

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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Date: April 11, 2025  
To: Board of Governors  
From: Staff<sup>1</sup>  
Subject: Proposed rule to reduce the volatility of the stress capital buffer requirement

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**ACTIONS REQUESTED:**

Approval of a draft notice of proposed rulemaking (proposal) that would average the results of the supervisory stress test over two years to reduce volatility in the stress capital buffer requirement. The proposal would also modify the annual effective date of the stress capital buffer requirement from October 1 to January 1 and make targeted changes to the FR Y-14A/M/Q reports to collect additional data that would improve the accuracy of the stress capital buffer requirement calculation, as well as remove data items no longer needed to conduct the supervisory stress test. Staff also requests authority to make technical, non-substantive changes to the attached materials prior to publication in the Federal Register.

**EXECUTIVE SUMMARY:**

- Consistent with the December 2024 Board press release, the proposal is the first of several steps to improve the transparency of the supervisory stress test and to reduce the volatility of stress capital buffer requirements.<sup>2</sup>

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<sup>1</sup> Michael Gibson, Art Lindo, Molly Mahar, Lisa Ryu, Anna Lee Hewko, Rob Sarama, Juan Climent, Skander Van den Heuvel, Hillel Kipnis, Missaka Warusawitharana, Andrew Willis, Christopher Appel, John Simone, Mehdi Beyhaghi, Emily Davine (Division of Supervision and Regulation); Mark Van Der Weide, Reena Sahni, Asad Kudiya, Julie Anthony, Jonah Kind, Kirin Walsh, Jasmin Keskinen, and Leah Kazar (Legal Division).

<sup>2</sup> See <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20241223a.htm> and <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20250205a.htm>.

- The Board also plans to issue proposals later in 2025 to seek public comment on the models it uses for the supervisory stress test and on the supervisory scenarios for the 2026 supervisory stress test.
- For firms subject to Category I-III standards, the proposal would reduce the volatility of stress capital buffer requirements by averaging the results of the supervisory stress test from each of the prior two annual supervisory stress tests.<sup>3</sup>
  - By averaging results, the proposal would mitigate the potential adverse effects that large and sudden changes in capital requirements can have on the provision of banking services.
- Firms subject to Category IV standards that choose, or are otherwise required, to be subject to consecutive supervisory stress tests would also be subject to results averaging.<sup>4</sup> Category IV firms that are subject to biennial supervisory stress tests would not be subject to results averaging.
  - The proposal includes questions for public comment on potential options to reduce the volatility of stress capital buffer requirements for firms subject to Category IV standards.
- The proposal would also provide three months of additional time for firms to comply with a new stress capital buffer requirement by extending the effective date of the stress capital buffer requirement from October 1 to January 1 in each year.
- The proposed changes to the calculation of the stress capital buffer requirement would be effective beginning with the stress capital buffer requirement from the 2025 supervisory stress test, which would average the stress capital decline components from the 2024 and 2025 supervisory stress tests for applicable firms.

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<sup>3</sup> Category I standards apply to U.S. global systemically important bank holding companies (GSIBs) and their depository institution subsidiaries. Category II standards apply to banking organizations with at least \$700 billion in total consolidated assets or at least \$75 billion in cross-jurisdictional activity and their depository institution subsidiaries. Category III standards apply to banking organizations with total consolidated assets of at least \$250 billion or at least \$75 billion in weighted short-term wholesale funding, nonbank assets, or off-balance sheet exposure and their depository institution subsidiaries. Category IV standards apply to banking organizations with total consolidated assets of at least \$100 billion that do not meet the thresholds for a higher category and their depository institution subsidiaries.

<sup>4</sup> Firms subject to Category I-III standards are subject to the supervisory stress test on an annual basis. Firms subject to Category IV standards are generally subject to the supervisory stress test on a biennial basis but may choose to opt in to the supervisory stress test in a year that they otherwise would not be subject to the supervisory stress test.

- The proposal would include questions on whether to (1) change the calculation of the stress capital buffer requirement effective beginning with the stress capital buffer requirement from the 2026 supervisory stress test, and (2) allow a firm to elect to have its stress capital buffer requirement from the 2025 supervisory stress test calculated as proposed.
- The proposal also would modify certain elements of the FR Y-14A/Q/M reporting forms to collect data that would provide greater insight into the composition of net income of large firms. The proposal would also remove several data items that are no longer needed to conduct the supervisory stress test.
- The changes in the proposal are not designed to materially affect overall capital requirements and would decrease regulatory reporting burden.

