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I. INTRODUCTION

Often, we ask ourselves whether we can predict the future. While a few predicted some sort of global pandemic, most never expected it to occur within their lifetime.\(^1\) If most people could not have predicted such an outbreak, should we expect any more from our banking system? In 2008, the answer was no.\(^2\) When the 2008 Financial Crisis devastated the housing market and economy, banks were not prepared, resulting in the worst economic disaster since the Great Depression.\(^3\)

To strengthen the U.S. banking system for the future, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) in 2010.\(^4\) Among its innovations were mandated stress tests, models that help analyze banks’ capital positions under harsh economic conditions.\(^5\) The Supervisory Capital Assessment Program (“SCAP”), in place before the passage of Dodd-Frank, pioneered the first use of stress tests for the nineteen institutions with assets in excess of $100 billion.\(^6\) Before these institutions were permitted to repay their

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2. See Martin Neil Baily et al., The Origins of the Financial Crisis, BROOKINGS (Nov. 24, 2008), https://www.brookings.edu/research/the-origins-of-the-financial-crisis/ [https://perma.cc/AQZ5-BR5C] (noting the reasons for the financial crisis, such as how the banks were not adequately capitalized to endure a financial crisis).

3. Id.


Troubled Asset Relief Program (“TARP”) funding and rid themselves of the government as a preferred shareholder, they needed to pass the stress test or raise the additional capital needed to pass the stress test. These tests were critical to restoring confidence in the U.S. banking system in the aftermath of the 2008 Financial Crisis. Inspired by the success of SCAP, the Dodd-Frank Act set forth the Dodd-Frank Act Stress Tests (“DFAST”) and the Board of Governors of the Federal Reserve Board System (“Federal Reserve Board”) created the Comprehensive Capital Analysis and Review Program (“CCAR”) to analyze the capital of banks on an annual basis.

Over time, CCAR and DFAST underwent a variety of changes, and have since deviated from their original purpose. The COVID-19 pandemic was the first true test of CCAR and DFAST, and what resulted was confusion and concern about the state of the U.S. banking system. Conversely, stress tests are essential to maintaining confidence in the U.S. banking system and help banks safely conserve capital to prepare for future economic crises. COVID-19 did not reveal the weaknesses in the banking system, but instead highlighted the flaws of the CCAR and DFAST process during another financial crisis. Therefore, the Federal Reserve Board should learn from the past, seek global influence, and


9. See Clark & Ryu, *supra* note 6 (discussing the importance of SCAP, the first stress test program to evaluate the strength of banks’ capital against harsh economic scenarios).


11. *Id.* (noting the regulatory changes over time, such as raising the CCAR minimum capital requirement from $50 to $250 billion); *see also* Clark & Ryu, *supra* note 6, at 1 (referencing several of the changes that CCAR and DFAST have experienced overtime).

12. See Rob Blackwell, *Virus is Dodd-Frank’s First Real Test, AM. BANKER* (Mar. 13, 2020, 9:00 AM), https://www.americanbanker.com/opinion/coronavirus-is-dodd-franks-first-real-test [https://perma.cc/QC5T-A4WG] (stating how Dodd-Frank will likely be impacted by the economic wave that COVID-19 will have on the banking system).

13. See Clark & Ryu, *supra* note 6 (detailing the value and purpose of stress testing within the U.S. economy).

reimplement the flexible, procedural response of SCAP that helped restore confidence in the U.S. banks in 2009.15

This Note discusses the development of stress testing and analyzes how COVID-19 has further shaped the arguments for and against this regulatory framework. This discussion ultimately leads to the conclusion that while the stress test programs have encouraged big banks to remain better capitalized over time, many of the beneficial procedural aspects of stress tests have since been weakened, reducing the credibility of the programs. This Note Proceeds in five parts. Part II highlights the Dodd-Frank Act regulatory framework that led to the development of CCAR and DFAST, while noting the subtle differences between the two programs.16 Part III then examines the impact of COVID-19 on the release of the annual stress tests and considers how both the Federal Reserve Board and the public have reacted to the Federal Reserve Board’s actions.17 Part IV provides alternatives to performing stress tests during a global pandemic and other periods of market stress and crisis.18 Finally, Part V concludes by restating the necessity of proper procedural standards upon both the performance and release of the annual stress test programs.19

II. WHAT ARE CCAR AND DFAST, AND WHY DO WE HAVE THEM?

A. Understanding the Dodd-Frank Act

Among the many reasons for the Financial Crisis in 2008 was risk.20 Risk rapidly increased in 2004 when the Securities and

16. See infra Part II.
17. See infra Part III.
18. See infra Part IV.
19. See infra Part V.
Exchange Commission ("SEC") loosened the net capital requirement. Capital, in the commercial sense, is composed of equity contributed by shareholders, retained earnings over time, and long-term funds. This increased risk, in addition to the lending of subprime mortgages that allowed big banks to profit from risky mortgage-backed securities, ultimately led to the collapse of the U.S. economy in 2008. The Great Recession saw the U.S. unemployment rate peak at 10% in 2009 and the failure of more than 450 commercial banks across the country.

