FINANCIAL SERVICES REGULATIONS

Improvements Needed to Policies and Procedures for Regulatory Analysis

Report to Congressional Committees

July 2024
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GAO Highlights

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July 2024

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Why GAO Did This Study

Since the 2007–2009 financial crisis revealed that many banks lacked adequate capital, banking regulators have made changes to capital and liquidity requirements. GAO made prior, priority recommendations on stress tests.

The 2011 Department of Defense and Full-Year Continuing Appropriations Act includes a provision for GAO to annually study financial services regulations. This report examines (1) recent changes to the Federal Reserve's stress testing, (2) regulators' analyses of the effects of capital and liquidity rules, and (3) regulators' policies and procedures for rule analyses.

GAO examined regulators' analyses for 22 major rules relating to capital and liquidity finalized in 2012–2021, and statutes, executive orders, and regulators' policies on regulatory analyses. GAO interviewed agency officials, industry and public interest groups, and officials of 12 banks (which were in prior stress tests and selected for a variety of asset sizes and complexity).

What GAO Recommends

GAO recommends the Federal Reserve update policies and procedures for regulatory analyses to align with leading practices, and OCC and the Federal Reserve develop policies for systematically performing retrospective reviews. The Federal Reserve agreed with the recommendations. OCC neither agreed nor disagreed but stated it will address the recommendation.

What GAO Found

Since 2017, the Board of Governors of the Federal Reserve System has made changes to its stress tests (which estimate the effect of economic scenarios on banks' capital levels). For example, it tailored tests to banks' risk profiles (size and complexity) and reduced the number of scenarios. Representatives of 12 banks GAO interviewed generally viewed the changes as improvements on prior stress tests. But some banks and industry groups wanted more information on the tests and cited concerns about short time frames for adhering to new capital requirements determined by test results. Federal Reserve officials stated they seek to balance transparency with risks to test effectiveness when disclosing information on methodologies and models.

The analyses regulators conducted for many of the 22 major capital and liquidity rules (issued 2012–2021) that GAO reviewed did not consistently reflect leading practices. Regulators improved analyses in recent years by including more information on a rule's expected impact. However, they did not always identify alternative approaches or quantify benefits and costs. The Federal Reserve also had little or no documentation of its analyses (other than descriptions in Federal Register notices) for three of 21 rules in which it was involved. Documentation for the other 18 rules did not consistently discuss methods and data used and how conclusions were reached.

Regulators' policies and procedures for rule analyses also did not always align with leading practices.

- The Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) revised policies and procedures for analyses of proposed rules in 2022 and 2021, and they now largely align with leading practices. The Federal Reserve has not updated its policies since 1994, such as to require benefit-cost assessment and documentation of data sources and analyses. Better policies and procedures for these analyses would help the Federal Reserve ensure its rules are cost-beneficial and its conclusions are transparent.
- The regulators conducted few retrospective reviews of the effects of their existing rules. Executive Order 13579 encourages independent regulatory agencies to have plans for conducting these reviews. FDIC adopted a policy in December 2022 to conduct at least one such review annually. OCC and the Federal Reserve do not have a similar policy. Implementing one could help them assess whether their rules have had intended effects and inform future rulemakings.

Contents

GAO Highlights ii

Why GAO Did This Study ii

What GAO Recommends ii

What GAO Found ii

Letter 1

Background 3

Stress Test Changes Generally Viewed as Beneficial but Some Concerns Remain 8

Regulatory Analysis Was Limited for Many Rules We Reviewed 14

Regulators Vary in the Extent to Which Their Policies and Procedures for Regulatory Analysis Align with Leading Practices 24

Conclusions 27

Recommendations for Executive Action 28

Agency Comments and Our Evaluation 28

Appendix I Selected Major Rules (2012–2021) That GAO Reviewed 32

Appendix II Objectives, Scope, and Methodology 35

Appendix III Comments from the Board of Governors of the Federal Reserve System 38

Accessible Text for Appendix III Comments from the Board of Governors of the Federal Reserve System 40

Appendix IV Comments from the Office of the Comptroller of the Currency 42

Accessible Text for Appendix IV Comments from the Office of the Comptroller of the Currency 43

Appendix V GAO Contact and Staff Acknowledgments 44

Tables

Table 1: Federal Banking Regulators and Their Basic Functions 3

Table 2: Alignment of Regulators' Policies and Procedures for Prospective Regulatory Analysis with Key Leading Practices in OMB Circular A-4 24

Table 3: Regulator, Publication and Effective Dates, and Federal Register Number for Selected Capital and Liquidity-Related Major Rules, 2012–2021 32

Table 4: Number of Major Capital and Liquidity Rules We Reviewed, Issued 2012—2021, by Regulator 36

Figures

Figure 1: Timeline of 2020 Stress Tests and Related Actions by the Board of Governors of the Federal Reserve System (Federal Reserve) 11
Accessible Data for Figure 1: Timeline of 2020 Stress Tests and Related Actions by the Board of Governors of the Federal Reserve System (Federal Reserve) 11
Figure 2: Extent to Which Major Rules We Reviewed Addressed Key Leading Practices for Regulatory Analysis, 2012–2021 16
Accessible Data for Figure 2: Extent to Which Major Rules We Reviewed Addressed Key Leading Practices for Regulatory Analysis, 2012–2021 17

Abbreviations

Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
E.O.	Executive Order
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
OCC	Office of the Comptroller of the Currency
OMB	Office of Management and Budget

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U.S. GOVERNMENT ACCOUNTABILITY OFFICE

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July 18, 2024

Congressional Committees

The 2007–2009 financial crisis revealed that many banking organizations lacked capital of sufficient quality and quantity to absorb substantial losses.[1] In response to the crisis, banking regulators around the world moved to strengthen requirements for capital adequacy. In December 2010, the Basel Committee on Banking Supervision issued the Basel III framework—a set of reforms to strengthen global capital and liquidity standards.[2] Starting in 2013, the U.S. federal banking regulators adopted regulations to implement many aspects of the Basel III capital framework. These include revisions to minimum capital requirements and the introduction of new liquidity requirements.

In addition, in 2011, the Board of Governors of the Federal Reserve System (Federal Reserve) began conducting annual stress tests. These exercises estimate the effect of stressful economic and financial conditions on the capital levels of large U.S. banking organizations and their ability to continue operations. In 2020, the Federal Reserve began incorporating results from its annual stress tests into its capital requirements for these organizations.

In July 2023, the banking regulators proposed and requested public comments on two new rules related to capital and liquidity. The changes are intended to align capital requirements for large banking organizations with emerging international standards.[3] The proposed rules also cite the effects of regional bank failures in 2023. The failures of Silicon Valley Bank and Signature Bank underscored the importance of bank supervision and regulation in ensuring the safety and soundness of banks and financial markets.[4]

Section 1573(a) of the Department of Defense and Full-Year Continuing Appropriations Act, 2011, amending the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), includes a provision for us to annually review financial services regulations, including the impact of regulation on the financial

[1]In general, capital represents a buffer against losses and declines in asset values without subjecting an institution to default or insolvency. The strongest form of regulatory capital is common equity, which carries no repayment obligation for principal or dividends, has the lowest payment priority in bankruptcy, and has no maturity date. In this report, we use banking organizations to refer to both banks and bank holding companies.

[2]See https://www.bis.org/bcbs/basel3.htm. The Basel Committee on Banking Supervision is a global standard setter for prudential regulation of banks and provides a forum for cooperation on banking supervision. Members represent central banks and bank supervisors from 28 jurisdictions.

[3]The proposed changes include implementing the final components of the Basel III framework, also known as the Basel III "endgame." When making changes to capital and liquidity requirements through public rulemaking, agencies normally must comply with various federal rulemaking requirements as they draft and implement regulations.

[4]In April 2023, we reported that risky business strategies and weak liquidity and risk management contributed to the failures of Silicon Valley Bank and Signature Bank. See GAO, *Bank Regulation: Preliminary Review of Agency Actions Related to March 2023 Bank Failures*, GAO-23-106736 (Washington, D.C.: Apr. 28, 2023). In March 2024, we also reported on the Federal Reserve's and FDIC's escalation and communication of supervisory concerns. See *Bank Supervision: More Timely Escalation of Supervisory Action Needed*, GAO-24-106974 (Washington, D.C.: Mar. 6, 2024). We also have ongoing work further examining the regulators' escalation and communication of supervisory concerns.

marketplace.[5] This report examines (1) the Federal Reserve's changes to its stress tests since 2017 and views on those changes, (2) how banking regulators evaluated the effects of selected capital and liquidity rules, and (3) banking regulators' policies and procedures for evaluating the effects of proposed and final rules.

For the first objective, we reviewed relevant regulations and Federal Reserve policies, procedures, and other program guidance related to stress testing. We also reviewed research on stress tests and interviewed Federal Reserve staff. We reviewed public comment letters on selected rules (described below) to identify and interview representatives of four bank industry groups and two public interest groups, as well as one academic and one former regulator with expertise in stress testing. Additionally, we interviewed representatives of 12 banking organizations that participated in stress tests from 2017 through 2022. We selected these organizations to include banks of different asset sizes and complexity.

For the second objective, we focused on 22 rules of the Federal Deposit Insurance Corporation (FDIC), Federal Reserve, and Office of the Comptroller of the Currency (OCC) that created capital and liquidity requirements.[6] These 22 rules constituted all major rules creating such requirements for large banking organizations that were finalized in 2012–2021.[7] We developed a data collection instrument to compare and assess the analyses conducted for these rules against principles in the Office of Management and Budget's (OMB) Circular A-4, which provides guidance to most federal agencies on the development of regulatory analysis.[8] We also reviewed the regulators' documentation of their regulatory analyses for the rules.

At the end of the agency comment period, Federal Reserve staff provided additional documentation, such as memorandums, spreadsheets, slide presentations, and emails. We reviewed these documents by assessing the extent to which they applied to regulatory analyses for the 22 rules in our review. We also assessed the extent to which a qualified third party could understand the basic elements of the analyses—such as data and methods used—and the way in which estimates were developed. We revised our findings accordingly.

[5]Pub. L. No. 112-10, §1573(a), 125 Stat. 38, 138-39 (codified at 12 U.S.C. § 5496b).

[6]See appendix I for a list of all the major rules we reviewed. Although it has certain bank oversight responsibilities, we did not include the Consumer Financial Protection Bureau in the scope of our review because it does not have authority to issue regulations with capital or liquidity requirements.

[7]As defined by the Congressional Review Act, a major rule is generally one that the Office of Management and Budget finds 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, individual industries, federal, state, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of U.S.-based enterprises to compete with foreign-based enterprises in domestic and export markets. Pub. L. No. 104-121, tit. II, § 251, 110 Stat. 868, 873 (1996) (codified at 5 U.S.C. § 804(2)). The 22 selected major rules were typically considered major because they exceeded $100 million in estimated annual effects on the economy, according to Federal Reserve, FDIC, and OCC officials. We considered large banking organizations as those entities with $100 billion or more in total assets, to include all banking institutions subject to the Federal Reserve's supervisory stress testing.

[8]Circular A-4 provides guidance to most federal agencies on the development of regulatory analysis (a formal way of organizing evidence to help understand the potential effects of new regulations). Although the banking regulators are not required to follow Circular A-4, its elements serve as examples of leading practices for conducting regulatory analyses. Office of Management and Budget, *Circular A-4: Regulatory Analysis* (Washington, D.C.: Sept. 17, 2003). In 2023, OMB issued an update to Circular A-4, superseding the 2003 version. The update became effective after the rules we reviewed were finalized and includes the key elements for good regulatory analysis that we discuss in this report. Office of Management and Budget, *Circular A-4: Regulatory Analysis* (Washington, D.C.: Nov. 9, 2023).

For the third objective, we compared agencies' policies and procedures for conducting regulatory analysis against related principles in Circular A-4 and Executive Order (E.O.) 13579.[9] We also interviewed agency officials responsible for conducting regulatory analysis. For more information on our scope and methodology, see appendix II.

We conducted this performance audit from August 2022 to July 2024 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Federal Banking Regulators

Each insured bank in the United States is primarily supervised by one of three federal banking regulators (Federal Reserve, FDIC, and OCC).[10] Each of these regulators generally may issue regulations and take enforcement actions against institutions within its jurisdiction (see table 1). Holding companies that own or control a bank are subject to Federal Reserve supervision.[11]

Table 1: Federal Banking Regulators and Their Basic Functions

Regulator	Basic functions
Board of Governors of the Federal Reserve System	Supervises state-chartered banks that opt to be members of the Federal Reserve System and bank and savings and loan holding companies. Also supervises certain other entities, including the U.S. operations of foreign banks.
Federal Deposit Insurance Corporation	Supervises insured state-chartered banks that are not members of the Federal Reserve System, state-chartered savings associations, and insured state-chartered branches of foreign banks. Also has backup supervisory responsibility for all federally insured depository institutions related to its role in insuring the deposits of all banks and thrifts that are approved for federal deposit insurance.
Office of the Comptroller of the Currency	Supervises national banks and savings associations and federally chartered branches and agencies of foreign banks.

Source: GAO. | GAO-24-106206

[9]Exec. Order No. 13579, 76 Fed. Reg. 41587 (July 11, 2011).

[10]The Consumer Financial Protection Bureau generally has primary consumer financial protection oversight responsibilities for insured depository institutions with more than $10 billion in total assets and their affiliates. FDIC, the Federal Reserve, and OCC have primary consumer financial protection supervisory and enforcement powers over insured depository institutions with $10 billion or less in assets. But the Consumer Financial Protection Bureau may participate in examinations of these smaller depository institutions to assess compliance with federal consumer financial protection laws. See 12 U.S.C. §§ 5515-5516. In addition, state-level bank regulatory agencies supervise banks chartered at the state level.

