U.S. GOVERNMENT ACCOUNTABILITY OFFICE
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Comptroller General
of the United States

April 5, 2019

The Honorable Jerome H. Powell
Chairman
Board of Governors of the Federal Reserve System
20th St. & Constitution Ave., NW
Washington, DC 20551

Priority Open Recommendations: Board of Governors of the Federal Reserve System

Dear Mr. Chairman:

The purpose of this letter is to provide an update on the overall status of the Board of Governors of the Federal Reserve System's (Federal Reserve) implementation of GAO's recommendations and to call your personal attention to areas where open recommendations should be given high priority. In November 2018, we reported that on a government-wide basis, 77 percent of our recommendations made 4 years ago were implemented.[1] The Federal Reserve's implementation rate for these recommendations was 100 percent. As of January 24, 2019, the Federal Reserve had 34 open recommendations. Fully implementing these open recommendations could significantly improve the Federal Reserve's efforts to more effectively oversee risks to consumers and the safety and soundness of the U.S. banking system.

We have identified 10 priority recommendations that fall into the following three areas (see the enclosure for the list of these recommendations):

Consumer Protection for Financial Data Aggregation Services. One recommendation relates to consumer protection for users of financial data aggregation services. Consumers are using financial technology—or "fintech"—firms to aggregate information from their various financial accounts, including their assets in bank accounts and brokerage accounts, as a way to better manage their finances. While financial institutions typically reimburse losses in credit card or bank accounts arising from unauthorized activity, in March 2018 we found that market participants disagreed over whether consumers using these financial account aggregators would be reimbursed if they experience such losses.

Industry efforts to address these issues are underway, and bank and credit union regulators and the Consumer Financial Protection Bureau have been holding collaborative discussions on the issues surrounding financial account aggregation. However, these collaborations have yet to result in any coordinated public outcomes. We recommended that the Federal Reserve engage in collaborative discussions with other relevant financial regulators and stakeholders to address these issues. We urge the Federal Reserve to continue to actively participate in ongoing efforts to help ensure that these efforts result in tangible outcomes that balance both financial institution and consumer interests.

[1]GAO, *Performance and Accountability Report: Fiscal Year 2018*, GAO-19-1SP (Washington, D.C.: Nov. 15, 2018).

Derisking. One recommendation relates to derisking—the practice of banks limiting services or ending relationships with customers to, among other things, avoid perceived regulatory concerns about facilitating money laundering. In our February 2018 report, we determined that Bank Secrecy Act/anti-money laundering (BSA/AML) regulatory concerns have played a role in banks' decisions to terminate and limit customer accounts and close bank branches. However, the actions taken to address derisking by the federal banking regulators and the Financial Crimes Enforcement Network (FinCEN) and the retrospective reviews conducted on BSA/AML regulations have not fully considered or addressed these effects.

We recommended that the Federal Reserve jointly conduct a retrospective review of BSA/AML regulations and their implementation for banks with the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and FinCEN and revise regulations or their implementation, as appropriate. This review should focus on how banks' regulatory concerns may be influencing their willingness to provide services. In January 2019, Federal Reserve staff noted that the Federal Reserve convened a working group in 2018 with FDIC, OCC, FinCEN, the National Credit Union Administration, and the Office of Terrorism and Financial Intelligence to identify ways to improve the efficiency and effectiveness of BSA/AML regulations, supervision, and examinations. While the establishment of the working group has produced outcomes consistent with encouraging greater efficiency and effectiveness of banks' BSA/AML compliance programs and reducing burden, we have not yet seen outcomes that address the full range of factors that may be influencing banks to derisk or close bank branches.

