

December 1, 2025

Via Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551
Attention: Ann E. Misback, Secretary

Re: Request for Comment on Scenarios for the Board's 2026 Supervisory Stress Test (Docket No. OP-1871)

Ladies and Gentlemen:

The Bank Policy Institute, the American Bankers Association, the Financial Services Forum, the Securities Industry and Financial Markets Association, the International Swaps and Derivatives Association, Inc., and the Institute of International Bankers (the "Associations") submit this letter in response to the Board of Governors of the Federal Reserve System's Request for Comment on the proposed scenarios for the Federal Reserve's 2026 supervisory stress tests,¹ including the scenario data and model documentation used to produce the scenarios posted on the Federal Reserve's website. The Associations will submit a separate comment letter on the Notice of Proposed Rulemaking regarding Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL (the "Enhanced Transparency NPR"),² which was released on the same day as the request for comment on the proposed 2026 scenarios and has a comment deadline of February 21, 2026.

This letter addresses comments on the 2026 severely adverse scenario and related aspects of the Macroeconomic Model Guide and Global Market Shock ("GMS") used to produce the 2026 severely adverse scenario. We have also previewed in this letter some—but not all—of the comments on the broader scenario design and stress testing framework that we intend to address in greater detail in our

¹ Federal Reserve, *Request for Comment on Scenarios for the Board's 2026 Supervisory Stress Test*, 90 Fed. Reg. 51,762 (Nov. 18, 2025). The proposed scenarios themselves are posted on the Federal Reserve's website. See Federal Reserve, *Proposed 2026 Stress Test Scenarios* (Oct. 2025), available at <https://www.federalreserve.gov/aboutthefed/boardmeetings/2026-proposed-supervisory-stress-test-scenarios-20251024.pdf> (hereinafter "Proposed 2026 Scenarios").

² Federal Reserve, *Notice of Proposed Rulemaking regarding Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL*, 90 Fed. Reg. 51,856 (Nov. 18, 2025).

forthcoming letter on the Enhanced Transparency NPR.³ We also intend to provide further comments on the Macroeconomic Model Guide and GMS in that letter.⁴

As an initial matter, we welcome the Federal Reserve’s efforts to provide additional transparency and opportunities for public feedback on the scenarios used in its supervisory stress test, which is critical for the Federal Reserve to comply with its obligations under the Administrative Procedure Act (“APA”). The scenarios and models that the Federal Reserve uses in its stress testing framework are legislative rules (or components thereof) that are required to be subject to public notice and comment in accordance with the APA.⁵ The models and scenarios are used to determine firms’ binding capital requirements under the stress capital buffer requirement and have the force and effect of law. The annual stress tests—including the scenarios and models—also implement express statutory delegations.⁶ In addition, the Federal Reserve is required under both the APA⁷ and the Due Process Clause⁸ to make the models and scenarios available to the public to provide fair notice of the process and methodologies that it will use to impose binding capital requirements.⁹

In light of the Federal Reserve’s legal obligations, the Associations are concerned that critical components of the 2026 severely adverse scenario will be decided solely at the Federal Reserve’s discretion, and that the lack of transparency regarding how the Federal Reserve will exercise its discretion will undermine and effectively could circumvent the legally required public comment process going forward. As just one example, the Enhanced Transparency NPR notes the Federal Reserve “expect[s] that

³ The scenarios and models can also present severity and calibration issues. As a result, our future comments on the proposed framework for scenario design, including the Macroeconomic Model Guide and the GMS Model, in February 2026 will necessarily be relevant for the severely adverse scenario for the 2026 stress testing cycle.

⁴ A Federal Reserve Q&A confirmed that the Federal Reserve will accept comments in the context of the Enhanced Transparency NPR regarding “the proposed amendments to the Stress Test Policy Statement and Scenario Design Policy Statement (including the frameworks for the Global Market Shock (GMS) component and the Macro Model for Stress Testing) contained in” the Enhanced Transparency NPR. Federal Reserve, *Enhanced Transparency and Public Accountability Proposals Q&As* (Nov. 3, 2025), available at <https://www.federalreserve.gov/publications/ccar-qas/enhanced-transparency-public-accountability-proposals-qas.htm>.

⁵ See 5 U.S.C. § 552(a)(1)(D).

⁶ See 12 U.S.C. § 5365(i), § 1844(b), (c).

⁷ See *Azar v. Allina Health Services*, 587 U.S. 566, 582 (2019) (“Notice and comment gives affected parties fair warning of potential changes in the law and an opportunity to be heard on those changes—and it affords the agency a chance to avoid errors and make a more informed decision.”).