[11]The Bank Holding Company Act of 1956 sets forth the regulatory frameworks for bank holding companies. Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 133 (codified as amended at 12 U.S.C. §§ 1841-1852). Bank holding companies own or control a bank, as defined in the Bank Holding Company Act. 12 U.S.C. § 1841(a)(1) and (2).

The purpose of federal banking supervision is to help ensure that banks operate in a safe and sound manner and comply with federal laws and regulations for the provision of banking services. Federal banking regulators promulgate rules to implement banking laws, supervise banks to help ensure their compliance with those rules, and take formal and informal enforcement actions against those that do not comply. Federal banking supervision also looks beyond the safety and soundness of individual banks to promote the stability of the financial system as a whole.

Bank Capital and Liquidity Requirements

For banking organizations, capital exists to absorb unexpected losses. The amount of capital a firm uses to fund its assets is critical to its ability to continue lending operations during stressful conditions.[12] The Federal Reserve, FDIC, and OCC require banking organizations to maintain certain minimum levels of capital. These requirements identify types of regulatory capital, including common equity tier 1 capital, which is considered the most loss-absorbing form of capital that a banking organization can have to support its operations and absorb unexpected financial losses.[13] Regulators establish required capital levels in comparison with various measures of an institution’s assets. The minimum requirements are specified as a ratio (regulatory capital ratio).[14]

In addition to capital, banking organizations must maintain adequate levels of liquidity, a measure of the cash and other assets available to meet short-term obligations. Since 2014, banking regulators have adopted rules to implement Basel III and Dodd-Frank Act liquidity requirements.[15] The requirements include two quantitative liquidity standards (ratios).[16] The liquidity requirements apply to certain U.S. bank holding companies, certain savings and loan holding companies, and large insured depository institution subsidiaries.

In July 2023, the federal banking regulators requested comments on a proposal to modify large bank capital requirements to better reflect underlying risks and increase the consistency of how banks measure their risk. The proposed changes would implement certain final components of the agreed Basel III standards. Banking regulators requested comments by January 2024 and, as of June 2024, had not adopted a final rule.

[12]Capital is a source of long-term funding, contributed largely by a bank’s equity stockholders and its own returns in the form of retained earnings, which provides banks with a cushion to absorb unexpected losses.

[13]Common equity tier 1 capital consists primarily of retained earnings (profits a bank has earned but not paid out to shareholders in the form of dividends or other distributions) and common stock, with deductions for items such as goodwill and deferred tax assets.

[14]Regulators use different ratios to assess an institution’s capital adequacy. These include the tier 1 risk-based capital ratio, which measures tier 1 capital as a share of risk-weighted assets, and the tier 1 leverage ratio, which measures tier 1 capital as a share of average total consolidated assets. Risk-weighted assets are on- and off-balance sheet assets adjusted for their risk characteristics.

[15]The Basel III standards are intended to strengthen the regulation, supervision, and risk management of the banking sector, and as previously noted, the United States began to implement some of them in 2013.

[16]The liquidity coverage ratio is designed to promote the short-term (30-day) resilience of the liquidity risk profile of large banking organizations. It seeks to improve the banking sector’s ability to absorb shocks arising from economic and financial stress over a short term. The net stable funding ratio focuses on the stability of a company’s funding structure over a longer, 1-year horizon.

Stress Testing

Stress testing is one of many risk-management tools used by banking organizations and the Federal Reserve. As noted in a Federal Reserve Bank of New York staff report, stress testing before the 2007–2009 financial crisis was not seen as a major component of banking regulators' supervisory programs.[17] Since the financial crisis, the report explains that comprehensive firm-wide stress testing has become an integral and critical part of firms' internal capital adequacy assessment processes and of the Federal Reserve's supervisory regimes.[18]

Since 2011, the Federal Reserve has used annual stress tests to assess the capital of large banking organizations (supervisory stress tests). The tests seek to determine the adequacy of a bank's capital under stressful economic scenarios, including a severe recession. The Federal Reserve aims to provide subject companies, the public, and supervisors with forward-looking information to help gauge the potential effect of stressful economic and financial conditions on the companies' ability to absorb losses and continue operations.

Results of the tests are publicly disclosed and used in the Federal Reserve's supervisory assessments. Some large banking organizations also are required to run their own stress tests (company-run stress tests) as part of their capital planning and risk management and publicly disclose their test results.

Prior to 2019, the Federal Reserve used the Comprehensive Capital Analysis and Review to quantitatively and qualitatively evaluate the capital adequacy and capital planning processes of large bank holding companies. As further discussed in this report, the Federal Reserve integrated the qualitative evaluation into the standard, confidential supervisory process in 2019. And in 2020, the Federal Reserve replaced the quantitative evaluation with the stress capital buffer requirement.

Regulatory Analysis in Federal Rulemaking

Regulation is one of the principal tools the federal government uses to implement public policy. Section 553 of the Administrative Procedure Act contains requirements for informal (or notice-and-comment) rulemaking. Most federal rulemaking is conducted as informal rulemaking, in which agencies publish a notice of proposed rulemaking in the Federal Register and provide a comment period for the proposed rule, generally at least 30 days.[19]

Regulatory analysis is a formal way to organize evidence to help understand the effects of regulations—either of proposed rules and their potential effects (prospective reviews) or of existing rules (retrospective reviews). It

[17]Beverly Hirtle and Andreas Lehnert, *Supervisory Stress Tests*, Federal Reserve Bank of New York, Staff Report No. 696 (New York City, New York: November 2014).

[18]In November 2016, we reported on the Federal Reserve's supervisory programs that involved stress testing and made 15 recommendations to help improve them. As of April 2024, the Federal Reserve had implemented 14 recommendations. One recommendation was closed because it was no longer applicable as a result of program changes. See GAO, *Federal Reserve: Additional Actions Could Help Ensure the Achievement of Stress Test Goals*, GAO-17-48 (Washington, D.C.: Nov. 15, 2016).

[19]The Administrative Procedure Act provides for other methods by which agencies may promulgate rules, including formal, hybrid, and direct final rulemaking. Administrative Procedure Act, Pub. L. No. 79-404, 60 Stat. 237, ch. 324, §§ 1-12 (1946) (codified as amended at 5 U.S.C. §§ 551-559 and other scattered sections in 26 U.S.C.). Agencies generally provide for comment periods that last 30–60 days and most rules generally must be published not less than 30 days before the effective date.

can assist agencies in developing regulations and also informs the public about the anticipated consequences of government action.

Prospective Reviews

Federal banking regulators may have to conduct regulatory analyses as part of their rulemakings, in accordance with the following laws:

- The **Paperwork Reduction Act** requires agencies, including banking regulators, to minimize the paperwork burden of their rulemaking and evaluate whether a proposed information collection is necessary for the proper performance of agency functions.[20] Under the act, agencies include this analysis in the notice of proposed rulemaking and obtain approval for an information collection from OMB. The act does not require agencies to conduct formal benefit and cost analyses.
- The **Regulatory Flexibility Act** requires that federal agencies consider the impact of certain regulations they issue on small entities and alternatives to lessen regulatory burden on small entities.[21] The act also requires agencies to assess various impacts and costs of their rules, although it does not require agencies to conduct formal benefit and cost analyses.
- Under the **Congressional Review Act**, before rules can take effect, agencies must submit their rules to Congress and the Comptroller General.[22]

In addition, the Unfunded Mandates Reform Act generally requires most federal agencies—but not banking regulators—to prepare a written statement containing a qualitative and quantitative assessment of the anticipated benefits and costs for rules that may result in certain expenditures by certain entities, including the private sector.[23] However, the act does not apply to rules published by independent regulatory agencies.

Furthermore, E.O. 12866, supplemented by E.O. 13563, generally requires executive agencies—which do not include the banking regulators—to formally assess benefits and costs of available regulatory alternatives.

[20]Paperwork Reduction Act of 1995, Pub. L. No. 104-13, 109 Stat. 163 (codified as amended at 44 U.S.C. §§ 3501-3521).

[21]Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. §§ 601-612).

[22]Congressional Review Act, Pub. L. No. 104-121, tit. II, § 251, 110 Stat. 868 (1996) (codified at 5 U.S.C. §§ 801-808). The Congressional Review Act requires agencies to submit to both houses of Congress and the Comptroller General, before rules can become effective, a report containing (i) a copy of the rule, (ii) a concise general statement relating to the rule, including whether it is a major rule, and (iii) the proposed effective date of the rule. 5 U.S.C. § 801(a)(1)(A). Rules classified as not major take effect as otherwise provided by law after submission to Congress, while rules classified as major take effect on the later of 60 days after Congress receives the rule report, or 60 days after the rule is published in the Federal Register, as long as Congress does not pass a joint resolution of disapproval. 5 U.S.C. § 801(a)(3) and (4). The Congressional Review Act also mandates that we provide a report to Congress for each major rule that includes an assessment of an agency's compliance with the Congressional Review Act process. We do not analyze or comment on the substance or quality of rulemaking. We must report to each house of Congress by the end of 15 calendar days after a rule's submission or publication date. 5 U.S.C. § 801(a)(2)(A).

[23]Unfunded Mandates Reform Act of 1995, Pub L. 104-4, 109 Stat. 48 (codified at 2 U.S.C. §§ 602, 632, 653, 658-658g, 1501-1504, 1511-1516, 1531-1538, 1551-1556, and 1571). The law generally applies to rules that impose a federal mandate that may result in expenditures of $100 million or more in any one year by state, local, and tribal governments in the aggregate, or by the private sector. This amount is adjusted for inflation annually using 1995 as the reference year, as required by the act.

These analyses are to include both quantifiable and qualitative measures of benefits and costs.[24] According to OMB, these analyses can help determine if the benefits of a rule justify its costs and can help identify the alternatives that would yield the greatest net benefit or be most cost-effective.

In 2003, OMB issued Circular A-4 to provide guidance to executive agencies on developing the regulatory analysis required by E.O. 12866.[25] The circular defines good regulatory analysis as including a statement of the need for the proposed regulation, an assessment of alternatives, and an evaluation of the benefits and costs of the proposed regulation and the alternatives. It also standardizes the way benefits and costs of regulatory actions should be measured and reported, including by identifying a baseline for analysis. As we previously reported, some independent regulatory agencies consult Circular A-4.[26]

Retrospective Reviews

Some regulatory analysis requirements call for retrospective reviews, which evaluate existing regulations.[27] Such reviews are intended to help agencies evaluate how regulations have worked and if changes may be warranted.

- The Economic Growth and Regulatory Paperwork Reduction Act of 1996 requires federal banking regulators to review all existing regulations every 10 years and eliminate (or recommend statutory changes needed to eliminate) any requirements that are outdated, unnecessary, or unduly burdensome.
- Federal banking regulators also may review their regulations in response to E.O. 13579. That order notes that independent regulatory agencies should consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome. It further notes that each agency should develop and release to the public a plan for periodically reviewing its existing significant regulations.[28]
- Section 610 of the Regulatory Flexibility Act requires independent and other regulatory agencies to review within 10 years of publication any of their final rules assessed as having a significant economic impact on a substantial number of small entities. The review's purpose is to determine whether such rules

[24]Exec. Order No. 12866*, Regulatory Planning and Review*, 58 Fed. Reg. 51735 (Oct. 4, 1993). E.O. 12866 was amended in 2023; however, those changes do not affect the regulations we reviewed because the regulations became effective prior to the amendments. Exec. Order No. 14094, *Modernizing Regulatory Review*, 88 Fed. Reg. 21879 (Apr. 6, 2023). See appendix I for additional information on the rules we reviewed and when they were finalized.

[25]*Circular A-4: Regulatory Analysis* (2003). Circular A-4 replaced OMB's best practices guidance issued in 1996 and 2000. OMB promulgated a new version of Circular A-4, as required by E.O. 14094. The new guidance applies to regulatory analyses in support of proposed rules, interim final rules, and direct final rules OMB receives starting March 1, 2024, and starting January 1, 2025, for regulatory analyses OMB received in support of all other final rules. E.O. 13579 encourages independent regulatory agencies to comply with E.O. 13563. Exec. Order No. 13579, 76 Fed. Reg. 41587 (July 11, 2011).

[26]For example, see GAO, *Dodd-Frank Regulations: Agencies' Efforts to Analyze and Coordinate Their Recent Final Rules*, GAO-17-188 (Washington, D.C.: Dec. 29, 2016); *Dodd-Frank Regulations: Regulators' Analytical and Coordination Efforts*, GAO-15-81 (Washington, D.C.: Dec. 18, 2014); and *Federal Rulemaking: Agencies Included Key Elements of Cost-Benefit Analysis, but Explanations of Regulations' Significance Could Be More Transparent*, GAO-14-714 (Washington, D.C.: Sept. 11, 2014).

[27]Based on applicable statutes and executive orders, we generally use the term retrospective review to mean any assessment of an existing regulation, primarily to determine whether (1) the expected outcomes have been achieved and whether (2) the agency should retain, amend, or rescind it.

[28]E.O. 12866 notes significant regulations are those likely to result in a rule that may have an annual effect on the economy of $100 million or more, among other criteria.

should be maintained, amended, or rescinded to minimize their impact on small entities. Federal banking regulators have conducted some separate Section 610 reviews. They included these reviews in broader retrospective reviews done pursuant to the Economic Growth and Regulatory Paperwork Reduction Act.[29]

Stress Test Changes Generally Viewed as Beneficial but Some Concerns Remain

Changes to Stress Testing Include Stress Capital Buffer and Tailoring

In 2019 and 2020, the Federal Reserve introduced significant changes to its supervisory stress tests through three rulemakings.[30] Two of these rulemakings tailored stress testing requirements to a banking organization's risk profile and one introduced a stress capital buffer requirement.[31]

Tailoring. The tailoring rules placed large banking organizations into four main categories that consider size and complexity (e.g., based on total asset size, international activities, and other factors).[32] The rules generally scale requirements for banking organizations with $100 billion or more in total assets as categories move from largest and most complex to comparatively smaller and less complex.