In an immediate response to the 2008 Financial Crisis, Congress passed the Dodd-Frank Act "to promote the financial stability of the United States by improving accountability and transparency in the financial system." The Act aims to protect consumers by preventing banks from "abusive financial services practices" and "by ending bailouts." To further this purpose, the Act requires the Federal Reserve Board to conduct and publicly disclose annual stress tests to help banks determine whether they can continue lending to households and businesses, even during a severe recession like that of 2008. These scenarios serve as a tool to help big banks measure their capital under baseline, adverse, and severely adverse models.

Before the development of the CCAR and DFAST programs, the Federal Reserve Board established SCAP in 2009. This program took

23. See Hargrave, supra note 7 (defining capital).
24. See Erin Coughlan, et al., Univ. of Cal., Berkeley Inst. for Res. on Labor and Emp’t, WHAT REALLY CAUSED THE GREAT RECESSION? (2018), https://irle.berkeley.edu/what-really-caused-the-great-recession/ [https://perma.cc/PY4M-54P5] (describing the various factors that led to the 2008 Financial Crisis, such as the collapse of the housing market and the lending of subprime mortgages).
25. Id.
27. Id.
28. Id.
29. See Dodd-Frank § 165(i), 12 U.S.C. § 5365(i) (2010) (noting that there are annual stress tests conducted by the Federal Reserve Board for companies with greater than $50 billion in assets, now $250 billion after the Economic Growth Act of 2018, and company-run stress tests for companies with greater than $10 billion in assets).
30. See Clark & Ryu, supra note 6 (discussing the three scenarios that vary in harshness in economic conditions that the Federal Reserve Board uses to determine the metrics for the stress tests).
31. Id.
place during the aftermath of the 2008 Financial Crisis and aimed to create simultaneous stress tests for the nineteen biggest bank holding companies as they faced deteriorating conditions in the financial markets.  

To ease concerns about the future of the U.S. economy, SCAP required these banks to participate in a stress test based on economic scenarios harsher than the 2008 Financial Crisis and publicly disclose those results. The stress test measured whether these nineteen banks had enough capital to absorb future losses while still being able to operate under the harsh scenarios. Banks that failed the test were given one month to develop a capital plan and six months to raise the necessary amount of capital to meet their plan. While ten of the nineteen banks initially failed the stress test, almost all of them were able to meet their capital plans within the required six months.

In addition to providing economic stability to the markets, the hastily-established SCAP also yielded several other important results. By publicly disclosing the stress test results of the nineteen largest bank holding companies, the program created transparency between banks and market participants. Additionally, this disclosure added credibility to the process itself and helped ease fears about the financial health of the big banks. In other words, SCAP helped to “restore confidence in the U.S. banking system.”

B. The Comprehensive Capital Analysis and Review Program

Inspired by the success of SCAP, the Federal Reserve Board established the Comprehensive Capital Analysis and Review Program in

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33. See Clark & Ryu, supra note 6 (defining a bank holding company as a company that either controls or owns one or more U.S. banks).

34. See id. (emphasizing that one of the successful elements of SCAP was to publicly disclose the results of the stress tests).

35. Id.

36. Id.

37. Id.

38. See id. (noting how SCAP restored confidence in the American public and helped banks better manage their capital).

39. Id.

40. Id.

41. See id. (stating that the public disclosure element of the stress tests and honesty with the public restored confidence in the banking system after such a devastating financial crisis).
2010.42 While CCAR is complementary to DFAST, the programs use different testing exercises while measuring similar data and requirements.43 CCAR is an annual exercise conducted by the Federal Reserve Board that analyzes whether the capital plans and expected capital distributions of big banks are sufficient to survive times of economic and financial stress.44 The program helps ensure that banks are taking a forward-looking approach, in which they can restructure their capital plans to make sure there is enough capital in place to continue operations throughout times of economic stress.45 The tests are measured by “post-stress capital ratios” that incorporate large bank holding companies “planned capital action over the nine-quarter planning horizon under their baseline scenario.”46 The stress tests help banks gauge whether they would remain above the minimum capital requirements with their baseline capital actions under stressful conditions.47

CCAR has changed since its initial implementation.48 In its early years, CCAR applied to bank holding companies with assets of $50 billion or more, which at that time included the thirty biggest banks in the United States.49 In 2019, the Economic Growth, Regulatory Relief, and Consumer Protection Act (“EGRRCPA”) raised the threshold minimum to $250 billion in total assets.50

Since its implementation, compliance with CCAR has helped these banks secure large amounts of capital to protect themselves from future economic crisis.52 For example, one of the key CCAR

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42. See id. (providing a detailed history on the creation of CCAR, which acts as an annual measuring tool of the capital adequacy of big banks).
43. Id.
45. Clark & Ryu, supra note 6.
46. Id.
47. See id. (describing scenarios such as sharp changes in gross domestic product and the unemployment rate).
49. See 12 C.F.R. § 252.12 (2020) (defining the current asset threshold as the average total consolidated assets of greater than $250 billion).
51. See 132 Stat. 1296 (describing a regulatory relief package that included the lessening of the minimum capital requirement for CCAR testing).
52. Clark & Ryu, supra note 6.
measurements is Common Equity Tier 1 ratio ("CET1").

