regulatory Capital, Capital Plan, and Stress Test Rules at 15580-81; RIN: 7100-AF02; Docket Number R-1603; Document Number 2020-04838; 85 Fed. Reg. 15576 (Mar. 18, 2020), https://www.federalregister.gov/documents/2020/03/18/2020-04838/regulations-q-y-and-yy-regulatory-capital-capital-plan-and-stress-test-rules; s*ee also* Memorandum of Law in Support of Defendant's Cross-Motion for Summary Judgment and Opposition to Plaintiffs' Motion for Summary Judgment at 46–47, *Bank Policy Institute v. Board of Governors of the Federal Reserve System*, No. 2:24-cv-04300 (S.D. Oh. Apr. 29, 2025).

These observations are especially relevant to a banking and financial system that can be rocked by sudden and unpredictable domestic and worldwide events that quickly and dramatically cause a deterioration in banks' financial condition.

While the stress tests began in the wake of the 2008 Crash as a robust framework that was truly strong enough to reassure regulators and the public that the banks were relatively strong and resilient, the tests have been severely weakened in recent years.[10] The net effect of these past 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.[11]

We, therefore, strongly oppose this Proposal not only because it prioritizes banks' private interests over the public interest, but also because it would weaken the information provided by the stress test results, erode their usefulness in promoting a strong and resilient financial system, and reduce overall transparency. Finally, it would unnecessarily complicate the stress test calculations (while also making them less relevant for the current environment) and increase the complexity of the results, which will, by design, be less valuable.

BACKGROUND

In the aftermath of the 2008 Crash, fear permeated the country as millions of Americans lost their jobs, savings, and homes.[12] Lending and economic activity ground 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 spiral was stopped in large part because the government imposed very strong stress tests on the banks to determine which ones would survive the economic downturn and which ones might not. After Troubled Asset Relief Program capital infusions and liquidity support from the Fed, the stress tests put hypothetical but plausible 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).

---

10 *See, e.g.*, Shayna Olesiuk, *The Fed's Bank Stress Tests Protect Americans' Jobs and Homes: They Need to Be Stronger* 6-12, Better Markets Fact Sheet (May 29, 2025), https://bettermarkets.org/wp-content/uploads/2025/05/Fact-Sheet-Stress-Tests-5.28.2025.pdf.

11 *See, e.g.*, *Conference: "Stress Testing: A Discussion and Review" Panel One "Stress Tests as Policy Tool"*, (July 19, 2019), https://bettermarkets.org/analysis/conference-stress-testing-discussion-and-review-panel-one-stress-tests-policy-tool/; Better Markets Comment Letter, *Enhanced Disclosure of the Models Used in the Federal Reserve's Supervisory Stress Test (Docket No. OP–1586) ("Model Disclosure Proposal"); Stress Testing Policy Statement (Docket No. OP-1587) ("Stress Testing Policy Proposal"); and Policy Statement on the Scenario Design Framework for Stress Testing (Docket No. OP-1588) ("Scenario Design Proposal")* (Jan. 22, 2018), https://bettermarkets.org/wp-content/uploads/2021/07/FRS-CL-Stress-Testing_0.pdf.

12 BETTER MARKETS, COST OF THE CRISIS (July 2015), https://bettermarkets.org/wp-content/uploads/2021/07/Better-Markets-Cost-of-the-Crisis-2_0.pdf.

Stress testing of any system should use severe enough scenarios that can identify and remediate weaknesses in the system. 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 potential 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, if it causes large banks to fail and require bailouts. It does not take a finance or banking expert to understand that strong testing protocols are necessary to generate useful results. Using strong stress tests to help set bank capital buffers 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, which could make crashes and bailouts more likely, and endanger Main Street families, businesses, and community banks.