⁸ See *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012) (“[T]he void for vagueness doctrine addresses at least two connected but discrete due process concerns: first, that regulated parties should know what is required of them so they may act accordingly; second, precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way.”).

⁹ These legal requirements have been explained at length in the plaintiffs’ complaint and brief in *Bank Policy Institute et al. v. Board of Governors of the Federal Reserve Systems*, Case No. 2:24-cv-04300 (S.D. Ohio), which has been temporarily stayed in light of the Federal Reserve’s commitments to implement reforms to the stress tests. Plaintiffs’ complaint and brief are incorporated by reference in this letter.

there will be some important instances when it will be appropriate to augment the recession approach with salient risks and to set variables values inside of, and in some cases, outside of the ranges and values provided in the guides in the Scenario Design Policy Statement.”¹⁰ Similarly, the Federal Reserve noted that it “will endeavor to disclose and explain” its reasoning in the publication of the annual scenarios.¹¹ “Endeavoring” to explain these deviations is not sufficient. The ranges and values provided in the guides generally should apply, with deviations occurring only if they have been thoroughly described and explained in the proposed annual severely adverse scenario and the public is provided a meaningful opportunity to provide comments on the proposed scenario, including the rationale for any such deviation. Given the short timeframe to finalize the severely adverse scenario each year, consistency and transparency will also be critical to avoid delays related to a lack of clarity or rationale for the Federal Reserve’s proposed annual scenario.

We also are concerned with the overall coherence and plausibility of the 2026 severely adverse scenario. Given that the scenario design translates directly into binding capital requirements, it is critical that the scenario consider risks that firms may plausibly face so that the Federal Reserve can evaluate whether such firms have the capital to absorb losses resulting from adverse economic conditions.

The first section of this letter addresses the proposed severely adverse scenario for the 2026 stress tests, including the GMS component. The second section addresses the design of the proposed severely adverse scenario for 2026, which has implications for scenario design in future years. The third section addresses thematic concerns regarding discretion and transparency, which we intend to supplement and address further in the forthcoming letter on the Enhanced Transparency NPR.

I. Comments Related to the Proposed 2026 Severely Adverse Scenario

In general, aspects of the proposed 2026 severely adverse scenario are overly severe and implausible given current market dynamics. The scenarios and associated models and guides that the Federal Reserve uses to design them often compress the timelines of observed stress periods to achieve peak-level stress calibrations over a shorter number of quarters than historically observed, including the Global Financial Crisis. For example, as discussed in Section I.B below, the pace and scale of increase in BBB credit spreads in the proposed 2026 severely adverse scenario are faster and higher than in the Global Financial Crisis, compressing five-quarter moves into a three-quarter window, despite reductions in leverage since the Global Financial Crisis that have reduced the level of risk as compared to prior to the Global Financial Crisis.

The 2026 severely adverse scenario also results in severe shocks across asset classes simultaneously without appearing to consider the recent dynamics in these markets. Asset classes in the early stage of recovery, for example, should be subject to smaller shocks. Thus, the calibration of shocks should reflect the current level of the relevant variables. As discussed further in Section I.A below, the decline in commercial real estate prices in the proposed severely adverse scenario seems particularly severe and would increase procyclicality. There are similar issues with the shocks to mortgage spreads. In the context of the GMS, the shocks to non-investment grade cash bonds appear too severe considering the

¹⁰ See Enhanced Transparency NPR at 51,878.

¹¹ *Id.* at 51,879.

characteristics of this market today.

Other aspects of the proposed 2026 severely adverse scenario that are overly severe include that the level of the VIX stays elevated for a longer period than has been observed historically, due to the linear reversion approach used to determine the peak-to-endpoint path (as opposed to the more appropriate exponential decay). In addition, the term spread is nearly constant following the initial shocks given that short-term and long-term rates remain at their respective troughs for most of the scenario, which is inconsistent with historical data.

The severely adverse scenarios (and guides used to create the variable paths) must remain grounded in plausible economic stress forecasts and the individual variables within the scenarios should interact in a coherent manner. Any departures from historical precedent necessitate explanation to enable the public to determine (and have the opportunity to comment on) whether the Federal Reserve is appropriately fulfilling its statutory mandate to evaluate firms' abilities to absorb losses under adverse economic conditions.

A. The proposed severity of the decline in commercial real estate prices is overly severe based on the scenario design principles outlined in the Enhanced Transparency NPR and is not sufficiently explained.

