

Office of Inspector General



Office of Evaluations
Report No. EVAL-11-003

**Evaluation of the FDIC's Economic
Analysis of Three Rulemakings to
Implement Provisions of the Dodd-Frank
Act**

June 2011



Why We Did The Evaluation

In a May 4, 2011 letter, 10 minority members (Members) of the U.S. Senate Committee on Banking, Housing, and Urban Affairs expressed concern that regulatory agencies are conducting rulemakings to implement specific provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) without adequately considering the costs and benefits of their rules and the effects those rules could have on the economy. The letter requested that our office prepare a report describing the economic analysis that the FDIC performed for three proposed rules associated with the Dodd-Frank Act. The Members also asked other financial agency Inspectors General to initiate a review of the economic analyses performed by their respective agencies for specific rulemakings.

The primary objective of this evaluation is to address the issues included in the request. In this regard, our report describes:

1. Any statutory or other requirements for the FDIC to perform economic analysis associated with rulemaking efforts;
2. Any internal policies, procedures, and guidance used to ensure rigor and consistency in the economic analysis of proposed rules;
3. The degree to which key staff involved in the three rulemaking efforts understood and followed statutory and agency requirements to perform economic analysis;
4. The degree to which the FDIC complied with economic analysis requirements for the three rulemaking efforts;
5. Any discretionary economic analysis that the FDIC undertakes voluntarily or on an ad hoc basis to ensure efficient and effective rulemaking;
6. The qualifications of staff who conducted economic analysis for the three rulemaking efforts; and
7. The economic analysis performed by the FDIC for three specific rulemaking efforts, including the quantitative and qualitative methods used, extent of consideration of alternative approaches, extent of public input requested by the FDIC, and transparency of the FDIC's economic analysis.

Additionally, the Members asked us to describe other rulemaking steps that would be required if the FDIC were subject to Executive Order 13563, *Improving Regulation and Regulatory Review* (January 18, 2011); Executive Order 12866, *Regulatory Planning and Review*, (October 4, 1993); and Office of Management and Budget (OMB) Circular A-4, *Regulatory Analysis*, (September 17, 2003).

Finally, the Members asked us to describe to what extent the FDIC is considering the cumulative burden of all Dodd-Frank Act rulemakings on market participants and the economy.

Background

The stated aim of the Dodd-Frank Act is to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail," to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes. Under the Act, the FDIC is required or authorized to implement some 44 regulations, including 18 independent and 26 joint rulemakings. Within the FDIC, each rulemaking effort is an interdivisional project that brings together personnel from the Legal Division, including the Executive Secretary's Section which is involved in all rulemakings, and the appropriate functional

division such as the Division of Risk Management Supervision (RMS), Division of Resolutions and Receiverships (DRR), and the Division of Insurance and Research (DIR). Subject matter experts within RMS, DRR, and DIR perform the economic analysis and draft the technical portions of the proposed rules. Attorneys from the Legal Division assist in drafting rulemakings and ensure compliance with statutory and regulatory provisions. Attorneys from the Executive Secretary's Section review statutory rulemaking requirements and assist in drafting rulemakings for purposes of compliance with the Paperwork Reduction Act (PRA), Congressional Review Act, and the Administrative Procedure Act (APA).

Evaluation Results

The FDIC is subject to the APA and other statutes that impose rulemaking requirements on the Corporation. The Regulatory Flexibility Act (RFA) and the PRA, in particular, include requirements for economic analysis of the impact a rule has on small businesses and the burden a rule has on information collection, respectively. The Small Business Regulatory Enforcement Fairness Act of 1996 also requires the FDIC to conduct cost benefit analyses of final rules.

As an independent agency, the FDIC is not required to follow Executive Orders 13563 and 12866 or OMB Circular A-4. However, the FDIC has issued a *Statement of Policy on the Development and Review of FDIC Regulations and Policies*, No. 5157 (1998) (Policy Statement) that establishes basic principles and guidance for the FDIC's rulemaking efforts. The Policy Statement generally addresses the spirit of, and principles found in, the two executive orders and OMB guidance. The FDIC has also drafted procedural guidance in the form of a *Paper on the Development and Review of FDIC Rules and Statements of Policy* (December 19, 2006) (Paper) that provides procedural guidance for the rulemaking process and provides specific guidance for economic analysis under the RFA and PRA.

Rulemaking at the FDIC is a collaborative process, with subject matter experts from the business line divisions (such as RMS) conducting the technical and economic analysis and attorneys from the Legal Division assisting in drafting the rule and ensuring compliance with statutory and regulatory provisions. Based on interviews with FDIC personnel and review of relevant documents, we determined that the FDIC officials who drafted the proposed rules referenced by the Members were highly qualified and experienced subject matter experts with respect to the underlying subject of the proposed rules. We also confirmed that the key staff involved in the rulemakings understood and followed the statutory and FDIC requirements related to rulemaking and economic analysis. Notably, FDIC officials expressed that it was a duty of the FDIC as an insurer and a safety and soundness regulator to ensure that the Corporation carefully considered how all aspects of rulemaking efforts individually and collectively affected depository institutions, the financial industry, and the broader economy.

With respect to the three rulemaking efforts referenced by the Members, all three were joint rulemakings among the FDIC and other Federal agencies. Each proposed rule implemented a specific congressional mandate in the Dodd-Frank Act legislation and, thus, the FDIC's consideration of alternatives or cost and benefit factors was limited by those statutory requirements. We found that for each proposed rule, FDIC staff: worked jointly with other financial regulatory agencies to ensure a coordinated rulemaking effort; performed quantitative analysis of relevant data; considered alternative approaches to the extent allowed by the legislation; requested comment from the public on numerous facets of the rules; and, where applicable, included information about the analysis that was conducted and assumptions that were used in

the text of the proposed rule. Each proposed rule was also considered by the FDIC Board of Directors in open, public meetings.

The FDIC is also considering the cumulative burden of all Dodd-Frank Act rulemakings, and, among other things, has established a broad-based Dodd-Frank Act working group that includes the Chairman. The working group discusses and evaluates the interrelationship of all Dodd-Frank Act rulemakings and their impact on existing FDIC rules.

Management Response

We provided a draft of this report to the FDIC on June 6, 2011. The FDIC provided technical accuracy comments in response to the draft report, and we made changes to the report where appropriate. The FDIC Chairman's office advised us that the Chairman had no other comments. The FDIC was not required to provide a written response because the report contained no recommendations.