CET1 measures the obvious equity that a bank holds, such as its common stock, treasury stock, retained earnings, and certain Accumulated Other Comprehensive Income ("AOCI"), and compares it against the bank’s risk-adjusted assets. For the eighteen banks that have participated in CCAR since 2013, this ratio has doubled from 5.6% to 11.3%. Since its establishment, CCAR has helped banks create better risk management practices to ensure a healthy banking system.

C. The Dodd-Frank Act Stress Test Program

Like CCAR, the DFAST Program stemmed from the influence of SCAP and was established in 2010. While its purpose is similar, DFAST can be distinguished from CCAR in two ways. First, DFAST reaches a larger number of banks with a minimum asset threshold requirement of $10 billion. On the other hand, CCAR’s initial $50 billion minimum asset threshold increased to $250 billion in 2018. Second, DFAST requires regulated banks to produce their own internal stress test, instead of being directly conducted by the Federal Reserve Board.

DFAST, like CCAR, conducts annual supervisory tests under three scenarios: baseline, adverse, and severely adverse. The baseline scenario measures a set of conditions that reflect the general views of both the economic and financial outlook of the United States economy with respect to the financial condition of a covered bank. The severely adverse scenario entails conditions that are significantly more harsh than

53. Id.
54. Id.
55. Id.
56. See id. (noting how banks have better managed their capital overtime due to the Dodd-Frank and CCAR regulations).
60. Id.
62. See id. (stating the three scenarios of measurement under DFAST and CCAR).
63. 12 C.F.R. § 325.2(c) (2020) ("Covered bank means any state nonmember bank or state savings association with average total consolidated assets calculated as required under this part that are greater than $250 billion."); see also 12 C.F.R. § 325.2(b) (2020) (defining the baseline scenario of the Dodd-Frank stress tests).
the baseline scenario and includes additional components such as trading conditions.\footnote{12 C.F.R. § 325.2(j) (2020) (defining the severely adverse scenario under DFAST and CCAR, but not including the adverse scenario in its statutory definition as the adverse scenario constantly changes).}

The more severe scenarios are not meant to forecast the future of the United States economy like with the baseline test; rather, they provide scenarios for a series of hypothetical sets of events designed to test the resilience of banking organizations.\footnote{Press Release, Fed. Reserve, Federal Reserve Board Releases Hypothetical Scenarios for its 2020 Stress Test Exercises, FED. RESERVE, (Feb. 6, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200206a.htm [https://perma.cc/TF9Q-GMNZ] [hereinafter Hypothetical Scenarios for its 2020 Stress Test Exercises] (releasing the hypothetical metrics regarding the annual stress tests for 2020).} The scenarios are composed of twenty-eight variables, ranging from gross domestic product, stock market prices, interest rates, and unemployment rates that are calculated accordingly to the three economic models.\footnote{Id.} In 2020, however, even the most severe of scenarios proved to be less harsh than the economic conditions brought on by the COVID-19 pandemic.\footnote{Press Release, Randal K. Quarles, Vice Chair for Supervision, Fed. Reserve, Statement by Vice Chair for Supervision Quarles (June 25, 2020), https://www.federalreserve.gov/newsevents/pressreleases/quarles-statement-20200625c.htm [https://perma.cc/SJ74-FAE2]; see also Unemployment Rate 16.1 Percent in Massachusetts, 4.5 Percent in Utah, in July 2020, U.S. BUREAU OF L. STAT.: ECON. DAILY (Aug. 27, 2020), https://www.bls.gov/opub/ted/2020/unemployment-rate-16-point-1-percent-in-massachusetts-4-point-5-percent-in-utah-in-july-2020.htm [https://perma.cc/H9C6-NXN5] [hereinafter Unemployment Rate 16.1 Percent in Massachusetts] (explaining the sudden rises in the unemployment rate due to COVID-19).}

III. CCAR AND DFAST IN 2020: THE IMPACT OF COVID-19

pandemic, only a few banks posted COVID-19 notifications on their website. Before long, however, several banks started to waive fees on products and services relating to bank accounts, mortgages, and credit cards. As many borrowers began to struggle due to the immediate shut down of businesses and the sudden increase of unemployment, the Federal Deposit Insurance Corporation (“FDIC”) encouraged banks to work with these individuals and businesses to alleviate further pressures. Additionally, many banks shifted to mobile and online banking, while also eliminating ATM fees and waiving early withdrawal fees.

A. The February 2020 Release of Stress Test Scenarios

On February 5, 2020, the Federal Reserve Board released the hypothetical scenarios for the 2020 stress tests. Combining both CCAR and DFAST, the Federal Reserve Board analyzed thirty-four big banks with at least $100 billion in total assets. For 2020, the tests analyzed the banks under the baseline and severely adverse scenario. Both the baseline and severely adverse scenarios incorporated twenty-eight variables subject to economic volatility, including the employment rate, interest rates, stock market prices, and gross domestic product. Under the severely adverse scenario, which included harsh conditions likened to a severe global recession, the unemployment rate rose rapidly from 6.5% to 10%, with additional stress in both the corporate debt and commercial real estate markets.
The test also incorporated global market influences. Banks with large trading operations had to incorporate a global market shock component in which international markets were factored into their analysis. These shock features included “heightened stress to trading book exposures to leveraged loans,” and required that firms with significant global trading provide a counterparty default scenario component. This latter component measures the probability that the other party involved in the trade may default on its obligation.

