

Congress of the United States

Washington, DC 20515

February 10, 2025

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

Dear Chair Powell:

We write to express serious concern regarding the threats to the banking system and the economy posed by the Federal Reserve Board’s December 2024 announcement that it will begin a rulemaking that could upend the stress testing framework used to ensure that banks are prepared for financial and economic shocks and downturns.¹ The new rule comes as big banks aggressively seek changes—from the Fed, and through the courts²—that would threaten the whole point of stress tests—to ensure that banks have adequate risk controls and are sufficiently capitalized to withstand adverse economic conditions without collapsing, requiring bailouts, or putting the whole financial system at risk. The Federal Reserve Board should refrain from weakening the stress testing framework and vigorously defend its clear legality in court. The changes sought by big banks—like previous rollbacks of banking rules—will come back to haunt families, small businesses, and the economy, increasing the likelihood of another Wall Street-driven economic collapse.

The Federal Reserve’s Stress Tests

Wall Street banks were severely undercapitalized in the lead up to the 2008 financial crisis.³ They funded their loans and risky bets with too much debt and not enough of their own capital. After the subprime mortgage market crashed, big banks did not have the capacity to absorb losses and continue serving businesses and households. Many big banks were on the brink of failure when they were bailed out by the public.⁴ Stress testing was a key tool that regulators deployed to restore confidence in the financial system in the wake of the crisis. In 2009, regulators established the first bank stress tests, the Supervisory Capital Assessment Program

¹ Federal Reserve Board, “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,” Press Release, December 23, 2024, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20241223a.htm>.

² Bank Policy Institute, “Banks and Business Groups File Legal Challenge Against Federal Reserve Over Flawed Stress Testing Framework,” Press Release, December 24, 2024, <https://bpi.com/banks-and-business-groups-file-legal-challenge-against-federal-reserve-over-flawed-stress-testing-framework/>.

³ United States Financial Crisis Inquiry Commission. The financial crisis inquiry report: final report of the National Commission on the Causes of the Financial and Economic Crisis in the United States. January 2011, <https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

⁴ U.S. Department of the Treasury, “Data: Troubled Asset Relief Program (TARP),” <https://home.treasury.gov/data/troubled-asset-relief-program>.

(“SCAP”).⁵ The exercise evaluated whether big banks could withstand continued economic weakness without breaching their minimum capital requirements.⁶ Due to the success of SCAP, Congress directed the Federal Reserve Board in the Dodd-Frank Wall Street Reform and Consumer Protection Act to annually stress test the nation’s largest bank holding companies and systemically important shadow banks.⁷

The Federal Reserve Board implemented this requirement by creating the Dodd-Frank Act Stress Test (“DFAST”) and the Comprehensive Capital Analysis and Review (“CCAR”).⁸ Through DFAST and CCAR, big bank balance sheets were stressed annually against a severe hypothetical economic downturn. If the projected losses brought a big bank’s capital levels below regulatory minimums, it would face restrictions on its planned dividends and share buybacks. The stress testing framework, and other post crisis improvements to capital requirements, helped increase big bank capital levels in the years following the financial crisis.⁹

But during the first Trump administration, the Federal Reserve Board watered down certain assumptions and requirements embedded in the stress testing framework.¹⁰ For example, leverage capital requirements were stripped from the stress tests, certain assumptions regarding balance sheet growth were relaxed, and pre-funding requirements for planned dividends and share buybacks were significantly reduced.¹¹ The Economic Growth, Regulatory Relief, and Consumer Protection Act and the Federal Reserve Board’s “tailoring” rule increased the size threshold at which banks are subjected to the stress tests, reduced the number of scenarios in the stress tests, and reduced their frequency for certain firms. Silicon Valley Bank is one firm that did not face

⁵ U.S. Department of the Treasury, “Data: Supervisory Capital Assessment Program & Capital Assistance Program (SCAP and CAP),” <https://home.treasury.gov/data/troubled-assets-relief-program/bank-investment-programs/scap-and-cap/>.

⁶ *Id.*

⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 165(i)(1). Distinct from the supervisory stress tests, the Dodd-Frank Act also established a company-run stress testing requirement.

⁸ DFAST and CCAR were ultimately merged, and stress testing results were more formally integrated into the point-in-time capital requirements through the Stress Capital Buffer rulemaking. See, Federal Reserve Board, “Federal Reserve Board approves rule to simplify its capital rules for large banks, preserving the strong capital requirements already in place,” press release, March 4, 2020, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm>.

