

Stress Testing Proposals (Docket Nos. R-1603, OP-1586, OP-1587, and OP-1588)

Members of the Federal Reserve Board met with the Federal Advisory Council (FAC) on September 7, 2018. During the meeting, Council members provided written comments on several aspects of regulatory reform, including the following comments on stress testing of large banks. (The complete FAC Record of Meeting is available at <https://www.federalreserve.gov/aboutthefed/files/fac-20180907.pdf>.)

The FRB has multiple efforts underway to address this issue, including the following proposals: (i) Enhanced Disclosure of the Models Used in the Federal Reserve's Supervisory Stress Test, (ii) Policy Statement on the Scenario Design Framework for Stress Testing, (iii) Stress Testing Policy Statement, and (iv) the Stress Capital Buffer (SCB), which would integrate stress testing results with regulatory capital requirements. While focusing on different issues and processes, each of these initiatives would increase the transparency of the stress testing process and include the following proposed enhancements:

- release more information about the models used by the FRB to estimate hypothetical losses in stress tests;
- provide additional detail on principles/policies that guide the FRB's development of its stress testing models;
- modify the framework for the design of stress test economic scenarios, including providing more information on the hypothetical path of house prices in these hypothetical scenarios; and
- revise certain stress test assumption used in CCAR (e.g., flat balance sheet, curtailment of buybacks in stress).

The Council applauds those efforts and fully supports the underlying goal of enhanced transparency of the stress testing process. The Council also endorses the FRB's increased use of the notice and comment process to more directly solicit third-party input into the design and implementation of enterprise stress tests. That said, additional efforts are needed to address the opaqueness of the current system and the practical impact of the proposals. For example, the industry has provided comment on the SCB proposal described above, noting that the 2018 CCAR results highlighted transparency concerns with the existing process and the increased volatility of capital requirements that would result if the SCB were implemented as proposed.