In the severely adverse scenario for the 2025 supervisory stress test, commercial real estate prices declined by 30%, which was 10 percentage points less than in the 2024 scenario because "those prices already declined a little more than 10 percent relative to their most recent peaks," and taking that into account "limits the procyclicality in the stress tests."¹² However, in the Proposed 2026 Scenarios, the decline in commercial real estate prices would be 40%, despite a forecasted jump-off level that is similar to the jump-off level for the 2025 scenario (311 vs. 309).¹³ Relative to the recent peak of commercial real estate prices in the second quarter of 2023, the decline to the jump-off points in the 2026 and 2025 scenarios is -11% and -12%, respectively.¹⁴ Therefore, as was the case in the 2025 scenario, the 2026 scenario begins from a point that is more than 10% lower than the recent peak.

In addition, as the Federal Reserve has observed, there is a relationship between commercial real

¹² Federal Reserve, *2025 Stress Test Scenarios* (Feb. 2025) at 7, available at <http://federalreserve.gov/publications/files/2025-stress-test-scenarios-20250205.pdf>.

¹³ See Proposed 2026 Scenarios at 9, 22; 2025 Stress Test Scenarios, *supra* note 12 at 15. We note that the historical data on the CRE index included in the Proposed 2026 Scenarios seems to be forecasted (rather than actuals) starting with the first quarter of 2025. Actuals have come in lower than the forecasted values, indicating that the jump-off value is likely to be lower than the Federal Reserve suggests, which would indicate even weaker CRE prices than last year.

¹⁴ These numbers are based on the historical data included in the Proposed 2026 Scenarios and the 2025 Stress Test Scenarios, which identified 348 and 352, respectively, as the level of commercial real estate prices in the second quarter of 2023.

estate prices and nominal GDP.¹⁵ However, while the decline in GDP in the proposed 2026 scenario would be three percentage points less than the decline in the 2025 scenario,¹⁶ the decline in commercial real estate prices in the proposed 2026 scenario would be 10 percentage points, or 33%, more than in the 2025 scenario. The Federal Reserve does not explain this year-over-year divergence.

The Proposed 2026 Scenarios do not sufficiently explain why the Federal Reserve proposed a decline of 40% in commercial real estate prices for the 2026 severely adverse scenario relative to the 30% decline from last year. The more severe decline seems particularly inappropriate given that there has broadly been a tightening of CRE lending standards and stabilization in CRE prices, vacancy rates and rent growth, as well as a jump-off point that again is approximately 10% below a recent peak. The Federal Reserve should reconsider the commercial real estate price decline in the 2026 scenarios or provide further explanation for why a 40% decrease is appropriate this year (especially as compared to last year) in light of the scenario design principles outlined in the Enhanced Transparency NPR.¹⁷

B. The pace and severity of increases in BBB credit spreads in the proposed severely adverse scenario should be moderated to better align with current market evidence.

Stress testing should not be a static exercise; the severity of certain shocks should be adjusted, where relevant, to account for more recent evidence when market structure or risk management has evolved such that historical experience becomes less relevant. For example, financial system leverage leading up to the Global Financial Crisis resulted in BBB credit spreads in 2008 unobserved before or after that crisis. Credit markets have significantly stabilized in the intervening years, with lower financial system leverage.¹⁸

The Federal Reserve should moderate the path of BBB spreads to account for these changes in market features and systemic risk. The proposed 2026 severely adverse scenario would include a peak increase in the BBB spread to the 10-year Treasury yield of 570 basis points.¹⁹ While we recognize that such a spread level may be justified in some scenarios, currently prevailing economic and market conditions support a modest downward adjustment in the proposed severity. Evidence cited in the Federal Reserve's November 2025 Financial Stability Report underscores the relative health and stability of current market conditions when compared with the Global Financial Crisis, demonstrating that the level of private non-financial sector debt relative to GDP remained at its lowest level in over 20 years and leverage

¹⁵ See, e.g., Federal Reserve, *Macroeconomic Model Guide* (Oct. 2025), at 46–7, available at <https://www.federalreserve.gov/supervisionreg/files/macroeconomic-model-guide.pdf> (hereinafter “Macroeconomic Model Guide”).

¹⁶ See Proposed 2026 Scenarios at 9; 2025 Stress Test Scenarios, *supra* note 12 at 5.

¹⁷ See Enhanced Transparency NPR at 51,880–4.

¹⁸ BBB spreads today are at a level half of that in 2008 (130 basis points as of September 30, 2025 vs. 260 basis points as June 30, 2008). See Proposed 2026 Scenarios at 21–2 (differences between 10-year Treasury yield and BBB corporate yield in Q2 2008 and Q3 2025).