## **BACKGROUND:**

The Dodd-Frank Act<sup>5</sup> requires the Board to conduct an annual supervisory stress test of large firms.<sup>6</sup> Stress testing is a core element of the Board’s regulatory framework and supervisory program for large firms. It enables the Board to assess whether large bank holding companies, savings and loan holding companies, U.S. intermediate holding companies of foreign banking organizations, and nonbank financial companies supervised by the Board (collectively, firms) have sufficient capital to absorb potential losses and continue lending under severely adverse conditions.<sup>7</sup> Since its inception in 2009, the supervisory stress test<sup>8</sup>—together with

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<sup>5</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 165(i)(1), Public Law 111-203, 124 Stat. 1376 (2010).

<sup>6</sup> See 12 U.S.C. 5365(i)(1). Section 401(e) of the Economic Growth, Regulatory Relief and Consumer Protection Act requires the Board to conduct periodic stress tests for bank holding companies with total consolidated assets between \$100 billion and \$250 billion. 12 U.S.C. 5365 note.

<sup>7</sup> The stress capital buffer requirement framework generally applies to firms with \$100 billion or more in total consolidated assets.

<sup>8</sup> In 2009, the Board used the supervisory stress test to assess the capital sufficiency of large banking organizations under stress in the Supervisory Capital Assessment Program (SCAP). In 2012, the Board finalized a rule that subjects large firms to annual supervisory stress testing. See 77 FR 62378 (October 12, 2012).

stronger capital requirements implemented in the Board's capital rule—has played a critical role in helping to ensure the resilience of the U.S. banking system.<sup>9</sup>

Using supervisory stress test results, the Board calculates a firm's stress capital buffer requirement as the difference between the firm's starting and lowest projected common equity tier 1 capital ratio under the severely adverse scenario in the supervisory stress test plus four quarters of planned common stock dividends, expressed as a percentage of risk-weighted assets.<sup>10</sup> The stress capital buffer requirement provides a dynamic, forward-looking approach to capital regulation that adapts to changing economic conditions and individual firm risk profiles.<sup>11</sup> At the same time, certain elements of the supervisory stress test can increase the volatility and reduce the predictability of capital requirements. Large and sudden changes in capital requirements can impede the ability of firms to engage in capital planning and can negatively impact the supply of credit and other banking services to borrowers or other customers.<sup>12</sup>

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<sup>9</sup> The common equity capital ratios of firms subject to the supervisory stress test have more than doubled since 2009, with common equity capital of such firms increasing by over \$1 trillion, based on FR Y-9C report (Consolidated Financial Statements for Holding Companies) filings.

<sup>10</sup> In 2020, the Board finalized a rule to integrate supervisory stress test results into the capital framework, known as the stress capital buffer requirement. 85 FR 15576 (March 18, 2020).

<sup>11</sup> Under the current supervisory stress test timeline, a firm's preliminary stress capital buffer requirement is generally announced in June, with the final requirement released by August 31 and effective on October 1.

<sup>12</sup> See Fraisse, H., Lé, M., & Thesmar, D. (2020). The real effects of bank capital requirements. *Management Science*, 66(1), 5-23; Jiménez, G., Ongena, S., Peydró, J. L., & Saurina, J. (2017). Macroprudential policy, countercyclical bank capital buffers, and credit supply: Evidence from the Spanish dynamic provisioning experiments. *Journal of Political Economy*, 125(6), 2126-2177; Groppe, R., Mosk, T., Ongena, S., & Wix, C. (2019). Banks response to higher capital requirements: Evidence from a quasi-natural experiment. *The Review of Financial Studies*, 32(1), 266-299; Berger, A. N., & Udell, G. F. (1994). Did risk-based capital allocate bank credit and cause a "credit crunch" in the United States? *Journal of Money, credit and*

## **DISCUSSION:**

### **A. Results Averaging**

To reduce the volatility of stress capital buffer requirements, the proposal would use the average of the maximum common equity tier 1 capital declines projected in each of the Board's two most recent annual supervisory stress tests to determine a firm's stress capital buffer requirement.<sup>13</sup> Averaging in this manner would preserve the ability of the supervisory stress test to vary with changing risks, while phasing in any year-over-year changes to a firm's stress capital buffer requirement.<sup>14</sup> The proposal would not apply averaging to a firm that does not participate in the supervisory stress test in consecutive years, and seeks comment on alternatives to ensure requirements for such firms are appropriately tailored.<sup>15</sup>