Qualifying banks were required to submit their capital plans to the Federal Reserve Board by April 6, with the results to be released by June 30. However, as the banks prepared their capital plans for 2020 in the following months, the original test was immediately rendered stale. For example, the U.S. unemployment rate jumped from 4.5% in March to 14.7% in April, exceeding the severely adverse scenario of 10% set out in February for the 2020 stress test. As unemployment rapidly increased and gross domestic product declined, the stress test became out of touch with reality.

B. The June 2020 Results and the New Sensitivity Analysis

On June 25, 2020, the Federal Reserve Board released the results of the 2020 stress test, along with a newly developed sensitivity analysis in light of COVID-19. In its original release, the Federal Reserve Board

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80. See id. (defining global market influences as heightened stress to trading book exposures to leveraged loans and counterparty default scenarios, and including banks such as Goldman Sachs, Bank of America and Wells Fargo).
81. Id.
82. Id.
84. Hypothetical Scenarios for its 2020 Stress Test Exercises, supra note 65.
85. See Tarullo, supra note 14 (noting the impacts stemming from the Federal Reserve Board’s confusing 2020 release of bank stress tests).
87. Tarullo, supra note 14.
briefly noted that the original February 2020 stress test under the severely adverse model yielded similar metrics as the V-shaped recession and recovery model, as discussed below, under the new sensitivity analysis. Additionally, the Federal Reserve Board stated that all of the banks involved in the February 2020 test remained strongly capitalized under both models.

The Federal Reserve Board also conducted a new sensitivity analysis in the aggregate to better align with the ongoing COVID-19 pandemic. The new test presented three downside scenarios: a V-shaped recession and recovery; a U-shaped recession and recovery; and a W-shaped, double-dip recession. In these scenarios, the unemployment rate ranged between 15.6% and 19.5%, a significant jump from the 10% maximum set for the severely adverse scenario presented in February. Unemployment at these rates would likely cause individuals to default on car loans, credit card debt, mortgages, and student loans, further negatively affecting banks.

The new sensitivity analysis results were released in aggregate for the thirty-four banks originally included in the February 2020 analysis, leaving out any bank-specific information. The results revealed that the banks involved in the sensitivity analysis experienced
aggregate loan losses ranging from $560 to $700 billion and capital ratios declined from 12% in the fourth quarter of 2019 to between 7.7% and 9.5%. Under both the U and W-shaped scenarios, most of the banks involved remain well capitalized but several would approach their minimum capital levels. Even so, Vice Chair Randal Quarles stated that “the results of our sensitivity analysis show that our banks can remain strong in the face of even the harshest shocks.”

In response to these results, the Federal Reserve Board took several actions to ensure that the banks remain well-capitalized even with the economic uncertainty of COVID-19. For the third quarter of 2020, the Federal Reserve Board required that banks preserve capital by suspending share purchases and capping dividend payments, while only allowing the distribution of dividends according to an income-based formula. Additionally, banks were required to resubmit their capital plans in October 2020.

Shortly following the release of the new sensitivity analysis scenarios, the Federal Reserve Board also announced new capital requirements for the big banks effective October 1, 2020. The metrics are individualized to each bank, however the minimum CET1 Capital Ratio for all banks is 4.5%. Additionally, the stress capital buffer, which is a way to ensure that banks have extra usable capital against losses, must be at least 2.5%. Finally, eight of the thirty-four big U.S. banks would approach their minimum capital levels unless they took actions to preserve capital.
banks also serve as global systemically important banks ("G-SIBs") and are required to keep a capital surcharge of at least 1.0%. This surcharge requires G-SIBs to maintain an additional capital supply to protect from losses and harsh economic scenarios.

C. The Third Test of 2020: The Mid-Cycle Stress Test

In addition to the February 2020 stress test and the new sensitivity analysis conducted from February to June 2020, the Federal Reserve Board released another test to measure the uncertainty imposed by the COVID-19 pandemic. The Federal Reserve Board created this first-of-its-kind test, released in September 2020, to better analyze the capital strength and resiliency of the big banks throughout the COVID-19 pandemic. This mid-cycle stress test, similar to the February 2020 stress test, measures two different types of hypothetical scenarios: severely adverse and alternative severe. The severely adverse scenario consists of an unemployment rate peak of 12.5% and then a decline to 7.5% through the end of 2021. The model also includes a 3% decline in gross domestic product from the third quarter of 2020 to the end of 2021. The alternative severe scenario, on the other hand, records a slow decline in the unemployment rate from 11% to 9% through to the end of 2021, and a gross domestic product that drops 2.5% from the third quarter of 2020.
to the fourth quarter of 2020. The results of the mid-cycle stress test were released in December 2020.

IV. CCAR AND DFAST IN 2020: HOW COVID-19 COULD INFLUENCE THE FUTURE OF STRESS TESTING

The COVID-19 pandemic served as the first true test of CCAR and DFAST in a moment of crisis. However, the new sensitivity analysis created a sense of confusion about the process and raised questions about the original purpose of stress tests.

