July 2024

FINANCIAL SERVICES REGULATIONS

Improvements Needed to Policies and Procedures for Regulatory Analysis

GAO Highlights

Highlights of GAO-24-106206, a report to congressional committees

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.

View GAO-24-106206. For more information, contact Michael E. Clements at (202) 512-8678 or clementsm@gao.gov.

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.