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ACRONYMS IN THE REPORT

APA	Administrative Procedure Act
CFTC	U.S. Commodity Futures Trading Commission
DIR	Division of Insurance and Research
DRR	Division of Resolutions and Receiverships
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FHFA	Federal Housing Finance Agency
FRB	Board of Governors of the Federal Reserve System
GSE	Government Sponsored Entities
ISDA	International Swap Dealers Association
OCC	Office of the Comptroller of the Currency
OMB	Office of Management and Budget
PRA	Paperwork Reduction Act
QRM	Qualified Residential Mortgage
RFA	Regulatory Flexibility Act
RMS	Division of Risk Management Supervision
SBA	Small Business Administration
SBREFA	Small Business Regulatory Enforcement Fairness Act of 1996
SEC	Securities and Exchange Commission



DATE: June 13, 2011

MEMORANDUM TO: Sheila C. Bair
Chairman

FROM: /Signed/
Jon T. Rymer
Inspector General

SUBJECT: *Evaluation of the FDIC's Economic Analysis of Three Rulemakings to Implement Provisions of the Dodd-Frank Act* (Report No. EVAL-11-003)

In a May 4, 2011 letter, 10 minority members (Members) of the U.S. Senate Committee on Banking, Housing, and Urban Affairs expressed concern that regulatory agencies are conducting rulemakings to implement specific provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) without adequately considering the costs and benefits of their rules and the effects those rules could have on the economy. In particular, the letter requested that our office prepare a report describing the economic analysis that the FDIC performed for three proposed rules: (1) *Credit Risk Retention*, 76 Fed. Reg. 83, 24090 (April 29, 2011); (2) *Margin and Capital Requirements for Covered Swap Entities*, 76 Fed. Reg. 91, 27564 (May 11, 2011); and (3) *Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor*, 75 Fed. Reg. 250, 82317 (December 30, 2010).

The Members also asked the Inspectors General from the Board of Governors of the Federal Reserve System (FRB), Commodity Futures Trading Commission (CFTC), Department of the Treasury (Treasury), and Securities and Exchange Commission (SEC) to initiate a review of the economic analyses performed by their respective agencies for specific rulemakings.

EVALUATION OBJECTIVE

The primary objective of this evaluation is to address the issues included in the request. In this regard, our report describes:

1. Any statutory or other requirements for the FDIC to perform economic analysis associated with rulemaking efforts;
2. Any internal policies, procedures, and guidance used to ensure rigor and consistency in the economic analysis of proposed rules;
3. The degree to which key staff involved in the three rulemaking efforts understood and followed statutory and agency requirements to perform economic analysis;
4. The degree to which the FDIC complied with economic analysis requirements for the three rulemaking efforts;

5. Any discretionary economic analysis that the FDIC undertakes voluntarily or on an ad hoc basis to ensure efficient and effective rulemaking;
6. The qualifications of staff who conducted economic analysis for the three rulemaking efforts; and
7. The economic analysis performed by the FDIC for the three rulemaking efforts, including the quantitative and qualitative methods used, extent of consideration of alternative approaches, extent of public input requested by the FDIC, and transparency of the FDIC's economic analysis.

Additionally, the Members asked us to describe other rulemaking steps that would be required if the FDIC were subject to Executive Order 13563, *Improving Regulation and Regulatory Review* (January 18, 2011); Executive Order 12866, *Regulatory Planning and Review*, (October 4, 1993); and Office of Management and Budget (OMB) Circular A-4, *Regulatory Analysis*, (September 17, 2003).

Finally, the Members asked us to describe to what extent the FDIC is considering the cumulative burden of all Dodd-Frank Act rulemakings on market participants and the economy.

Our evaluation work focused on determining the requirements, policy, and FDIC actions associated with the three rulemakings in order to describe them in this report. Given the reporting time frames requested by the Members, we did not perform evaluation procedures designed to support recommendations. Appendix I presents additional information on our objective, scope, and methodology.

BACKGROUND

The stated aim of the Dodd-Frank Act is to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes. Under the Dodd-Frank Act, the FDIC is required or authorized to implement some 44 regulations, including 18 independent and 26 joint rulemakings. The Congressional Research Service Report for Congress on *Rulemaking Requirements and Authorities in the Dodd-Frank Wall Street Reform and Consumer Protection Act* (November 3, 2010) reported that the Dodd-Frank Act does not impose additional procedures, requirements, and controls to guide and oversee the rulemaking process for agencies other than each agencies' standard rulemaking authority.

Within the FDIC, each rulemaking effort is an interdivisional project that brings together personnel from the Legal Division, including the Executive Secretary's Section which is involved in all rulemakings, and the appropriate functional division such as the Division of Risk Management Supervision (RMS), Division of Resolutions and Receiverships (DRR), and the Division of Insurance and Research (DIR). Subject matter experts within RMS, DRR, and DIR perform the economic analysis and draft the technical portions of the proposed rules. Attorneys from the Legal Division assist in drafting rulemakings and ensure compliance with statutory and regulatory provisions. Attorneys from the Executive Secretary's Section review statutory rulemaking requirements and assist in drafting rulemakings for purposes of compliance with the Paperwork Reduction Act (PRA), Congressional Review Act, and the Administrative Procedure Act (APA).

EVALUATION RESULTS

The FDIC is subject to certain statutes and FDIC policies that establish the basic principles that guide the FDIC in its economic analysis of rulemakings. As an independent agency, the FDIC is not subject to Executive Orders 13563 and 12866 or OMB Circular A-4. However, FDIC policies and practices generally address the spirit of, and principles found in, these orders and guidance. For the three rulemakings referenced by the Members, we found that the FDIC assigned highly qualified subject matter experts to develop the technical aspects of the proposed rules and to conduct economic analysis, where appropriate. We confirmed that these experts were knowledgeable of, and followed the applicable statutory and FDIC requirements related to, rulemaking and economic analysis. For each of the three rules, the FDIC worked jointly with other financial regulatory agencies; performed analysis of relevant data as required; considered alternative approaches to the extent allowed by the legislation; requested comments from the public; and, where appropriate, presented information supporting agency analysis and conclusions in the proposed rule. The FDIC is also considering the cumulative burden of all Dodd-Frank Act rulemakings and, among other things, has established a broad-based working group to evaluate the interrelationships of all Dodd-Frank rulemaking efforts.

Statutory or Other Requirements for the FDIC to Perform Economic Analysis Associated with Rulemaking Efforts

The FDIC is subject to the rulemaking requirements of the statutes described below. The Regulatory Flexibility Act (RFA) and the PRA, in particular, include requirements for economic analysis of the impact a rule has on small business and review of the paperwork burden that may be imposed by each rule, respectively. The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) also requires the FDIC to conduct a cost benefit analysis of final rules to determine whether they should be considered major rules under the Act. Further, a rulemaking prerequisite for the FDIC is the Federal Deposit Insurance Act (FDI Act) requirement that the FDIC Board of Directors approve each rulemaking prior to publication in the Federal Register. FDIC Board meetings to consider various rulemakings are announced in advance to the public, meetings are open to the public, and videos of meetings are available on the FDIC public Web site.

Administrative Procedure Act and Related Laws

The APA¹ defines rulemaking as the agency process for formulating, amending, or repealing a rule, and defines a rule as the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency. Formal rulemaking under the APA requires an agency hearing process, while informal rulemaking involves public notice and comment. Most FDIC rules are promulgated through the informal rulemaking process. Section 553 of the APA requires the publication in the Federal Register of most rules, and a period for public comment.

Rulemaking under the APA must comply with the following minimum procedural requirements:

¹ 5 U.S.C. §551 et. seq.

1. Unless a good-cause exception applies, a notice of proposed rulemaking must be published in the Federal Register that includes a statement of the time, place, and nature of the public rulemaking proceedings; a reference to the legal authority under which the rule is proposed; and either the terms or a description of the subjects and issues to be addressed by the proposed rule;
2. interested persons must be given an opportunity to submit written data, views, or arguments on the proposal, with or without opportunity for oral presentation;
3. a concise general statement of the basis and purpose must accompany the final rule; and
4. subject to certain exceptions, publication of the final rule must take place not less than 30 days before its effective date.