A. The New Sensitivity Analysis: Lack of Transparency

The delayed switch to the new sensitivity analysis raised a variety of criticisms. In addition to the confusion and the unclear, aggregate release of the banks’ results for the new sensitivity analysis, critics raised concern about the lack of public disclosure. While the Federal Reserve Board still released bank-specific information for the severely adverse scenario, that scenario had a maximum unemployment rate of 10%. Meanwhile, U.S. unemployment rate had already reached 10.2% in July 2020, with some individual states even reaching 16%.

The new sensitivity analysis stated that while many banks remained well-capitalized under the V-shaped model, several banks would reach their minimum capital levels under both the U-shaped and W-shaped model. This lack of transparency is exactly what SCAP, in

114. Id; see also Press Release, Fed. Reserve, Federal Reserve Board Releases Second Round of Bank Stress Test Results (Dec. 18, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201218b.htm [https://perma.cc/LC4B-2CSV] (detailing the results of the second stress test, which showed that the banks were strongly capitalized when faced with the alternative severe and severely adverse scenarios).
115. See Blackwell, supra note 12 (stating how Dodd-Frank will likely be impacted by the economic wave that COVID-19 will have on the banking system).
116. See Tarullo, supra note 14 (noting the impacts stemming from the Federal Reserve Board’s confusing 2020 release of bank stress tests).
117. Id.
118. Id.
119. Hypothetical Scenarios for its 2020 Stress Test Exercises, supra note 65.
120. Quarles, supra note 67; see also Unemployment Rate 16.1 Percent in Massachusetts, supra note 67 (stating the sharp rise in unemployment due to COVID-19).
121. Additional Sensitivity Analyses, supra note 88.
response to the 2008 Financial crisis, sought to avoid. SCAP helped to restore confidence and credibility in the U.S. banking system by being transparent with market participants and consumers, which reduced fears about the possible collapse of the banks and U.S. economy. Some argued that the Federal Reserve Board refused to publicly disclose the sensitivity results because the analysis was an escape mechanism from negatively impacting the markets out of fear from the stress test scenarios. If the results were publicly disclosed, the Federal Reserve Board would have sent negative signals about the soundness of large banks. However, this lack of transparency raises even more concerns to market participants and consumers than what might have occurred if the results were fully disclosed. For example, the transparency and public disclosure of the SCAP program restored confidence in the U.S. economy by being honest with the American people, whereas hiding the financial standing of the big banks, even if strong, could reasonably lead to the conclusion that the Federal Reserve Board wanted to avoid the public disclosure of the results to obscure the fact that certain banks were struggling to meet minimum capital standards.

Vice Chair for Supervision, Randal Quarles, supported the lack of disclosure associated with new sensitivity analysis in light of COVID-19. He characterized the new scenarios as simply scenarios and not an official stress test, as they did not follow the normal protocol used for the annual stress tests. Therefore, the public disclosure element often associated with the stress test was absent, raising both concern and confusion about the state of the U.S. banking system during COVID-19. In support of the new sensitivity analysis, Vice Chair Quarles’ June

122. Clark & Ryu, supra note 6.
123. Id.
125. Id.
126. Id.
127. Clark & Ryu, supra note 6; see also Tarullo, supra note 14 (noting the impacts stemming from the Federal Reserve Board’s confusing 2020 release of bank stress tests).
128. See Quarles, supra note 67 (stating that the sensitivity analysis was not a stress test because the Federal Reserve Board did not publicly disclose the results and the scenarios were more in line with the forecast of the current economy instead of hypothetical scenarios).
129. Quarles, supra note 67.
130. See id. (detailing his opinion on the new adjustments to stress testing and the current stability of the banks).
2020 speech defended several aspects of the process.\textsuperscript{131} He noted that while COVID-19 upended the United States economy and markets, the banks remained strong.\textsuperscript{132} Compared to the 2008 Financial Crisis, big banks entered the COVID-19 pandemic with high levels of capital and liquidity.\textsuperscript{133}

Vice Chair Quarles also defended the unorthodox release of the sensitivity analysis,\textsuperscript{134} noting that the Federal Reserve Board chose not to follow the normal public disclosure process for stress tests because of the need for timely analysis.\textsuperscript{135} For example, the Federal Reserve Board avoided completely recalculating capital plans and instead made slight adjustments to the involved banks’ balance sheets to yield a more reasonable forecast in light of the current pandemic.\textsuperscript{136} Additionally, the sensitivity analysis reflected current economic forecasts influenced from COVID-19, rather than the normal hypothetical scenarios associated with the stress tests.\textsuperscript{137} In defending the aggregate release of information, Vice Chair Quarles stated that the purpose was to understand “the performance of the banking system as a whole; we did not provide any firm with firm-specific results nor are we publicly disclosing firm-specific results.”\textsuperscript{138} He ended his statement by concluding that the Federal Reserve Board would actively monitor the conditions of the banks in the coming months.\textsuperscript{139}

B. \textit{A Waste of Time and Resources}

Another general concern raised about the release of the sensitivity analysis was why the Federal Reserve Board would make the banks go through with testing hypothetical scenarios released in February 2020 and release results in June of that same year while simultaneously conducting another sensitivity analysis.\textsuperscript{140} As a CCAR testing cycle takes several

