February 2016

GAO Highlights

Highlights of GAO-16-175, a report to congressional requesters

FINANCIAL REGULATION

Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness

Why GAO Did This Study

The U.S. financial regulatory structure has evolved over the past 150 years in response to various financial crises and the need to keep pace with developments in financial markets and products in recent decades.

GAO was asked to review the financial regulatory structure and any related impacts of fragmentation or overlap. This report examines the structure of the financial regulatory system and the effects of fragmentation and overlap on regulators' oversight activities. GAO reviewed relevant laws and agency documents on their oversight responsibilities; held discussion groups with former regulators, industry representatives, and experts; and interviewed agency officials.

What GAO Recommends

Congress should consider whether changes to the financial regulatory structure are needed to reduce or better manage fragmentation and overlap. Congress should also consider whether legislative changes are needed to align FSOC's authorities with its mission to respond to systemic risks. GAO also recommends that OFR and the Federal Reserve (1) jointly articulate individual and common goals for their systemic risk monitoring activities and engage in collaborative practices to support those goals; and (2) regularly and fully incorporate their monitoring tools, assessments, or results of monitoring activities into Systemic Risk Committee deliberations. Federal Reserve and OFR agreed with GAO's recommendations.

View GAO-16-175. For more information, contact Lawrance Evans, Jr. at (202) 512-8678 or evansl@gao.gov

What GAO Found

The U.S. financial regulatory structure is complex, with responsibilities fragmented among multiple agencies that have overlapping authorities. As a result, financial entities may fall under the regulatory authority of multiple regulators depending on the types of activities in which they engage (see figure on next page). While the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) made a number of reforms to the financial regulatory system, it generally left the regulatory structure unchanged.

U.S. regulators and others have noted that the structure has contributed to the overall growth and stability in the U.S. economy. However, it also has created challenges to effective oversight. Fragmentation and overlap have created inefficiencies in regulatory processes, inconsistencies in how regulators oversee similar types of institutions, and differences in the levels of protection afforded to consumers. GAO has long reported on these effects in multiple areas of the regulatory system. For example,

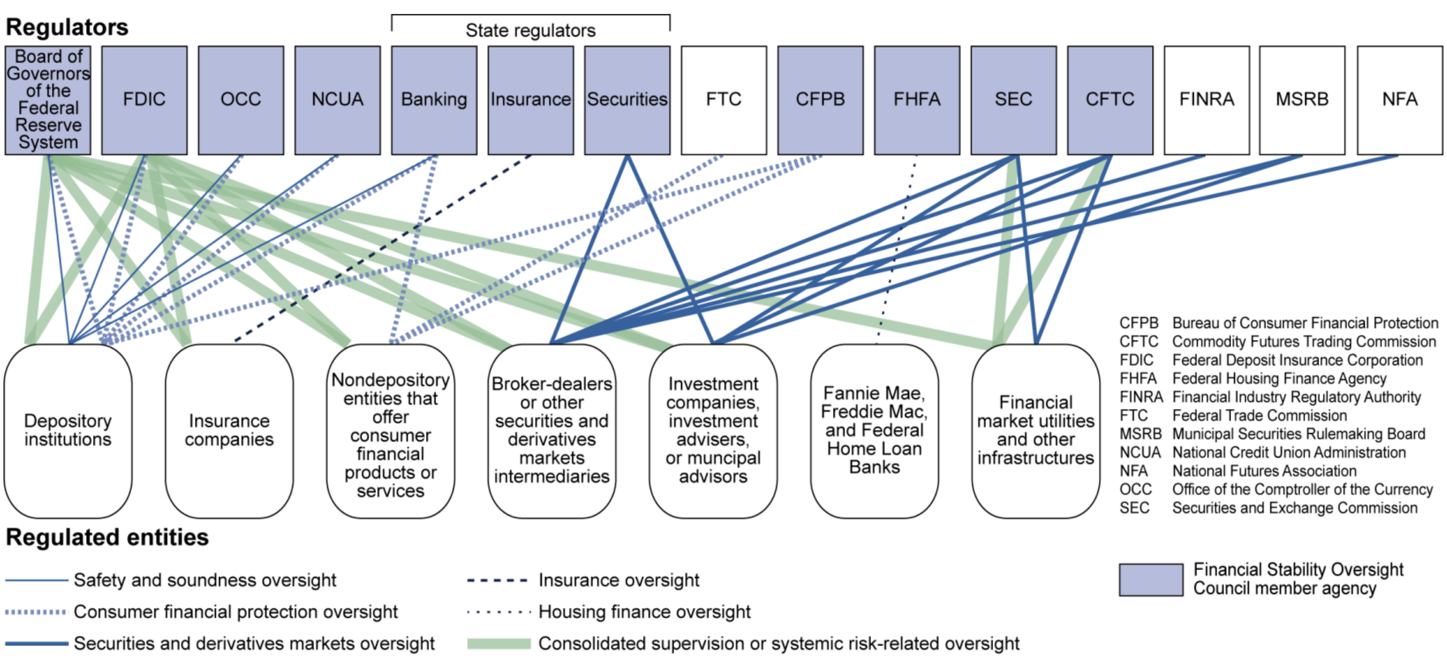
- **Depository institutions.** Inconsistencies in examination activities of the depository institution regulators can result in different conclusions regarding the safety and soundness of an institution and difficulties identifying emerging trends.
- **Securities and derivatives markets.** Securities and derivatives markets have become increasingly interconnected, and regulation of these markets by separate agencies has created challenges. For example, regulation of entities that engage in similar activities is at times duplicative and at other times inconsistent.
- **Insurance.** Insurance regulation is primarily state-based, and a lack of uniformity, including inconsistencies in the licensing of insurance agents and the approval of insurance products, has resulted in uneven consumer protection and increased costs to insurers.