Banks and regulators alike view the stress tests conducted directly following the 2008 Crash as a great success because they provided much needed information on banks financial condition and ultimately were used to require many of the largest banks to raise capital in the private markets, which helped to restore confidence in the financial system at a time of tremendous uncertainty. 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.[13]

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."[14]

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-

---

13 Dakin Campbell, *U.S. Banks Safer Than Europeans Due to Early Medicine*, BLOOMBERG (Feb. 9, 2016), https://www.bloomberg.com/news/articles/2016-02-09/u-s-banks-safer-than-europeans-due-to-early-medicine-cohn-says (emphasis added).

14 Board of Governors of the Federal Reserve System, *Departing Thoughts* (Apr. 4, 2017), https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm (emphasis added).

capitalize themselves, and restarted the provision of credit to the economy that began the process of recovery.[15]

Unfortunately, the Fed stress tests have been systematically and structurally weakened over time. This latest attack, embodied in the Proposal, was launched by the banking industry and supported by the Fed in late 2024,[16] threatens to further undermine and weaken the value of the Fed's stress test, placing its future in a losing situation where the tests and the associated capital requirements have been so gutted that the results provide false comfort and result in insufficient capital requirements.

SUMMARY OF THE PROPOSAL

As detailed earlier, the Proposal would make two key changes[17] that would render the Fed's stress tests less sensitive to deterioration in the financial condition and resilience of the largest, systemically important banks in our financial system:

1. Average each firm's maximum common equity tier 1 capital decline from the current year's and the prior year's stress test to determine the firm's current year's stress capital buffer requirement.

2. Extend the time that firms have to comply with the stress capital buffer requirement by one quarter, from October 1 of the year in which the stress test was conducted, to January 1 of the year after the stress test was conducted.

SUMMARY OF COMMENTS

As stated earlier in this letter, we strongly oppose the Proposal because it prioritizes banks' interests over the public interest. It would weaken the value of, and the information provided by, the stress test results, actually reducing—not increasing—transparency, and would undermine the value of the stress-related capital requirements even more than they have been by further divorcing them from banks' current risks and current macroeconomic conditions. The Proposal would also unnecessarily complicate the stress test's calculations and increase the complexity of the results.

In summary, our responses to the Proposal are as follows:

- <u>The Fed should maintain the current stress test framework, with tests that are conducted and results that are reported for each year</u>. The stress test results ***should not*** be averaged for the current and prior years. This practice would only serve to dilute the value of the entire stress testing process and severely reduce the usefulness of the results. If the Fed

15 Board of Governors of the Federal Reserve System, *Multiple Scenarios in Stress Testing* (Oct. 19, 2023), https://www.federalreserve.gov/newsevents/speech/files/barr20231019a.pdf.

16 Press Release, Board of Governors of the Federal Reserve System, *supra* note 3.

17 Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, *supra* note 2 at 16843.

decides to go against this advice and average the results over two years, the current year's result should be weighed more heavily in the calculation.[18] However, this alternative would further complicate the stress testing calculations, cloud the understanding of the results, and still yield less accurate stress test results, but it would at least mitigate some of the negative impacts of the Proposal by emphasizing the banks' current conditions.

- The Fed should maintain the current implementation date for the stress capital buffer requirement of October 1 in the year in which the stress test was conducted. It is in the public's best interest for banks to comply with the stress capital buffer that is derived from the Fed's stress test as soon as possible. The results of the stress test are typically published in June, based on bank conditions as of the previous year end. An implementation date of October 1, therefore, is already three months after the results are determined and nine months after the actual bank positions and conditions on which the stress capital buffers are based. Moreover, if the results indicate that additional capital is required, extending the implementation date will only benefit the banks, allowing them more time to take actions to either raise that capital or lower the requirement by trying to offload risky assets, while the American public and the financial system are exposed to increased risk.

- The Fed should, rather than proposing even more ways in which the stress test can be weakened, implement enhancements that strengthen the stress test framework. These changes include assuming that banks will continue to pay dividends and grow through the full duration of the stress test, reinstating the qualitative objection from the Comprehensive Capital Analysis and Review ("CCAR"), and expanding the stress test to include both more diverse and more severe scenarios that can have potential capital implications.