\textsuperscript{131} See id. (discussing how Quarles referred to the new sensitivity analysis as “not a stress test” and thus the lack of public disclosure was allowed).
\textsuperscript{132} Id.
\textsuperscript{133} See id. (stating that the thirty-four banks that participated in the sensitivity analysis had in aggregate $1.2$ trillion in common equity and $3.3$ trillion in high quality assets).
\textsuperscript{134} Id.
\textsuperscript{135} Id.
\textsuperscript{136} Id.
\textsuperscript{137} Id.
\textsuperscript{138} Id.
\textsuperscript{139} Quarles, supra note 67.
\textsuperscript{140} Tarullo, supra note 14.
months to complete, the Federal Reserve Board could have paused the 2020 test between the months of February and the June deadline to adjust the test to more relevant economic figures.\textsuperscript{141} In addition, the Federal Reserve Board released yet another stress test in September 2020, which only furthers this argument.\textsuperscript{142} In 2009, SCAP worked because the Federal Reserve Board stopped current testing and reevaluated with metrics that were more in tune with the economic crisis.\textsuperscript{143} Therefore, the 2020 response of the Federal Reserve Board raises the question as to why the same approach was not taken here.\textsuperscript{144} In its release, the Federal Reserve Board stated that the sensitivity analysis will help judge whether banks would have enough capital if economic and financial conditions were to worsen, but that is exactly the function of stress tests.\textsuperscript{145} If the Federal Reserve Board was unsure as to what metrics to use to reflect the uncertainty of the COVID-19 pandemic, releasing a detailed analysis that may not have been wholly accurate would have undermined the credibility of the entire stress test process and reduced confidence in the Federal Reserve Board.

Some critics argue that the COVID-19 pandemic revealed the flaws in both DFAST and CCAR, and thus call for the end of the programs.\textsuperscript{147} This argument especially holds true for 2020, when banks still were required to prepare capital plans by June for a stress test model released in February that did not reflect the uncertainty of the economy due to COVID-19.\textsuperscript{148} Managers spent time providing internal results of the stress tests when they could have been serving customers or allocating

\textsuperscript{141} Id.

\textsuperscript{142} Id.; see also Second Round of Bank Stress Tests, supra note 108 (noting how the Federal Reserve Board released another stress test in addition to the one earlier in the year and the new sensitivity analysis).

\textsuperscript{143} Clark & Ryu, supra note 6.

\textsuperscript{144} See Tarullo, supra note 14 (“Faced with this, the Fed had three options. First, it could shift gears quickly by substituting a COVID-informed stress scenario for the stale one. Second, it could suspend the dated stress test until markets stabilized and then recommence with an updated scenario. Third, it could soldier on with its original test, ignoring the potential impact of COVID on bank earnings and losses.”).

\textsuperscript{145} Id.

\textsuperscript{146} Id.

\textsuperscript{147} Id.

\textsuperscript{148} See id. (noting the impacts stemming from the Federal Reserve Board’s confusing 2020 release of bank stress-tests); see also Hugh Carney, Stress Tests for Midsize Banks are More Trouble Than They’re Worth, AM. BANKER (Oct. 26, 2017), https://www.americanbanker.com/opinion/stress-tests-for-midsise-banks-are-more-trouble-than-theyre-worth [https://perma.cc/3WLW-XS4C] (discussing how stress tests burden midsize bank and how one solution would be to call the end the programs).
their time elsewhere in the bank. Additionally, DFAST imposes significant costs on smaller to mid-size banks around the $10 billion threshold. These banks must produce thousands of documents and spend over 10,000 in compliance with stress tests, which in turn imposes a heavier burden on smaller to mid-size banks.

Conversely, the preparatory process has strengthened the capital of big banks over time. In 2020, the thirty-four banks involved in the annual stress test entered the pandemic with higher levels of capital and liquidity than during the 2008 Financial Crisis, indicating a safer lending regime and showing that banks have better conserved their capital over time. Additionally, when the stress tests are transparent with market participants and the American people, as demonstrated through SCAP, disclosing stress tests ultimately ensures trust and credibility within the markets.

C. The Global Impacts of the COVID-19 Pandemic: What Has Worked in Other Countries?

The European Banking Authority (“EBA”) took a different approach to stress testing in response to COVID-19. The EBA chose to postpone EU-wide stress testing until 2021, relieving pressure on the banking system. In addition, the EBA also postponed supervisory visits throughout 2020 and removed deadlines for reporting data to further this relief. This decision will allow banks to focus more on their core operations, such as support for their customers. However, the EBA will still carry out an EU-wide transparency exercise in order to