Regulatory Flexibility Act

Pursuant to the RFA,² whenever an agency is required to publish a general notice of proposed rulemaking for any proposed rule, the agency must also prepare and make available for public comment an initial regulatory flexibility analysis. The RFA requires agencies to analyze the economic impact of proposed regulations when there is likely to be a significant economic impact on a substantial number of small entities, and to consider regulatory alternatives that will minimize burden while achieving the agency's goal. Agencies are required to prepare initial and final regulatory flexibility analyses when promulgating a proposed or final rule, unless the agency head can certify that the final rule will not have a significant impact on a substantial number of small entities. The Small Business Administration (SBA) is responsible for administering the RFA and has defined "small entities" for banking purposes as a bank or savings association with \$175 million or less in assets.³

When required, the initial regulatory flexibility analysis describes the impact of the proposed rule on small entities; the reasons why action by the agency is being considered; the objectives of, and legal basis for, the proposed rule; the number of small entities to which the proposed rule will apply; the projected reporting, recordkeeping, and other compliance requirements of the proposed rule; and all relevant Federal rules that may duplicate, overlap, or conflict with the proposed rule. Each initial regulatory flexibility analysis also contains a description of any significant alternatives to the proposed rule that accomplish the stated objectives of applicable statutes and that minimize any significant economic impact of the proposed rule on small entities.

In addition, in accordance with the RFA, the FDIC publishes a semiannual agenda of regulations in process to inform the public of its regulatory actions and to enhance public participation in the rulemaking process.

² 5 U.S.C. §601-612.

³ 13 CFR 121.201.

Paperwork Reduction Act

The PRA⁴ was enacted to minimize the paperwork burden for individuals; small businesses; educational and nonprofit institutions; Federal contractors; State, local and tribal governments; and other persons resulting from the collection of information by or for the Federal Government. The PRA requires that agencies, with respect to general information resources management, manage information resources to reduce information collection burdens on the public; increase program efficiency and effectiveness; and improve the integrity, quality, and utility of information to all users within and outside the agency.

The PRA defines a collection of information as the obtaining, causing to be obtained, soliciting, or requiring the disclosure to third parties or the public, of facts or opinions by or for an agency, regardless of form or format, which calls for answers to identical questions posed to or imposing recordkeeping requirements on 10 or more people. Under the PRA, an agency must establish a process for the review and collection of information and the control of paperwork, and receive approval for proposed collections of information from OMB before conducting or sponsoring a collection of information.

For a proposed rulemaking that involves a collection of information or changes an existing collection, the FDIC publishes an estimate of the paperwork burden and requests public comments on, for example, the accuracy of the estimates of the burden of the information collection (including of the validity of the methodology and the assumptions used), the necessity of the information collection for the proper performance of the FDIC's functions, and ways to enhance the quality or utility of the information to be collected. FDIC staff reviews the comments received from the public and OMB on the proposed rulemaking and determines what changes, if any, should be made to the proposed information collection in the final rule in response to the comments. If a rulemaking involves a PRA collection of information, the PRA requires publication of a notice in the Federal Register stating that the agency has made a submission to OMB seeking approval of the proposed collection. The proposed collection of information may not be conducted unless the agency has received prior approval from OMB of the collection or the collection has been inferred and received a control number from OMB.

Section 722 of the Gramm-Leach-Bliley Act of 1999

Section 722 of the Gramm-Leach-Bliley Act of 1999⁵ imposes a plain language requirement for federal banking agency rules. The Act states that each federal banking agency, as defined by Section 3 of the Federal Deposit Insurance Act, must use plain language in all proposed and final rulemakings published by the agency in the Federal Register after January 1, 2000.

⁴ 44 U.S.C. §3501 et seq.

⁵ 12 U.S.C. §4809.

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994

Section 302 of the Riegle Community Development and Regulatory Improvement Act⁶ requires federal banking agencies to consider, in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions, and the benefits of such regulations.

New regulations and amendments to regulations prescribed by a federal banking agency that impose additional reporting, disclosures, or other new requirements on insured depository institutions shall take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form, unless the agency determines, for good cause published with the regulation, that the regulation should become effective before such time.

The Small Business Regulatory Enforcement Fairness Act

SBREFA amended the RFA to provide additional tools to aid small businesses in gaining regulatory fairness.⁷ SBREFA requirements apply to final rules and therefore do not apply to the three Dodd-Frank Act rulemaking efforts included in the Members' request. Section 212 of SBREFA requires Federal agencies to issue compliance guides for each rule or group of related rules for which an agency is required to prepare a final regulatory flexibility analysis under section 5 U.S.C. 605(b). The publication of the guide must take place the same day the rule is published (or as soon as possible after that date), be accompanied by the posting of the guide in an easily identified location on the Web site of the agency; and be distributed to known industry contacts, such as small entities, associations, or industry leaders affected by the rule. SBREFA also provides a procedure by which agency rules are reviewed by Congress. The Congressional Review Act,⁸ a part of SBREFA, allows Congress to review every new federal regulation issued by the government agencies and, by passage of a joint resolution, overrule a regulation. All covered rules, as defined by the APA,⁹ must be submitted to Congress and the Comptroller General before they become effective, and all major rules¹⁰ may not become effective until 60 days after submission.

⁶ 12 U.S.C. §4802(b).

⁷ SBREFA amendments of the RFA included ensuring judicial review of agency compliance with some of the RFA's provisions; additional requirements for detailed and substantive regulatory flexibility analyses; and inclusion of small entities in the development of rules by the Occupational Safety and Health Administration and the Environmental Protection Agency.

⁸ 5 U.S.C. §801 et. seq.

⁹ The APA defines a rule as the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy.

¹⁰ A major rule is defined in SBREFA as being any final rule that the Administrator of the SBA Office of Information and Regulatory Affairs finds has resulted in or is likely to result in (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, industries, governments, or geographic regions; or (3) significant adverse effects on competition and the economy.

SBREFA's reporting requirement occurs when the FDIC is issuing a final rule as defined by the APA. Before a final rule can take effect, the FDIC must publish the rule in the Federal Register, as well as submit reports to Congress and the Comptroller General that include a copy of the rule; a general statement of the rule; a determination of whether it is a major rule; and the proposed effective date of the rule. Additionally, the FDIC must submit to the Comptroller General and Congress a complete copy of the cost-benefit analysis of the final rule; the agency actions under the RFA; and any other relevant requirements from statutory, regulatory, or Presidential sources.

Federal Deposit Insurance Act – Approval by the FDIC Board of Directors (FDIC Board)

The FDI Act¹¹ authorizes the FDIC, through its Board of Directors, to prescribe such rules and regulations as it may deem necessary to carry out the FDI Act or any other law it has the responsibility of administering or enforcing. To fulfill its duty under the FDI Act, the FDIC Board, whose members include the FDIC Chairman, Vice Chairman, an internal Director, the Comptroller of the Currency, and the Director of the Office of Thrift Supervision, must approve every rule proposed by the FDIC whether on its own or through a joint rulemaking.¹² For each new rule, a memorandum is presented to the FDIC Board that includes a description of the proposed rule, the reasons for the rule, and important points and issues that would be helpful for the FDIC Board to consider in rendering a decision. FDIC Board meetings for the consideration of new rulemakings are open to the public and, pursuant to the Government in the Sunshine Act,¹³ an advance notice is provided of the meeting dates and agenda. Further, a video of more recent FDIC Board meetings is available on the FDIC public Web site.¹⁴ In addition to the memorandum, an FDIC Board Resolution is drafted to document the FDIC Board's findings regarding the rule and directs that the rule be published in the Federal Register.