In 2009, GAO established a framework for evaluating regulatory reform proposals and noted that an effective regulatory system would need to address certain structural shortcomings created by fragmentation and overlap. While changes made by the Dodd-Frank Act were consistent with some of the characteristics identified in this framework, the existing regulatory structure does not always ensure (1) efficient and effective oversight, (2) consistent financial oversight, and (3) consistent consumer protections. As a result, negative effects of fragmented and overlapping authorities persist throughout the system. For example, regulation of the swaps and security-based swaps markets by separate agencies creates potential market inefficiencies because of differences in certain of the agencies' rules for each product. GAO has previously made suggestions to Congress to modernize and improve the effectiveness of the financial regulatory structure. Without congressional action it is unlikely that remaining fragmentation and overlap in the U.S. financial regulatory system can be reduced or that more effective and efficient oversight of financial institutions can be achieved.

The 2007-2009 financial crisis highlighted the lack of an agency or mechanism responsible for monitoring and addressing risks across the financial system. The Dodd-Frank Act tried to address this gap in systemic risk oversight by placing this responsibility on a collective group of financial regulators and other entities through the creation of the Financial Stability Oversight Council (FSOC) and the Office of Financial Research (OFR). However, collaborative efforts have not been sufficient, and FSOC's authorities are limited and unclear. Specifically:

- The Board of Governors of the Federal Reserve System (Federal Reserve) and OFR have been developing systemic risk monitoring efforts with similar goals, but have not effectively engaged in key collaboration practices that GAO has previously identified. As a result, OFR and the Federal Reserve could miss opportunities to benefit from each other's work and may conduct unnecessarily duplicative analyses.
- FSOC's Systemic Risk Committee has improved interagency collaboration on systemic risk monitoring among regulators, but its process for identifying new threats continues to be based on participants' expert views and is not fully informed by OFR or the Federal Reserve's systemic risk monitoring efforts. Federal internal control standards call for the use of relevant, reliable, and timely information to achieve the entity's responsibilities. Without better access to existing systemic risk monitoring tools and other outputs, the committee may miss some risks or not identify them in a timely manner.
- Although FSOC's mission is to respond to systemic risks, which may involve multiple entities, its recommendations are not binding and do not guarantee regulatory response. FSOC has authorities to designate certain entities or activities for enhanced supervision by a specific regulator, but these authorities may not allow FSOC to address certain broader risks that are not specific to a particular entity. For such risks, FSOC can recommend but not compel action. GAO's 2009 framework states that financial systems should include a mechanism for managing risks regardless of the source of the risks, and international best practices for systemic risk oversight state that macroprudential entities require authorities to foster the ability to act and ensure regulatory responses. Because of the limitations in FSOC's authorities, without congressional action FSOC may not have the tools it needs to carry out its mission to comprehensively respond to systemic risks, and it may be difficult to hold the council accountable for doing so.

U.S. Financial Regulatory Structure, 2016



Source: GAO. | GAO-16-175

Note: This figure depicts the primary regulators in the U.S. financial regulatory structure, as well as their primary oversight responsibilities. "Regulators" generally refers to entities that have rulemaking, supervisory, and enforcement authorities over financial institutions or entities. There are additional agencies involved in regulating the financial markets and there may be other possible regulatory connections than those depicted in this figure.