Global systemically important banks are generally the largest and most complex organizations, and they are subject to the greatest number of requirements. These include multiple capital requirements, annual supervisory and company-run stress testing and capital plan submission, and liquidity requirements and reporting. In contrast, firms that are comparatively smaller and less complex are subject to supervisory stress tests every 2 years rather than every year.

Stress capital buffer requirement. The stress capital buffer requirement is separate from minimum regulatory capital ratios. The buffer indicates the amount of common equity tier 1 capital in excess of regulatory

[29]See GAO, *Financial Services Regulations: Procedures for Reviews under Regulatory Flexibility Act Need to Be Enhanced*, GAO-18-256 (Washington, D.C.: Jan. 30, 2018).

[30]See Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019); Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, 84 Fed. Reg. 59032 (Nov. 1, 2019); and Regulations Q, Y, and YY: Regulatory Capital, Capital Plan, and Stress Test Rules, 85 Fed. Reg. 15576 (Mar. 18, 2020).

[31]In 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act amended certain stress testing provisions of the Dodd-Frank Act. Pub. L. No. 115-174, tit. IV, §401, 132 Stat. 1296, 1356 (2018) (codified at 12 U.S.C. 5365). Under the Dodd-Frank Act, all banking organizations with $50 billion or more in total assets were subject to additional requirements. The Economic Growth, Regulatory Relief, and Consumer Protection Act raised the minimum asset threshold for applying these requirements to $100 billion and gave the Federal Reserve greater discretion to tailor requirements for banking organizations with $100 billion or more in total assets.

[32]Supervisory stress tests apply to U.S. bank holding companies and savings and loan holding companies with $100 billion or more in average total consolidated assets, certain U.S. intermediate holding companies, and certain nonbank financial companies supervised by the Federal Reserve. 12 C.F.R. pt. 252, subpt. E; 12 C.F.R. pt. 238, subpt. O. For this report, we generally use the term banking organizations to refer to institutions subject to the Federal Reserve's supervisory stress test requirements.

minimums each institution must have to avoid restrictions on planned capital distributions (such as dividends) and discretionary bonus payments.[33]

The stress capital buffer rule replaces a fixed buffer requirement—2.5 percent of risk-weighted assets—with a dynamic stress capital buffer requirement (but one with a floor of 2.5 percent).[34] The stress capital buffer requirement for a firm subject to the rule is recalibrated with each supervisory stress test (annually or every 2 years, depending on the firm's category).

The Federal Reserve first applied the stress capital buffer requirement using results from the 2020 stress test. According to officials, Federal Reserve staff evaluate a firm's compliance with the requirement at least quarterly. With this requirement, the Federal Reserve has integrated its stress testing regime into its ongoing regulatory capital requirements.[35]

The implementation of tailoring rules and the stress capital buffer requirement resulted in other significant changes to the stress test rules and assumptions for banking organizations:

Increased applicability threshold. In response to the Economic Growth, Regulatory Relief, and Consumer Protection Act, the Federal Reserve increased the threshold at which banking organizations become subject to supervisory stress testing from $50 billion in total assets to $100 billion.

Removal of quantitative objection. The Federal Reserve no longer objects to a firm's planned capital distributions based on the results of its annual supervisory stress test. Under the Comprehensive Capital Analysis and Review, firms had to demonstrate an ability to maintain capital ratios above the regulatory minimums. If a firm could not do so, it was potentially subject to Federal Reserve limitations on planned capital distributions. The Federal Reserve instead uses stress test results to determine a banking organization's stress capital buffer requirement.

Changes to balance sheet and capital action assumptions. In prior supervisory stress tests, the Federal Reserve assumed covered banking organizations would continue to make certain planned capital actions (such as dividends and stock repurchases) and have balance sheet growth over a nine-quarter planning horizon. Recent changes to stress test methodologies now include four quarters of planned dividends in the stress capital buffer requirement, which replaced the prior quantitative assessment. Additionally, the current stress test methodology assumes firms maintain a constant level of assets over the planning horizon.

[33]The stress capital buffer requirement is the greater of 2.5 percent of risk-weighted assets or the sum of (1) the maximum projected decline in an institution's common equity tier 1 capital ratio over the stress test's nine-quarter horizon (expressed as a percentage of risk-weighted assets), and (2) a firm's planned common stock dividends for the fourth through seventh quarters of the nine-quarter stress test horizon (expressed as a percentage of projected risk-weighted assets for the quarter in which the bank's projected common equity tier 1 capital ratio reaches its minimum).

[34]The fixed buffer requirement, known as the capital conservation buffer, was introduced in 2013 and was intended to strengthen an institution's financial resilience during economic cycles. The capital conservation buffer applies to certain banking organizations with less than $100 billion in total consolidated assets. The stress capital buffer applies to certain bank holding companies and savings and loan holding companies with average total consolidated assets of $100 billion or more.

[35]The stress capital buffer requirement replaced the quantitative assessment in the Comprehensive Capital Analysis and Review. The qualitative assessment, which had been used to evaluate a bank organization's internal risk-management processes, was incorporated into supervisory examinations and processes. Federal Reserve staff said the stress capital buffer requirement did not change how models were created but changed how stress test results were used.

Prospective business changes. The calculation of the stress capital buffer requirement does not consider prospective business plan changes (such as mergers and divestitures) that have not yet been completed. However, in three instances, the Federal Reserve used the next year's stress test to recalculate the stress capital buffer requirement of firms that had material changes to their business plans.[36]

Scenarios used. In 2020, the Federal Reserve reduced the number of scenarios used for supervisory stress tests from three (baseline, adverse, and severely adverse) to two (baseline and severely adverse).[37]

In 2023, the Federal Reserve introduced an exploratory market shock component, which was applied to U.S. global systemically important banks.[38] This component explored the banks' resiliency across an alternative set of risks that differed from those of the global market shock component against which the Federal Reserve tests banks with significant trading activity.[39]

Reconsideration requests. The Federal Reserve has allowed a firm to submit a request for reconsideration of its stress capital buffer requirement (within 15 days of the receipt of notice of its requirement). Firms also may request changes to capital action and balance sheet assumptions (within 2 business days of receipt).

Federal Reserve Conducted Sensitivity Analyses, Increased Stress Testing, and Applied Bank Restrictions during the Pandemic

During the COVID-19 pandemic, the Federal Reserve used sensitivity analyses, ran additional stress tests, and applied restrictions to firms to safeguard capital. Figure 1 provides a timeline of 2020 stress tests and other actions taken during the COVID-19 pandemic.

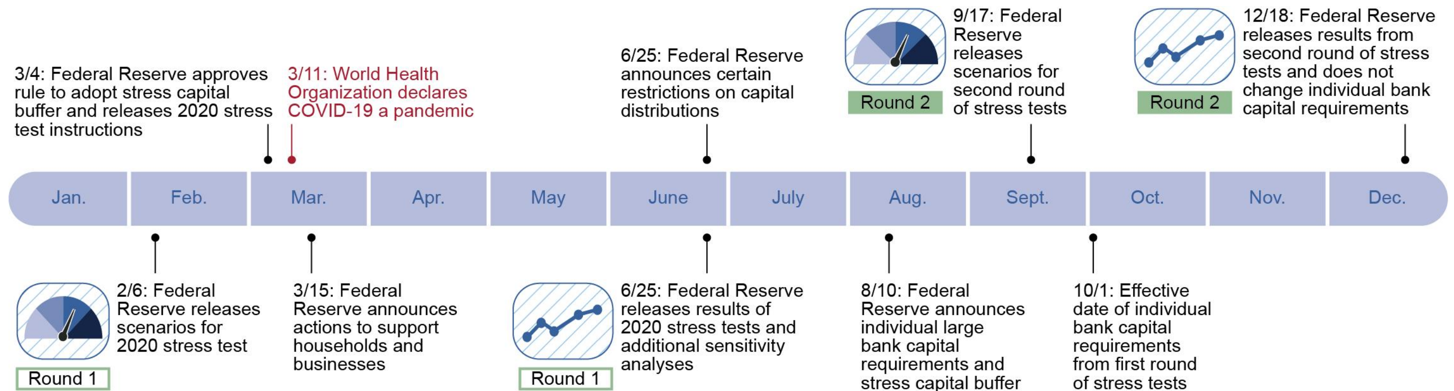
[36]In March 2022, the Federal Reserve determined to use the 2023 supervisory stress tests to recalculate the stress capital buffer requirements of M&T Bank Corporation and Citizens Financial Group, Inc. to incorporate the effects of their respective material acquisitions of other banking organizations. In January 2023, the Federal Reserve made a similar determination to recalculate the stress capital buffer requirement of BMO Financial Corporation to include the effects of an approved acquisition. Each of the firms was normally on a 2-year stress test cycle.

[37]In 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act amended section 165(i) of the Dodd-Frank Act to no longer require the Federal Reserve to include an "adverse" scenario (in addition to baseline and severely adverse scenarios) in the company-run stress test or its supervisory stress tests. *See* 84 Fed. Reg. 59032 (Nov. 1, 2019).

[38]The exploratory market shock component of the scenario assumed a less severe recession with greater inflationary pressures induced by higher inflation expectations. The results produced by this component did not contribute to capital requirements determined by the overall supervisory stress test results.

[39]The global market shock component included in the supervisory severely adverse scenario is a set of hypothetical shocks to a large set of risk factors (including equity prices, foreign exchange rates, and interest rates) reflecting general market distress and heightened uncertainty. For example, in 2023, this component assumed a severe recession with fading inflation expectations.

Figure 1: Timeline of 2020 Stress Tests and Related Actions by the Board of Governors of the Federal Reserve System (Federal Reserve)



Source: GAO analysis and icons. | GAO-24-106206

Accessible Data for Figure 1: Timeline of 2020 Stress Tests and Related Actions by the Board of Governors of the Federal Reserve System (Federal Reserve)

Date	Description
6-Feb-20	Federal Reserve releases scenarios for 2020 stress test
4-Mar-20	Federal Reserve Board approves rule to adopted stress capital buffer
4-Mar-20	Federal Reserve releases 2020 stress test methodology
11-Mar-10	World Health Organization declares COVID-19 a pandemic
15-Mar-20	Federal Reserve announces actions to support households and businesses due to pandemic
25-Jun-20	Federal Reserve releases results of 2020 stress testsand additional sensitivity analyses
10-Aug-20	Federal Reserve announces individual large bank capital requirements and stress capital buffer
17-Sep-20	Federal Reserve releases scenarios for second round of stress tests
1-Oct-20	Effective date of individual bank capital requirements from first round of stress tests
18-Dec-20	Federal Reserve releases results from second round of stress test and does not change individual bank capital requirements.

Source: GAO analysis and icons. I GAO-24-106206

As previously planned, the Federal Reserve conducted its annual supervisory stress test from March through June 2020. By mid-March, the Federal Reserve noted that the pandemic event was disrupting the economy and that even more extreme outcomes than contemplated in the stress test's severely adverse scenario were possible. As a result, the Federal Reserve undertook a sensitivity analysis to explore the vulnerabilities of banks to the pandemic's economic effects.

In June 2020, the Federal Reserve released the sensitivity analysis, which examined all subjected firms across three alternative scenarios.[40] The sensitivity analysis leveraged stress test models but was not directly tied to

[40]See Board of Governors of the Federal Reserve System, *Assessment of Bank Capital during the Recent Coronavirus Event* (Washington, D.C.: June 2020).

capital requirements. The analysis included adjustments to reflect first quarter features that the Federal Reserve's models or alternative scenarios did not capture. These features included increased financial market volatility, financial stress on corporate borrowers in certain industry sectors, and temporary amendments to the tax code. According to Federal Reserve officials, the Federal Reserve has not conducted a sensitivity analysis since 2020. Officials noted a similar approach could be used in the future if merited by economic conditions.

In September 2020, the Federal Reserve announced that banking organizations would undergo a second supervisory stress test that incorporated two hypothetical scenarios with severe global recessions. Under those two scenarios, the Federal Reserve found that all firms' risk-based capital ratios would remain above the required minimums. Based on the results, the Federal Reserve decided not to reset stress capital buffer requirements, although it extended the additional limitations on capital distributions into 2021.

From June 2020 through June 2021, the Federal Reserve placed certain restrictions on banking organization dividends and share repurchases.[41] For example, in the third and fourth quarters of 2020, the Federal Reserve restricted firms from making dividend payments that exceeded a measure of net income for the four preceding quarters or were larger than common stock dividends paid in the second quarter of 2020. Additionally, the Federal Reserve did not authorize any share repurchases, other than an amount to offset share issuance related to employee compensation. The Federal Reserve's decision to restrict distributions was informed in part by the sensitivity analysis and supervisory stress test results, according to Federal Reserve officials. The capital restrictions were intended to preserve capital at the banks.

Banks We Interviewed Generally Viewed Changes as an Improvement, but Banks and Market Observers Remain Concerned about Effects

Officials from several banking organizations with whom we spoke generally viewed the recent changes to stress tests as simplifying requirements and as an improvement on prior stress tests.[42] For instance, banking organization officials and industry groups said the stress capital buffer requirement provides a clear message to the public and markets about the banking sector's resiliency.