Internal Policies, Procedures, and Guidance Used to Ensure Rigor and Consistency in the Economic Analysis of Proposed Rules

The FDIC Board issued a *Statement of Policy on the Development and Review of FDIC Regulations and Policies*, No. 5157 (1998)¹⁵ (Policy Statement) that establishes the basic principles that guide the FDIC's issuance and review of regulations and written statements of policy. The Policy Statement includes broad economic analysis principles that focus on minimizing the burden a regulation imposes on the banking industry and the public; determining the need for a regulation; the effect of a regulation on competition within the financial industry, with specific emphasis on smaller institutions and whether there are alternatives to accomplish the FDIC's goal that would minimize any burden on small institutions; and a weighing of the potential cost and benefits of the regulation. Further, the Policy Statement includes a requirement to carefully analyze any new reporting and recordkeeping requirements. Additionally, the Policy Statement recognizes that the FDIC frequently must implement statutory

¹¹ 12 U.S.C. 1811 *et seq.*

¹² The Dodd-Frank Act changed the composition of the FDIC Board by replacing the OTS Director with the Director of the Consumer Financial Protection Bureau.

¹³ 5 U.S.C. § 552b.

¹⁴ Open Board meeting from November 5, 2007 to the present have video.

¹⁵ 63 Fed. Reg. 25157 (1998).

provisions with other financial institution regulators and states that the FDIC will work with other regulators to ensure regulations are made in a uniform way. Finally, the Policy Statement provides that the FDIC should draft regulations that are clearly and understandably written; the public should have a meaningful opportunity to participate in the rulemaking process; rulemakings should be carried out in accordance with the APA; and regulations should be periodically reviewed.

The Legal Division drafted a *Paper on the Development and Review of FDIC Rules and Statements of Policy* (December 19, 2006) (Paper) that discusses general steps and key issues to consider once a decision is made to develop a rule or statement of policy. The Paper describes each statutory requirement for FDIC rulemaking and provides specific guidance for economic analysis under RFA and PRA. Further, the Paper refers to the SBA's, *A Guide for Government Agencies – How to Comply with the Regulatory Flexibility Act*, for guidance on economic analysis. Additionally, the Paper describes the information to include when presenting a rulemaking to the FDIC Board for approval. The Paper also presents the steps required to develop a rule, including the preparation of a memorandum to the FDIC Board for its consideration.

Finally, the Legal Division has a checklist it uses to ensure regulatory analysis requirements are completed for the statutes noted above. The checklist indicates whether a statute is applicable to a proposed or final rule and the party responsible for ensuring compliance.

The Degree to Which Key Staff Involved in the Three Rulemaking Efforts Understood and Followed Statutory and Agency Requirements to Perform Economic Analysis

The key FDIC staff involved in the three rulemaking efforts are subject matter experts with respect to the issues covered by the proposed rules, and they were assisted in complying with statutory and agency requirements by attorneys from the Legal Division and the Executive Secretary's Section. All key FDIC staff involved in the rulemakings had an understanding of the statutory and agency requirements for economic analysis and followed those requirements. Additionally, FDIC personnel involved in the rulemakings expressed that it was a duty of the FDIC as an insurer and safety and soundness regulator to ensure that the FDIC carefully considered how all aspects of particular rules individually and collectively affected the banks it insures, the financial industry, and the broader economy. Specific analysis of each rulemaking effort is described more fully below.

The Degree to Which the FDIC Complied with Economic Analysis Requirements for the Three Rulemaking Efforts

As mentioned above, the FDIC is subject to statutory economic analysis requirements under the RFA and PRA. The RFA requires agencies to analyze the economic impact of proposed regulations when there is likely to be a significant economic impact on a substantial number of small businesses, and to consider regulatory alternatives that will minimize burden while achieving the agency's goal. Under the PRA, an agency must establish a process for the review and collection of information and the control of paperwork, and receive approval for proposed collections of information from OMB before conducting or sponsoring a collection of information.

Based on interviews with FDIC personnel and review of documents provided, the FDIC included RFA analysis in each proposed rule and determined the impact of the proposed rules on insured institutions. With respect to the Credit Risk Retention rule and the Risk-Based Capital rule, the FDIC reviewed Call Report data and concluded that the rules will not result in a significant economic impact on a substantial number of entities. For the Swap rule, the FDIC published an initial regulatory flexibility analysis and requested comments on the analysis. The impact of the Swap rule in terms of the RFA is dependent on the number of uncleared swap transactions that will be entered into after the rule is made final, and that number could not be determined with a level of certainty at this point in time. The FDIC will issue a final RFA analysis once the agency reviews comments on the proposed rule.

With respect to the PRA, the FDIC prepared the PRA analysis required for the OMB Supporting Statement submission for the Credit Risk Retention and Swap proposed rules. It determined, however, that the Risk-Based Capital proposed rule will have no impact on reporting frequency or response time and therefore did not require a PRA analysis.

Based on a review of FDIC Board minutes, memoranda submitted to the FDIC Board, and FDIC Board Resolutions, all three rulemakings were reviewed and approved by the FDIC Board prior to publication.

Any Discretionary Economic Analysis that the FDIC Undertakes Voluntarily or on an Ad Hoc Basis to Ensure Efficient and Effective Rulemaking

As mentioned previously, the Policy Statement covering rulemaking establishes the basic principles that guide the FDIC's issuance and review of regulations and written statements of policy. The Policy Statement includes broad economic analysis principles that focus on minimizing the burden a regulation imposes on the banking industry and the public; determining the need for a regulation; determining the effect of a regulation on competition within the financial industry, with specific emphasis on smaller institutions and whether there are alternatives to accomplish the FDIC's goal that would minimize any burden on small institutions; and weighing the potential cost and benefits of the regulation.

The Policy Statement is not prescriptive in terms of the analysis that must be performed in order to comply with its principles because the nature of analysis required depends on the particular rulemaking. In complying with the Policy Statement, each rulemaking team – which is comprised of subject matter experts – determines the appropriate type of analysis needed, taking into consideration any analysis prescribed by Congress and the legislative history of an authorizing statute. An example of analysis prescribed by Congress is Section 941(e)(4)(B) of the Dodd-Frank Act (the Credit Risk Retention rule). In that section, Congress specifically requested that in developing regulations to define Qualified Residential Mortgages (QRM) that would be exempt from the statute, the Federal banking agencies *shall* consider underwriting and product features that historical loan performance data indicate result in a lower risk of default. Section 941(e)(4)(B) goes on to list possible underwriting criteria that fit such a low risk definition.

At other times, a statute is less prescriptive, and rulemaking teams determine, based on the nature of the rule and any legislative history, the appropriate analysis to perform in order to evaluate the impact of a particular rulemaking.

