MEMORANDUM

To: Members of the Committee on Financial Services

From: FSC Majority Staff

Date: June 21, 2024

Re: June 26, 2024, Financial Institutions and Monetary Subcommittee Hearing

On Wednesday, June 26, 2024, at 2:00 p.m. in Room 2128 of the Rayburn House Office Building, the Subcommittee on Financial Institutions and Monetary Policy will hold a hearing titled "Stress Testing: What's Inside the Black Box?" Testifying at the hearing will be:

- Sean Campbell, Chief Economist & Head of Policy Research, Financial Services Forum
- Francisco Covas, Executive Vice President & Head of Research, Bank Policy Institute
- Jonathan Gould, Partner, Jones Day
- Greg Feldberg, Research Director, Yale Program on Financial Stability, and Research Scholar and Lecturer, Yale School of Management

Background

Section 165 of the Dodd Frank Act requires the Federal Reserve to conduct stress tests of certain bank holding companies to determine whether they have "the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions."

The Federal Reserve uses supervisory financial data to subject each covered firm to a severely adverse scenario, which is characterized by a severe global recession.[1] This test is intended to evaluate the financial resilience of the covered firms by estimating their losses, revenues, expenses, and resulting capital levels under the hypothetical scenario. Firms with large trading operations are also subject to a global market shock component (GMS), which stresses their trading, private equity, and other fair valued positions. Firms with substantial trading or custodial operations are tested against the default of their largest counterparty.

The stress tests results are used by the Federal Reserve to determine a firm's "stress capital buffer" (SCB), which is at least 2.5 percent. The SCB is an additional amount of capital that these firms are required to maintain on top of their minimum regulatory capital ratios and considers both the stress test results and a firm's dividend plans. If a firm fails to maintain an SCB, it is subject to automatic restrictions on capital distributions, including limitations on dividends to shareholders, share repurchases, and executive compensation.

The hearing will examine stress testing and scenario analysis, including whether the Federal Reserve should decouple stress tests from capital requirements.

[1] In the 2023 stress tests, GSIBs were also subject to an additional, exploratory market shock component that was intended to probe a different set of risks that those posed by this year's GMS. The exploratory market shock will not contributed to any capital requirements set by this year's stress tests.

Legislation Attached

1. H.R. ___, the *Fair Audits and Inspections for Regulators' Exams Act* (Hill)
The *Fair Audits and Inspections for Regulators' Exam Act* would establish an Office of Independent Examination Review within the Federal Financial Institutions Examination Council to review material supervisory determinations issued by the Federal banking agencies.

2. H.R.8591, the *Federal Reserve Financial Accountability and Transparency Act* (Williams)
H.R. 8591 would enhance the annual reporting requirements for the Federal Reserve.