⁹ For example, the 34 large bank holding companies subjected to the 2017 stress tests had more than doubled their high-quality risk-weighted capital levels from 5.5% in Q1 2009 to 12.5% in Q1 2017. Similarly, these banks materially increased their simpler and more reliable leverage capital levels between 2009 and 2017. Federal Reserve Board, “Federal Reserve releases results of Comprehensive Capital Analysis and Review (CCAR),” press release, June 28, 2017, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20170628a.htm>; See Chart 1, Federal Reserve Bank of Kansas City. Bank Capital Analysis Semiannual Update. (October 2024), https://www.kansascityfed.org/Banking/documents/10556/Bank_Capital_Analysis_Report_-_20_2024_-_final.pdf.

¹⁰ Federal Reserve Board, “Federal Reserve Board approves rule to simplify its capital rules for large banks, preserving the strong capital requirements already in place.”; Governor Lael Brainard, “Statement by Governor Brainard,” March 4, 2024, <https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200304a.htm>; Federal Reserve Board, “Federal Reserve Board announces it will limit the use of the “qualitative objection” in its Comprehensive Capital Analysis and Review (CCAR) exercise, effective for the 2019 cycle,” press release, March 6, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm>; Better Markets. Comment Letter Re: Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, Docket No. R-1603 and RIN 7100-AF 01. June 25, 2018, <https://bettermarkets.org/sites/default/files/Better%20Markets%20CL%20to%20Fed%20-%20Cap%20buffer%20and%20stress%20testing%206-25-18.pdf>.

¹¹ *Id.*

stress tests prior to its failure due to these rollbacks and the associated long transition periods. In its SVB post-mortem, the Fed found that:

“A comprehensive assessment of changes from EGRRCPA, the 2019 tailoring rule, and related rulemakings show that they combined to create a weaker regulatory framework for a firm like SVBFG. Further, the long transition periods provided by the rules that did apply further delayed the implementation of requirements, such as stress testing, that may have contributed to the resiliency of the firm.”¹²

As a result of these and other changes, big banks’ loss-absorbing cushions have stopped increasing or have actually decreased since 2017, depending on the preferred measurement of capital.¹³

In addition to undermining certain stress testing assumptions and requirements, the Federal Reserve Board finalized a series of “transparency” amendments prompted by requests from Wall Street lobbyists.¹⁴ Pursuant to these changes, the Federal Reserve Board released loss rates for certain types of loans of participating banks and loss rates on portfolios of hypothetical loans, generated by the Federal Reserve Board’s internal models. These disclosures were paired with more detailed descriptions of the internal models, including certain equations and variables. In reality, this “transparency” allowed banks to identify and take advantage of loopholes in the system: former Federal Reserve Governor, and key stress testing architect, Dan Tarullo stated at the time, “I suspect that the smart people who work on such things for the big banks now have most of what they need to reverse engineer the model’s loss functions.”¹⁵

Last year, Greg Feldberg, Research Director of Yale’s Program on Financial Stability testified before the House Financial Services Committee, explaining that, “Too much transparency can be a bad thing... US supervisors are already revealing a lot about the stress test methodologies to the regulated industry, which may allow banks to merely optimize to the stress test rather than build resiliency. The Federal Reserve’s disclosures about its models and methods, along with the Bank of England’s, are far more transparent than other authorities across the world.”¹⁶

¹² Federal Reserve Board. Review of the Federal Reserve’s Supervision and Regulation of Silicon Valley Bank. (April 2023), <https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf>.

¹³ Federal Reserve Bank of New York, Quarterly Trends for Consolidated U.S. Banking Organizations Third Quarter 2024, https://www.newyorkfed.org/medialibrary/media/research/banking_research/QuarterlyTrends2024Q3.pdf.

¹⁴ Federal Reserve Board, “Federal Reserve Board finalizes set of changes that will increase the transparency of its stress testing program for nation’s largest and most complex banks,” Press Release, February 5, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190205a.htm>; The Clearing House, “The Clearing House Offers Recommendations to Improve Stress Testing Transparency,” Press Release, January 22, 2018, <https://www.theclearinghouse.org/advocacy/Articles/2018/01/improve-stress-testing-transparency-01-23-18>.

¹⁵ Daniel K. Tarullo, “Taking the Stress Out of Stress Testing,” Americans for Financial Reform Conference on Big Bank Regulation Under the Trump Administration, May 21, 2019, <https://ourfinancialsecurity.org/wp-content/uploads/2019/05/Tarullo-AFR-Talk.pdf>.