149. Carney, supra note 148.
150. Id.
151. Id.
152. Quarles, supra note 67.
153. Id.
155. See Jones & Canepa, supra note 15 (noting the decrease in capital requirements instilled by the EU’s decision to postpone stress testing in light of the pandemic); cf. Tarullo, supra note 14 (critiquing how the Federal Reserve Board instituted more burdens and stress tests/analyses on U.S. banks during COVID-19).
156. See Jones & Canepa, supra note 15 (noting how the EBA’s decision to reduce regulatory burdens should help banks focus on more important services, such as with their customers).
157. Id.
158. See id. (discussing how the EBA’s decision to remove burdens on banks during COVID-19 allows for the banks to better allocate their time to deal with customer needs).
provide updated information on banks’ exposures and asset quality to participants in the market.\textsuperscript{159} This transparency exercise, which has been an annual analysis conducted by the EBA dating back to 2011, includes data collected by the EBA from 129 banks across twenty-six countries.\textsuperscript{160} The report releases the assets, liabilities, exposures, and asset quality of the banks involved to create transparency with the markets.\textsuperscript{161} In 2020, the EBA conducted both a spring and fall exercise which only looked at supervisory reporting data, reducing any additional burdens for banks during the COVID-19 pandemic.\textsuperscript{162}

The EBA is also allowing banks to operate below their required capital level buffer to continue to finance households and corporations experiencing complications due to the COVID-19 pandemic.\textsuperscript{163} To aid in this financing, the European Central Bank (“ECB”) has increased lending to these banks through their Pandemic Emergency Purchase Programme (“PEPP”), which includes the purchasing of bonds from banks to free up room for more lending to business and households.\textsuperscript{164} These adjustments in response to a financial crisis help to free banks from the regulatory burden of complying with stress tests during the pandemic, and instead allows the banks to instead focus their efforts on their customers and the economy.\textsuperscript{165}

V. WHERE DO WE GO FROM HERE? REFORM AND OTHER SUGGESTIONS TO THE CHANGING ROLE OF STRESS TESTING

While some critics push for the demise of the CCAR and DFAST programs, they fail to acknowledge that CCAR and DFAST have resulted in banks preserving capital to be better prepared for periods of economic

\begin{footnotesize}
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\item \textsuperscript{159} Id.
\item \textsuperscript{161} Id.
\item \textsuperscript{162} Id.
\item \textsuperscript{163} See Jones & Canepa, supra note 15 (noting the decrease in capital requirements instilled by the EU’s decision to postpone stress testing in light of the pandemic).
\item \textsuperscript{165} Jones & Canepa, supra note 15.
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crisis like that experienced during the COVID-19 pandemic. The critique of these tests, instead, is centered on the lack of consistent procedural standards for stress testing during a financial crisis. In releasing the new sensitivity analysis, the Federal Reserve Board retreated from the values of public disclosure and transparency and moved towards a vague sensitivity analysis. The 2009 SCAP response restored confidence in the banks by being clear and honest about their capital state. As discussed, banks that initially failed the stress test were given one month to devise a new capital plan and six months to raise the necessary capital to satisfy it. Due to the new 2020 sensitivity analysis, however, the thirty-four banks were required to meet new capital requirements by October 1, 2020, giving the banks only three full months to reanalyze their capital plans. This rushed process only led to more confusion and added pressure to the banks during an already stressful pandemic.

In addition to revisiting the success of the SCAP response, the Federal Reserve Board should also seek influence from the EBA. By postponing the 2020 stress tests to the following year, the EBA relieved added constraints of EU-wide banks and allowed them to better allocate their resources to their customers. To maintain a sense of transparency, the EBA still planned to carry out EU-wide exercises to reveal the asset quality and exposures of the banks. Finally, the EBA allowed their banks to fall below their capital requirements, utilizing the buffers in place to continue lending to households and corporations while

166. See Tarullo, supra note 14 (noting the impacts stemming from the Federal Reserve Board’s confusing 2020 release of bank stress-tests); but see Clark & Ryu, supra note 6 (providing a detailed history on the creation of CCAR, DFAST, and SCAP).
168. See id. (noting the impacts stemming from the Federal Reserve Board’s confusing 2020 release of bank stress tests); but see Clark & Ryu, supra note 6 (stating how the transparency of SCAP helped to restore confidence between market participants and the U.S. banking system).
169. See Clark & Ryu, supra note 6 (noting how the transparency of SCAP helped to restore confidence between market participants and the banks).
170. Id.
171. See Large Bank Capital Requirements, supra note 102 (stating the updated requirements for larger banks as well as establishing a timeline for response).
172. Tarullo, supra note 14.
173. See Jones & Canepa, supra note 15 (noting how the EU’s decision to postpone stress testing in light of the pandemic decreased capital requirements).
174. See id. (“The EBA said that some capital buffers have been designed for use during a downturn to ensure continued lending to the economy.”).
175. Id.
additionally receiving support from the ECB. This relief, in addition to the continued transparency between the banks and EU market participants, could serve as a simpler, clearer process for CCAR and DFAST for future economic crises.

The SCAP response showed that in times of crisis, transparency is key. One of the main purposes of SCAP was to publicly disclose the results of the stress tests to create a mode of transparency between banks, market participants, and the American people. By disregarding this approach, the new sensitivity analysis has lost a piece of the original purpose of stress tests. To save additional resources for the thirty-four banks, the Federal Reserve Board should have reevaluated their response during a time of economic crisis. After the Federal Reserve Board released the February 2020 stress test scenarios, aimed to be completed only in June 2020, the Federal Reserve Board should have halted the test in March to recalibrate new scenarios that better reflected the metrics of the COVID-19 pandemic. This adjustment would have given the banks a month to develop a new plan similar to what happened with SCAP.