¹⁹ *Id.* at 9.

at broker-dealers likewise remained low.²⁰

We also recommend that historical maximum spread widening movements should be considered. This is consistent with the Federal Reserve’s guidance that both the absolute level and quarterly changes in severity are critical determinants of overall scenario severity.²¹ The maximum observed movement in the BBB spread across three quarters (the peak in the proposed scenario is in the third quarter) in the historical data provided in the Proposed 2026 Scenarios is a 350-basis point increase.²² Given the jump-off value of 130 basis points, this would bring the spread to peak at 480 basis points, which is already conservative, as it disregards post-Global Financial Crisis reforms, including those that have reduced bank leverage.

If the Federal Reserve were to decide to retain the proposed BBB spread path, it should explain why the proposed path is justified in light of the proposed 2026 scenario and the principles cited in the Enhanced Transparency NPR.²³

C. The trajectories of several of the modeled variables reflect deviations from the macroeconomic model that are not explained.

The Enhanced Transparency NPR notes that the paths of certain variables in the severely adverse scenario, including GDP, disposable income, inflation, and the three-month Treasury rate, are “informed by” the Federal Reserve’s macroeconomic model.²⁴ However, the values of these variables in the proposed 2026 severely adverse scenario are not solely the outcomes of the macroeconomic model. In particular, the decline in real GDP appears to be larger than the decline implied by the macroeconomic model (-4.8% vs. approximately -4.1% resulting from the model).²⁵

Consistent with the Federal Reserve’s stated goal of increasing the transparency of the stress test process—and its legal obligations under the APA and Due Process Clause—the Federal Reserve should describe the adjustments that it made from the model-implied outputs of these variables to arrive at the proposed values for the 2026 severely adverse scenario. In addition, the Federal Reserve should disclose the methodology it intends to use to make these adjustments in general, specify the range of the permitted adjustments from the model-implied output and, for any particular scenario, describe and explain any such adjustments for that scenario. These disclosures are necessary to ensure transparency

²⁰ See Federal Reserve, *Financial Stability Report* (Nov. 2025), at 17, 30–1, available at <https://www.federalreserve.gov/publications/files/financial-stability-report-20251107.pdf>.

²¹ See Proposed 2026 Scenarios at 14 (“An additional consideration is that the overall scenario severity is a function of both levels and changes in the scenario variables.”).

²² See *id.* at 21 (BBB spread from Q1 2008 to Q4 2008).

²³ See Enhanced Transparency NPR at 51,880–4.

²⁴ *Id.* at 51,880.

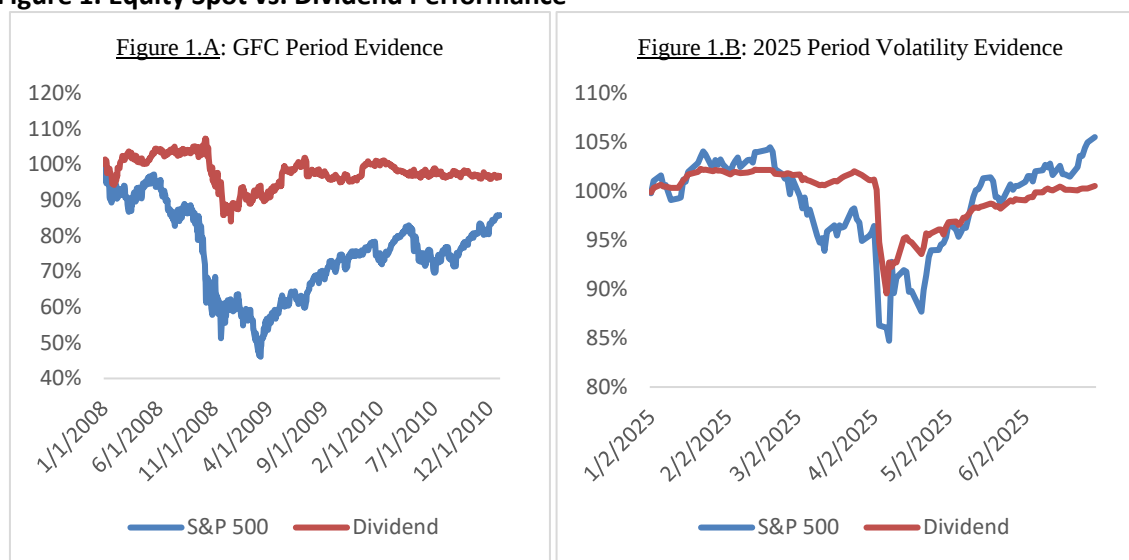
²⁵ See Proposed 2026 Scenarios at 9. The Associations derived the -4.1% decline in GDP by using the macroeconomic model. The proposal does not disclose the GDP decline that would result from the macroeconomic model or explain the basis for the deviation.

and to provide a meaningful opportunity for public comment.