COMMENTS

I. THE FED SHOULD MAINTAIN THE CURRENT STRESS TEST FRAMEWORK, WITH TESTS THAT ARE CONDUCTED AND RESULTS THAT ARE REPORTED FOR EACH YEAR.

Question 03: What are the advantages and disadvantages of the proposed results averaging calculation, including the proposal to base the stress capital buffer requirement on the stress capital decline components from the prior two consecutive, annual supervisory stress tests?

Question 13: Under what circumstances would firms not subject to two consecutive annual

18 *See* Press Release, Board of Governors of the Federal Reserve System, *Statement on Stress Test Proposal by Governor Adriana D. Kugler* (Apr. 17, 2025), https://www.federalreserve.gov/newsevents/pressreleases/kugler-statement-20250417.htm.

supervisory stress tests be more or less likely to opt-in to the supervisory stress test in an off-year as a result of the proposal? What other options should the Board consider to reduce volatility in the stress capital buffer requirements for such firms and why? For example, what are the advantages and disadvantages of averaging the two most recent stress capital declines for a firm that is not subject to two consecutive annual supervisory stress tests?

The stress test results ***should not*** be averaged for the current and prior years. This practice would only serve to dilute the value of the entire stress testing process and severely reduce the usefulness of the results. The Fed should maintain its current practice of reporting and applying stress test results for each year for several reasons:

- Statistical problems: Simply put, when numbers of any kind are averaged, tail risks are hidden and overlooked. This is a problem for stress tests because tail risks are often the triggers for bank failures, so masking these risks robs the Fed and the public of vital information. The Proposal is not only minimizing the identification of tail risk, but it is obscuring the vitally important current year's tail risk with the addition of the now irrelevant results from the prior year.

- Unclear and misleading results: Bank conditions and economic conditions are constantly changing. In some cases, these conditions improve from year to year, and in other cases, these conditions deteriorate from year to year. If stress test results are averaged for multiple years, the information that these trends provide is muddied. Moreover, if a firm's condition improves between the first year and the second year, its capital buffer would be unnecessarily high. If, on the other hand, a firm's condition deteriorates between the first year and the second year, its capital buffer would be too low. This is, of course, the more dangerous result because it means that the public disproportionately shoulders the risk of that firm's failure until the statistical calculations are no longer diluted by the prior—and now irrelevant—stronger year. The bottom line is that averaging results ensures the results are not reflective of current bank activities or macroeconomic conditions.

- Added complexity: While calculating an average may seem simple at first, this Proposal would add complexity, not reduce it. Systems at both the Fed and the banks need to change to accommodate new calculations in this Proposal. At the same time, understanding the meaning of the new, average result would become more challenging and complicated. It would likely require dissecting the average into its component parts—the results of each individual year's stress test—which again illustrates and proves why it is not wise or helpful to implement the Proposal.

- Uneven application: The Proposal states that firms in Categories I-III—the largest and most complex banking organizations that participate in the supervisory stress test each year[19]—would average their stress test results from the current year and the prior year.

[19] *See, e.g.*, *Requirements for Domestic and Foreign Banking Organizations*, Board of Governors of the Federal Reserve System (Oct. 10, 2019), https://www.federalreserve.gov/aboutthefed/boardmeetings/files/tailoring-rule-visual-20191010.pdf.

But, firms in Category IV—which are not as large and typically not as complex and only participate in the supervisory stress test every other year[20]—would not average their stress test results. This system further erodes the value of the stress test results because the largest systemically important banks would report a diluted average, but the smaller and less complex Category IV banks would continue to report single-year results that are not averaged. Moreover, the Proposal says that a Category IV firm could opt-in and participate in the stress test each year, and therefore average its test results, but a firm would only have an incentive to do this if its capital requirement would be reduced by the choice, which does not benefit the value of the stress test or benefit the public interest.

- Increased cost: Such changes, if implemented, will require public resources at the Fed and other regulators for staff and technical systems. At a time when the Fed and regulatory agencies are facing severe staffing cuts,[21] staff should be deployed to more important functions, not distracted by changes like these that only benefit a small number of large banks while increasing risks to the financial system and the public interest.