However, banking organization officials, other market participants, and market observers also noted the following concerns about the effects of the recent changes and about stress tests generally:[43]

[41]Under the capital plan rule, the Federal Reserve can require firms to obtain prior approval before making capital distributions if it determines the banking organization's risk profile or financial condition materially changed. The rule permits the Federal Reserve to make this determination for individual banking organizations based on current economic conditions. According to Federal Reserve officials, the Board of Governors ultimately decides on taking actions during unusual circumstances. Decisions are largely based on the Division of Financial Stability's analysis, which evaluates recent trends in certain financial and macroeconomic variables against their historical distribution. Significant changes in these trends may signify a material change in economic and financial conditions. The Division of Financial Stability and the Director of Supervision and Regulation may then make recommendations to the Board based on the analysis.

[42]We interviewed officials of 12 banking organizations subjected to supervisory stress testing. Five of the 12 organizations expressed this view.

[43]The market participants and observers with whom we spoke included representatives of four industry groups and two public interest organizations, as well as one academic and one former regulator. We identified these parties from their public comments to proposed rules or from suggestions by others we interviewed.

Time frames for compliance. Banking organization officials said that stress testing can affect their capital allocation decisions and strategic initiatives. For example, the necessity of implementing a stress capital buffer requirement within 3 months after results are published can be challenging for large banking organizations, according to three bank officials and one banking industry group.

Number of scenarios. As previously discussed, as of 2020, the Federal Reserve uses two scenarios for supervisory stress tests. An academic and an industry group noted that additional scenarios could be useful to identify emerging risks in the banking sector or for individual banks. According to officials from one public interest organization, the Federal Reserve has been too slow to incorporate new risks in its stress tests. Federal Reserve officials told us they have been assessing the usefulness of additional scenarios.

Reduction in public information. As previously discussed, stress test results no longer include a qualitative assessment of a banking organization's internal capital planning practices. As a result, according to one public interest organization, there is less assurance that banks have appropriate processes to manage capital levels. Similarly, an academic told us the qualitative assessment had provided greater insights into bank capital planning and into how the Federal Reserve follows through in its oversight.

Officials from another public interest organization said that varying requirements, such as the tailoring rule, made it more difficult to compare banks against each other. For example, some banks are tested annually and others are tested every 2 years. An academic and a former regulator said the potential effects of the stress capital buffer requirement, such as on the availability of credit, were unclear.

Disclosure of models and methodology. As we previously reported, disclosure of additional information on stress tests could provide valuable information to the public. More detailed disclosure of the underlying models also could make it easier for companies to "game" the models—for example, by managing capital decisions in relation to the stress tests without necessarily limiting risk. This could result in a form of regulatory arbitrage (circumvention of regulation).[44] Federal Reserve officials stated that they seek to balance transparency with risks to test effectiveness when disclosing model and methodology information.

In 2019, the Federal Reserve started disclosing additional information on stress test methodologies and models. Officials from three banking organizations stated that the Federal Reserve's disclosures had improved in recent years. Officials from four other banking organizations said the disclosures had stayed largely the same or called for additional disclosure. For example, one organization's officials said further details on how the stress test models work would help it understand how the Federal Reserve will set the organization's stress capital buffer requirement.

The Federal Reserve may revise supervisory stress test models, according to officials. Such revisions may result from the availability of more detailed data, identification of a better-performing model, or the results of model validation (the process of confirming a model achieves its intended purpose). Revisions to models also may be made in response to public comment. Because revisions may have a material effect on modeled outcomes, the Federal Reserve generally phases in highly material revisions to models over 2 years to mitigate sudden and unexpected changes to the stress test results.

[44]See GAO-17-48.

For example, the Federal Reserve's 2022 Supervisory Stress Test Methodology updated one loan model for the 2022 stress test, which resulted in material changes to projections for firms' small-business and corporate credit card loan portfolios.[45] These projections were the average of the results produced by the 2021 model and the updated 2022 model. The Federal Reserve fully phased in the model changes for the 2023 supervisory stress test.

The Federal Reserve has discretion on when it discloses its supervisory stress test methodology, which can include changes to its methodology and models. The Federal Reserve released its 2023 methodology disclosure in June of that year.[46] In previous years, the release dates ranged from March to June. As in previous years, the 2023 methodology document was not shared with firms before its public release in June 2023, according to officials.

Stress testing during the pandemic. Banks and market participants had mixed views on the Federal Reserve's actions during the pandemic. Four banks and an industry expert said the sensitivity analysis and second stress test promoted the resiliency of the banking sector and helped reassure markets. However, an academic and officials from one trade organization said it was difficult to measure the impact of the sensitivity analysis due to ongoing market distress in 2020. According to a public interest organization, the test results provided a false sense of comfort about the banking system's resilience because the tests ignored the effect of broader Federal Reserve and government actions to support the economy, which already had improved the financial condition of banks.

Regulatory Analysis Was Limited for Many Rules We Reviewed

The banking regulators' regulatory analysis described in public notices for rules we reviewed did not always reflect key elements of good regulatory analysis outlined in OMB Circular A-4.[47] The extent to which the Federal Reserve and FDIC documented their analyses beyond what was described in public notices also was inconsistent. Banking regulators also conducted few retrospective reviews of their rulemakings. As discussed later in this report, FDIC and OCC recently revised policies and procedures related to these issues.

Regulators' Analyses Did Not Consistently Reflect Key Elements of Good Regulatory Analysis

The public notices for 22 major rules we reviewed did not consistently reflect some key elements of good regulatory analysis. These capital and liquidity-related rules were issued individually or jointly by the banking

[45]See Board of Governors of the Federal Reserve System, *2022 Supervisory Stress Test Methodology* (Washington, D.C.: March 2022).

[46]The Federal Reserve released its 2024 stress test methodology document in March 2024.

[47]As noted previously, the banking regulators are not required to follow Circular A-4, but its elements serve as examples of leading practices for conducting regulatory analyses.

regulators from August 30, 2012, through February 11, 2021.[48] Additionally, rules issued prior to November 2019 generally lacked a dedicated impact analysis section.

Federal Register notices finalizing these major rules varied in length and purpose. Notices ranged from six to 275 pages and implemented various changes to capital and liquidity requirements. These changes included those made to implement Dodd-Frank Act provisions and to respond to the COVID-19 pandemic, as well as those related to agency-specific initiatives, such as the stress capital buffer requirement.

Inclusion of Impact Analysis Section

The regulators have improved their analyses in recent years by including more information on the expected impact of a rule in public notices. Nearly all the notices we reviewed for rules issued after October 2019 had a dedicated impact analysis section. These sections often discussed potential overall effects of the changes to capital and liquidity requirements on subject banking organizations, with notices also separately addressing comments from associated proposed rules. For example, the impact analysis section in one jointly issued notice from November 2019 discussed the effect that changes in required capital and liquid assets would have on certain banking organizations with assets of $100 billion or more.

The impact analysis sections also sometimes addressed broader potential macroeconomic effects. For example, in a 2020 Federal Reserve notice, the section discussed that rule's potential long-term impact on the U.S. gross domestic product.

Banking regulators provided multiple reasons why they began consistently including a dedicated impact analysis section starting in November 2019:

- In 2019, the Federal Reserve, FDIC, and OCC jointly decided to include an impact analysis section, according to OCC officials, to improve visibility of rules' estimated effects. The officials said the step was taken in response to public comments requesting more information about the economic analysis conducted during rulemaking.
- Federal Reserve officials cited the 2017 creation of their Policy Effectiveness and Assessment Section, which they said conducts economic analysis of rulemaking as part of a general effort to increase analysis transparency and discipline.
- FDIC officials cited the 2016 creation of that agency's Regulatory Analysis Section, which analyzes the expected effects of regulations.

The notices we reviewed for 12 rules issued prior to November 2019 did not consistently incorporate a dedicated impact analysis section. They also did not describe the rule's potential effects on all affected banking organizations or the economy. For example, the notices included a Regulatory Flexibility Act analysis of the rule's potential effects on small entities covered by the act, but not on larger banking organizations.[49] Notices

[48]Of the 22 rules we reviewed, 21 were final rules and one was an interim final rule. Four of the 21 final rules finalized interim final rules; the other 17 finalized proposed rules. (See appendix I for additional information on the rules we reviewed.) As discussed previously, a major rule is generally one that OMB finds resulted in or is likely to result in an annual effect on the economy of $100 million or more, among other significant effects. 5 U.S.C. § 804(2).

[49]As discussed earlier, the Regulatory Flexibility Act requires that federal agencies consider the impact of certain regulations they issue on small entities.

for eight of these 12 rules included a section prepared by OCC in adherence with the Unfunded Mandates Reform Act.[50] Analyses described in these sections solely considered OCC-supervised institutions.

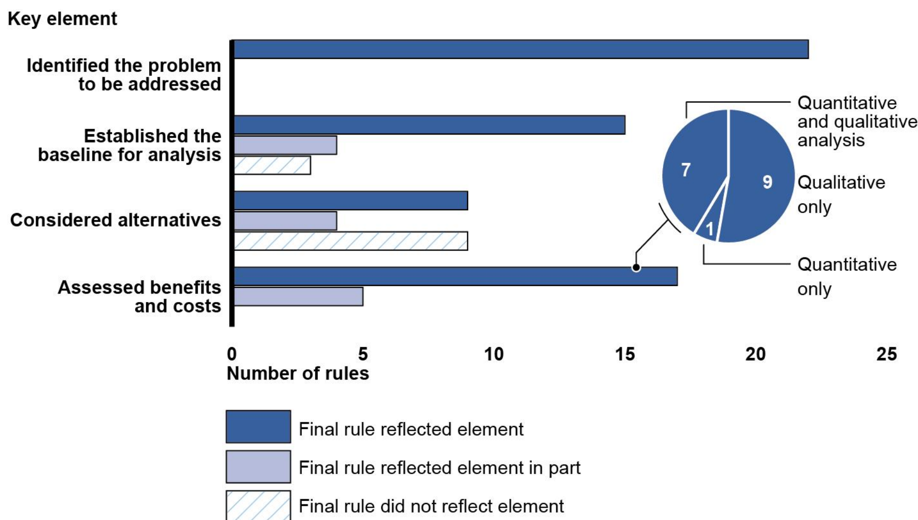
Elements of Analyses

The public notices for the 22 rules we reviewed also did not always reflect key elements of good regulatory analysis as outlined in Circular A-4. Banking regulators are not required to comply with Circular A-4, but its elements serve as leading practices for conducting regulatory analyses. Good regulatory analysis informs the public and agencies conducting the analysis of the effects of alternative actions and can help demonstrate whether a proposed rule is reasonable and justified.

We examined publicly provided documentation for each of the 22 major rules we reviewed to assess the extent to which the banking regulators followed four key elements from Circular A-4 (see fig. 2).[51] Specifically, we examined whether the public notices for each rule (1) identified the problem to be addressed by the regulation, (2) established the baseline for analysis (the best assessment of the way the world would look absent the proposed action), (3) considered alternatives reflecting the range of statutory discretion, and (4) assessed the benefits and costs—quantitative and qualitative—of the regulation.

Figure 2: Extent to Which Major Rules We Reviewed Addressed Key Leading Practices for Regulatory Analysis, 2012–2021

We reviewed the public notices for 22 selected major rules of federal banking regulators to determine the extent to which they reflected four key elements outlined in Office of Management and Budget (OMB) Circular A-4.



Source: GAO analysis of selected Federal Register notices. | GAO-24-106206

[50]As discussed earlier, that act generally requires an assessment of anticipated benefits and costs for rules that may result in expenditures of $100 million or more for certain entities.

[51]Circular A-4 suggests that agencies generally post the analysis and all supporting documents on the internet so the public can review the findings. A rule identified by the regulators as a major rule under the Congressional Review Act, if deemed a significant regulatory action, would be subject to formal benefit-cost analysis under E.O. 12866 if the relevant agencies were required to follow it.

Accessible Data for Figure 2: Extent to Which Major Rules We Reviewed Addressed Key Leading Practices for Regulatory Analysis, 2012–2021

Inclusion of Key OMB Circular A-4 Elements in Public Notices for Selected Major Rules, 2012-2021

	Identified the problem to be addressed	Established the baseline for analysis	Considered alternatives	Assessed "benefits and costs"
Final rule did not reflect element	0	4	9	0
Final rule reflected element in part	0	4	4	5
Final rule reflected element	22	15	9	17

Blow-up: Analysis of Costs and Benefits in Federal Register Notices for Selected Major Rules Including the OMB Circular A-4 Element, 2012-2021

	Number of Rules
Final rule included both quantitative and qualitative analysis of benefits or costs	7
Final rule included quantitative analysis of benefits or costs	1
Final rule included qualitative analysis of benefits or costs	7

Source: GAO analysis of selected Federal Register notices. I GAO-24-106206

Notes: "In part" signifies that the public notice reflected the key element to satisfy specific requirements, such as consideration of effects on small entities for the Regulatory Flexibility Act. As independent regulatory agencies, the banking regulators are not required to follow OMB Circular A-4, but its elements serve as leading practices for agencies to follow when conducting regulatory analyses.