D. The shocks to equity dividends in the GMS are inconsistent with shocks to equity spot prices.

The Federal Reserve should moderate the equity dividend shocks included in the proposed 2026 GMS component to align with the severity calibrations in the equity market price declines included in the proposed GMS component. Equity market shocks in the GMS include risk factors such as spot prices, dividends and volatility. The calibration of the dividend shocks across term structure and regions appears to be inconsistent with the spot prices and volatility shocks. As shown in Figure 1 below, during stress, observed equity spot and dividend moves are correlated, and equity dividends largely do not underperform equity spot prices.

Figure 1. Equity Spot vs. Dividend Performance



As reflected in Table 1 below, the proposed GMS scenario would halve the shock to equity spot prices, while the dividend shock is roughly unchanged. The GMS equity dividend shocks in the proposed 2026 scenario are calibrated to a much more severe historical market stress than the GMS equity spot price shocks, which are generally consistent with a one-month, approximately 99%-confidence level of historical market stress. The Federal Reserve should align equity dividend shocks to the equity spot price shocks as they both relate to the anticipated performance of equity securities in an instantaneous stress. As an example, a one-year U.S. dividend decline consistent with a one-month, 99%-confidence level of historical market stress would be approximately -10% (compared to -20% in the proposed 2026 GMS).²⁶

²⁶

See 2026 Proposed Severely Adverse Market Shock (simplified shocks), available at https://www.federalreserve.gov/supervisionreg/files/2026_Proposed_Severely_Adverse_Market_Shock_simplified-shocks.xlsx.

Table 1. U.S. Equity Spot and Dividend Shocks – Proposed 2026 vs. 2025

Region and Tenor	2026	2025
Equity Spot Shocks		
United States	-15.0%	-26.0%
Dividend Shocks		
United States – 1 year	-20.0%	-21.0%
United States – 2 year	-19.0%	-21.0%
United States – 3 year	-18.0%	-19.0%
United States – 5 year	-16.0%	-16.0%
United States – 7 year	-14.0%	-14.0%
United States – 10 year	-14.0%	-10.0%
United States – Unspecific tenor	-14.0%	-21.0%

E. The Largest Counterparty Default (“LCD”) component of the 2026 severely adverse scenario should exclude sovereigns, public sector entities, and multilateral development banks rated AA- or better.

Question 9 in the Proposed 2026 Scenarios requests comment on how the Enhanced Transparency NPR’s separate proposal to exclude certain additional sovereign entities from the LCD component should be incorporated into the 2026 GMS.²⁷ We recommend that the 2026 scenario exclude from the scope of the LCD all sovereign and public sector entity counterparty exposures that receive an internal credit rating equivalent to AA- or higher, as calculated by a firm’s second-line credit risk management function.

Relatedly, the list of multilateral development banks excluded from the LCD component should be further expanded to all multilateral development banks that are rated AA- or better under a firm’s internal credit rating system.

This approach would exclude only the highest credit quality sovereigns, public sector entities, and multilateral development banks, improve risk sensitivity relative to the historical G7 exclusion, and achieve broadly similar outcomes across institutions (while internal ratings may be variable by institution, a common minimum internal rating would achieve a degree of consistency in approach). We do not recommend that the Federal Reserve rely on a median rating where banks assign different internal ratings, as that would add unnecessary complexity and uncertainty to the 2026 stress test exercise. Other approaches, such as relying on CDS spreads, raise similar concerns, as CDS on some sovereigns do not trade with sufficient liquidity or with sufficient frequency for the data to be reliable.

Alternatively, if the Federal Reserve does not utilize AA- equivalent internal ratings as the basis for sovereign and public sector entity exclusions, we recommend that the Federal Reserve instead exclude sovereigns and public sector entities from the LCD component when exposures to such sovereigns receive a 0% risk weight in the Federal Reserve capital rule, or exposures to public sector entities that receive a 20% risk weight. Similarly, the multilateral development banks that are given a 0% risk weight in the

²⁷ Proposed 2026 Scenarios at 19.

current capital rules should be excluded from the LCD component.²⁸ This includes, but is not limited to, the African Development Bank, Asian Development Bank, Caribbean Development Bank, Council of Europe Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, Inter-American Investment Corporation, International Finance Corporation, and the Multilateral Investment Guarantee Agency. This approach would harmonize the approach taken in the stress test context with the Federal Reserve’s existing capital framework, improve coherence, and result in a consistent methodology across all impacted firms.

In addition, the Federal Reserve should revise the counterparty aggregation principles utilized in the LCD component so that sovereign agencies, central banks, sovereign wealth funds and state-sponsored entities are treated like the relevant related sovereign. This approach would align with credit risk management principles.