The Qualifications of Staff Who Conducted Economic Analysis for the Three Rulemaking Efforts

FDIC staff members who performed and reviewed economic analysis with respect to the three Dodd-Frank Act rulemaking efforts are considered subject matter experts for the underlying subject of each rule. Specifically, for the Credit Risk Retention rule, the staff member has been with the FDIC for over 25 years; holds a degree in accounting, finance, and business; and is the FDIC subject matter expert for nontraditional mortgage loans, subprime mortgage lending, loan modifications, appraisal issues, commercial real estate loan workouts, and small business lending. For the Swap proposed rule, economic analysis was performed by (1) an FDIC Senior Capital Markets Specialist who holds a PhD in economics and (2) the director of the RMS Capital Markets Branch Policy Section, who is an accountant and FDIC staff lead for regulations related to regulatory capital and capital markets activities. Finally, for the Risk-Based Capital rule, the FDIC staff member is an economist who heads the RMS Capital Markets Branch.

The Economic Analysis Performed by the FDIC for the Three Rulemaking Efforts

The three rulemaking efforts discussed in detail below were all joint rulemakings among the FDIC and other Federal agencies. Each proposed rulemaking effort implements a specific Congressional mandate in the Dodd-Frank Act; thus, the FDIC's consideration of alternatives or cost and benefit factors was limited by those statutory requirements. According to FDIC analysis of the three proposed rules, it is likely that the three proposed rules will have a limited impact on FDIC-supervised institutions, but they may impact FDIC-insured institutions.

Credit Risk Retention, 76 Fed. Reg. 83, 24090 (April 29, 2011).

Brief summary of the proposed rule and rulemaking efforts. In general, the Credit Risk Retention proposed rule implements the credit risk retention requirements of section 15G of the Securities and Exchange Act, as added by section 941 of the Dodd-Frank Act and is designed to address problems experienced during the financial crisis with respect to the securitization of mortgages and other assets where securitizations were sold with little or no credit risk borne by participants in the securitization chain. The proposed rule generally would require sponsors of asset-backed securities to retain at least 5 percent of the credit risk of the assets underlying the securities and would not permit sponsors to transfer or hedge that credit risk.

The Credit Risk Retention proposed rule was a joint rulemaking of the FDIC, Office of the Comptroller of the Currency (OCC), FRB, SEC, Federal Housing Finance Agency (FHFA), and Department of Housing and Urban Development (HUD). The Secretary of the Treasury, as Chairperson of the Financial Stability Oversight Council, coordinated the development of the joint proposed rule. As such, the Department of the Treasury facilitated the development of an interagency working group comprised of subject matter experts from each agency. The agencies analyzed the requirements of section 941 and their potential impact on consumers, investors, and financial institutions in drafting the proposed rule. The interagency working group assigned specific analytical tasks to smaller interagency subgroups based on a particular agency's data and the special expertise of agency members. The small interagency subgroups provided their analysis

and findings to the larger interagency working group, and each interagency working group member reviewed the underlying analysis and findings. All aspects of the proposed rulemaking were developed collectively by the agency members of the interagency working group.

The quantitative and qualitative methods used. Broadly, the FDIC, as a member of the interagency working group, performed quantitative analysis of data to understand the breadth and scope of securitizations that could be affected by the proposed rule as well as each technical aspect of the rulemaking. For example, quantitative analysis included reviewing the following datasets in order to fulfill the section 941 mandate of the Dodd-Frank Act to determine which underwriting criteria and product features result in lower risk of default:

- (1) mortgage performance data supplied by Lender Processing Services, which included data for prime, fixed-rate loan originations from 2005 to 2008;
- (2) data from the 1992 to 2007 triennial *Survey of Consumer Finances*; and
- (3) loans purchased or securitized by the Government Sponsored Entities (GSEs).

Moreover, the proposed rule includes supplementary information that shows in detail the effects the proposed rule would have had if it were imposed on loans purchased and secured by the GSEs from 1997-2009.

With respect to administrative law matters such as RFA and PRA, the FDIC performed quantitative analysis under the RFA using September 30, 2010 Call Report information to determine that six small banking organizations that sponsor securitizations may be affected by the proposed rule. Thus, the FDIC concluded that the proposed rule would not have a significant economic impact on the 4,779 FDIC-supervised institutions, a substantial number of which are small, state nonmember banks. Additionally, the FDIC reviewed Call Report data to determine the burdens on insured institutions under the PRA. The FDIC considered the burden in hours related to disclosures and recordkeeping that the proposed rule would require and estimated an annual hourly burden for participating securitization sponsors and creditors.

Finally, the SEC, in coordination with the FDIC and the other agencies involved in the rulemaking, prepared an economic analysis of the proposed rule as required by section 23(a)(2) of the Securities Exchange Act of 1934 (Exchange Act), as amended. Specifically, the Exchange Act requires that the SEC, when making rules under the Exchange Act, consider the impact that the rules would have on competition and prohibits the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act. FDIC personnel told us they reviewed the analysis and data underlying the SEC's work and made comments that were incorporated by the SEC. The SEC economic analysis concentrated on the costs and benefits of the decisions with respect to areas where the agencies were permitted discretion to fulfill the mandate of Section 941 of the Dodd-Frank Act. The SEC analysis concluded that the menu of options provided in the proposed rule for permissible forms of risk retention would have no competitive effects and would implement the risk retention mandate without causing economic inefficiencies or hindering capital formation.

The FDIC, as a member of the interagency working group, also reviewed qualitative information such as government, private sector, and academic studies of various aspects of securitizations to understand, among other things, how credit risk exposure is maintained for securitized assets as well as the minimum standards for loans that have low credit risk. For example, the FDIC reviewed the FRB's *Report to the Congress on Risk Retention* (October 2010) to understand options for retaining credit risk. The FDIC also reviewed information from the *Journal of Real Estate Finance and Economics' Explicit Test of Contingent Claims Models of Mortgage Default* (1995) to understand the importance of loan-to-value ratio at origination as an underwriting factor for low credit-risk loans.

Extent of consideration of alternative approaches. The FDIC, as a member of the interagency working group, reviewed numerous alternative means to fulfill the mandate of section 941 of the Dodd-Frank Act. For example, the proposed rule offers multiple ways for sponsors or other entities to retain risk for securitized assets. The alternatives are based on historical market practices as well as the diversity of assets that are securitized. Additionally, the FDIC, in conjunction with the other agencies determined that based on the quantitative and qualitative analysis discussed above, certain underwriting criterion would not be included in the proposed rule because underlying data did not adequately demonstrate that mortgages with such criterion were less likely to default. For example, after reviewing reports and information concerning the performance of loans with mortgage guarantee insurance, the agencies were unable to support that having such insurance would reduce a borrower's default risk.

The agencies also considered an alternative approach to implementing the exemption for QRMs by creating a broader definition of a QRM that includes a wider range of mortgages of potentially lower credit quality, and that increases the risk retention requirements for non-QRM mortgages. As a result, within this alternative approach, the standards to qualify as a QRM would be more liberal. This alternative approach was presented for public consideration and comment.