Identification of the problem to be addressed. Circular A-4 states that a rule should clearly identify the specific problem the proposed regulatory action is intended to address or the need for regulatory action. Consistent with this practice, the regulators identified the problem to be addressed through regulation or need for regulatory action in all 22 rules we reviewed. For example, a 2014 Federal Reserve rule stated it sought to prevent or mitigate risks to financial stability arising from large, interconnected financial institutions.[52] Similarly, a joint 2021 rule stated it sought to address weaknesses in banks' management of liquidity risks and overreliance on short-term, less stable funding that contributed to the 2007–2009 financial crisis.[53]

Establishment of a baseline for analysis. Circular A-4 states that agencies should establish a baseline against which the benefits and costs of a rule should be measured. The baseline should be the best assessment of the way the world would look absent the proposed action. In 15 of the 22 rules we reviewed, the regulators established the baseline for evaluating the effects of the action. For example, a 2020 joint rule established the baseline as the then-current regulatory framework and compared it to the final rule's changes.[54] A 2020 joint rule delayed the impact on regulatory capital resulting from changes to accounting standards.[55] That rule established the baseline as the existing timeline if no delay were implemented. The

[52]The rule amended certain prudential standards for large banking organizations, including risk-based capital requirements and liquidity standards. 79 Fed. Reg. 17240 (Mar. 27, 2014).

[53]The rule created a stable funding requirement for large banking organizations. 86 Fed. Reg. 9120 (Feb. 11, 2021).

[54]The rule implemented a new approach for calculating the exposure amount of derivative contracts under the agencies' regulatory capital rule. 85 Fed. Reg. 4362 (Jan. 24, 2020).

[55]85 Fed. Reg. 61577 (Sept. 30, 2020).

other seven rules either did not establish a baseline for analysis or only did so as part of analysis required by the Regulatory Flexibility Act or Unfunded Mandates Reform Act.

Consideration of alternative approaches. Circular A-4 states that good regulatory analysis should include an examination of alternative approaches designed to inform the agency and the public of the effects of alternative actions and help determine which action would be the most cost-effective. For nine of the 22 rules we reviewed, the analysis considered alternative approaches to the proposed regulatory action. Often this was in response to public comments on the proposed rule. For example, after considering comments, agencies adopted an alternative approach to a 2014 proposed rule that would have required daily recalculation of certain bank exposures.[56] For four of the 22 rules we reviewed, the analysis considered alternatives only in response to specific requirements under the Regulatory Flexibility Act or Unfunded Mandates Reform Act.

Analysis of effects. Circular A-4 also states that a good regulatory analysis should include an evaluation of the benefits and costs—quantitative and qualitative—of the proposed action. In 17 of the 22 rules we reviewed, the regulators considered potential effects of the rule (including benefits, costs, or both).

Some Federal Register notices discussed both potential quantitative and qualitative effects. For example, for a 2020 rule, the Federal Register notice included estimates of the expected aggregate cost of additional capital for subject institutions to be $11 billion.[57] The rule's Federal Register notice also discussed expected reductions in the cost of long-term debt needed to meet requirements. The analysis accompanying a 2020 interim final rule easing regulatory requirements in response to the COVID-19 pandemic calculated a potential temporary $55 billion reduction in capital requirements, along with other relief for banking organizations.[58] The analysis also discussed the qualitative benefit of increased financial market liquidity during economic stress, and the cost of associated changes to institutions' internal processes.

However, for nine of the 17 rules that considered potential effects, the regulators' Federal Register notices did not explicitly quantify or monetize the benefits and costs they considered. For example:

- The analysis accompanying a 2019 Federal Reserve rule primarily described expected effects without quantifying or monetizing them.[59] For instance, the notice stated that the capital levels for certain subject firms were not expected to materially increase, while the rule was expected to reduce aggregate compliance costs for certain banking organizations.

[56]While OMB guidance suggests that agencies consider reasonably feasible alternatives, in some instances feasible alternatives may not exist. For example, an underlying statute requiring a regulation may provide an agency with little or no discretion in the rulemaking process. As we previously reported, in such cases an agency might still discuss alternatives, which could provide valuable information to agencies, Congress, and the public. See GAO-14-714.

[57]The rule aligned stress testing and capital requirements. 85 Fed. Reg. 15576 (Mar. 18, 2020).

[58]Regulatory Capital Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks From the Supplementary Leverage Ratio, 85 Fed. Reg. 32980, 32983 (June 1, 2020).

[59]This was one of two rules that tailored prudential standards for large banking organizations. 84 Fed. Reg. 59032 (Nov. 1, 2019). The Federal Register notice for the other rule included a discussion of expected benefits and costs in quantified and monetized terms. 84 Fed. Reg. 59230 (Nov. 1, 2019).

- A joint 2020 rule finalizing interim revisions to capital and liquidity requirements related to pandemic response efforts summarized the revised requirements and discussed potential effects without monetizing or quantifying any of their benefits or costs.[60]

Additionally, eight of the nine rules that evaluated benefits or costs solely in qualitative terms did not provide a rationale for not quantifying or monetizing them.[61]

Circular A-4 states that quantifying benefits and costs allows agencies to evaluate different regulatory options using a common measure. However, the circular also recognizes that some important benefits and costs may be inherently too difficult to quantify given current data and methods. For these cases, it recommends a careful analysis of qualitative benefits and costs, and an explanation of why costs and benefits could not be quantified. Officials from two of the federal banking regulators noted that a quantified benefit-cost analysis or evaluation of alternatives may not be practicable when statutes allow regulators limited discretion in rulemaking, or for rules with tight time frames. In prior work, we identified similar challenges to quantifying benefits and costs, and potential solutions for overcoming these challenges.[62]

Circular A-4 also suggests that agencies clearly document all the methods used in an analysis and make specific reference to all sources of data. However, these rules did not always include information about the data the regulators considered and methods they employed to support their conclusions that a rule's benefits outweighed the costs or that the benefits justified regulator action.

Other Analyses

As noted above, rules typically included analysis specific to requirements of the Regulatory Flexibility Act. This analysis did not capture effects on large banks, as the act's scope is limited to small entities subject to the rule. For example, the public notice of one 2014 FDIC rule estimated the direct compliance costs for certain small FDIC-supervised institutions.[63] But it did not discuss such costs for banking organizations larger than the threshold FDIC used for its Regulatory Flexibility Act analysis ($500 million in total assets).[64]

For each of the rules we reviewed in which OCC was involved, the regulator separately analyzed the final rule under the factors set forth in the Unfunded Mandates Reform Act.[65] For four of these rules, OCC monetized or

[60] 85 Fed. Reg. 68243 (Oct. 28, 2020).

[61] The one notice that provided a rationale for not conducting a benefit-cost analysis in quantitative terms cited methodological challenges and noted that benefit-cost analysis was not directly related to statutory requirements.

[62] For example, in a 2014 report, we found that federal banking regulators were constrained in quantifying benefits and costs by several factors, such as limited or unavailable data and difficulties in modeling. See GAO-15-81. However, we also found regulators were able to more effectively consider the costs and benefits of rulemakings by drawing on several sources, such as public comments on proposed rulemakings or data from other regulators. See GAO-17-188.

[63] The rule adopted as final an interim final rule that revised risk-based and leverage capital requirements for FDIC-supervised institutions. 79 Fed. Reg. 20754 (Apr. 14, 2014).

[64] The Regulatory Flexibility Act permits agencies to formulate their own definitions of small entities. *See* 5 U.S.C. § 601(3)-(5). In addition, the Small Business Administration publishes size standards that agencies can use to determine eligibility for classification as a small entity.

[65] OCC conducted this analysis for final rules for which a general notice of proposed rulemaking was published. Rules finalizing interim final rules did not include such an analysis, because the Unfunded Mandates Reform Act does not apply to final rules for which a general notice of proposed rulemaking was not published.

quantified the benefits and costs. For example, the notice for a 2012 rule estimated the increase in required market risk capital that would result from the rule.[66] It noted this increase would buttress the capital position of certain banking organizations and lower the likelihood of catastrophic losses to capital from market risk. For a 2014 rule, OCC estimated the overall annual cost that would be incurred by certain banking organizations.[67] The analyses for these four rules were specific to OCC-supervised banking organizations. They did not assess potential effects to organizations supervised by the Federal Reserve or FDIC.

Federal Reserve and FDIC Did Not Consistently Document Their Regulatory Analyses

Circular A-4, which contains leading practices for regulatory analysis, suggests that agencies clearly document all the assumptions and methods used in such an analysis. It also recommends that agencies prepare documentation of their regulatory analysis so that a qualified third party can understand the basic elements and the way in which the agency developed its estimates. We requested from the banking regulators any documentation supporting the regulatory analysis conducted—beyond the descriptions in Federal Register notices—for the 22 rules finalized in 2012–2021 that we reviewed.

OCC Typically Documented Its Analyses with Detailed Memorandums

OCC's documentation of its analyses of the potential effects typically consisted of comprehensive internal memorandums for the 16 rules in which it was involved. These internal memorandums generally were from OCC's Policy Analysis Division and included analyses in accordance with regulatory requirements. Specifically, the memorandums analyzed (1) the expected effect on small OCC-supervised banking organizations (per the Regulatory Flexibility Act), (2) whether expenditures of at least $100 million were required by the private sector (per the Unfunded Mandates Reform Act), and (3) whether effects on the economy totaled at least $100 million (per the Congressional Review Act).[68]

The memorandums also typically included information on the need for the regulation, and often established the baseline for regulatory analysis. OCC typically analyzed expected benefits and costs, such as capital and compliance costs, and the impact to OCC-supervised institutions and the economy. In addition, the memorandums discussed the methods used for the analysis and the data considered.

The specific benefits and costs OCC considered varied based on the rulemaking. For example, for a 2013 joint rule implementing Basel III, OCC's internal memorandum outlined the potential effects on minimum capital requirements and risk weights for certain bank assets. In estimating the overall cost of the rule to OCC-supervised banking organizations, the 23-page analysis calculated the net costs of individual requirements. These included capital costs, costs from applying alternative measures of creditworthiness, and disclosure requirements.

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[66]77 Fed. Reg. 53060 (July 22, 2013).

[67]This rule established a quantitative liquidity requirement consistent with international standards. 77 Fed. Reg. 61440 (Oct. 10, 2014).

[68]Memorandums primarily were addressed to OCC's Legislative and Regulatory Activities Division or its Chief Counsel's Office. One memorandum was addressed to OCC's Bank Advisory group. For the sole selected rule from 2012, OCC's documented analysis was prepared by its Economics Department rather than its Policy Analysis Division. OCC typically documented analyses for both the proposed and final rule; for several proposed rules, OCC memorandums considered alternatives to the proposed rulemaking.

For a 2021 joint rule finalizing a stable funding requirement for certain large banking organizations, OCC's internal memorandum estimated the rule's overall costs for the first and subsequent years. These estimates were based on the sum of individual net estimates derived from funding costs, operational costs, and agency-specific costs. The analysis compared the final rule to the baseline and alternatives. It also considered potential unintended effects, as well as how effects might differ based on an institution's business model.

Federal Reserve's Documentation Included Limited Information on Analysis of Expected Effects for Many Rules in Which It Was Involved

The Federal Reserve provided limited or no documentation (other than descriptions in Federal Register notices) for three of the 21 rules in which it was involved.

- For one rule lacking documentation, Federal Reserve staff indicated that an impact analysis was not conducted because staff believed the rule would have no immediate, direct impact. The rule aimed to remove the possibility of large future effects on subject firms by making more gradual any automatic limitations on capital distributions under certain capital rules.
- For another rule lacking documentation, Federal Reserve staff provided us with a document that did not contain an analysis of the rule's potential effects. The rule delayed the impact of a capital rule change to make time for a new, simplifying approach. Although the memorandum the staff provided analyzed the new approach (implemented in a subsequent rulemaking), it did not address the potential effects from the rule delaying the impact.
- Documentation for the third rule consisted of an email and figures that lacked a narrative explanation of how the figures supported the analysis of the rule's potential effects.

For the other 18 rules, the Federal Reserve's documentation of its regulatory analysis (other than descriptions in Federal Register notices) did not consistently include information that would allow a qualified third party to understand the basic elements of its analysis, including a discussion of methods and data used and how conclusions were reached.

- For eight rules, Federal Reserve staff provided at least one document that was a primary analysis document, according to our analysis. These documents, generally organized in memorandums and economic impact analysis reports, contained the analysis conducted. They included (1) an analysis of potential effects, (2) the methods and data used to perform the analysis, and (3) a narrative explanation of how the analysis was performed and conclusions reached. For example, a 2020 rule aligning stress testing and capital requirements was supported by a memorandum providing a 22-page analysis. This analysis estimated the rule's potential effects on capital requirements for banking organizations by category, calculated the requirement's risk sensitivity, and modeled its potential impact on U.S. economic activity.
- For 10 rules, documentation instead included a summary of the primary analysis, such as in presentations and memorandums. These documents did not include information that would allow a qualified third party to understand the analysis, such as a full description of the data and methods used and an explanation of how conclusions were reached. For example, for one joint rule implementing a standardized method for calculating certain exposure amounts, the Federal Reserve provided a five-page staff memorandum to the Board of Governors that was attached to the draft notice of proposed rulemaking requesting its review and approval. This document provided a brief paragraph on the impact of the proposal, but it did not include information on the methods used to analyze the data and reach its conclusions.

Moreover, documentation for these 18 rules did not consistently include analyses beyond what was in the Federal Register notice.

- For 13 rules, the documents included additional analysis not provided in the notice. For example, a rule implementing a quantitative liquidity requirement had an economic impact study with an analysis of effects more detailed than the Federal Register description.
- In contrast, documentation for five rules did not include information substantively different from that summarized in corresponding Federal Register notices. For example, for a joint rule revising the definition of high volatility commercial real estate exposure, the summary staff memorandum included one sentence on the rule's potential effects, noting that the rule should reduce administrative burden.[69] Information in the Federal Register on the rule's potential effects also was limited. For example, it did not include information on alternatives, explicitly establish a baseline for analysis, or include comprehensive information on benefits and costs. Similarly, for a rule related to changes made in response to the COVID-19 pandemic, the summary staff memorandums and the Federal Register notice did not include information on the data and methods used to analyze potential effects.