VI. Conclusion

Within the span of twelve years, the United States economy has faced two financial crises. In 2008, the collapse of the housing market

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176. Id.; Our Response to the Coronavirus Pandemic, supra note 164.
177. See Jones & Canepa, supra note 15 (noting the decrease in capital requirements instilled by the EU’s decision to postpone stress testing in light of the pandemic); see also Tarullo, supra note 14 (noting the impacts stemming from the Federal Reserve Board’s confusing 2020 release of bank stress-tests).
179. Id.
180. Id.; see also Additional Sensitivity Analyses, supra note 88 (stating the results of both the 2020 stress tests and the additional sensitivity analysis).
181. See Carney, supra note 148 (detailing the many adjustments needed for Dodd-Frank to be as effective as intended).
182. See Tarullo, supra note 14 (suggesting that the Federal Reserve Board should have reevaluated their metrics and paused the initial stress test to better align with the market factors and risks of COVID-19).
183. Id.; see Jones & Canepa, supra note 15 (noting the decrease in capital requirements instilled by the EU’s decision to postpone stress testing in light of the pandemic).
184. See Clark & Ryu, supra note 6 (providing a detailed history on the creation of CCAR, DFAST, and SCAP).
185. See Erin Coughlan, supra note 24 (discussing the factors that led to the 2008 financial crisis); see also Hauck, supra note 68 (providing a detailed timeline of the evolution of COVID-19 and its impact on the United States).
led to the 2008 Financial Crisis, resulting in the failure of over 450 commercial banks across the country as well as a spiked unemployment rate of 10%. In 2020, the United States faced the COVID-19 pandemic, leading to unemployment spikes of 16% in some states.

The Federal Reserve Board Board’s response to each financial crisis, however, led to adverse results. In 2009, with the development of the SCAP stress tests, the Federal Reserve Board allowed big banks to have one month to develop a capital plan and six months to adequately raise that capital. While there were many benefits to these sudden regulatory requirements, the most important was the public disclosure of the stress test results. The public disclosure requirement helped to rebuild trust in the U.S. economy by allowing market participants to learn of the financial standing of the banks.

In 2020, however, the Federal Reserve Board required thirty-four big banks involved in the annual stress tests to not only comply with an outdated stress test that had been exceeded by the economic conditions of COVID-19, but also comply with a new, vague sensitivity analysis, and a second annual stress test. The sensitivity analysis, classified to not be a stress test, allowed the Federal Reserve Board to evade the public disclosure requirement with normal stress tests. At the same time, the EBA postponed stress tests for 2020, allowing banks to delve into their capital buffers to meet customer requests and relieving regulatory visits until 2021.

186. See Labaton, supra note 22 (providing an overview of how the five big banks abused the relaxation of the net capital requirement); see also Erin Coughlan, supra note 24 (discussing the collapse of the housing market that led to the 2008 financial crisis).
187. Unemployment Rate 16.1 Percent in Massachusetts, supra note 67.
188. See Clark & Ryu, supra note 6 (noting how the successful implementation of SCAP restored confidence in the U.S. banking system); see also Tarullo, supra note 14 (“Why, then, in the face of an unprecedented economic situation and the powerful precedent of the 2009 SCAP, didn’t the Fed quickly pivot to a meaningful stress scenario, require resubmission of banks’ capital plans, and suspend dividend distributions to preserve capital in the interim until more was known?”).
190. Id.
191. Id.
192. Tarullo, supra note 14; see also Second Round of Bank Stress Tests, supra note 108 (discussing the released of a mid-cycle stress test).
193. See Quarles, supra note 67 (detailing his opinion on the new adjustments to stress testing and the current stability of the banks).
194. See Jones & Canepa, supra note 15 (noting the decrease in capital requirements instilled by the EBA’s decision to postpone stress testing in light of the pandemic).
The Federal Reserve Board’s 2020 response to the COVID-19 pandemic shows a deviation from the success of SCAP in 2009. By allowing for this deviation, critics have raised concerns about the credibility of the stress tests and the Federal Reserve Board as a whole, leading to a variety of misguided conclusions about the state of the U.S. banking system due to the lack of transparency with the public. Going forward, the Federal Reserve Board should revert to the more flexible SCAP procedures instead of the rigid adherence to a stress testing cycle and sporadic, non-public testing, while also considering the global response when faced with a future economic crisis.

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195. Compare Clark & Ryu, supra note 6 (detailing how SCAP helped to restore trust in the U.S. banking system), with Tarullo, supra note 14 (discussing the vague and confusing release of the 2020 sensitivity analysis).

196. Tarullo, supra note 14 (“Although the stale stress test results have been released to the public on a bank-by-bank basis as usual, the results of the sensitivity analysis have been released to the public only in the aggregate, with some ranges indicating how many banks may fall into certain categories of projected losses. So we have full information about a largely irrelevant stress test, but limited information about the relevant analysis.”)

197. Clark & Ryu, supra note 6 (detailing how SCAP helped to restore confidence in the U.S. banking system through transparency and flexible time frames that allowed banks to reevaluate, build, and better manage their capital); see also Jones & Canepa, supra note 15 (discussing how the EBA imposed less burdensome measures on EU-wide banks during the stress of COVID-19).

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