United States Government Accountability Office

Report to Congressional Requesters

February 2016

FINANCIAL REGULATION

Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness

GAO-16-175

GAO Highlights

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

February 2016

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,

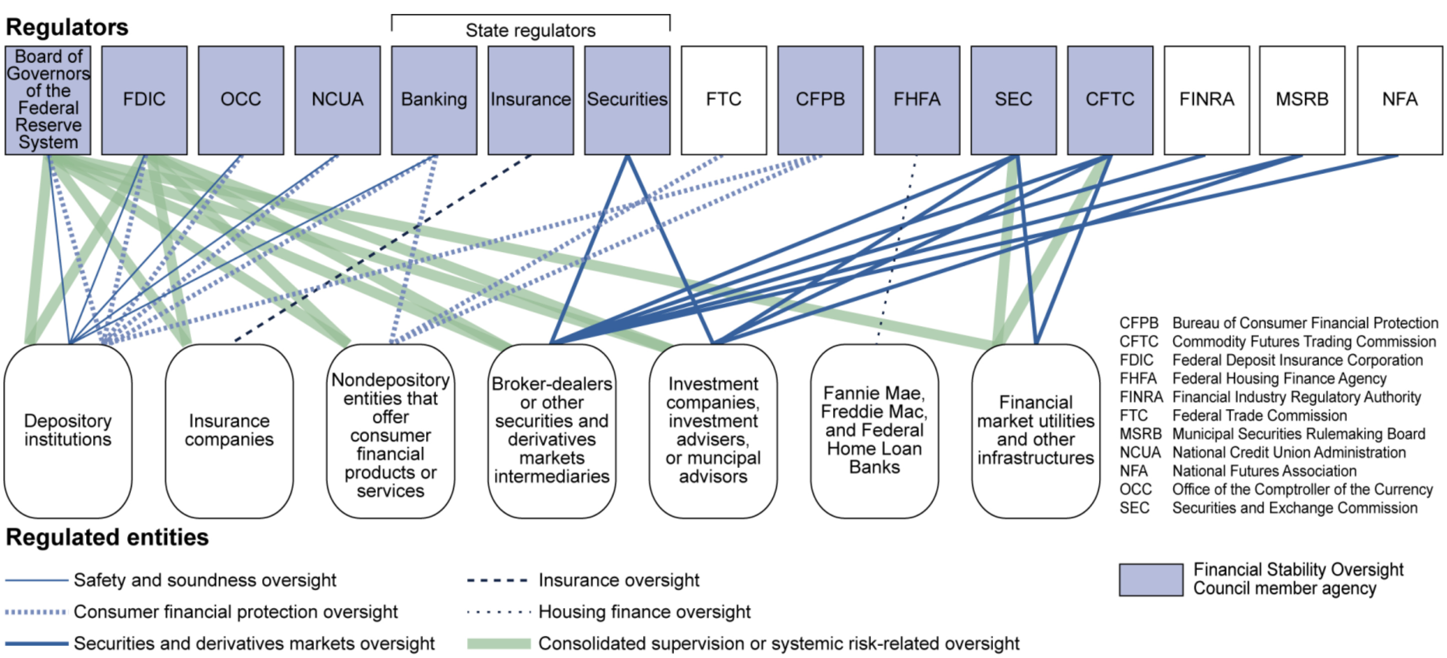
- **Depository institutions.** Inconsistencies in examination activities of the depository institution regulators can result in different conclusions regarding the safety and soundness of an institution and difficulties identifying emerging trends.
- **Securities and derivatives markets.** Securities 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.