Beginning in 2019, FDIC's Documentation of Its Analysis Typically Included Detailed Memorandums

Beginning in 2019, FDIC's documentation of its analysis (beyond descriptions in Federal Register notices) typically included a detailed memorandum with a recommendation and supporting analysis to OMB's Office of Information and Regulatory Affairs. The analysis focused on whether the rule was a major rule pursuant to the Congressional Review Act.[70] For example, for a 2019 rule, a 22-page memorandum submitted to OMB (to determine whether it met the Congressional Review Act threshold for being considered major), described FDIC's analysis, and estimated the annual monetary benefit of the rule for FDIC-supervised institutions.

For other rules, FDIC's documentation largely consisted of tables and figures that summarized potential effects of the rulemaking but did not include a corresponding written analysis or narrative, similar to some of the Federal Reserve's documentation.

For five rules, FDIC could not provide documentation of analysis. FDIC officials told us that the agency no longer maintained this documentation because FDIC's applicable document retention period had expired. FDIC's document retention policy in effect from 2012 through 2020 required a 5-year retention period.

FDIC's current policy, implemented in 2020, requires a 15-year retention period for all regulations and policy statements, including drafts, analyses, and research. As a result of this policy change, according to FDIC officials, documentation of agency regulatory analysis is now maintained for at least 15 years.

[69]The federal banking agencies jointly finalized a rule that establishes which loans can be classified as high volatility commercial real estate loans for the purposes of assigning heightened risk weights to these loans.

[70]The independent banking regulators are not required to submit rules to OMB's Office of Information and Regulatory Affairs. However, per a 2019 OMB memorandum, these regulators are encouraged to submit rules to OMB's Office of Information and Regulatory Affairs for determination of whether they are major rules per the Congressional Review Act. See Office of Management and Budget, *Guidance on Compliance with the Congressional Review Act*, M-19-14 (Washington, D.C.: Apr. 11, 2019).

Federal Banking Regulators Performed Few Retrospective Reviews

From 2012 through 2023, OCC, the Federal Reserve, and FDIC each completed one independent retrospective review of one or more existing capital and liquidity regulations.

OCC. In 2015, OCC began a pilot program for conducting respective reviews of the costs, benefits, and efficacy of existing regulations. An internal memorandum suggested procedures for performing such reviews and identified six possible regulations for review. In 2017, OCC conducted a retrospective review on the impact to large banking organizations of a series of capital, liquidity, and operational requirements made in response to the 2007–2009 financial crisis.

OCC officials also noted they collaborated with the Basel Committee on Banking Supervision's Task Force on Evaluations to study the effects of Basel III.[71] However, the Basel Committee review was not specific to the United States or to OCC-issued capital and liquidity regulations, and OCC did not produce any independent analysis as part of this effort. As of June 2023, officials said they had no current plans for another retrospective review.

Federal Reserve. The Federal Reserve's one retrospective review, conducted in 2018, explored the costs and benefits of the regulatory reforms enacted after the 2007–2009 financial crisis. The review was conducted at the request of senior management and focused on key aspects of capital, liquidity, and resolution. The Federal Reserve also conducted a review of the first 5 years of its supervisory stress testing in 2016–2017 by convening meetings with experts and stakeholders, soliciting their feedback, and generating recommendations from their feedback, according to agency documentation. However, this review's focus on supervisory stress testing did not include an analysis of the effects of its capital or liquidity regulations.

Federal Reserve staff also contributed to articles in research journals that reviewed the effects of existing regulations, but these studies do not represent the views or assessments of the Federal Reserve.[72] The Federal Reserve also contributed to the Basel Committee's evaluation of the effects of Basel III, but this review was not specific to the United States or to Federal Reserve-issued capital and liquidity regulations. In addition, the Federal Reserve did not produce any independent analysis as part of the review.

FDIC. Since 2012, FDIC completed one retrospective review, in 2022, and two others were in progress as of December 2023, according to FDIC officials. However, these reviews were not related to capital or liquidity requirements. Officials noted that FDIC participated in three Basel Committee on Banking Supervision reports containing retrospective reviews of prior Basel reforms, but FDIC did not produce any independent analysis as part of this effort. As discussed in the following section, as of 2022, FDIC had a policy in place to conduct routine retrospective reviews.

Officials of all the banking regulators noted that the interagency reviews they conducted pursuant to the Economic Growth and Regulatory Paperwork Reduction Act helped satisfy their statutory retrospective review responsibilities. The first such joint review was completed in 2007. The second began in 2014, and the report

[71]See Bank for International Settlements, Basel Committee on Banking Supervision: *Evaluation of the Impact and Efficacy of the Basel III Reforms* (December 2022).

[72]Studies authored by Federal Reserve staff published in academic journals generally include a disclaimer that the research represents the views of the authors and does not indicate concurrence by other Federal Reserve staff or the Board of Governors.

summarizing its results was submitted to Congress in March 2017.[73] However, these reports relied on issues identified through public comments to initiate agency action and did not include independent agency analyses of rules' effects, based on our review of the two reports.

Regulators Vary in the Extent to Which Their Policies and Procedures for Regulatory Analysis Align with Leading Practices

Regulators varied in the extent to which their policies and procedures for prospective reviews fully aligned with key elements of Circular A-4 (see table 2) and in the extent to which they had or followed policies for retrospective reviews that aligned with other leading practices.

Table 2: Alignment of Regulators' Policies and Procedures for Prospective Regulatory Analysis with Key Leading Practices in OMB Circular A-4

Key element	Federal Reserve	FDIC	OCC
Describe the need for regulatory action	fully aligned	fully aligned	fully aligned
Define the baseline	not aligned	fully aligned	fully aligned
Identify a range of regulatory alternatives	fully aligned	fully aligned	fully aligned
Evaluate the benefits and costs—quantitative and qualitative—of the proposed action	aligned in part	fully aligned	fully aligned

● = Fully aligned ◑ = Aligned in part ○ = Not aligned

FDIC = Federal Deposit Insurance Corporation; Federal Reserve = Board of Governors of the Federal Reserve System; OCC = Office of the Comptroller of the Currency; OMB = Office of Management and Budget

Source: GAO analysis of Federal Reserve, OCC, and FDIC documentation. | GAO-24-106206

Note: OMB Circular A-4 provides guidance to federal agencies on the development of regulatory analysis. Although the independent banking regulators are not required to follow Circular A-4, its elements generally are considered leading practices for regulatory analysis.

FDIC's Recently Revised Policies and Procedures Align with Leading Practices

Prospective reviews. In 2022, FDIC revised its policies and procedures for the analysis of proposed and final rules. The new policies and procedures identify staff responsibilities for the creation, internal review, and distribution of analyses looking at the potential effects of rules. They also require analyses to include a statement of the need for proposed action; a discussion of relevant alternative approaches; an identification of a baseline against which to compare effects of the action; and an analysis of benefits and costs of the action that includes qualitative and quantitative analysis, where relevant and supportable. These requirements align with key elements identified in Circular A-4. As noted previously, the current policies and procedures were not in effect at the time FDIC finalized the rules we reviewed.

[73]See Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act, 82 Fed. Reg. 15900 (Mar. 30, 2017).

FDIC implemented the current policies and procedures to ensure that staff effectively implement the overarching principles identified in its 2013 policy statement on the development of regulations, according to agency officials.[74]

Retrospective reviews. FDIC finalized a new retrospective review policy in December 2022. The policy was developed in response to a 2020 recommendation from the FDIC Office of Inspector General.[75] It establishes the agency's intention to complete one retrospective review per year resulting in a written report.

OCC Policies for Prospective Reviews Align with Leading Practices, but It Does Not Have Policies for Retrospective Reviews

Prospective reviews. OCC's policies and procedures for prospective regulatory analysis were revised in 2021, and they align with key elements in Circular A-4.[76] For example, they require its Policy Analysis Division to conduct a benefit-cost analysis of rules for which staff preliminary analysis determine the economic impact to be $100 million or greater. This analysis is to include, at a minimum, a statement of the need for the proposed action, comparisons with plausible alternatives, and a qualitative or quantitative assessment (or both). Additionally, OCC's policies and procedures note that staff should reference Circular A-4 for guidance when conducting analyses for rules with an economic effect of $100 million or greater.

Retrospective reviews. OCC does not have policies or procedures for conducting retrospective reviews of its existing regulations. As discussed earlier, a 2015 pilot program produced draft procedures for retrospective reviews, but OCC has not adopted the procedures. OCC officials told us that the draft procedures were submitted to agency leadership but there has been no subsequent request to formalize them. The officials indicated that the agency has not adopted formal procedures because, unless statutorily required, its retrospective review needs have been satisfied by its ad hoc reviews (as directed by senior management) and as part of international and interagency collaborations.

E.O. 13579 (*Regulation and Independent Regulatory Analysis*) encourages independent regulatory agencies to develop and implement plans to conduct periodic retrospective reviews. The plans are to include processes for periodically reviewing existing significant regulations to determine whether they should be modified or repealed. FDIC and the Federal Reserve, as discussed below, have policies for performing retrospective reviews of existing rules. Without such policies and procedures, OCC does not have reasonable assurance that those rules have been achieving their intended effects and avoiding unintended economic consequences. Retrospective reviews also can provide important lessons to inform future rulemakings.

[74]78 Fed. Reg. 22771 (Apr. 17, 2013).

[75]In 2020, the FDIC Office of Inspector General recommended that FDIC develop policies and procedures for conducting retrospective benefit-cost analyses on existing rules, as well as on roles and responsibilities for contributing staff. See Federal Deposit Insurance Corporation, Office of Inspector General, *Cost Benefit Analysis Process for Rulemaking,* EVAL-20-003 (Washington, D.C.: February 2020).

[76]OCC officials told us that since 2021 the agency annually has reviewed and reaffirmed its policies and procedures, most recently in October 2023.

Federal Reserve Policies Do Not Fully Align with Leading Practices or Have Not Been Consistently Followed

Prospective reviews. The Federal Reserve's rulemaking policies were issued in 1979 and last revised in 1994. They require staff to prepare a regulatory analysis of any regulatory proposal before Board review. The policy notes that the extent of the regulatory analysis may vary, but it must discuss the need for the regulation, identify various options, and discuss its possible economic implications, where appropriate. The 1979 policies, as revised in 1994, remain in effect.

The Federal Reserve's rulemaking policies do not include certain key elements recommended by Circular A-4 for good regulatory analysis. For example, the regulator's policies do not call for

- establishing a baseline against which to compare potential effects;
- quantitatively or qualitatively assessing benefits and costs of the proposed rule (beyond a discussion of possible economic implications); or
- documenting the data sources, assumptions, and methods used in an analysis.

In 2011, we recommended that the Federal Reserve more fully incorporate OMB's regulatory analysis guidance into its rulemaking policies.[77] Consistent with this recommendation, the Federal Reserve created the Policy Effectiveness and Assessment Section in 2017 to evaluate the potential effects, such as benefits and costs, of its proposed rules.

However, the Federal Reserve has not developed any additional policies or procedures to guide the work of the Policy Effectiveness and Assessment Section on when and how to conduct such reviews. Federal Reserve officials stated that staff determine the need for analysis on an ad hoc basis, based on internal staff discussions and the complexity of the analysis, among other factors.

In addition, the Federal Reserve does not have policies and procedures for how staff should document their regulatory analyses. Agency officials told us that they historically have given staff discretion in this regard. As discussed earlier, the Federal Reserve's documentation of its analysis, beyond descriptions in public Federal Register notices, did not consistently include information on basic elements of its analysis (such as data and methods used) for many rules we reviewed.

OMB Circular A-4 states that an analysis of the benefits and costs of potential rulemaking is a basic element of good regulatory analysis. The guidance also suggests that agencies clearly document all the assumptions and methods used in an analysis. E.O.13579 (*Regulation and Independent Regulatory Analysis*) encourages independent regulatory agencies, to the extent permitted by law, to make regulatory decisions only after consideration of their benefits and costs (both quantitative and qualitative). The Administrative Conference of the United States, an independent federal agency, recommended in 2013 that each "independent regulatory agency should develop and keep up to date written guidance regarding the preparation of benefit-cost and

[77]See GAO, *Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination*, GAO-12-151 (Washington, D.C.: Nov. 10, 2011).

other types of regulatory analyses," with guidance tailored to the agency's particular statutory and regulatory environment.[78]

Without policies and procedures aligned with leading practices for regulatory analysis, including for analyzing rules' benefits and costs and for documenting the analysis, the Federal Reserve does not have reasonable assurance it has chosen the most cost-beneficial option or that a rule's benefits justify regulator action. It also lacks transparency in its regulatory analyses and decision making.

Retrospective reviews. The Federal Reserve's 1979 rulemaking policies also call for the Board to review each of its existing regulations at least once every 5 years. Each regulation is to be re-examined with a view toward eliminating or simplifying it and easing burdens imposed by it. The policies do not specify staff roles and responsibilities for conducting these reviews.

However, the Federal Reserve has not followed this policy. During 2012–2023, it conducted one retrospective review of existing capital and liquidity regulations. While it participated in selected interagency reviews and a review of its supervisory stress testing program, as previously noted, these reviews did not include independent agency analyses of existing rules. Agency officials stated that although the Federal Reserve seeks to follow its policy, the agency often prioritizes resources toward more holistic reviews or unexpected events, such as the 2007–2009 financial crisis and the COVID-19 pandemic.

The Federal Reserve's 2020–2023 strategic plan includes an objective to continue to refine rules, practices, and tools to enhance efficiency and effectiveness of supervision. This is to include reviewing safety and soundness regulations and policies to enhance effectiveness, efficiency, and simplicity.[79] Similarly, E.O. 13579 encourages independent regulatory agencies to consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.