Extent of public input requested by the FDIC. The FDIC, in conjunction with the other agencies, is requesting significant input from the public with respect to the proposed rule. The rulemaking includes approximately 174 requests for comment, a significant number of which request information concerning the cost benefit or economic impact of both broad and narrow aspects of the proposed rule. While the comment period is open to the public for 42 days according to the date it was published in the *Federal Register*, the proposal was publicly available on March 29, 2011, which resulted in a comment period of 73 days.¹⁶ The agencies have agreed to extend the comment period to August 1, 2011, in response to requests for an extension to allow the industry and the public more time to analyze the proposal and provide meaningful comment on its potential impact. The FDIC and other agencies are expecting thousands of comments and, according to the Policy Statement, those comments will be made publicly available on the FDIC Web site and considered by the FDIC and the other agencies as they determine the requirements of the final rule.

¹⁶ FDIC comment periods are rarely shorter than 30 days or longer than 120 days. Sixty days is the most common comment period.

Additionally, as noted in the Policy Statement, any person or organization may petition the FDIC Board for the issuance, amendment, or repeal of any regulation or policy by submitting a written petition to the Executive Secretary of the FDIC. The FDIC Board has authority to take such action under the broad powers of the FDI Act. Petitions are generally reviewed by FDIC legal and subject matter personnel, and a recommendation is made to the FDIC Board. The final decision rests with the FDIC Board.

Finally, the FDIC also initiated an *Open Door Policy for Regulatory Reform Rulemaking* that goes beyond what is required under the APA. Key elements of the Open Door Policy include roundtable discussions with external parties concerning implementation issues; a bi-weekly release of the names and affiliations of private-sector individuals who meet with senior FDIC officials to discuss how the FDIC should interpret or implement provisions of the Dodd-Frank Act that are subject to independent or joint rulemaking; a dedicated public mailbox to encourage public input with the content and applicability of the input posted to the FDIC Web site; the ability of members of the public to request a meeting with FDIC staff on implementation issues; and Webcasts of all open FDIC Board meetings.

The transparency of the FDIC's economic analysis. We used the definition of transparency contained in OMB Circular A-4 (September 17, 2003) to define transparent economic analysis to include disclosure with respect to studies conducted, assumptions used, and implications of plausible alternative assumptions, so that a qualified third party could clearly see how the agency arrived at its estimates and conclusions. The preamble to the proposed rule lays out in substantial detail the data and studies that the FDIC, in conjunction with the other agencies, relied on to determine how best to fulfill the mandate under section 941 of the Dodd-Frank Act, including the agencies' rationale for their decisions based on the data reviewed and why the agencies included or disregarded possible rulemaking criteria. For example, in describing the overall approach to defining QRMs that are exempt from the provisions of section 941, the agencies presented their overall approach and defined and described each dataset that was evaluated to determine whether a mortgage is of sufficient credit quality. Further, for each underwriting criterion used to define a QRM, the agencies provided summary data and their rationale for including or excluding the criterion.

Additionally, as mentioned above, the preamble includes an economic analysis of the proposed rule as required by section 23(a)(2) of the Exchange Act, as amended. The SEC economic analysis concentrates on the costs and benefits of the decisions with respect to areas where the agencies were permitted discretion to fulfill the mandate of section 941 of the Dodd-Frank Act.

In addition to the preamble, the proposed rulemaking was considered by the FDIC Board in an open meeting on March 29, 2011. The memorandum presented to the FDIC Board, a copy of the proposed rule, as well as a video of the Board proceedings are available on the FDIC public Web site. The FDIC Board video documents the rationale for the proposed rulemaking and discusses some of the economic analysis considered in the rulemaking.

Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 91, 27564 (May 11, 2011).

Brief summary of rule and rulemaking efforts. The Swap proposed rule implements sections 731 and 764 of the Dodd-Frank Act and addresses specific aspects of the financial crisis concerning the uncertainty over the vulnerability of derivatives dealers to the failure of other dealers and the large derivatives exposure of major non-dealers in the market. Specifically, the Swap proposed rule requires some of the largest and most active participants in the derivatives market to collect margin for swap transactions that are not cleared through central counterparties. The Swap proposed rule was a joint rulemaking effort among the FDIC, OCC, FRB, FHFA, and Farm Credit Administration.

Quantitative and qualitative methods used. In developing the Swap proposed rule, FDIC personnel reviewed various sources of economic information to better understand the derivatives industry for which the Dodd-Frank Act required the agency to adopt regulations imposing initial margin, variation margin, and capital requirements on dealers and major participants of covered derivatives. For example, economic information included the OCC *Quarterly Report on Bank Derivatives Activities*, and the International Swap Dealers Association (ISDA) *Annual Margin Survey*, which provides information about the use of collateral in the non-cleared derivatives business.

In addition to reviewing public sources of economic information, in 2010, FRB staff, including staff from the New York Federal Reserve Bank, conducted a horizontal review of initial margin and variation margin practices among dealers. In and around August 2010, FRB staff shared a bullet-point summary of this horizontal review with FDIC staff and staff from the other banking agencies.

In September and October 2010, staff from the FDIC and the other banking agencies developed a series of questions about the current derivatives market and the possible impact of proposed rule changes. These questions were posed to several dealers of derivatives that are likely to be covered by the SEC and CFTC regulatory definitions of “swap dealer” and “security-based swap dealer.” Responses to these questions were received in late November and early December 2010 and evaluated by staff of the FDIC and other banking agencies.

Several aspects of the Swap proposed rule are intended to incorporate current market practices and therefore are not anticipated to impose additional incremental costs. For example, it was the understanding of FDIC officials that, under current practices, a bank that serves as a derivatives dealer to a commercial end user will not require the end user to post initial margin or variation margin if the underlying credit exposure is within the amount of unsecured credit that the bank had calculated as being consistent with safe and sound bank management. In establishing initial margin and variation margin requirements for transactions where the counterparty is a commercial end user, the FDIC generally intended to incorporate the current practice.

Other aspects of the proposal, however, would require departure from current market practices in order to implement the statutory mandate to impose initial margin requirements. For instance, it was the FDIC staff’s understanding that, under current

market practices, dealers and major participants do not require initial margin for transactions with other similar counterparties. The FDIC staff did not believe it could consider not imposing an initial margin requirement, given the statutory mandate to impose such a requirement.

For several reasons, the FDIC did not consider existing economic information about the current derivatives market to be relevant for evaluating the costs associated with the initial margin and variation margin requirements. First, the banking agencies did not propose to apply the Swap proposed rule retroactively—it would only be applied to covered derivatives entered into after the effective date of the final rule. Thus, no initial margin or variation margin requirements would apply to transactions entered into prior to the final rule's effective date. Second, the population of dealers and major participants to which the proposed rule would apply is subject to definitions that are presently being developed by the CFTC and SEC through rulemakings, and, as such, was unknown by the banking agencies as they developed the proposed rule. Third, certain derivatives that are currently not cleared may in the future be subject to the clearing requirement rather than the margin requirements in the proposed rule.

Extent of consideration of alternative approaches. Alternative approaches were proposed primarily in two main areas, namely initial margin and eligible collateral. Specifically, the Swap proposed rule provides two options for the calculation of the initial margin to be posted by covered swap entities and provides a limited range of the types of collateral eligible to satisfy margin requirements. However, the preamble to the Swap proposed rule indicates that alternative approaches may exist for many aspects of the proposed rule and requests comments that identify and analyze those alternatives.