¹⁶ Greg Feldberg. Written Testimony of Greg Feldberg. “Stress Testing: What’s Inside the Black Box?” U.S. House Subcommittee on Financial Institutions and Monetary Policy, June 26, 2024, <https://democrats-financialservices.house.gov/uploadedfiles/hhrg-118-ba20-wstate-feldbergg-20240626.pdf>. For an international comparison, see page 7.

Prior to the 2019 changes, the Federal Reserve Board prudently limited the information disclosed to big banks regarding its internal stress testing models. Disclosing information on the internal models enables big banks to game the stress tests and engineer their balance sheets to limit projected losses, reducing the capital required by the tests and increasing correlations across the banking system.¹⁷ This dynamic increases big banks' capacity for share buybacks and dividends, at the expense of their resiliency to stress.¹⁸

The risks outlined above are not theoretical. In 2002, the now defunct Office of Federal Housing Enterprise Oversight ("OFHEO") established a stress testing program for Fannie Mae and Freddie Mac.¹⁹ By law, OFHEO was required to fully disclose the models it used to conduct the stress test.²⁰ Perhaps unsurprisingly, the stress tests gave Fannie Mae and Freddie Mac a clean bill of health prior to the 2008 financial crisis. On September 7, 2008, the firms were placed into conservatorship and ultimately received a \$187.5 billion bailout.²¹

Big Banks' Efforts to Roll Back Stress Tests through Court Intervention

Under the second Trump administration, and with an eye towards the conservative judiciary, big banks are eyeing fresh attempts to water down the stress tests. On December 24, 2024, several big bank lobbying organizations sued the Federal Reserve Board over its stress testing framework.²² The lawsuit claims that the stress tests violate the Administrative Procedure Act.²³ The relief sought by the big banks includes a court order requiring the Federal Reserve Board to publish its internal stress testing models and scenarios for notice and comment: in short, banks not only want the answers to the test, they also want to design the questions.

¹⁷ Itay Goldstein and Yaron Leitner. Stress Tests Disclosure: Theory, Practice, and New Perspectives. Handbook of Financial Stress Testing, Cambridge University Press, 2022, <https://finance.wharton.upenn.edu/~itayg/Files/stresstestsnewperspectives-published.pdf>; Til Schuermann. Stress testing banks, International Journal of Forecasting. 30(3)(2014), 717-728, <https://www.sciencedirect.com/science/article/abs/pii/S016920701300143X> The scenarios used by the Federal Reserve Board are only a couple of the hundreds or thousands of scenarios that could play out in reality. They are not meant to be predictive. For example, the severely adverse scenarios have generally contemplated interest rate declines in periods of stress, unlike the Spring 2023 banking turmoil.

¹⁸ In addition, big banks have complained that changing the scenarios and refining the models every year may add some "volatility" to projected losses and required capital year-to-year. This variation is a prudent feature, not a bug, of the stress tests. It promotes conservative capital planning and preparation for unexpected events.

¹⁹ W. Scott Frame, Kristopher Gerardi, and Paul S. Willen. The Failure of Supervisory Stress Testing: Fannie Mae, Freddie Mac, and OFHEO. Federal Reserve Bank of Boston (2015), <https://www.bostonfed.org/publications/research-department-working-paper/2015/the-failure-of-supervisory-stress-testing-fannie-mae-freddie-mac-and-ofheo.aspx>.

²⁰ Federal Housing Enterprise Safety and Soundness Act of 1992.

²¹ The stress tests were stagnant, relied on stale assumptions, and provided the subjects of the test an opportunity to influence its design. U.S. Department of the Treasury, "Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers," Press Release, September 7, 2008, <https://home.treasury.gov/news/press-releases/hp1128>; W. Scott Frame et. Al, The Rescue of Fannie Mae and Freddie Mac. Federal Reserve Bank of New York Staff Reports, (March 2015), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf.

²² Bank Policy Institute, "Banks and Business Groups File Legal Challenge Against Federal Reserve Over Flawed Stress Testing Framework."