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*Banking*, 26(3), 585-628; Kashyap, A. K., Stein, J. C., & Hanson, S. (2010). An analysis of the impact of 'substantially heightened' capital requirements on large financial institutions. *Booth School of Business, University of Chicago, mimeo*, 2, 1-47.; Peek, J., & Rosengren, E. S. (1997). The international transmission of financial shocks: The case of Japan. *The American Economic Review*, 495-505.

<sup>13</sup> To calculate a firm's stress capital buffer requirement, the Board would (1) average the stress capital declines from the two most recent annual supervisory stress tests; then (2) add the four quarters of planned dividends for the current year; and finally (3) apply, as applicable, the 2.5 percent floor, in that order.

<sup>14</sup> The proposal would apply results averaging symmetrically with respect to increases and decreases in a firm's stress capital buffer requirement. The proposal also would include questions for public comment on other averaging approaches, including asymmetric averaging where the Board would only employ a two-year average of a firm's stress capital buffer requirements in situations where a firm's current-year stress capital buffer requirement is higher than its prior-year stress capital buffer requirement.

<sup>15</sup> Currently, the effects of material supervisory model changes are phased-in over a two-year period to mitigate the volatility of supervisory stress test results. Since the proposal would average all changes to a firm's stress capital decline component, material supervisory model changes would automatically be phased-in to the proposed calculation of the stress capital decline component. As such, the proposal would revise the Board's Stress Testing Policy

## **B. Effective Date of the Stress Capital Buffer Requirement**

With the goal of further enabling better capital planning by firms, the proposal would extend the effective date of the stress capital buffer requirement in a given year from October 1 to January 1.<sup>16</sup> This change would help alleviate the impact of large changes in capital requirements by providing firms with an additional three months relative to the current framework to comply with their updated stress capital buffer requirement.

## **C. FR Y-14 Reporting Requirements**

The proposal would make targeted changes to the FR Y-14 A/Q/M reports to collect additional data that would enhance supervisory models used to conduct the supervisory stress test. The proposed revisions would strengthen the Board’s ability to evaluate components of a firm’s net income in the supervisory stress test. The proposal would also remove several items from the FR Y-14 A/Q/M reports that are no longer needed to conduct the supervisory stress test.

## **D. Impact Analysis**

Staff have calculated what stress capital buffer requirements would have been under the proposal using data from 2019 to 2024.<sup>17</sup> The analysis shows that the proposed changes would reduce average year-over-year changes in stress capital buffer requirements by 11 basis points, or roughly 17 percent. Year-over-year stress capital buffer requirement changes average 65 basis

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Statement to no longer specify that material supervisory model changes would be phased in over a two-year period.

<sup>16</sup> The proposal would implement technical changes to align the dividend add-on component of the stress capital buffer requirement with the proposed effective date.

<sup>17</sup> Sample includes all firms subject to the Board’s supervisory stress test from 2019 to 2024. The 2019 supervisory stress test results have been adjusted to reflect the supervisory stress test assumption changes finalized in the rule that established the stress capital buffer requirement framework.

points under the current rule and would be reduced to an estimated change of 54 basis points under the proposal. For U.S. GSIBs, the analysis shows a reduction of year-over-year changes in stress capital buffer requirements of 16 basis points or 44 percent. Further, the proposed changes would roughly maintain the current average level of the stress capital buffer requirement. Under the proposal, the average stress capital buffer requirement would be 3.82 percentage points versus 3.88 percentage points under the current framework.

Under the proposal, a firm's current stress capital buffer requirement would derive partly from the previous year's supervisory stress test results. This would reduce the extent to which the stress capital buffer requirement reflects the current business profile of a firm. However, as previously described, the proposal would help alleviate the negative impact of large and sudden changes in capital requirements and help facilitate more informed capital planning by providing firms with additional time to comply with the stress capital buffer requirement.

#### **RECOMMENDATIONS:**

For the reasons discussed above, staff recommends that the Board approve the attached draft notice of proposed rulemaking. Staff also recommends that the Board authorize staff to make technical, non-substantive changes to the attached materials prior to publication.