Extent of public input requested by the FDIC. The Swap proposed rule includes requests for comment and over 90 questions that cover nearly every aspect of the proposed rule. The comment period is open to the public for 45 days. The largest proportion of comment requests and questions are focused on the initial margin aspect of the Swap proposed rule. Specifically, the agencies requested assistance with identifying the costs and benefits of, and alternative approaches for, the proposed initial margin requirements. Additionally, according to the Policy Statement, those comments will be made publicly available on the FDIC Web site and considered by the FDIC and the other agencies as they determine the final rulemaking language. As noted earlier, the FDIC's *Open Door Policy for Regulatory Rulemaking* and written petition avenue are available to individuals or entities with concerns about the rulemaking effort.

The transparency of the FDIC's economic analysis. The preamble to the Swap proposed rule states that assessing the quantitative impact of the proposed rule is difficult because of the wide-ranging and undetermined changes that are occurring to the derivatives market as a result of regulatory reform. The preamble goes on to list uncertainty with respect to: (1) which entities would be classified as swap entities, (2) the extent to which derivatives would be rolled over or renewed, and (3) the extent to which derivatives currently traded in over-the-counter markets would shift to clearing through central counterparties.

In addition to the preamble, the rulemaking was considered by the FDIC Board in an open meeting on April 12, 2011. The memorandum presented to the FDIC Board, a copy of the proposed rule, as well as a video of the Board proceedings with respect to the proposed rule are available on the FDIC public Web site. The FDIC Board video documents the rationale for the rulemaking and discusses some of the potential economic effects considered in the rulemaking.

Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor, 75 Fed. Reg. 250, 82317 (December 30, 2010).

Brief summary of rule and rulemaking efforts. The Risk-Based Capital proposed rule is an interagency effort among the FDIC, FRB, and OCC. The Risk-Based Capital proposed rule implements the requirements of section 171 of the Dodd-Frank Act (also known as the Collins Amendment). In the simplest terms, this proposed rule provides that the largest institutions will not have risk-based capital requirements that are less than the corresponding requirements for smaller institutions holding the same risk exposures. It does this by amending the Advanced Approaches Risk-Based Capital rule (Advanced Approaches rule)¹⁷ to require institutions subject to that rule to continue computing their capital requirements under both the Advanced Approaches rule and the agencies’ general risk-based capital rules, with the general risk-based capital requirements acting as a floor for the Advanced Approach risk-based capital requirement.

The Risk-Based Capital proposed rule amends the Advanced Approaches rule that the banking agencies published on December 7, 2007 that required certain large institutions to transition to capital rules established by the Basel Committee on Banking Supervision. The Advanced Approaches rule provides that after completing a “parallel run” to the satisfaction of supervisors, institutions enter a sequence of three “transitional floor periods” where their risk-based capital requirements would be permitted to drop below those of smaller insured institutions by progressively larger amounts. After the transitional floor periods, the Advanced Approaches rule allowed for the removal of floors on risk-based capital requirements for these large institutions. At the present time, no large institution has exited its parallel run and entered a transitional floor period. Therefore, all institutions, including those subject to the Advanced Approaches rule, are subject to the agencies’ general risk-based capital requirements.

Quantitative and qualitative methods used. As described above, the Risk-Based Capital proposed rule did not make any change to the risk-based capital floor that applies to all financial institutions today, but merely eliminated the potential for future reductions in risk-based capital requirements to levels less than those applying to smaller banks. In implementing the Advanced Approaches rule, the FDIC conducted analysis and determined that the Advanced Approaches rule would apply to 15 to 20 large financial institutions. The FDIC determined that since the Risk-Based Capital proposed rule implementing the Collins Amendment did not change the way the 15 to 20 banks currently compute or comply with their risk-based capital requirements, the Risk-Based

¹⁷ Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Final Rule 72 Fed. Reg. 235, 69288 (December 7, 2007).

Capital proposed rule would not require any additional capital and would be unlikely to have broad economic effects. As mentioned above, to comply with the RFA, the FDIC reviewed Call Report data and concluded that the proposed rule will not result in a significant economic impact on a substantial number of entities. Further, the Risk-Based Capital proposed rule did not fall within the PRA because it did not have an impact on reporting frequency or response time because current reporting requirements stay the same before and after implementation of the proposed rule.

Extent of consideration of alternative approaches. Section 171 of the Dodd-Frank Act requires that agencies set a capital floor that is no less than the existing capital floor. FDIC personnel told us that they implemented the language of section 171 as written and did not view alternatives as being consistent with the legislative intent of the Collins Amendment.

Extent of public input requested by the FDIC. The Risk-Based Capital proposed rule requests comment on five issues, and three of the five issues concern economic analysis with respect to the impact of the change and cost benefit analysis in case there are issues that the FDIC did not consider. Additionally, according to the Policy Statement, those comments will be made publicly available on the FDIC Web site and considered by the FDIC and the other agencies as they determine the final rulemaking language. As noted earlier, the FDIC's *Open Door Policy for Regulatory Rulemaking* and written petition avenue are available to individuals or entities with concerns about the rulemaking effort.

The transparency of the FDIC's economic analysis. The Risk-Based Capital proposed rule preamble describes the fact that the net effect of the proposed rule is that large financial institutions will maintain their current regulatory capital floor. In addition to the preamble, the proposed rule was considered by the FDIC Board in an open meeting on December 14, 2010. The memorandum presented to the FDIC Board, a copy of the proposed rule, and a video of the Board proceedings with respect to the proposed rule are available on the FDIC public Web site.

Comparison of Executive Orders 13563 and 12866 and OMB Guidance to the FDIC's Approach

As mentioned previously, the Dodd-Frank Act does not impose additional procedures, requirements, and controls to guide and oversee the rulemaking process for agencies other than those involved in each agency's standard rulemaking authority. As an independent agency, the FDIC is not subject to Executive Orders 13563 and 12866 or OMB Circular A-4. Instead, the FDIC is subject to certain statutes and FDIC policies that establish the basic principles that guide the FDIC in its economic analysis of rulemakings.

As requested, we compared the economic analysis requirements of Executive Orders 13563 and 12866 and OMB Circular A-4 (which provides guidance for regulatory analysis under Executive Order 12866) to the approach taken by the FDIC. The executive orders set forth the general principles of Federal regulation and require that agencies subject to the executive orders prepare a regulatory analysis for economically significant regulatory actions.¹⁸ In broad terms, the executive orders require that agencies subject to their provisions:

- Propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs.
- Design its regulations in the most cost-effective manner to achieve the regulatory objective.
- In choosing among alternative regulatory approaches, select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity) unless a statute requires another regulatory approach.
- Identify and assess alternative forms of regulation and, to the extent feasible, specify performance objectives rather than specifying the behavior or manner of compliance that regulated entities must adopt.
- Identify and assess available alternatives to direct regulation, including providing economic incentives or providing information upon which choices can be made by the public.

