

COMMITTEE ON CAPITAL MARKETS REGULATION, HAL SCOTT, ET. AL.

Proposal and Comment Information

Title: Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL, R-1873

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Submitter Information

Organization Name: Committee on Capital Markets Regulation

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Benjamin W. McDonough, Deputy Secretary
Board of Governors of the Federal Reserve System,
20th Street and Constitution Avenue NW
Washington, DC 20551

VIA ELECTRONIC PORTAL

Re.: Docket No. R-1873; RIN 7100-AH05; *Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL*

Dear Mr. McDonough:

The Committee on Capital Markets Regulation (the “Committee”) offers these comments to the Board of Governors of the Federal Reserve System (the “Board”) on the Board’s proposed rule entitled “Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL” (the “Proposal”).¹

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes forty-four leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Emeritus Dean, Columbia Business School) and John L. Thornton (Former Chairman, The Brookings Institution) and is led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

Our letter proceeds in two parts.

Part I describes how the Proposal would enhance the transparency of the Board’s annual stress test of large U.S. banks by publicly disclosing and accepting public comments on the economic models and scenarios the Board uses to conduct the tests and committing to develop the models and scenarios for future tests through the public notice and comment process. Importantly, the Proposal itself already enhances the transparency of the stress test process because it discloses the stress test models as part of the proposal document. Part II assesses the Proposal’s changes and finds that they will increase the effectiveness of the stress test in ensuring banks hold sufficient capital to

¹ BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL*, 90 FED. REG. 51,856 (Nov. 18, 2025), <https://www.federalregister.gov/documents/2025/11/18/2025-20211/enhanced-transparency-and-public-accountability-of-the-supervisory-stress-test-models-and-scenarios> [the “Proposal”].

withstand periods of economic distress. Furthermore, as the Committee has repeatedly argued, the development of the stress test models and scenarios through the public notice and comment process is a legal requirement under the Administrative Procedure Act. The Proposal's changes are therefore legally necessary and reduce the vulnerability of the stress test results to legal challenge. Part II also identifies minor modifications that the Board should apply to improve the Proposal. We conclude by recommending that the Board finalize the Proposal with the adjustments we specify as soon as practicable.

I. Summary of the Proposal

The Board conducts annual stress tests to assess whether the largest bank holding companies in the United States have adequate capital to sustain adverse economic and financial conditions. To conduct the stress test, the Board develops economic models and hypothetical scenarios to project the impact of an episode of severe economic and financial distress on a bank's capital levels. The Board adjusts its models and scenarios each year to reflect changing economic conditions with the aim of ensuring that the tests reflect how a hypothetical crisis would affect banks' capital levels.

The results of a bank's stress test are used to calculate a bank's "stress capital buffer." If a bank's risk-weighted capital falls below the sum of its stress capital buffer, minimum regulatory capital requirements, and other applicable capital buffers, then the Board can restrict the bank's distributions to its shareholders. The stress test thus effectively establishes binding capital constraints for many large U.S. banks.

The development and adjustment of these models and scenarios can therefore have a significant impact on banks' required capital ratios. However, prior to the Proposal, the Board did not develop or adjust the models or scenarios through the public notice and comment process. Although the Board published high-level information about the models, it did not disclose important details, including underlying economic assumptions, estimates of banks' portfolio composition, methodologies for validating the models' accuracy, and year-over-year adjustments to the models. Similarly, although the Board published the details of its scenarios before it conducted the annual test, prior to the Proposal the Board did not allow the public to comment on the scenarios.

The Proposal enhances the transparency of the stress test process by disclosing and inviting public comment on the stress test models, including the Board's proposed changes to the models for the 2026 stress tests. The Board has also disclosed and sought public comment on the 2026 stress test scenarios via a concurrent rulemaking proposal. In addition, the Proposal implements the same transparency framework for future years by providing that the Board will annually publish "comprehensive documentation" on the stress test models and invite public comment on any "material changes" that the Board seeks to make to those models and accept public comments on the annual scenarios.²

The Proposal indicates that the purpose of these changes is to "improve the transparency and public accountability of the supervisory stress test, while ensuring that the stress test remains an effective

² Proposal at 51,856.

tool for understanding and assessing risk and retaining appropriate risk sensitivity and risk capture in capital requirements.”³

II. Analysis of the Proposal

1. The Proposal’s changes will increase the effectiveness and reduce the costs of the stress tests.

Developing the stress test models and scenarios through the public notice and comment process will subject the models and scenarios to public scrutiny and allow for the incorporation of feedback from banks, industry analysts, and academic experts. This scrutiny and feedback will allow the Board to better identify and correct inaccurate and incomplete assumptions and methodologies in the models and scenarios and thus increase the accuracy of the stress test results. As the Committee has repeatedly argued, the increased rigor and transparency of this process is beneficial, for three main reasons.

First, inaccurate or unrealistic models and scenarios can fail to capture risks to which a bank is exposed, such that the stress test results fail to require the bank to carry enough capital to cover those risks. Increasing the accuracy of the models and scenarios through public comment will thus increase the ability of the stress test to perform its intended function of ensuring that banks carry enough capital to withstand periods of economic and financial distress.

