May 7, 2014

The Honorable Tim Johnson  
Chairman  
The Honorable Mike Crapo  
Ranking Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Jeb Hensarling  
Chairman  
The Honorable Maxine Waters  
Ranking Member  
Committee on Financial Services  
House of Representatives


The final rule is substantively the same rule as the interim final rule that revised the risk-based and leverage capital requirements for FDIC-supervised institutions, with no substantive changes. This final rule is substantively identical to a joint final rule issued by the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Federal Reserve) (together, with FDIC, the agencies). The only changes in this final rule are technical revisions to conform it to the final rules issued by the Federal Reserve and OCC. For example, the interim final rule became effective on January 1, 2014; however, the mandatory compliance date for FDIC-supervised institutions that are not subject to the advanced internal ratings-based approaches (advanced approaches) is January 1, 2015.

Enclosed is our assessment of FDIC’s compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review of the procedural steps taken indicates that FDIC complied with the applicable requirements.
If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer
Managing Associate General Counsel

Enclosure

cc: Eric J. Spitler
    Director, Office of Legislative Affairs
    Federal Deposit Insurance Corporation
FDIC incorporated by reference the cost-benefit analysis of the interim final rule, but did provide a cost benefit discussion as applicable to small FDIC-supervised institutions. FDIC states that to estimate the cost to small FDIC-supervised institutions of the new capital requirement, FDIC examined the effect of this requirement on capital structure and the overall cost of capital. The cost of financing a small FDIC-supervised institution is the weighted average cost of its various financing sources, which amounts to a weighted average cost of capital reflecting many different types of debt and equity financing. Because interest payments on debt are tax deductible, a more leveraged capital structure reduces corporate taxes, thereby lowering funding costs, and the weighted average cost of financing tends to decline as leverage increases. Thus, an increase in required equity capital would—all else equal—increase the cost of capital for that institution. This effect could be offset to some extent if the additional capital protection caused the risk premium demanded by the institution's counterparties to decline sufficiently. FDIC explains that it did not try to measure this effect. This increased cost in the most burdensome year would be tax benefits foregone: the capital requirement, multiplied by the interest rate on the debt displaced and by the effective marginal tax rate for the small FDIC-supervised institutions affected by the final rule. The effective marginal corporate tax rate is affected not only by the statutory federal and state rates, but also by the probability of positive earnings and the offsetting effects of personal taxes on required bond yields. FDIC explained that Graham (2000) considers these factors and estimates a median marginal tax benefit of $9.40 per $100 of interest. So, using an estimated interest rate on debt of 6 percent, FDIC estimated that for institutions with total assets of $500 million or less, the annual tax benefits foregone on $233 million of capital switching from debt to equity is approximately $1.3 million per year ($233 million * 0.06 (interest rate) * 0.094 (median marginal tax savings)). Averaged across 74 institutions, the cost is approximately $18,000 per institution per year.

Working with the other agencies, FDIC also estimated the direct compliance costs related to financial reporting as a result of the final rule. This aspect of the final rule likely will require additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios, in addition to updating risk weights for certain exposures. FDIC assumes that small FDIC-supervised institutions will spend approximately $43,000 per institution to update their reporting system and change the classification of existing exposures. Based on comments from the industry, FDIC increased this estimate from the $36,125 estimate used in the proposed rules. FDIC believes that this revised cost estimate is
more conservative because it has increased even though many of the labor-intensive provisions proposed in the Notice of Proposed Rulemakings have been excluded from the final rule. FDIC estimates that the $43,000 in direct compliance costs will represent a burden for approximately 34 percent of small FDIC-supervised institutions with total assets of $500 million or less. For purposes of the Final Regulatory Flexibility Analysis (FRFA), FDIC defines significant burden as an estimated cost greater than 2.5 percent of total non-interest expense or 5 percent of annual salaries and employee benefits. The direct compliance costs are the most significant cost since few small FDIC-supervised institutions will need to raise capital to meet the minimum ratios.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

FDIC states that in general, section 4 of the Regulatory Flexibility Act (5 U.S.C. 604) requires an agency to prepare a FRFA for a final rule unless the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banking entities with total assets of $500 million or less). Pursuant to the RFA, the agency must make the FRFA available to members of the public and must publish the FRFA, or a summary thereof, in the Federal Register. FDIC published a summary of its FRFA in the Federal Register with the Basel III interim final rule. 78 Fed. Reg. 55465-55468. According to FDIC, it did not receive comments on the FRFA provided in the interim final rule. As such, and consistent with the FRFA in the Basel III interim final rule, FDIC published a summary of its FRFA. For purposes of the FRFA, FDIC analyzed the potential economic impact of the final rule on FDIC-supervised institutions with total assets of $500 million or less (small FDIC-supervised institutions). FDIC believes that this final rule may have a significant economic impact on a substantial number of the small entities under its jurisdiction. Under regulations issued by the Small Business Administration, a small entity includes a depository institution with total assets of $500 million or less. As of December 31, 2013, the FDIC supervised approximately 3,394 small state nonmember banks and 303 small state savings associations.

