Banking and Finance Law Daily Wrap Up, FINANCIAL STABLITY—ABA, other groups file suit over Fed stress testing requirements, (Jan. 2, 2025)

Banking and Finance Law Daily Wrap Up

Click to open document in a browser

By Colleen M. Svelnis, J.D.

The day after an announcement by the Fed that it intends to seek public comment on significant changes to stress tests' impact on capital requirements, several industry groups have filed a complaint challenging the "opaque" aspects of the stress testing framework.

Several financial industry groups have jointly filed a complaint against the Federal Reserve Board. The complaint challenges the Fed's stress testing requirements, claiming that they are overly burdensome and lack transparency. The American Bankers Association, the U.S. Chamber of Commerce, Bank Policy Institute, the Ohio Bankers League, and the Ohio Chamber of Commerce are challenging the "opaque" aspects of the stress testing framework.

In the complaint—filed in the U.S. District Court for the Southern District of Ohio on Dec. 24, 2024—the industry groups argue that the stress testing requirements are unduly onerous and fail to provide adequate guidance to financial institutions. The groups request that the court declare the stress testing requirements to be arbitrary, capricious, and in violation of the Administrative Procedure Act. The industry groups seek injunctive relief to prevent the implementation of the current stress testing framework and urge the Fed to establish a more transparent and less burdensome regime.

Citing an "evolving legal landscape," on Dec. 23, 2024, the Fed released a statement that it would soon embark on "significant" changes to its annual stress testing requirements intended to reduce volatility of bank stress tests. The intended proposed changes include 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. The statement pointed to a forthcoming public comment period, as well as taking immediate steps to improve result consistency and model transparency for 2025 stress tests, noting that in the 15 years since the start of testing, capital levels at large banks had more than doubled, increasing by over $1 trillion.

Rob Nichols, ABA President and CEO issued a statement acknowledging support for stress testing "as an important risk management tool," but also conveying that the "ABA has long advocated for the Federal Reserve to increase the transparency of its stress testing program, which shields key components like supervisory models from public view." The opaque nature of these tests "undermines their value for providing meaningful insights into bank resilience." To meet federal law, the Fed should publish the supervisory models and stress scenarios and invite public comment, which would enable banks and the public to "better understand and prepare for regulatory expectations, reducing uncertainty and promoting a fairer, more predictable regulatory environment."

Complaint. The groups contend in the complaint that the current stress testing framework creates unnecessary compliance costs, restricts banks' ability to lend, and hampers economic growth. Also, the stress testing requirements lack transparency, making it difficult for banks to understand how the Fed evaluates their performance. They argue that this lack of transparency hinders banks' ability to effectively manage their capital and liquidity, which are critical for maintaining a stable financial system. According to the complaint, the stress testing requirements have become increasingly complex and burdensome over time, placing a disproportionate burden on smaller banks and regional financial institutions. The industry groups argue that this has led to a consolidation in the banking industry, reducing competition and limiting consumer choice.

© 2025 CCH Incorporated and its affiliates and licensors. All rights reserved.

The complaint contains the following allegations.

- The stress testing requirements are arbitrary, capricious, and not based on sound economic principles.
- The stress testing requirements are a violation of the Administrative Procedure Act (APA) as they were not properly promulgated and lack transparency.
- The Fed failed to provide adequate notice and an opportunity for public comment before implementing the stress testing requirements.
- The stress testing requirements impose unnecessary burdens on banks, resulting in increased costs and reduced lending capacity.
- The stress testing requirements are inconsistent with the Dodd-Frank Act and exceed the Federal Reserve's statutory authority.
- The stress testing requirements unfairly disadvantage smaller banks and hinder their ability to compete with larger institutions.
- The stress testing requirements are not tailored to the individual risk profiles of banks and do not adequately consider their unique business models.
- The stress testing process lacks transparency and accountability, making it difficult for banks to understand and comply with the requirements.
- The stress testing requirements have a chilling effect on economic growth and job creation by limiting the availability of credit.
- The stress testing requirements create a false sense of security and do not effectively address systemic risks in the banking industry.

Companies: American Bankers Association; Bank Policy Institute; Ohio Bankers League; Ohio Chamber of Commerce; U.S. Chamber of Commerce

LitigationEnforcement: BankingOperations CapitalBaselAccords DoddFrankAct OhioNews FederalReserveSystem FinancialStability GCNNews PrudentialRegulation

© 2025 CCH Incorporated and its affiliates and licensors. All rights reserved.