BETTER MARKETS, INC., DENNIS KELLEHER

Proposal and Comment Information

Title: Request for Comment on Scenarios for the Board’s 2026 Supervisory Stress Test, OP-1871

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Subject

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Submitter Information

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15 ANNIVERSARY YEARS

BETTER MARKETS

December 1, 2025

Ann Misback, Secretary
Attn: Docket OP-1871
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Request for Comment on Scenarios for the Board's 2026 Supervisory Stress Test; Docket Number OP-1871; Document Number 2025-20212; 90 Fed. Reg. 51762 (Nov. 18, 2025)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System's ("Fed") proposed scenarios for the 2026 supervisory stress test ("Proposal"). The Proposal 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 several proposed changes to the stress testing framework,[3] and this Proposal contains only a portion of those changes. As such, our comments are directed at this Proposal.

The Proposal unnecessarily and irresponsibly allows for public comment on the stress test scenarios for the 2026 supervisory stress test, but surely this Proposal sets a precedent that will continue for future supervisory stress tests. First, the Proposal undermines a key component of what makes an effective stress test – scenarios that vary sufficiently enough to capture salient and unseen or under-appreciated risks, which will be impossible to achieve through the public comment process. Second, despite the stated reason for the Proposal of "an effort to avoid litigation", the Proposal has the opposite effect of opening up the Fed to even more litigation. The Proposal, in conjunction with other completed and proposed changes to the supervisory stress test

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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 Request for Comment on Scenarios for the Board's 2026 Supervisory Stress Test; Docket Number OP-1871; Document Number 2025-20212; 90 Fed. Reg. 51762 (Nov. 18, 2025), https://www.federalregister.gov/documents/2025/11/18/2025-20212/request-for-comment-on-scenarios-for-the-boards-2026-supervisory-stress-test.

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.

framework, effectively destroys the purpose of the supervisory stress test and makes it very likely that the associated capital requirement – the stress capital buffer or "SCB" – will be perpetually floored at the 2.5 percent minimum.

While the stress tests began in the wake of the 2008 Financial Crisis ("2008 Crash") as a robust framework that was 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.[4] The net effect of these past changes is a reduction in the amount of capital that large banks must maintain. These changes – combined with the several proposed 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.[5]

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 and erode their usefulness in promoting a strong and resilient financial system.

BACKGROUND

In the aftermath of the 2008 Crash, fear permeated the country as millions of Americans lost their jobs, savings, and homes.[6] 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.

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. Additionally, using strong stress tests to help set bank capital buffers reduces the chance

[4] *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.

[5] *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.

[6] 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.

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.[7]

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."[8]

Unfortunately, the Fed stress tests have been systematically and structurally weakened over time. The latest attack, launched by the banking industry and supported by the Fed in late 2024,[9] 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.

COMMENTS

I. THE PROPOSAL UNDERMINES A KEY COMPONENT OF WHAT MAKES AN EFFECTIVE STRESS TEST – SCENARIOS THAT VARY SUFFICIENTLY AND CAPTURE SALIENT AND UNSEEN OR UNDER-APPRECIATED RISKS.

The purpose of stress tests is to be stressful, in accordance with the name. The level of stress broadly is based on two factors: the conservativeness of the assumptions within the framework – including assumptions within the models – and the severity of the scenarios. Arguably, the severity of scenarios is more important to the overall stressfulness of the exercise. And in order for the scenarios to be sufficiently stressful, they must capture salient risks as well as unseen or under-appreciated risks and push those risks to plausible extremes.

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7 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).

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

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

These goals of stress test scenarios are well established. In the Fed's own policy statements, it notes that scenarios may "incorporate events that have not occurred historically" because "[i]t is not necessarily consistent with the purpose of a stress testing exercise to assume that the future will be like the past."[10] The Fed also states that they may include "stress factors that may not necessarily be directly correlated to macroeconomic or financial assumptions but nevertheless can materially affect companies' risks." Furthermore, the Fed states that scenarios will be developed to "reflect specific risks to the economic and financial outlook that are especially salient but will feature minimally in the scenario if the [Federal Reserve] Board were to use approaches that looked to past recessions or relied on historical relationships between variables."[11]

Opening the supervisory stress test scenarios to public comment by the very banks to which the stress test applies ultimately will undermine the scenario design process and result in the scenarios being even more repetitive and historically tied than they already have been. Surely, each bank will object to any scenario design factors that would result in larger losses for itself under the stress test and will demand robust justification from the Fed for scenario factors that do not "look to past recessions" or "rely on historical relationships between variables." This will water down the severity of scenarios and make them predictable, allowing banks to limit their losses under the stress test.

Indeed, the proposed 2025 Scenario Design Policy Statement[12] and the Proposal front-run bank objections to a more severe scenario design process and already are reflections of a watered-down approach to scenario design. In fact, this year's scenario document notes that the 2025 Scenario Design Policy Statement narrows "the ranges of potential values for certain variables." Furthermore, this year's proposed scenario is a clear repeat of classic recessionary effects and financial market turmoil:

> The proposed 2026 severely adverse scenario is characterized by a severe global recession triggered by an abrupt decline in risk appetite that causes substantial declines in risky asset prices and declines in risk-free interest rates. At times during the first months of this scenario, financial market functioning is impaired, leading to substantial additional volatility. Those disruptions spill over into large reductions in household demand for goods and services and significantly reduce employment and business investment. The low levels of risk appetite and the declines in income and wealth persist for some time and lead to a protracted recession in the United States and abroad.[13]

Such a scenario easily could have been, and likely was, predicted by each of the banks subject to the supervisory stress test. This predictability will allow banks to further game the stress test, thereby limiting their losses and ensuring their SCB capital buffer requirements are at or close to the 2.5 percent minimum. Additionally, the results of the stress tests will provide the public with

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10 12 CFR Appendix B to Part 252 2.4(a).
11 12 CFR Appendix A to Part 252 4.2.4(a).
12 90 Fed. Reg. 51856.
13 Board of Governors of the Federal Reserve System, "Proposed 2026 Stress Test Scenarios", November 18, 2025, https://www.federalreserve.gov/publications/2025-november-proposed-2026-stress-test-scenarios.htm.

false comfort that our largest banks have sufficient capital to undergo losses from unseen or under-appreciated risks.

II. THE PROPOSAL OPENS THE FED UP TO MORE LITIGATION.

When the Proposal was issued, the Fed stated the primary reason for the proposal was “an effort to avoid litigation.”[14] Despite this, the Proposal actually opens up the Fed to more litigation. That is, by issuing the entirety of the Fed’s scenario design process and principles for public comment, the industry now can sue the Fed on each aspect of its scenario design process. For example, part of the proposed 2025 Scenario Design Policy Statement is to publish the macroeconomic modeling framework used to calculate the scenario factors, and the industry now can sue based on the functional form, assumptions, and parameters of that model framework.

CONCLUSION

The Proposal, in conjunction with other completed and proposed changes to the supervisory stress test framework, effectively destroy the purpose of the supervisory stress test and make it very likely that the SCB will be perpetually floored at the 2.5 percent minimum for many banks. The Proposal should be rescinded along with the proposed 2025 Scenario Design Policy Statement.

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

Sincerely,

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14 Board of Governors of the Federal Reserve System press release, “ Federal Reserve Board requests comment on proposals to enhance the transparency and public accountability of its annual stress test”, October 24, 2025, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20251024a.htm.