Second, inaccurate or unrealistic models and scenarios can also result in misidentification and overestimation of risks and thus require a bank to carry excessive capital relative to its true risk profile. An extensive body of empirical evidence demonstrates that excessive capital requirements cause banks to curtail their lending and capital markets activities, which slows economic growth. By reducing the likelihood of misidentifying or overestimating risks, the Proposal therefore also reduces the likelihood that the stress tests will impose unnecessary economic costs.⁴

Third, developing the models and scenarios through a transparent process will increase market confidence that a bank’s stress test result fairly reflects its ability to withstand a period of economic distress. A bank’s investors, counterparties, and rating agencies will thereby derive more accurate information from the stress test results about a bank’s risk profile that they can use in pricing an investment in or transaction with the bank or rating the bank’s creditworthiness.⁵

2. The Proposal’s changes are legally required.

Development of the stress test models and scenarios through the public notice and comment process is also a legal requirement of the Administrative Procedure Act (“APA”).⁶ Specifically, the

³ *Id.* at 51,857.

⁴ *Id.* at 51,858.

⁵ *Id.* at 51,863.

⁶ 5 U.S.C. §§ 551–559. COMMITTEE ON CAPITAL MARKETS REGULATION [“CCMR”], *U.S. Financial Regulatory Agencies and the Rule of Law* (Oct. 2022), <https://capmktreg.org/wp-content/uploads/2022/11/CCMR-Financial-Regulatory-Agencies-and-the-Rule-of-Law-10.18.22.pdf>; CCMR, *Stress Testing During a Pandemic: Enhancing Transparency & Financial Stability* (Oct. 2020), <https://capmktreg.org/wp-content/uploads/2022/11/Stress-Testing-During-a-Pandemic-Oct-2020.pdf>; CCMR, Comment Letter to Board of Governors of the Federal Reserve System

APA requires that federal agencies provide the public with notice and the opportunity to comment on the agency's rulemakings. In the past, the Board and some commentators argued that the APA's notice and comment requirement does not apply to the stress test models and scenarios because the models and scenarios are adjudications and not rulemakings. However, as the Committee has repeatedly argued, the models and scenarios are in fact rules and not adjudications because they: (a) are generally applicable to a group of banks, (b) have future effect through their significant influence over a bank's ability to make capital distributions, and (c) establish *de facto* capital requirements. There is therefore no legal basis for denying public comment on the models and scenarios that underlie the tests, and failing to do so is a major legal deficiency of the Board's current stress test process. Addressing this deficiency has the added benefit of reducing the vulnerability of the stress test results to legal challenge.

3. How the Board can improve the Proposal

The Proposal provides the Board discretion to specify certain features of the models and scenarios within a range of values or to depart from ranges specified in the publicly disclosed documentation of the models and scenarios, when the Board finds it necessary in order to ensure that the stress test captures relevant risks and current economic conditions. For example, the Board notes that it “expect[s] that there will be some important instances when it will be appropriate to augment the recession approach with salient risks and to set variables’ values inside of, and in some cases, outside of the ranges and values provided in the guides in the Scenario Design Policy Statement.”⁷

Stress test models and scenarios are highly complex and thus inherently require the application of judgment. It is therefore appropriate for the Board to retain discretion to specify certain aspects of the models and scenarios, including to incorporate data that is unavailable at the time of proposal or that emerges through the comment process. Moreover, requiring a reopening of the comment process for every minor adjustment would not be practicable and could delay the timely completion of the annual stress test cycle. However, the Board's discretion should not be too broad, nor should the differences between proposed and final versions be so significant that they in effect undermine the public's opportunity to comment. The Proposal should therefore clarify that the models and scenarios that the Board submits for public comment will clearly describe how the Board will apply its discretion and justify any departures from specified ranges, including the analytical basis for those choices. Similarly, modifications between proposed and finalized models or scenarios should be limited to instances where no reasonable alternative exists. Application of discretion and any changes between proposed and final versions should be fully explained with supporting evidence. Adherence to these principles will maintain transparency and public accountability while allowing the Board the flexibility necessary to capture relevant risks.

The Proposal would also no longer base the stress test scenarios on banks' year-end results. Instead, it would require banks to submit estimated third quarter results and base the stress test on those

Re. Docket No. OP-1586 (Jan. 19, 2018), https://capmksreg.org/wp-content/uploads/2018/01/19_18_CCMR-FINAL_Comment_Letter_Fed-Stress-Test-Proposals.pdf; CCMR, *The Administrative Procedure Act and Federal Reserve Stress Tests: Enhancing Transparency* (Sept. 2016), <https://capmksreg.org/wp-content/uploads/2022/11/The-Administrative-Procedure-Act-and-Federal-Reserve-Stress-Tests-Enhancing-Transparency-1.pdf>.

⁷ Proposal at 51,878.

estimates. The stress test results would therefore be a less accurate measure of bank resilience. We understand that the Board made this change because the new annual public comment process on stress test scenarios requires more time for the stress test process. However, the Board should explore potential alternatives that would allow for the retention of the existing year-end date while also accommodating the public comment process.

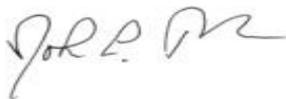
III. Conclusion

Disclosing and accepting public comments on the economic models and scenarios the Board uses to conduct its annual stress tests will increase the effectiveness of the stress test in ensuring banks hold sufficient capital to withstand periods of economic distress. Moreover, developing the models and scenarios through the notice and comment process is also a legal requirement under the APA and thus reduces the vulnerability of the stress test results to legal challenge. We therefore recommend that the Board finalize the Proposal with the adjustments we specify herein as soon as practicable.

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Thank you for your consideration of the Committee’s position. Should you have any questions or concerns, please do not hesitate to contact the Committee’s President, Professor Hal S. Scott (hscott@capmksreg.org) or its Executive Director, John Gulliver (jgulliver@capmksreg.org) at your convenience.

Respectfully submitted,



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CO-CHAIR



Hal S. Scott
PRESIDENT



R. Glenn Hubbard
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