

# Press Release

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April 17, 2025

## Statement on Stress Test Proposal by Governor Michael S. Barr

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I cannot support the package of planned changes to the stress test that begin with today's proposal. These changes risk turning stress testing into an ossified exercise that will provide false comfort in the resilience of the system.

Our first stress test in 2009 helped the country to turn the corner on the financial crisis. It restored market confidence in bank health, enabled firms to re-capitalize themselves, and restarted the provision of credit to the economy. Since then, we've made a number of adjustments to evolve the stress test, including to increase transparency, to incorporate the stress test in the capital framework, and to experiment with exploratory scenarios.

But I have fundamental doubts that we can keep the stress test agile, rigorous, and able to account for quickly developing risks if we subject model changes and scenarios to a protracted regulatory process.

Stress test models are inherently complex and require nimble adjustments to maintain accuracy and relevance as banks innovate and create new products and risks. Subjecting the models to the notice and comment process could lead them to ossify, and the dynamism and rigor may fade. We saw this play out before the financial crisis, as supervisory stress tests of Fannie Mae and Freddie Mac failed to capture mounting risks.<sup>1</sup> It took Fannie and Freddie's regulator, OFHEO, more than five years to work through the notice and comment process, and after the models were in place, OFHEO never updated them. We can try to learn from OFHEO's mistakes, but I fear we are setting ourselves up for a sequel—that the burden of preparing updated models and scenarios for the regulatory process will undermine the Fed's ability to maintain accurate models and probing scenarios, and prevent the stress test from capturing the build-up of risk.

There are several other ways in which I believe this process will result in a weaker and less credible stress test. First, there could be an incentive for bank commenters to object to various aspects of the Federal Reserve's models that result in higher capital requirements, and not to highlight the areas in which the models underestimate downside risk. Responding to these comments could create a one-way ratchet that weakens capital requirements.

Second, banks are likely to game the capital requirements once they know the details of the stress test. Full disclosure of the Fed's stress models and scenarios could enable banks to optimize stress test results by adjusting their balance sheet based on their knowledge of where the models underprice risk, in order to reduce their capital requirements without materially reducing risks.

Third, banks are likely to invest less in their own risk management if the test becomes too predictable.

Fourth, full disclosure of our models may encourage concentration across the system in assets that receive comparably lighter treatment in the test, which could create risks to financial stability.

And fifth, banks are likely to reduce their management buffers, which is the capital cushion a bank holds over its required levels and regulatory buffers. This will bring greater risks of breaching the minimums and regulatory buffers when a significant risk event eventually happens.

It is critical to maintain the dynamism and rigor of the stress test so that supervisors, banks, and the public understand the underlying vulnerabilities in the banking system and at individual banks. This will require the Federal Reserve to have flexibility to make regular model updates and use multiple, robust scenarios that test a range of risks. To enable us to do this, given the current legal environment, I could support removing the stress test from binding regulatory capital requirements and increasing regulatory capital requirements to offset the resulting decline in capital in the system. At the same time, it is also crucial to ensure that idiosyncratic risks on bank balance sheets are identified and addressed. The Fed should use its discretion to set individual capital requirements based on idiosyncratic risk.

I have deep concerns that the set of changes begun today will result in a stress test that can no longer effectively assess the resilience of the largest banks. The path the Board has begun today is regrettable, and I cannot join it.

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1. Scott Frame, Krisopher Gerardi, and Paul Willen, "The Failure of Supervisory Stress Testing: Fannie Mae, Freddie Mac, and OFHEO," Federal Reserve Bank of Boston Working Paper No. 15-4 (October 2015). [Return to text](#)

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