FDIC states that the final rule may impact small FDIC-supervised institutions in several ways. The final rule affects small FDIC-supervised institutions’ regulatory capital requirements by changing the qualifying criteria for regulatory capital, including required deductions and adjustments, and modifying the risk-weight treatment for some exposures. The final rule also requires small FDIC-supervised institutions to meet a new minimum common equity tier 1 capital to risk-weighted assets ratio of 4.5 percent and an increased minimum tier 1 capital to risk-weighted assets ratio of 6 percent. Under the final rule, all FDIC-supervised institutions would remain subject to a 4 percent minimum tier 1 leverage ratio requirement. The final rule imposes limitations on capital distributions and discretionary bonus payments for small FDIC-supervised institutions that do not hold a minimum buffer of common equity tier 1 capital above the minimum ratios. FDIC states that there are also changes to the general risk-based capital requirements that address the calculation of risk-weighted assets. As a result of the new requirements, FDIC states that some small FDIC-supervised institutions may have to alter their capital structure (including by raising new capital or increasing the retention of earnings) in order to achieve compliance.

FDIC states that a comparison of the capital requirements in the final rule on a fully-implemented basis to the minimum requirements under the general risk-based capital rules shows that approximately 74 small FDIC-supervised institutions with total assets of $500 million or less currently do not hold sufficient capital to satisfy the requirements of the final rule. Those institutions, which represent approximately 3 percent of small FDIC-supervised institutions,
collectively would need to raise approximately $233 million in regulatory capital to meet the minimum capital requirements under the final rule. According to FDIC, steps were taken to minimize the economic impact on and substantially reduce compliance burden for small FDIC-supervised institutions.

(iii) **Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535**

As an independent regulatory agency, FDIC is not subject to the Act.

(iv) **Other relevant information or requirements under acts and executive orders**

**Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.**

On August 30, 2012, FDIC, the Office of the Comptroller of the Currency, and the Federal Reserve published in the *Federal Register*, three joint notices of proposed rulemaking seeking public comment on revisions to their risk-based and leverage capital requirements and on methodologies for calculating risk-weighted assets under the standardized and advanced approaches. 77 Fed. Reg. 52,792; 77 Fed. Reg. 52,888; 77 Fed. Reg. 52,978. On September 10, 2013, the interim final rule with request for comments was published. 78 Fed. Reg. 55,340. In response to the interim final rule, FDIC received three public comments from two banking organizations and one trade association representing the financial services industry. FDIC discussed the comment letters and responded to them. FDIC did not receive comments on the FRFA provided in the interim final rule.

**Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520**

FDIC states that in conjunction with the proposed rules, FDIC submitted the information collection requirements contained therein to the Office of Management and Budget (OMB) for review. In response, OMB filed comments with FDIC in accordance with 5 C.F.R. 1320.11(c) withholding PRA approval and instructing that the collection should be resubmitted to OMB at the final rule stage. As instructed by OMB, the information collection requirements contained in this final rule were submitted by FDIC to OMB for review in connection with the adoption of the Basel III interim final rule under PRA, under OMB Control No. 3064–0153. On January 24, 2014, OMB approved FDIC’s information collection request for a 6-month period under emergency clearance procedures.

The final rule contains the same information collection requirements subject to PRA that were included in the Basel III interim final rule. Therefore, FDIC states that it will submit another information collection request for extension without change of the currently approved collection for the typical 3-year period. The information collection requirements contained in certain sections concerning market risk are approved by OMB under Control No. 3604–0178.

**Statutory authorization for the rule**

Executive Order No. 12,866 (Regulatory Planning and Review)

FDIC states that it has advised OMB that this final rule is a major rule for the purpose of congressional review.

Executive Order No. 13,132 (Federalism)

As an independent regulatory agency, FDIC is not subject to the requirements of the Executive Order.