F. GMS shocks applied to agency pass-through securities should distinguish between deliverable and non-deliverable pools, with a lower shock applying to the former.

Some Agency pass-through securities that meet specified characteristics are eligible to be delivered into corresponding To-Be-Announced securities (“TBAs”). In these circumstances, the floor for these Agency pass-through securities is limited to the corresponding TBA price given the deliverability for these securities.

The proposed 2026 GMS component includes option-adjusted spread-widening shocks for pass-through securities (as a general category) and TBAs, but there is no distinction in these shocks for deliverable and non-deliverable pass-through securities. As a result, the GMS incorrectly implies that some deliverable pools trade at a discount to the TBA into which they are deliverable.

The Federal Reserve should implement a control to correct for this problem when administering the 2026 stress tests. Although a comprehensive solution might involve changes to the FR Y-14 reporting forms, for 2026 the Federal Reserve could either use a special collection to permit firms to collect additional information to adjust for such exposures on the GMS as-of date, or otherwise consider reducing the magnitude of the pass-through securities shock.

G. The Federal Reserve should continue to publish relative shocks for the GMS or, if it does not, explain how the reduced set of shocks map to the original template.

The Federal Reserve did not publish the relative shocks for those shocks that are noted in absolute terms (e.g., credit-related sub-schedules and vega shocks such as rates and commodities). Questions E4-E6 in the GMS Model Documentation seek comment on this proposed simplification.²⁹ In response, we encourage the Federal Reserve to continue to publish the relative shocks in its final scenario, as it has done in prior years. Declining to publish relative shocks will decrease transparency as compared to previous

²⁸ See 12 C.F.R. §§ 217.2; 217.32(b).

²⁹ Federal Reserve, *Supervisory Stress Test Documentation: Global Market Shock Component* (Oct. 2025), at 88, available at <https://www.federalreserve.gov/supervisionreg/files/gms-model.pdf> (the “GMS Model Documentation”).

years, rather than increasing it consistent with the Federal Reserve’s stated goals and legal obligations. Publication would also promote consistent scenario application across firms that use relative shocks in their internal stress testing approaches. Only providing absolute shocks may result in inconsistency in how shocks are applied depending on how each firm converts absolute to relative shocks.

In connection with its proposal to reduce the number of disclosed risk factors, the Federal Reserve noted that it “would provide instructions for how this reduced set of shocks maps to most of the risk factor shocks contained in the original global market shock template.”³⁰ However, this mapping was not included in the published materials. The Federal Reserve should publish this mapping and seek comment on it. The mapping should be prescriptive and avoid assumptions or interpretations having to be made independently by each firm. Any such room for interpretation may result in inconsistencies in shock application across firms.

II. Comments Related to the Design of the Proposed 2026 Scenarios and Future Scenarios

As noted above, we preview in this letter some—but not all—of the comments on the broader scenario design and stress testing framework that we intend to address in greater detail in our forthcoming letter on the Enhanced Transparency NPR. We also intend to provide further comments on the Macroeconomic Model Guide and GMS in that letter. Below, we include a few observations relevant to the proposed 2026 scenario to be further developed in that letter.

- In general, the proposed guides for the guide-based variables do not adequately explain the calibration of the rate of change needed to get from the jump-off point to the peak or trough. For example, the proposed 2026 severely adverse scenario for equity prices compresses into three quarters evidence from a decline that was observed over six quarters during the Global Financial Crisis. Moreover, the -60% maximum decline contemplated in the guide materially exceeds the decline observed during the Global Financial Crisis. This results in a three-quarter rate of change that is more than double any rate observed historically.
- The proposed 2026 GMS includes ahistorical correlations across risk factors that have never been historically observed. The scenario therefore lacks coherence and requires further explanation of why such correlations are appropriate to allow a meaningful opportunity for public feedback on these choices.
- The LCD component assumes a 90% loss given default for a given counterparty.³¹ However, to align the LCD component with firms’ business-as-usual capital management, this assumed loss given default should be reconsidered or supporting data and analysis should be provided to justify the assumption.

In the sections that follow, we address in more detail certain other observations that have

³⁰ *Id.* at 86.

³¹ Federal Reserve, *Supervisory Stress Test Model Documentation: Market Risk Models* (Oct. 2025), at 266, available at <https://www.federalreserve.gov/supervisionreg/files/market-risk-models.pdf>.

implications both for the proposed 2026 scenario and overall scenario design.