Without policies and procedures for systematically performing retrospective reviews of existing rules, the Federal Reserve does not have reasonable assurance that it is determining whether those rules have been achieving their intended effects and avoiding unintended economic consequences. Such reviews also could provide important lessons to inform future Federal Reserve rulemakings.

Conclusions

Regulatory analysis is a key tool for helping banking regulators ensure their rules are sound and cost-effective. The capital adequacy rules for large banking organizations are critical to maintaining the safety and soundness of the U.S. financial system. As banking regulators continue to propose rules to finish implementing the Basel framework, it is important that they consistently assess the potential and actual effects of their rules.

[78]See Administrative Conference of the United States, *Benefit-Cost Analysis at Independent Regulatory Agencies*, Recommendation 2013-2. See 78 Fed. Reg. 41355 (July 10, 2013). The Administrative Conference of the United States convenes expert representatives from the public and private sector to consider and recommend improvements to administrative processes and procedures. In 2013, it adopted recommendations relating to the use of regulatory analysis by independent regulatory agencies.

[79]Board of Governors of the Federal Reserve System, *Strategic Plan 2020–23* (Washington, D.C.: December 2019).

However, the Federal Reserve's policies for reviewing the effects of proposed rules, last revised in 1994, do not incorporate certain leading practices, such as systematically assessing benefits and costs and fully documenting the analysis. Policies that aligned its regulatory analysis with leading practices could help the Federal Reserve ensure its rules justify regulatory action and represent the most cost-beneficial option. They also would help ensure that the conclusions reached are more transparent and supported by appropriate documentation.

Retrospective reviews help agencies evaluate the effectiveness of existing regulations. However, the banking regulators' retrospective reviews since the introduction of the Basel III framework have been limited to ad hoc efforts, single reviews, or broad interagency efforts. FDIC's recent policy to systematically conduct retrospective reviews is a positive step. Similar policies by OCC and the Federal Reserve could help them assess whether their rules have been achieving their intended effects and could help inform future rulemakings.

Recommendations for Executive Action

We are making a total of three recommendations (two to the Federal Reserve and one to OCC):

The Chair of the Board of Governors of the Federal Reserve System should develop and implement policies and procedures for consistently performing regulatory analyses that align with leading practices, including for documenting the analyses performed. (Recommendation 1)

The Chair of the Board of Governors of the Federal Reserve System should develop and implement policies and procedures for systematically performing retrospective reviews of regulations. (Recommendation 2)

The Comptroller of the Currency should ensure that its Policy Analysis Division develops and implements policies and procedures for systematically performing retrospective reviews of regulations. (Recommendation 3)

Agency Comments and Our Evaluation

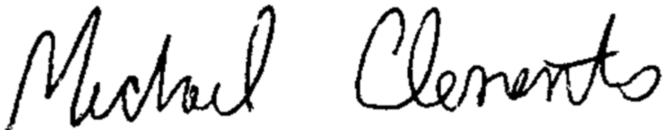
We provided a draft of this report to FDIC, the Federal Reserve, and OCC for review and comment. FDIC and the Federal Reserve provided technical comments, which we incorporated as appropriate.

In its written comments, reproduced in appendix III, the Federal Reserve agreed with our recommendations to adopt formal policies and procedures for consistently performing regulatory analyses that align with leading practices and for conducting retrospective reviews of existing rulemakings. The Federal Reserve stated its belief that rigorous analysis is a critical element of the Federal Reserve's regulatory process, and that it has made substantial improvements to its process in recent years. The Federal Reserve also stated that it had engaged in a large number of retrospective reviews over the past decade to evaluate the effectiveness and efficiency of its existing regulations. As stated in our report, while the Federal Reserve participated in other reviews, these reviews either did not include an analysis of the effects of its capital or liquidity regulations or independent Federal Reserve analyses as part of the review.

In its written comments, reproduced in appendix IV, OCC neither agreed nor disagreed with our recommendation on retrospective reviews (Recommendation 3) but identified steps it will take to address the recommendation. It stated that its Policy Analysis Division plans to develop and implement policies and procedures for systematically performing retrospective reviews of regulations by March 31, 2025.

We are sending copies of this report to the appropriate congressional committees, Chair of the Federal Deposit Insurance Corporation, Chair of the Board of Governors of the Federal Reserve System, Acting Comptroller of the Currency, and other interested parties. In addition, the report is available at no charge on the GAO website at https://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or clementsm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.



Michael E. Clements
Director, Financial Markets and Community Investment

List of Addressees

The Honorable Charles E. Schumer
Majority Leader
The Honorable Mitch McConnell
Minority Leader
United States Senate

The Honorable Debbie Stabenow
Chairwoman
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Ranking Member
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United States Senate

The Honorable Sherrod Brown
Chairman
The Honorable Tim Scott
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Maria Cantwell
Chair
The Honorable Ted Cruz
Ranking Member
Committee on Commerce, Science, and Transportation
United States Senate

The Honorable Chris Van Hollen
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The Honorable Bill Hagerty
Ranking Member
Subcommittee on Financial Services and General Government
Committee on Appropriations
United States Senate

The Honorable Mike Johnson
Speaker
The Honorable Hakeem Jeffries
Minority Leader
House of Representatives

The Honorable Glenn "GT" Thompson
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The Honorable David Scott
Ranking Member

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House of Representatives

The Honorable Cathy McMorris Rodgers
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The Honorable Frank Pallone, Jr.
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The Honorable Patrick McHenry
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House of Representatives

The Honorable David Joyce
Chairman
The Honorable Steny Hoyer
Ranking Member
Subcommittee on Financial Services and General Government
Committee on Appropriations
House of Representatives

Appendix I: Selected Major Rules (2012–2021) That GAO Reviewed

Table 3 provides information on the 22 major rules covered by our review. These represent all major rules implementing or amending capital and liquidity requirements for large banking organizations that were finalized from 2012 to 2021.[1]

Table 3: Regulator, Publication and Effective Dates, and Federal Register Number for Selected Capital and Liquidity-Related Major Rules, 2012–2021

Rule	Responsible regulator	Date published	Date effective	Federal Register number
Risk-Based Capital Guidelines: Market Risk	Federal Reserve, OCC, FDIC	Aug. 30, 2012	Jan. 1, 2013	77 Fed. Reg. 53060
Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule	Federal Reserve, OCC	Oct. 11, 2013	Jan. 1, 2014	78 Fed. Reg. 62018
Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations	Federal Reserve	Mar. 27, 2014	June 1, 2014	79 Fed. Reg. 17240
Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule	FDIC	Apr. 14, 2014	Apr. 14, 2014	79 Fed. Reg. 20754
Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions	Federal Reserve, OCC, FDIC	May 1, 2014	Jan. 1, 2018	79 Fed. Reg. 24528
Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio	Federal Reserve, OCC, FDIC	Sep. 26, 2014	Jan. 1, 2015	79 Fed. Reg. 57725
Liquidity Coverage Ratio: Liquidity Risk Measurement Standards	Federal Reserve, OCC, FDIC	Oct. 10, 2014	Jan. 1, 2015	79 Fed. Reg. 61440

[1]As defined by the Congressional Review Act, a major rule is generally one that the Office of Management and Budget finds 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; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of U.S.-based enterprises to compete with foreign-based enterprises in domestic and export markets. 5 U.S.C. § 804(2).

Rule	Responsible regulator	Date published	Date effective	Federal Register number
Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies	Federal Reserve	Aug. 14, 2015	Dec. 1, 2015	80 Fed. Reg. 49082
Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations	Federal Reserve	Jan. 24, 2017	Mar. 27, 2017	82 Fed. Reg. 8266
Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations That Are Not Subject to the Advanced Approaches Capital Rules	Federal Reserve, OCC, FDIC	Nov. 21, 2017	Jan. 1, 2018	82 Fed. Reg. 55309
Regulatory Capital Rule: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rule and Conforming Amendments to Other Regulations	Federal Reserve, OCC, FDIC	Feb. 14, 2019	Apr. 1, 2019	84 Fed. Reg. 4222
Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996	Federal Reserve, OCC, FDIC	July 22, 2019	Oct. 1, 2019	84 Fed. Reg. 35234
Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations	Federal Reserve	Nov. 1, 2019	Dec. 31, 2019	84 Fed. Reg. 59032
Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements	Federal Reserve, OCC, FDIC	Nov. 1, 2019	Dec. 31, 2019	84 Fed. Reg. 59230
Regulatory Capital Treatment for High Volatility Commercial Real Estate Exposures	Federal Reserve, OCC, FDIC	Dec. 13, 2019	Apr. 1, 2020	84 Fed. Reg. 68019
Standardized Approach for Calculating the Exposure of Derivative Contracts	Federal Reserve, OCC, FDIC	Jan. 24, 2020	Apr. 1, 2020	85 Fed. Reg. 4362
Regulations Q, Y, and YY: Regulatory Capital, Capital Plan, and Stress Test Rules	Federal Reserve	Mar. 18, 2020	May 18, 2020	85 Fed. Reg. 15576
Regulatory Capital Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio for Depository Institutions	Federal Reserve, OCC, FDIC	June 1, 2020	June 1, 2020	85 Fed. Reg. 32980
Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology for Allowances	Federal Reserve, OCC, FDIC	Sep. 30, 2020	Sep. 30, 2020	85 Fed. Reg. 61577
Regulatory Capital Rule and Total Loss-Absorbing Capacity Rule: Eligible Retained Income	Federal Reserve, OCC, FDIC	Oct. 8, 2020	Jan. 1, 2021	85 Fed. Reg. 63423
Treatment of Certain Emergency Facilities in the Regulatory Capital Rule and the Liquidity Coverage Ratio Rule	Federal Reserve, OCC, FDIC	Oct. 28, 2020	Dec. 28, 2020	85 Fed. Reg. 68243

Rule	Responsible regulator	Date published	Date effective	Federal Register number
Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements	Federal Reserve, OCC, FDIC	Feb. 11, 2021	July 1, 2021	86 Fed. Reg. 9120

FDIC = Federal Deposit Insurance Corporation; Federal Reserve = Board of Governors of the Federal Reserve System; OCC = Office of the Comptroller of the Currency

Source: GAO analysis of Federal Register notices and Congressional Review Act filings. | GAO-24-106206

Note: We considered the earliest published date shown in the final Federal Register releases for each relevant rulemaking. If the published date shown fell within our scope (from August 30, 2012, through February 11, 2021), we included it regardless of the effective date of the rule.

Appendix II: Objectives, Scope, and Methodology

This report examines (1) the Board of Governors of the Federal Reserve System's (Federal Reserve) changes to its stress tests since 2017 and views on those changes; (2) how banking regulators evaluated the effects of selected capital and liquidity rules; and (3) banking regulators' policies and procedures for evaluating the effects of proposed and final rules. Banking regulators in the scope of our review were the Federal Deposit Insurance Corporation, the Federal Reserve, and Office of the Comptroller of the Currency. We did not include the Consumer Financial Protection Bureau because it did not issue regulations with capital or liquidity requirements during the review period, either solely or jointly with other regulators.

To review changes to supervisory stress tests, we reviewed the tailoring and stress capital buffer rules. We focused on changes made since 2017 because our previous review of supervisory stress tests was issued in 2016.[1] We reviewed Federal Reserve policies and procedures for implementing and using stress testing in its supervision of banking institutions. We analyzed internal guidance documents and instructions, methodology, and results related to stress tests and reviewed public statements by Federal Reserve officials and other Federal Reserve documentation about the tests. We interviewed staff from the offices of the Federal Reserve responsible for stress tests, including the Division of Supervision and Regulation and the Division of Financial Stability, on the scope of and changes to the program. We also conducted a literature review to identify relevant research on the changes to stress tests.

To obtain views about the changes to the stress tests, we reviewed publicly available comment letters on the tailoring and stress capital buffer rules. Based on our review of these letters and suggestions by others we interviewed, we identified and interviewed four banking industry groups, two public interest groups, one academic, and one former regulator with expertise on stress testing. We selected these groups and individuals to capture diverse perspectives on the topic. Additionally, we judgmentally selected 12 banking organizations that participated in stress tests in 2017–2022 and interviewed their officials. We selected these banking organizations because they represented a mix of tailoring rule categories and business types and to ensure perspectives from various sizes and types of such organizations.[2] We reviewed information from the Federal Reserve on banking organizations participating in the stress tests in prior years to identify them and their tailoring rule category and other characteristics. If we were unable to schedule interviews with selected banking organizations, we chose additional organizations based on the same selection criteria.

To examine how the banking regulators evaluated the effects of selected capital and liquidity rules (that is, conducted regulatory analyses), we focused our review on 22 rules. We started by identifying all rules that created capital or liquidity requirements and were finalized in 2012–2021. We chose that review period to include significant changes to capital and liquidity requirements implemented after the 2007–2009 financial

[1]See GAO, *Federal Reserve: Additional Actions Could Help Ensure the Achievement of Stress Test Goals*, GAO-17-48 (Washington, D.C.: Nov. 15, 2016).

[2]The Federal Reserve categorized subjected banking organizations based largely on asset size and complexity and set stress testing and capital requirements accordingly. For our selection, we also considered business model (such as a focus on custodial or investment services) and if the organization was U.S.-based or foreign-based.

crisis. We further narrowed our selection to rules that affected large banking organizations.[3] We searched the federal docket and initially identified 29 rules meeting these criteria.