Stress Testing of Banking Institutions. Eight recommendations relate to the stress testing of banking institutions to assess how they might perform in adverse scenarios. Broadly, the Federal Reserve's stress testing programs are intended to evaluate if banking institutions have sufficient capital and capital planning processes to remain solvent under stressful economic conditions. In November 2016, we found some limitations in the areas of scenario design and model risk management, including the following examples:

- The Federal Reserve's approach to designing stress test scenarios has not included analysis of whether the current approach, which uses one severe economic scenario rather than several, is sufficient to assess the resilience of the banking system, or proactively considered levels of severity outside of U.S. postwar historical experience. Such analysis could help the Federal Reserve to ensure that it is not missing risks to the banking system and to guard against those risks.
- The Federal Reserve's risk management of its stress test models also has not included a focus on the risks associated with the system of models that produce the stress test results, in which the results of component models are combined with assumed or planned capital actions.
- Further, the Federal Reserve has not conducted sensitivity and uncertainty analyses of how its modeling decisions affect overall results, or developed a process for communicating information about uncertainty to the Board or a process for the Board and senior staff to articulate tolerance levels for key risks.

We recommended that the Federal Reserve take steps to address the limitations in scenario design and model risk management. As of January 2019, the Federal Reserve had taken actions to address some of our recommendations. For example, in some cases the Federal Reserve has indicated that projects are underway which—upon completion—may result in implementation of processes that are responsive to our recommendations. However, for other recommendations, the Federal Reserve has not yet taken actions that fully implement the recommendation, such as establishing a process to facilitate proactive consideration of scenario severity that may fall outside U.S. postwar historical experience. For one recommendation, the Federal Reserve's responsive actions are part of a proposed rulemaking that has yet to be finalized. Completing the implementation of our recommendations can help the Federal Reserve identify and manage the risks introduced into its models and account appropriately for uncertainty and sensitivity of model results.

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In addition, on March 6, 2019, we issued our biennial update to our high-risk program, which identifies government operations with greater vulnerabilities to fraud, waste, abuse, and mismanagement or the need for transformation to address economy, efficiency, or effectiveness challenges.[2] Our high-risk program has served to identify and help resolve serious weaknesses in areas that involve substantial resources and provide critical service to the public.

Several government-wide high-risk areas, including (1) ensuring the cybersecurity of the nation, (2) improving management of information technology acquisitions and operations, (3) strategic human capital management, (4) managing federal real property, and (5) the government-wide security clearance process, have implications for the Federal Reserve and its operations. We urge your attention to these government-wide high-risk issues as they relate to the Federal Reserve. Progress on high-risk issues has been possible through the concerted actions and efforts of Congress, the Office of Management and Budget, and the leadership and staff in agencies, including the Federal Reserve. Another of our high-risk areas is modernizing the U.S. financial regulatory system, including encouraging regulators to strengthen systemic risk oversight and monitor progress on reforms.

Copies of this report are being sent to the Director of the Office of Management and Budget and appropriate congressional committees, including the Committees on Appropriations, Budget, and Homeland Security and Governmental Affairs, United States Senate; and the Committees on Appropriations, Budget, and Oversight and Reform, House of Representatives. In addition, the report will be available at no charge on the GAO website at https://www.gao.gov.

I appreciate the Federal Reserve's commitment to these important issues. If you have any questions or would like to discuss any of the issues outlined in this letter, please do not hesitate to contact me or Lawrance Evans, Managing Director, Financial Markets and Community Investment at evansl@gao.gov or 202-512-8678. Contact points for our Offices of

[2]GAO, *High-Risk Series: Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas*, GAO-19-157SP (Washington, D.C.: Mar. 6, 2019).

Congressional Relations and Public Affairs may be found on the last page of this report. Our teams will continue to coordinate with your staff on all of the 34 open recommendations. Thank you for your attention to these matters.

Sincerely yours,

Gene L. Dodaro
Comptroller General
of the United States

Enclosure

cc: The Honorable Mick Mulvaney, Director, Office of Management and Budget

Enclosure

Priority Open Recommendations to the Board of Governors of the Federal Reserve System (Federal Reserve)

Consumer Protection for Financial Data Aggregation Services

Financial Technology: Additional Steps by Regulators Could Better Protect Consumers and Aid Regulatory Oversight. GAO-18-254. Washington, D.C.: March 22, 2018.

Recommendation: The Chair of the Board of Governors of the Federal Reserve System should engage in collaborative discussions with other relevant financial regulators in a group that includes all relevant stakeholders and has defined agency roles and outcomes to address issues related to consumers' use of account aggregation services.