A. The Federal Reserve should clarify its determination of jump-off values to avoid an overly severe scenario.

As discussed in the Enhanced Transparency NPR, the trajectories of specified variables that are used to construct the stress test scenarios are based on guides that describe each variable's trajectory relative to a given jump-off point (for the proposed 2026 scenarios, the fourth quarter of 2025).³² Under this construct, the "specific levels of the peak or trough often depend on the jump-off values."³³ However, data for the fourth quarter of 2025 is not yet available. The Federal Reserve noted that the "final dataset will incorporate data released through mid-January, as well as updated external forecasts"³⁴ and that the guide-based variables in the Proposed 2026 Scenarios will be revised to reflect the jump-off conditions, in particular by keeping constant the level reached by each variable at its peak or trough so long as the relative change is in line with the guide for the variable.³⁵

The Proposed 2026 Scenarios do not provide sufficient transparency or guardrails regarding the determination of the final jump-off values. Changes in the final jump-off values across variables may result in a scenario that is much more severe in the aggregate than the proposed scenario, which, in turn, could undermine the plausibility and coherence of the scenario and affect firms' binding capital requirements. In addition, as noted at the outset, both the APA and fair notice principles of due process require the Federal Reserve to provide transparency and sufficient notice regarding how the Federal Reserve will exercise the flexibility built into the framework to determine such variables that affect a firm's capital requirement. In general, the final scenario should be broadly aligned with the proposed scenario in terms of overall severity to comply with these legal obligations.

This is a particular issue for 2026, given the uncertainty in the jump-off values for certain variables that rely on government-produced reports and data because of the recent government shutdown. In addition, for those variables for which data as of the fourth quarter of 2025 will not be available in mid-January, including the commercial real estate price index, the Federal Reserve does not specify how it will determine the jump-off values.

B. Securitized product shocks in the GMS should include spread shocks in addition to market value-based shocks.

The shocks to securitized products in the GMS are market value-based,³⁶ which does not always properly reflect market behavior. In addition, using market values does not account for bond duration. The Federal Reserve should adopt a spread-based shock approach for securitized products, which would capture the impact of duration. The Federal Reserve should also add fundamental parameters, such as the

³² See Enhanced Transparency NPR at 51,883–84.

³³ *Id.* at 51,883.

³⁴ Proposed 2026 Scenarios at 21.

³⁵ *Id.* at 14.

³⁶ See GMS Model Documentation at 8.

conditional prepayment rate and conditional default rate to accurately capture the risk inherent in securitized products.

The Federal Reserve should disclose both shock types (price and spread), with standardized definitions to permit comparability across firms. Spread shocks align stress inputs with market conventions and internal risk models, while price shocks ensure simplicity and comparability across firms.

III. Thematic Concerns

The Enhanced Transparency NPR and the publication of the Proposed 2026 Scenarios for public comment represent an improvement in the overall transparency and accountability of the Federal Reserve's stress testing processes. However, the proposed framework would grant inordinate discretion to the Federal Reserve, without requiring sufficient explanation for its design choices year-to-year. The level of discretion built into the proposed framework would permit the Federal Reserve to establish capital requirements at, effectively, any level it wants with minimal accountability for or transparency into its decision-making. This is not consistent with foundational principles of the APA or due process.³⁷

In addition, we are concerned that the level of discretion built into the framework could lead to an economically incoherent scenario, with continued volatility in binding capital requirements year-over-year. The Federal Reserve proposes to use a combination of model-based and guide-based variables to develop the scenarios. The model-based variables are based on an economic model calibrated using historical data, while the guide-based variables result from recent recession experience and some consideration of macroeconomic movements, with Federal Reserve discretion to depart from the guides layered on top. The result may not be coherent, with variables moving in ways that do not make economic sense or are not appropriately correlated with the movements of other variables. These design choices directly affect binding capital requirements and, accordingly, must be adequately explained and reasonably justified, especially when departing from model-based outputs. It is all the more critical to produce coherent scenarios given the interplay between the stress testing framework—particularly the GMS and LCD components—and other aspects of the broader capital and prudential framework, notably the implementation of the final Basel III standards including updated frameworks for market risk, credit valuation adjustment risk and operational risk.

We expect to address these issues in greater depth in our letter in response to the Enhanced Transparency NPR, but in the meantime take this opportunity to highlight significant instances of discretion and insufficient transparency evident in the Proposed 2026 Scenarios.

The Proposed 2026 Scenarios note that the Federal Reserve has chosen to calibrate variables for which it retains flexibility near or in the upper one-third of their ranges of severity.³⁸ According to the Federal Reserve, it “chose this calibration to generate an appropriate level of overall severity given the paths of the unemployment rate and house prices, and given the prevailing macroeconomic and financial conditions.”³⁹ The Federal Reserve asserts that the calibration “reflects both the Board’s principle of

³⁷ See *Azar v. Allina Health Services* at 582; see also *FCC v. Fox Television Stations, Inc.* at 253.