Section 69(a)(3)(c) of Executive Order 12866 requires, for significant regulatory action, the agency to provide to OMB an assessment of:

- the underlying analysis of benefits anticipated from the regulatory action and, to the extent feasible, a quantification of those benefits;
- the underlying analysis of costs anticipated from the regulatory action and, to the extent feasible, a quantification of those costs; and
- potentially effective and reasonably feasible alternatives to the planned regulation and an explanation of why the planned regulatory action is preferable.

As discussed in OMB Circular A-4, the regulatory analysis required by the executive orders provides a formal way of anticipating and evaluating the likely consequences of a rule by organizing evidence on the key effects of the various alternatives that should be considered in developing a regulation. The general motivation is to learn whether the benefits of an action are likely to justify the costs or discover which of various possible alternatives would be most cost-effective.

We found that the broad principles guiding economic analysis of the executive orders and Circular A-4 were generally incorporated into the Policy Statement, the FDIC Paper, and the analysis performed by FDIC personnel with respect to the three proposed rules discussed above. For example, the Policy Statement provides that the FDIC is committed to continually improving the quality of its regulations and policies, to minimizing regulatory burdens on the public and the banking industry, and generally to ensuring that its regulations and policies achieve legislative

¹⁸ Among other things, Executive Order 12866 defines significant regulatory action as one that is likely to result in a rule that may have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities.

goals effectively and efficiently. The Policy Statement presents the following principles to guide the FDIC in its development of regulations and written policies:

- Burdens imposed on the banking industry and the public should be minimized. This involves (1) considering the impact of new regulations with respect to new reporting requirements, the impact on competition, and the impact on small institutions and whether there are workable alternatives, and (2) weighing the potential benefits associated with the regulation or statement of policy against the potential costs.
- Regulations and policies should be clearly and understandably written.
- The public should have a meaningful opportunity to participate in the rulemaking process. This involves ensuring that the Board gives careful consideration to the impact of its actions as public policy, and that all rulemaking is carried out in accordance with the APA.
- Common statutory and supervisory requirements should be implemented by the Federal financial institution regulators in a uniform way.
- Regulations and statements of policy should be reviewed periodically. This involves considering the continued need for the regulation or policy, opportunities to simplify or clarify regulation or policy, and the need to eliminate duplicative or inconsistent regulations and policies.

FDIC Consideration of the Cumulative Burden of All Dodd-Frank Act Rulemakings on Market Participants and the Economy

The FDIC is considering the cumulative burden of all Dodd-Frank Act rulemakings. In the FDIC Board minutes for the three rulemaking efforts, we noted comments by FDIC Board members noting their consideration of the cumulative effect of Dodd-Frank Act rulemakings. Legal Division and RMS officials we interviewed also expressed that they were alert to the cumulative impact of rulemaking as they prepared their respective rules. In this regard, the FDIC is working on a number of efforts to establish clear rules under the Dodd-Frank Act that will ensure financial stability while implementing those rules in a targeted manner to avoid unnecessary regulatory burden. These efforts include:

- A broad-based Dodd-Frank Act working group that includes the Chairman and FDIC executives that discusses and evaluates the interrelationship of all Dodd-Frank Act rulemakings as well as the impact the rulemakings would have on existing FDIC rules. For example, the FDIC is trying to rely as much as possible on the current regulatory reporting structure in implementing new rules under the Dodd-Frank Act.
- The FDIC's Advisory Committee on Community Banking that is working on ideas to ease the regulatory burden on small institutions. In this regard, the FDIC developed a short paper entitled, *Impact of the Dodd-Frank Act on Community Banks*, that details how various aspects of the Dodd-Frank Act provisions may benefit community banks.

- Establishment of an FDIC Corporate Performance Goal to modify Financial Institution Letters used to alert banks of any regulatory changes or guidance so that such letters will include a section making clear the applicability to smaller institutions (under \$1 billion).¹⁹
- The FDIC plans to review all recurring questionnaires and information requests to the industry and to develop recommendations to improve the efficiency and ease of use and to develop an action plan to implement these changes.
- A review of industry reporting requirements to identify areas for streamlining. Further, as part of every risk management examination, the FDIC will solicit the views of the institution on aspects of the regulatory and supervisory process that may be adversely affecting credit availability.
- The FDIC's continued participation in the Federal Financial Institutions Examination Council (FFIEC),²⁰ which sponsors interagency efforts and establishes interagency working groups and task forces to establish consistent rules and supervisory approaches among the banking agencies.
- The Economic Growth and Regulatory Paperwork Reduction Act of 1996 requirement that the banking agencies, including the FDIC, review their regulations at least once every 10 years to identify any outdated, unnecessary or unduly burdensome regulatory requirements imposed on insured depository institutions.

MANAGEMENT RESPONSE

We provided a draft of this report to the FDIC on June 6, 2011. The FDIC provided technical accuracy comments in response to the draft report, and we made changes to the report where appropriate. The FDIC Chairman's office advised us that the Chairman had no other comments. The FDIC was not required to provide a written response because the report contained no recommendations.

¹⁹ Corporate Performance Goals include specific performance targets and measures that are approved by the FDIC Chairman and monitored through quarterly performance reports to the Chief Operating Officer and Chief Financial Officer.

²⁰ The FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the FRB, FDIC, OCC, Office of Thrift Supervision, and the National Credit Union Administration, and to make recommendations to promote uniformity in the supervision of financial institutions.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our evaluation was to address the Members' May 4, 2011 letter concerning Dodd-Frank Act rulemaking.

Specifically, we determined:

- FDIC statutory, regulatory, and procedural rulemaking requirements.
- Internal policies, procedures, and guidance used to ensure rigor and consistency in the economic analysis of proposed rules.
- Whether the FDIC performs any discretionary economic analysis that the FDIC undertakes voluntarily or on an ad hoc basis to ensure efficient and effective rulemaking.
- Key FDIC staff involved in the three rulemaking efforts and their respective qualifications.
- Quantitative and qualitative analysis performed by the FDIC with respect to the three rulemaking efforts.
- Alternatives evaluated by the FDIC with respect to the three rulemaking efforts.
- Transparency of economic analysis performed by the FDIC with respect to the three rulemaking efforts.
- FDIC economic analysis requirements and those of Executive Orders 13569 and 12866 and OMB Circular A-4.
- How the FDIC is considering the cumulative burden of all Dodd-Frank rulemaking.

We interviewed FDIC staff from the Legal Division responsible for tracking all Dodd-Frank Act rulemakings as well as lead counsel for the three rulemakings. We also interviewed the three lead rulemaking subject matter experts from the Division of Risk Management Supervision.

Additionally, we reviewed the:

- FDIC Dodd-Frank Act Implementation Tracking Chart.
- FDIC Board minutes, memoranda, and resolutions for the three rulemaking efforts.
- *Statement of Policy on the Development and Review of FDIC Regulations and Policies*, No. 5157 (1998).
- *Paper on the Development and Review of FDIC Rules and Statements of Policy* (December 19, 2006).
- Executive Order 13563, *Improving Regulation and Regulatory Review* (January 18, 2011).
- Executive Order 12866, *Regulatory Planning and Review*, (October 4, 1993).
- OMB Circular A-4, *Regulatory Analysis*, (September 17, 2003).
- Economic analysis documentation provided by the FDIC for each rulemaking.
- FDIC 2011 Corporate Goals.

We performed our evaluation during May and June 2011 in accordance with the Council of Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*.