²³ *Id.*

Big banks' legal arguments do not have merit. The Federal Reserve Board should vigorously defend the legality of the stress tests in court. Congress explicitly afforded the Federal Reserve Board significant discretion in administering capital standards, including through stress testing, in the Dodd-Frank Wall Street Reform and Consumer Protection Act and the International Lending Supervision Act (ILSA).²⁴ Certain provisions in the ILSA explicitly codified the significant discretion Congress afforded to the banking agencies with respect to capital standards in direct response to an adverse 1983 court decision.²⁵ And the Administrative Procedure Act does not require stress test models and scenarios to undergo notice and comment, which would render the tests useless and even counterproductive to the statutory directives enacted by Congress, as demonstrated by the OFHEO stress tests.²⁶

The New Fed Rulemaking Could Result in Even Weaker Stress Tests

We are concerned that, instead of fighting against the banks in courts and elsewhere, the Fed is now – in the wake of President Trump's election – seeking new avenues for premature surrender. On December 23, 2024, the Fed released an announcement indicating that, “In view of the evolving legal landscape, the Federal Reserve Board will soon seek public comment on significant changes to improve the transparency of its bank stress tests and to reduce the volatility of resulting capital buffer requirements.”²⁷ The announcement indicated that, in fact, the Board had already made up its mind to weaken the tests, stating that:

The Board intends to propose changes that include, but are not limited to: disclosing and seeking public comment on all of the models that determine the hypothetical losses and revenue of banks under stress; averaging results over two years to reduce the year-over-year changes in the capital requirements that result from the stress test; and ensuring that the public can comment on the hypothetical scenarios used annually for the test, before the scenarios are finalized.

This announcement makes it clear the Federal Reserve Board intends to voluntarily oblige big banks and initiate a rulemaking to undermine the stress tests. This posture directly conflicts with previous statements you have made to the Banking Committee, in which you expressed concern that the now-proposed changes to increase transparency would increase risks. In your 2017 nomination hearing to become Chair, you stated:

[T]he benefits of increased transparency must be carefully weighed against the potential downsides of providing the firms subject to the stress test with full details about the models. For example, complete knowledge of the models could lead to a ‘model monoculture’ in which all firms have similar internal stress testing models, which could

²⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 165(i); International Lending Supervision Act, Section 908.

²⁵ S. REPT. 98-122, at 16.

²⁶ Daniel K. Tarullo. Bank Supervision and Administrative Law. *Columbia Business Law Review*, 2022(1), <https://journals.library.columbia.edu/index.php/CBLR/article/view/9983/5045>.

²⁷ Federal Reserve Board, “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.”

increase the correlation of risk in the system, and miss key idiosyncratic risks faced by the firms.²⁸

Conclusion and Questions

Rolling back stress test rules that ensure that banks are stable during a fiscal or economic crisis is unwise and unnecessary, and would not be consistent with the Fed's mandate of promoting the safety and soundness of the banking system and broader financial stability.

Indeed, any actions taken by the banking agencies related to stress testing or the broader capital framework should increase the resiliency of big banks. Strong capital levels enable banks to reliably serve businesses and households in good times and bad. There are many ways the banking agencies could improve this framework, including by creating more dynamic stress tests²⁹, undoing the deregulatory changes under the first Trump administration, and finalizing a strong Basel III Endgame rule³⁰, among others.

To help the Committee better understand the serious implications of the December 23, 2024, announcement, and its intent to roll back banking stability and supervision rules, I ask that you please respond to the following questions by February 24, 2025:

1. How and why did you decide to announce the proposed rollback of these important banking rules one day prior to the banks' filing of their lawsuit? Did you communicate or coordinate with banks in any way regarding this matter?
2. List all meetings between any Governor or Federal Reserve Board staff and any representative from the Bank Policy Institute, American Bankers Association, Ohio Bankers League, U.S. Chamber of Commerce, or Ohio Chamber of Commerce, including outside counsel, related to a potential lawsuit against the Federal Reserve Board's stress testing framework and/or the Federal Reserve Board's December 23 statement.
 - a. For any such meetings, provide a list of attendees and any meeting minutes or other meeting summaries.
 - b. Provide all written communications between the Federal Reserve Board and the above stated parties regarding a potential lawsuit against the Federal Reserve

²⁸ S.Hrg. 115-157 — NOMINATION OF JEROME H. POWELL, OF MARYLAND, TO BE CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, <https://www.congress.gov/event/115th-congress/senate-event/LC58502/text>.