- Loss of public confidence: The initial success of the stress test came from the fact that it provided a credibly severe test and showed that the largest banks could withstand a severely negative event or economic downturn.[22] By watering down the results with a multi-year average, the Fed will be undermining its own success with the stress testing framework, reducing transparency, and eroding the credibility of the informational value of the test results. The Proposal would, in effect, reintroduce a measure of uncertainty and reduced confidence that largely defeats the purpose of the stress tests.

- Increased chance of bank failures and financial crisis: As detailed earlier, the only thing standing between a failing bank, a financial crisis, a taxpayer bailout, and economic and human catastrophe is bank capital. Moreover, it is an indisputable fact that the economy and financial markets are moving faster, not slower. The 2023 banking crisis proved the speed at which a bank's condition can deteriorate and precipitate failure and the need for government bailouts. Such triggering events can occur within days, weeks, or months, not just years. If the Fed chooses to average results, it will block or at least impede its ability to see a firm's rapidly deteriorating conditions that require larger

---

20 *Id*.

21 *See, e.g.*, Jesse Pound, *Federal Reserve Will Reduce Staff By 10% in Coming Years, Powell Memo Says*, CNBC (May 16, 2025), https://www.cnbc.com/2025/05/16/federal-reserve-will-reduce-staff-by-10percent-in-coming-years-powell-memo-says.html; Katanga Johnson & Weihua Li, *Trump Cuts Thousands of Wall Street Cops While Markets Swing*, BLOOMBERG (May 7, 2025), https://www.msn.com/en-us/money/markets/trump-cuts-thousands-of-wall-street-cops-while-markets-swing/ar-AA1Elr4t; Pete Schroeder, *US Bank Regulator Lays Out Plans for 20% Staff Reduction, Emails Says*, REUTERS (Apr. 21, 2025), https://www.reuters.com/business/world-at-work/us-bank-regulator-lays-out-plans-20-staff-reduction-emails-says-2025-04-21/.

22 *See, e.g.*, Olesiuk, *supra* note 10 at 1.

capital buffers. This is a clear mistake.

If the Fed decides to go against this advice and proceeds with averaging the stress test results, ***the current year's result should be weighed much more heavily than the prior year's result in the calculation of the two-year average and both results should be reported in detail so the public can see the impact of the averaging and the drivers of the most current results***. This is, while better than what has been proposed, an alternative that increases cost and complexity because it will require the Fed to determine an appropriate proportional weighting of the inputs from each year. It will also further complicate the interpretation of the results by both regulators and the public. But it would at least mitigate the negative impact of the Proposal.

In summary, all these problems should be considered alongside the status quo of calculating stress test results on an annual basis, which works well. Making changes only adds cost and complication for no benefit to the public interest.

Finally, we note that the Fed also offers an option of averaging three years of stress test results in its list of alternatives in the Proposal.[23] Needless to say, this option is even worse than a two-year average and would only exacerbate all of the negative effects listed above.

II. THE FED SHOULD MAINTAIN THE CURRENT IMPLEMENTATION DATE FOR THE STRESS CAPITAL BUFFER REQUIREMENT OF OCTOBER 1 IN THE YEAR IN WHICH THE STRESS TEST WAS CONDUCTED.

Question 17: What are the advantages and disadvantages of moving the effective date of the stress capital buffer requirement from October 1 to January 1? What other alternative dates or approaches to modifying the effective date of the stress capital buffer requirement should the Board consider, and why? Please provide any rationale or data that may be helpful for the Board to consider.

It is in the public's best interest for banks to implement the stress capital buffers derived from the Fed's stress test as soon as possible. In fact, the results of the stress test are typically published in June, and the stress capital buffers are published in August, so the current implementation date of October 1 is already months after the results are determined. If additional capital is required, extending the implementation date will only benefit the banks, while the American public and the financial system are unjustifiably exposed to increased risk.