Action Needed: The Federal Reserve agreed with the recommendation. The Federal Reserve stated that it will continue to facilitate and engage in collaborative discussions with other relevant financial regulators in these and other settings to help market participants address the important issues surrounding reimbursement for consumers who use financial account aggregators and experience unauthorized transactions. In November 2018, Federal Reserve staff told us that they had met and discussed these issues at a June 2018 meeting, that they are monitoring industry efforts to resolve the issues, and that additional discussions would be held in the future. Aligning ongoing collaborative efforts with leading practices could help regulators and market participants resolve disagreements over financial account aggregation and related consumer compliance issues more quickly and in a manner that balances the competing interests involved. Specifically, the collaborating agencies should define the short-term and long-term outcomes that the collaboration is seeking to achieve and clarify the roles and responsibilities of the participating agencies.

Managing Director: Lawrance Evans, Jr., Financial Markets and Community Investment
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Derisking

Bank Secrecy Act: Derisking along the Southwest Border Highlights Need for Regulators to Enhance Retrospective Reviews. GAO-18-263. Washington, D.C.: February 26, 2018.

Recommendation: The Chair of the Board of Governors of the Federal Reserve System should jointly conduct a retrospective review of Bank Secrecy Act/anti-money laundering (BSA/AML) regulations and their implementation for banks with the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Financial Crimes Enforcement Network (FinCEN). This review should focus on how banks' regulatory concerns may be influencing their willingness to provide services. In conducting the review, the Federal Reserve, FDIC, OCC, and FinCEN should take steps, as appropriate, to revise the BSA regulations or the way they are being implemented to help ensure that BSA/AML regulatory objectives are being met in the most effective and least burdensome way.

Action Needed: In its agency comment letter dated February 2018, the Federal Reserve said it would leverage ongoing initiatives to respond to our recommendation. In January 2019, Federal Reserve staff said that the Federal Reserve convened a working group in 2018 with FDIC, OCC, FinCEN, the National Credit Union Administration, and the Office of Terrorism and Financial Intelligence to identify ways to improve the efficiency and effectiveness of BSA/AML regulations, supervision, and examinations while continuing to meet the requirements of the statute and regulations, supporting law enforcement, and reducing BSA/AML compliance burden. Federal Reserve staff believe that the ongoing review conducted by this working group addresses our recommendation and noted two recent interagency joint statements that resulted from the activities of the working group as examples. The first, issued in October 2018, clarified the permissibility of sharing BSA resources among institutions with lower risk profiles to increase efficiency and reduce burden. The second, issued in December 2018, encouraged innovative industry approaches by banks to enhance the efficiency and effectiveness of their BSA/AML compliance programs. While the establishment of the working group has produced outcomes consistent with encouraging greater efficiency and effectiveness of banks' BSA/AML compliance programs and reducing burden, we have not yet seen outcomes that address the full range of factors that may be influencing banks to derisk or close bank branches. We will continue to monitor the activities and related outcomes of the working group for actions that are fully responsive to our recommendation.

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Stress Testing of Banking Institutions

Federal Reserve: Additional Actions Could Help Ensure the Achievement of Stress Test Goals. GAO-17-48. Washington, D.C.: November 15, 2016.

Recommendation: To strengthen the scenario design process, the Federal Reserve should assess—and adjust as necessary—the overall level of severity of its severely adverse scenario by establishing a process to facilitate proactive consideration of levels of severity that may fall outside U.S. postwar historical experience.

Action Needed: In January 2019, Federal Reserve staff stated that, in accordance with its Policy Statement on the Scenario Design Framework for Stress Testing, the Federal Reserve generates and considers scenarios with severity levels that fall outside of postwar U.S. history. While the framework may produce scenarios that in some ways exceed postwar severity levels, it does not indicate that a process has been established to facilitate proactive consideration of such severity levels. We will continue to monitor the Federal Reserve's implementation of its scenario design framework for actions that may be responsive to our recommendation.

Recommendation: To strengthen the scenario design process, the Federal Reserve should assess—and adjust as necessary—the overall level of severity of its severely adverse scenario by expanding consideration of the trade-offs associated with different degrees of severity.