³⁸ Proposed 2026 Scenarios at 7.

³⁹ *Id.*

conservatism and its goal that the annual stress tests should not add to other sources of procyclicality in the financial system.”⁴⁰ However, the Federal Reserve does not provide an explanation of how it assessed systemic risk and arrived at such a severe calibration.

The methodology described in the GMS model documentation also provides significant discretion to the Federal Reserve with minimal accountability for or transparency into its decision-making, which can lead to volatility in capital requirements and fundamental incoherence in the scenario. The GMS model documentation describes that one methodology for specifying GMS primary risk factor shocks is based on a qualitative description of the severity of the shock (*i.e.*, mild, moderate, large, severe, or unprecedented). The qualitative characteristics are then mapped to quantitative shocks based on a percentile range of historical data for the primary risk factors.⁴¹ For example, a “large” shock falls within the 1st to 5th percentiles or within the 95th to 99th percentiles, whereas a “severe” shock falls within the historical minimum and the 1st percentile or within the 99th percentile and the historical maximum.⁴² Even within a given percentile category, the actual level of the shock can vary enormously.

For example, Table 2 implements the GARCH-t methodology specified in the GMS technical documentation for the CDX IG and CDX HY indices and compares them to the 2026 GMS shocks. The Federal Reserve’s proposed shocks for IG and HY are calibrated to the 94th and 83rd percentile, respectively, using the Federal Reserve’s univariate GARCH-t model methodology. Moving the percentile to the 97th percentile for CDX IG increases the shock to 214 basis points. Going to the 98th percentile moves the IG shock to 293 basis points and going to the 99th percentile produces a shock of 468 basis points. CDX HY shocks are similarly sensitive to the choice of percentile. A 90th percentile choice produces a 470-basis point shock while a 95th percentile choice yields a 921-basis point shock.

Table 2. GARCH-t Methodology for CDX Under Various Percentile Assumptions

		60 days		40 days		60 days		60 days		60 days	
	Fed 2026 GMS (bps)	Percentile	GARCH-t (bps)	Percentile	GARCH-t (bps)	Percentile	GARCH-t (bps)	Percentile	GARCH-t (bps)	Percentile	GARCH-t (bps)
CDX IG	126.7	94	122.6	94	97.5	97	214	98	293	99	468
CDX HY	260.9	83	255.66			90	470	93	677	95	921

The effect of the Federal Reserve’s chosen percentile level for a specific shock may therefore translate to vastly different severities of the shocks, with direct effects on binding capital requirements for GMS firms. This is clear also from the fact that the Federal Reserve has generally reduced the liquidity horizons of the GMS primary risk factors⁴³ and yet the shocks have not significantly decreased across all asset classes. This could lead to increased volatility in capital requirements for GMS firms year-to-year, in

⁴⁰ *Id.*

⁴¹ GMS Model Documentation at 12–3.

⁴² *Id.* at 13.

⁴³ Compare GMS Model Documentation at 7–8 (describing the liquidity horizons for the primary risk factors as ranging from one month to three months) with 2025 Stress Test Scenarios, *supra* note 12 at 10 (describing the liquidity horizons for primary risk factors as ranging from three months to 12 months).

contrast to the Federal Reserve's recently stated intention to reduce volatility in capital requirements.⁴⁴ The proposal provides insufficient explanation regarding how the Federal Reserve will calibrate the severities of these shocks each year.

The Federal Reserve should provide further explanation as to how it selected the severity and the particular level within the range implied by the severity for each primary shock in the proposed 2026 GMS component of the severely adverse scenario. In addition, the Federal Reserve should explain how it expects to make these determinations for future GMS components and avoid excessive volatility as a result.

* * * * *

The Associations appreciate the opportunity to comment on the proposed scenarios. If you have any questions, please contact the undersigned at sarah.flowers@bpi.com, HBenton@aba.com, scampbell@fsforum.com, gzhang@sifma.org, LGalletta@isda.org, and swebster@iib.org, respectively.

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⁴⁴ See, e.g., Federal Reserve, *Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement*, 90 Fed. Reg. 16,843 (Apr. 22, 2025) (“[V]olatility in stress capital buffer requirements can potentially impact the provision of banking services. . . . With the proposed revisions [in the April 2025 proposal], the capital buffer requirements would continue to be forward-looking and risk-sensitive, while reducing the volatility of capital requirements and thereby allowing for improved ability for firms to plan their capital positions and financial intermediation activity.” *Id.* at 16,846.).

Appendix

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