²⁹ For example, the Federal Reserve Board could integrate second order effects of short-term funding market runs and asset fire-sales into the stress tests. See Bookstaber et. Al. Stress Tests to Promote Financial Stability: Assessing Progress and Looking to the Future. Office of Financial Research Working Paper, (July 2023), https://www.financialresearch.gov/working-papers/files/OFRwp0010_BookstaberCetinaFeldbergFloodGlassermanStressTeststoPromoteFinancialStability.pdf.

³⁰ Letter from Senator Sherrod Brown et. al. to Federal Reserve Board Vice Chair Michael S. Barr, FDIC Chairman Martin J. Gruenberg, and Acting Comptroller Michael J. Hsu, January 18, 2024, https://www.banking.senate.gov/imo/media/doc/basel_iii_comment_letter.pdf; U.S. House Committee on Financial Services, "Ranking Member Waters Leads 41 House Democrats in Urging Banking Regulators to Quickly Finalize Rules to Strengthen Capital Requirements for Big Banks, Prevent Financial Crisis," press release, February 16, 2024, <https://democrats-financialservices.house.gov/news/documentsingle.aspx?DocumentID=411202>.

Board's stress testing framework and/or the Federal Reserve Board's December 23 statement.

- c. Provide any legal opinions drafted by the Federal Reserve Board's Legal Division regarding the propriety of ex parte regulatory negotiations with supervised entities outside of the Administrative Procedure Act.
3. Do you still agree with your November 28, 2017, testimony that publishing the Federal Reserve Board's internal stress testing models could "lead to a 'model monoculture' in which all firms have similar internal stress testing models, which could increase the correlation of risk in the system, and miss key idiosyncratic risks faced by the firms." How is the Federal Reserve Board's December 23, 2024, announcement consistent with your testimony?
4. What do you see as the lessons learned from the Office of Federal Housing Enterprise Oversight's stress tests of Fannie Mae and Freddie Mac prior to the 2008 financial crisis? Would you agree with the consensus view that publishing the models and scenarios for notice and comment undermined the effectiveness of the OFHEO stress tests?
5. Proposing "significant changes" to the stress testing framework would constitute a major rulemaking. Does the Federal Reserve Board intend to follow its January 6 declaration that, "The Board does not intend to take up any major rulemakings until a vice chair for supervision successor is confirmed."?
6. In order to "soon seek public comment" through a rulemaking, a majority of the Federal Reserve Board would have to vote in the affirmative on a proposed rule. Did the Federal Reserve Board vote to publish the December 23, 2024, statement? If so, please provide a record of the vote. If not, under whose direction, and under what authority, did the Federal Reserve Board publish the December 23, 2024, statement?
7. Through this potential rulemaking process, does the Federal Reserve Board intend to propose significantly higher minimum capital requirements to offset any reduction in the stringency of the stress tests?
8. The Federal Reserve Board has yet to finalize rules on Long Term Debt and the treatment unrealized losses in the capital framework that are directly responsive to the failures of Silicon Valley Bank, Signature Bank, and First Republic Bank in the Spring of 2023. The Federal Reserve Board has yet to finalize a strong Basel III Endgame rule, as well as improvements to the GSIB surcharge. The Federal Reserve Board has yet to finalize the long overdue executive compensation rule under Section 956 of the Dodd-Frank Act. Why is the Federal Reserve Board prioritizing weakening the stress tests over these unfinished rules?
9. Do you believe that certain explicit grants of discretion in the Dodd-Frank Wall Street Reform and Consumer Protection Act and International Lending Supervision Act related to capital standards and stress testing supersede procedural requirements in the Administrative Procedure Act? If not, do you believe the stress tests constitute an

informal adjudication under the APA? If the stress tests were found to constitute a rule, do you believe the Federal Reserve Board would be permitted to exercise the “good cause” exception in the APA to refrain from publishing the scenarios and models for notice and comment?

10. What specific “evolutions in the legal landscape and changes in the framework of administrative law” do you think necessitate changes to the stress tests? Please provide specific legal analysis as to how these “evolutions” and “changes” have directly constrained the discretion afforded to the Federal Reserve Board in the Dodd-Frank Act and ILSA related to capital standards and stress testing.
11. If the Federal Reserve Board reevaluates its stress testing framework, will it revisit the decision to weaken assumptions related to balance sheet growth and prefunded capital distributions, as well as the removal of the leverage ratio, given that these changes were not supported by reasoned analysis in violation of the APA?

Sincerely,



Elizabeth Warren
Ranking Member
Committee on Banking,
Housing, and Urban Affairs



Maxine Waters
Ranking Member, Committee
on Financial Services