Action Needed: In January 2019, the Federal Reserve said it had initiated two projects that would allow a more efficient evaluation of multiple scenarios, including assessing trade-offs associated with different levels of scenario severity. We will continue to monitor the Federal

Reserve's completion and implementation of these projects and any additional actions it takes that may be responsive to our recommendation.

Recommendation: To improve understanding of the range of potential crises against which the banking system would be resilient and the outcomes that might result from different scenarios, the Federal Reserve should assess whether a single severe supervisory scenario is sufficient to inform Comprehensive Capital Analysis and Review (CCAR) decisions and promote the resilience of the banking system. Such an assessment could include conducting sensitivity analysis involving multiple severe supervisory scenarios—potentially using CCAR data for a cycle that is already complete, to avoid concerns about tailoring the scenario to achieve a particular outcome.

Action Needed: In January 2019, the Federal Reserve said it had initiated two projects that would allow a more efficient evaluation of multiple scenarios. We will continue to monitor the Federal Reserve's completion and implementation of these projects and any additional actions it takes that may be responsive to our recommendation.

Recommendation: To improve the Federal Reserve's ability to manage model risk and ensure that decisions based on supervisory stress test results are informed by an understanding of model risk, the Federal Reserve should apply its model development principles to the combined system of models used in the supervisory stress tests.

Action Needed: In 2017, the Federal Reserve took actions to address the incorporation of a combined system of models into execution of its supervisory stress tests, including amending guiding principles and policies governing supervisory stress test model development. In January 2019, the Federal Reserve indicated that it was nearing completion of model-system documentation and had initiated a longer-term project to test the system of models. Once we receive documentation demonstrating the Federal Reserve's application of model development principles to the combined system of models—including the completion of these projects—we will update the status of this recommendation.

Recommendation: To improve the Federal Reserve's ability to manage model risk and ensure that decisions based on supervisory stress test results are informed by an understanding of model risk, the Federal Reserve should create an appropriate set of system-level model documentation, including an overview of how component models interact and key assumptions are made in the design of model interactions.

Action Needed: In January 2019, the Federal Reserve indicated that it was nearing completion of a project to develop system-level model documentation. Once we receive documentation, we will update the status of this recommendation.

Recommendation: To improve the Federal Reserve's ability to manage model risk and ensure that decisions based on supervisory stress test results are informed by an understanding of model risk, the Federal Reserve should design and implement a process to test and document the sensitivity and uncertainty of the model system's output—the post-stress capital ratios used to make CCAR quantitative assessment determinations—including, at a minimum, the cumulative uncertainty surrounding the capital ratios and their sensitivity to key model parameters, specifications, and assumptions from across the system of models.

Action Needed: In January 2019, the Federal Reserve said that it had previously initiated multiple projects to respond to our recommendation and that several of these were complete.

We will continue to monitor the Federal Reserve's completion and implementation of these projects, and we will update the status of this recommendation once we receive documentation demonstrating the completion of responsive actions.

Recommendation: To improve the Federal Reserve's ability to manage model risk and ensure that decisions based on supervisory stress test results are informed by an understanding of model risk, the Federal Reserve should design and implement a process to communicate information about the range and sources of uncertainty surrounding the post-stress capital ratio estimates to the Board during CCAR deliberations.

Action Needed: In January 2019, the Federal Reserve said it had previously initiated a project to respond to our recommendation. We will continue to monitor the Federal Reserve's completion and implementation of this project, and we will update the status of this recommendation once we receive documentation demonstrating the completion of responsive actions.

Recommendation: To improve the Federal Reserve's ability to manage model risk and ensure that decisions based on supervisory stress test results are informed by an understanding of model risk, the Federal Reserve should design and implement a process for the Board and senior staff to articulate tolerance levels for key risks identified through sensitivity testing and for the degree of uncertainty in the projected capital ratios.

Action Needed: In January 2019, the Federal Reserve said that it had previously initiated a project to respond to our recommendation. We will continue to monitor the Federal Reserve's completion and implementation of this project, and we will update the status of this recommendation once we receive documentation demonstrating the completion of responsive actions.

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