We then used GAO's Federal Rules database to identify which of these 29 were major rules, as defined by the Congressional Review Act.[4] We focused on major rules because such rules generally require formal benefit-cost analyses for agencies subject to Executive Order (E.O.) 12866.[5]

Of the initial 29 rules, we identified that 17 were major rules. We consulted with officials from the regulatory agencies to identify any rules that should be added or removed from this list. To avoid duplication, we excluded interim rules later made final by other rules in our set. This resulted in 22 rules meeting our criteria: major rules creating capital and liquidity requirements for large banking organizations finalized from August 30, 2012, through February 11, 2021 (see table 4).

Table 4: Number of Major Capital and Liquidity Rules We Reviewed, Issued 2012—2021, by Regulator

Type of rulemaking	Federal Reserve	FDIC	OCC	Total[a]
Issued jointly	16	15	16	**16**
Issued solely	5	1	0	**6**
Total	**21**	**16**	**16**	**22**

FDIC = Federal Deposit Insurance Corporation; Federal Reserve = Board of Governors of the Federal Reserve System; OCC = Office of the Comptroller of the Currency

Source: GAO. | GAO-24-106206

[a]Totals do not always sum across columns because of overlap in joint rulemaking.

We reviewed federal statutes, regulations, and prior GAO reports to identify the regulatory analyses that regulators were required to conduct as part of their rulemakings.[6]

We requested from the banking regulators any analysis they conducted for the 22 rules we selected. We also requested any documentation beyond that disclosed in public notices that supported the analyses. We reviewed those analyses and their documentation.

[3]We considered large banking organizations as those entities with $100 billion or more in total assets, to include all banking institutions subject to the Federal Reserve's supervisory stress testing.

[4]The act defines major rules as those that resulted in or were likely to result in an annual impact on the economy of $100 million or more; a major increase in costs or prices; or significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of U.S.-based enterprises to compete with foreign-based enterprises in domestic and export markets. 5 U.S.C. § 804(2). The 22 selected major rules were typically considered major because they exceeded $100 million in annual effects on the economy, according to Federal Reserve, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency officials.

[5]The Congressional Review Act's definition of a major rule is similar, but not identical, to the definition of a "significant regulatory action" under E.O. 12866. A rule identified by the financial regulators as a major rule under the Congressional Review Act, if deemed a significant regulatory action, would be subject to formal benefit-cost analysis under E.O. 12866 if the relevant agencies were required to follow it.

[6]For example, see GAO, *Dodd-Frank Regulations: Agencies' Efforts to Analyze and Coordinate Their Recent Final Rules*, GAO-17-188 (Washington, D.C.: Dec. 29, 2016).

We developed a data collection instrument to compare and assess the regulatory analysis conducted for the 22 rules against key elements of the Office of Management and Budget's Circular A-4, which provides guidance to federal agencies on the development of regulatory analysis.[7] More specifically, we reviewed public Federal Register notices of the final rules and the regulatory analyses discussed in the notices. We then compared the regulatory analyses in public notices against specific elements in Circular A-4. For each, we categorized the regulatory analysis discussed in the public notice as reflecting or addressing the element, not doing so, or doing so "in part" if the analysis was specific to the Regulatory Flexibility Act or Unfunded Mandates Reform Act.

At the end of the agency comment period, Federal Reserve staff provided additional documentation, such as memorandums, spreadsheets, slide presentations, and emails. We reviewed these documents to assess the extent to which they applied to regulatory analyses for the 22 rules in our review. We also assessed the extent to which a qualified third party could understand the basic elements of the analyses—such as data and methods used—and the way in which estimates were developed. We revised our findings accordingly.

To examine regulators' policies and procedures for regulatory analysis, we requested from each banking regulator its policies and procedures guiding prospective and retrospective regulatory analyses. We reviewed this documentation and interviewed agency officials responsible for conducting regulatory analyses. To assess the extent to which policies and procedures for prospective analyses aligned with leading practices for regulatory analysis, we compared them against key elements of OMB Circular A-4, guidance on benefit-cost analysis in E.O. 13579 (*Regulation and Independent Regulatory Analysis*), and a recommendation from the Administrative Conference of the United States.[8] To assess the extent to which agencies' policies and procedures for retrospective analyses aligned with leading practices for regulatory analysis, we compared them with E.O. 13579.[9]

We conducted this performance audit from August 2022 to July 2024, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[7]Because independent regulatory agencies are not required to follow the economic analysis requirements of E.O. 12866, the banking regulatory agencies also are not required to follow Circular A-4. However, the elements of the circular represent leading practices for agencies to follow when conducting regulatory analyses.

[8]Office of Management and Budget, *Circular A-4: Regulatory Analysis* (Washington, D.C.: Sept. 17, 2003). Exec. Order No. 13579, 76 Fed. Reg. 41587 (July 11, 2011). E.O. 13579 encourages independent regulatory agencies to develop and implement plans to conduct periodic retrospective reviews. Also see Board of Governors of the Federal Reserve System, *Strategic Plan 2020–23* (Washington, D.C.: December 2019); and Administrative Conference of the United States, *Benefit-Cost Analysis at Independent Regulatory Agencies*, Recommendation 2013-2, 78 Fed. Reg. 41355 (July 10, 2013). The Administrative Conference of the United States convenes expert representatives from the public and private sector to consider and recommend improvements to administrative processes and procedures. In 2013, the Administrative Conference adopted recommendations relating to the use of regulatory analysis by independent regulatory agencies.

[9]Exec. Order No. 13579, 76 Fed. Reg. 41587 (July 11, 2011).

Appendix III: Comments from the Board of Governors of the Federal Reserve System

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MARK E. VAN DER WEIDE
GENERAL COUNSEL

June 20, 2024

Michael E. Clements
Director
Financial Markets and Community Investment Team
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Clements:

Thank you for providing the Board of Governors of the Federal Reserve System ("Federal Reserve" or "Board") with an opportunity to review the final draft of the Government Accountability Office ("GAO") report titled: *Financial Services Regulations: Improvements Needed to Policies and Procedures for Regulatory Analysis* (GAO-24-106206). The GAO's report reviews changes to the Federal Reserve's use of its supervisory stress tests since 2017, and potential benefits and drawbacks of such changes to the stress testing framework identified by market participants and observers; bank regulators' evaluation of the effects of selected capital and liquidity rules from 2012 to 2021; and the extent to which bank regulators established policies and procedures for evaluating the effects of proposed and final rules.

The Board believes that rigorous analysis is a critical element of our regulatory process. The GAO's report reviewed regulators' analyses of selected major capital and liquidity rules finalized from 2012 to 2021, and the Board has made substantial improvements to its processes for assessing the impact and effectiveness of its rulemakings in recent years. Increasingly over the past decade, Board staff has carefully assessed the impact and effectiveness of our regulatory policies. The staff team includes economists and other policy experts that conduct analysis of the quantitative and qualitative costs and benefits of proposed and final rulemakings. This analysis improves the efficacy and efficiency of the Board's rules, while ensuring that the Board adopts rules that faithfully implement laws passed by Congress. Complementary to this process, the Federal Reserve has engaged in a large number of retrospective reviews over the past

decade to evaluate the effectiveness and efficiency of its existing regulations. These reviews included comprehensive and completed retrospective reviews of the post-crisis bank capital and liquidity frameworks, the Federal Reserve's stress testing framework, the interagency Volcker Rule, and the Federal Reserve's control rule. These reviews also have included comprehensive Board staff evaluations of Regulations O, W, H, K, and Y, which reviews have not yet resulted in proposed rule changes. It is the Board's hope that its numerous retrospective reviews help ensure that its regulations are achieving their intended purpose in the most efficient manner possible.

The GAO's report makes two recommendations to the Board:

> The Chair of the Board of Governors of the Federal Reserve System should develop and implement policies and procedures for consistently performing regulatory analyses that align with leading practices, including for documenting the analyses performed.

> The Chair of the Board of Governors of the Federal Reserve System should develop and implement policies and procedures for systematically performing retrospective reviews of regulations.

As discussed in the report, the Board has over time improved the consistency and rigor of its regulatory analysis. The Board agrees that it should adopt more formal policies and procedures to ensure that its ongoing regulatory analysis continues to align with leading practices in the future. The Board also recognizes (i) the benefits of conducting retrospective reviews of existing rulemakings to evaluate whether the rules are achieving their intended objectives and (ii) the need for policies and procedures to ensure that such retrospective reviews are conducted systematically. Accordingly, the Board intends to implement the GAO's recommendations and already has commenced work to determine how best to implement the recommendations.

We appreciate the GAO's review of the Federal Reserve's supervisory stress tests and the banking regulators' rulemaking processes, as well as the GAO's consideration of the Board's additional documentation submitted at the end of the agency comment period.

Sincerely,

Mark Van Der Weide

2

Accessible Text for Appendix III: Comments from the Board of Governors of the Federal Reserve System

June 20, 2024

Michael E. Clements
Director
Financial Markets and Community Investment Team
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Clements:

Thank you for providing the Board of Governors of the Federal Reserve System ("Federal Reserve" or "Board") with an opportunity to review the final draft of the Government Accountability Office ("GAO") report titled: Financial Services Regulations: Improvements Needed to Policies and Procedures for Regulatory Analysis (GAO-24-106206). The GAO's report reviews changes to the Federal Reserve's use of its supervisory stress tests since 2017, and potential benefits and drawbacks of such changes to the stress testing framework identified by market participants and observers; bank regulators' evaluation of the effects of selected capital and liquidity rules from 2012 to 2021; and the extent to which bank regulators established policies and procedures for evaluating the effects of proposed and final rules.

The Board believes that rigorous analysis is a critical element of our regulatory process. The GAO's report reviewed regulators' analyses of selected major capital and liquidity rules finalized from 2012 to 2021, and the Board has made substantial improvements to its processes for assessing the impact and effectiveness of its rulemakings in recent years. Increasingly over the past decade, Board staff has carefully assessed the impact and effectiveness of our regulatory policies. The staff team includes economists and other policy experts that conduct analysis of the quantitative and qualitative costs and benefits of proposed and final rulemakings. This analysis improves the efficacy and efficiency of the Board's rules, while ensuring that the Board adopts rules that faithfully implement laws passed by Congress. Complementary to this process, the Federal Reserve has engaged in a large number of retrospective reviews over the past decade to evaluate the effectiveness and efficiency of its existing regulations. These reviews included comprehensive and completed retrospective reviews of the post-crisis bank capital and liquidity frameworks, the Federal Reserve's stress testing framework, the interagency Volcker Rule, and the Federal Reserve's control rule. These reviews also have included comprehensive Board staff evaluations of Regulations O, W, H, K, and Y, which reviews have not yet resulted in proposed rule changes. It is the Board's hope that its numerous retrospective reviews help ensure that its regulations are achieving their intended purpose in the most efficient manner possible.

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As discussed in the report, the Board has over time improved the consistency and rigor of its regulatory analysis. The Board agrees that it should adopt more formal policies and procedures to ensure that its ongoing regulatory analysis continues to align with leading practices in the future. The Board also recognizes (i) the benefits of conducting retrospective reviews of existing rulemakings to evaluate whether the rules are achieving their intended objectives and (ii) the need for policies and procedures to ensure that such retrospective reviews are conducted systematically. Accordingly, the Board intends to implement the GAO’s recommendations and already has commenced work to determine how best to implement the recommendations.

We appreciate the GAO’s review of the Federal Reserve’s supervisory stress tests and the banking regulators’ rulemaking processes, as well as the GAO’s consideration of the Board’s additional documentation submitted at the end of the agency comment period.

Sincerely,

Mark Van Der Weide

Appendix IV: Comments from the Office of the Comptroller of the Currency

Office of the Comptroller of the Currency

Washington, DC 20219

March 27, 2024

Mr. Michael Clements
Director, Financial Markets and Community Investment
U. S. Government Accountability Office
Washington, DC 20548

Dear Mr. Clements:

Thank you for providing the Office of the Comptroller of the Currency (OCC) an opportunity to review the Government Accountability Office's (GAO) draft report titled *Financial Services Regulations: Improvements Needed to Policies and Procedures for Regulatory Analysis (GAO-24-106206)*.

As part of this review, the GAO has provided the following recommendation to the OCC.

The Comptroller of the Currency should ensure that its Policy Analysis Division develop and implement policies and procedures for systematically performing retrospective reviews of regulations. (Recommendation 3)

To address GAO's recommendation, the OCC's Policy Analysis Division will develop and implement policies and procedures for systematically performing retrospective reviews of regulations. The Policy Analysis Division will develop and implement these policies and procedures by March 31, 2025.

If you need additional information, please contact Adrianna Bailey, Senior Advisor to the Senior Deputy Comptroller for Supervision Risk and Analysis, at (202) 649-5426.

Sincerely,

James M. Gallagher Digitally signed by James M. Gallagher
Date: 2024.03.27 08:42:13 -04'00'

Jay Gallagher
Senior Deputy Comptroller for Supervision Risk and Analysis

Accessible Text for Appendix IV: Comments from the Office of the Comptroller of the Currency

March 27, 2024

Mr. Michael Clements
Director, Financial Markets and Community Investment
U. S. Government Accountability Office
Washington, DC 20548

Dear Mr. Clements:

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Sincerely,

James M. Gallagher

Digitally signed by James M.
Gallagher
Date: 2024.03.27 08:42:13 -04'00'

Jay Gallagher
Senior Deputy Comptroller for Supervision Risk and Analysis

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Michael E. Clements, 202-512-8678 or clementsm@gao.gov

Staff Acknowledgments

In addition to the contact named above, Kevin Averyt (Assistant Director), Nathan Gottfried (Analyst in Charge), Pin-En Annie Chou, M'Baye Diagne, Risto Laboski, Alberto Lopez, Alex Massey, Marc Molino, Barbara Roesmann, and Farrah Stone made significant contributions to this report.

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