[23] Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, *supra* note 2 at 16851.

III. <u>THE FED SHOULD, RATHER THAN PROPOSING EVEN MORE WAYS IN WHICH THE STRESS TEST CAN BE WEAKENED, IMPLEMENT ENHANCEMENTS THAT STRENGTHEN THE STRESS TEST FRAMEWORK.</u>

Question 02: What other approaches, if any, should the Board consider with respect to the supervisory stress test that would continue to help ensure that large firms are operating safely and soundly?

As detailed earlier, the American people rely on the Fed to develop and implement a stress testing protocol that is sufficiently challenging and 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.

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***.

Moreover, recent evidence[24] 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, all to maximize profits without concern for the array of negative consequences that threaten financial stability and Main Street Americans. Research from the Basel Committee[25] and the Fed[26] shows 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, enabling them to increase short-term profits and bonuses and shift the costs of losses and failures to society.

We therefore recommend several changes that would strengthen the stress testing framework.

- <u>The Fed should reinvigorate and strengthen the stress tests</u>: 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.

---

24 *See, e.g.*, Better Markets Comment Letter, *Global Systemically Important Banks—Revised Assessment Framework* (June 7, 2024), https://bettermarkets.org/wp-content/uploads/2024/06/Better-Markets-Comment-Letter-BCBS-GSIBS-Revised-Assessment-Framework.pdf.

25 Matthew Naylor, Renzo Corrias, & Peter Welz, *Banks' Window-Dressing of the G-SIB Framework: Causal Evidence from a Quantitative Impact Study* 6-7, Basel Committee on Banking Supervision, Working Paper 42 (Mar. 7, 2024), https://www.bis.org/bcbs/publ/wp42.pdf.

26 Jared Berry, Akber Khan, & Marcelo Rezende, *How Do U.S. Global Systemically Important Banks Lower Their Capital Surcharges?*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM: FEDS NOTES (Jan. 31, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/how-do-us-global-systemically-important-banks-lower-their-capital-surcharges-20200131.html.

- The stress test calculations should assume that banks will continue to make ***dividend payouts for the full nine-quarter duration of the stress test***. It is not realistic, or consistent with historical precedent, to assume that banks will discontinue dividends to shareholders unless they are required to by regulators. However, assuming in the stress test calculations that dividends would be paused makes banks' capital look higher than it otherwise would, which reduces additional capital needs in the stress test models and falsely overstates what a bank's capital would likely be in the stressful scenario.

- The stress tests should further assume that ***banks can and will continue to grow during periods of stress, which is an observable historical reality in many cases***. Assuming that banks will not grow makes their capital levels appear larger than they would otherwise be, which also dangerously distorts and inflates the stress test results.

- The Fed should ***reinstate the qualitative objection from the CCAR***, a complementary process designed to work with the stress tests and which had become a powerful tool to ensure that banks were effectively measuring and managing their own risks and capital needs under severe potential stress, not relying solely on the Fed stress test.

- The Fed should expand the stress tests to include more, and more severe, scenarios that have potential 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 additional, useful 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.[27] The Fed built on its success and included exploratory macroeconomic scenarios and exploratory market shocks in the 2024 stress test.[28] 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.

---

27 *See* Board of Governors of the Federal Reserve System, *2023 Stress Test Scenarios* 12 (Feb. 2023), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230209a1.pdf.

28 *See* Board of Governors of the Federal Reserve System, *Exploratory Analysis of Risks to the Banking System* (Feb. 2024), https://www.federalreserve.gov/publications/files/exploratory-analysis-of-risks-to-the-banking-system-20240215.pdf.

CONCLUSION

We hope these comments are helpful as the Fed considers changes to the stress tests.

Sincerely,

Shayna M. Olesiuk

Shayna M. Olesiuk
Director of Banking Policy
solesiuk@bettermarkets.org

Better Markets, Inc.
2000 Pennsylvania Avenue, NW
Suite 4008
Washington, DC 20006
(202) 618-6464
http://www.bettermarkets.org