Contents

Letter		1
	Background	5
	The Financial Regulatory Structure Is Fragmented among Multiple Agencies with Overlapping Regulatory Authorities	9
	Complex Structure Creates Inefficiencies and Inconsistencies and Limits International Coordination	30
	Limitations in Agencies' Collaboration and FSOC's Authorities May Hinder Systemic Risk Oversight Efforts	65
	Conclusions	86
	Matters for Congressional Consideration	87
	Recommendations for Executive Action	88
	Agency Comments	88
Appendix I	Objectives, Scope, and Methodology	94
Appendix II	History of the U.S. Financial Regulatory Structure	101
Appendix III	GAO Framework for Evaluating Financial Regulatory Reforms	116
Appendix IV	List of Discussion Group Participants	117
Appendix V	Comments from the U.S. Commodity Futures Trading Commission	120
Appendix VI	Comments from the National Credit Union Administration	121
Appendix VII	Comments from the Board of Governors of the Federal Reserve System	123

Appendix VIII	Comments from the Office of Financial Research	126
Appendix IX	GAO Contact and Staff Acknowledgments	128

Tables

Table 1: Broad Financial Regulatory Missions 10
Table 2: Federal Prudential Regulators and Their Basic Functions 14
Table 3: Financial Stability Oversight Council's (FSOC) and Certain Federal Agencies' Select Authorities/Missions Related to Systemic Risk Oversight 66
Table 4: Office of Financial Research (OFR) Monitors Related to Financial Stability, January 2016 72

Figures

Figure 1: Definitions of Fragmentation, Overlap, and Duplication 8
Figure 2: U.S. Financial Regulatory Structure, 2016 12
Figure 3: Examples of Overlap in the Safety and Soundness and Consumer Protection Oversight for Certain Depository Institutions 19
Figure 4: Example of Overlap in Consumer Protection Oversight for a Nondepository Mortgage Servicer 21
Figure 5: Examples of Overlap in the Securities and Derivatives Markets Oversight for Certain Market Intermediaries 25
Figure 6: Examples of Overlap in Oversight for Certain Types of Insurance Company Subsidiaries 27
Figure 7: Financial Stability Oversight Council's (FSOC) Systemic Risk Committee Process for Identifying, Monitoring, and Reporting on Systemic Risks 70
Figure 8: Formation of U.S. Financial Regulatory Structure (1863-2015) 102

Abbreviations

AIG	American International Group, Inc.
Basel Committee	Basel Committee on Banking Supervision
BSA	Bank Secrecy Act
CEA	Commodity Exchange Act
CFPB	Consumer Financial Protection Bureau
CFTC	Commodity Futures Trading Commission
CSBS	Conference of State Banking Supervisors
CSE	consolidated supervised entities
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FFIEC	Federal Financial Institutions Examination Council
FHFA	Federal Housing Finance Agency
FinCEN	Financial Crimes Enforcement Network
FINRA	Financial Industry Regulatory Authority
FIO	Federal Insurance Office
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
FTC	Federal Trade Commission
GLBA	Gramm-Leach-Bliley Act of 1999
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
MOU	memorandum of understanding
MSRB	Municipal Securities Rulemaking Board
NAIC	National Association of Insurance Commissioners

NCUA	National Credit Union Administration
NRSRO	nationally recognized statistical rating organization
OCC	Office of the Comptroller of the Currency
OFHEO	Office of Federal Housing Enterprise Oversight
OFR	Office of Financial Research
OIG	Office of the Inspector General
OTS	Office of Thrift Supervision
PCS	payment, clearing, or settlement
SEC	Securities and Exchange Commission
SRO	self-regulatory organization
Treasury	Department of the Treasury

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Congressional Requesters

While a fully functioning financial system is critical to the well-being of our citizens and overall economic growth, financial services activities can, at times, cause significant harm, as evidenced in the 2007-2009 financial crisis. In response to this experience and past crises, the U.S. financial regulatory structure has evolved into an extremely complex system. Reforms eliminated some agencies but created others with the intent of more appropriately overseeing ever-evolving financial markets. Most recently, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) abolished one regulatory agency, created a new regulatory agency, and expanded the authorities of some existing agencies, among other things.[1] The act also established the Financial Stability Oversight Council (FSOC), a council of the heads of the federal financial regulatory agencies, as well as representatives from state regulatory agencies and others in charge of identifying and responding to systemic risks.[2]

You asked us to review the current financial regulatory structure and any effects of fragmentation or overlap. In addition, Congress included a provision in statute for GAO to identify and report to Congress on federal programs, agencies, offices, and initiatives—either within departments or government-wide—that have duplicative goals or activities. This report examines the following: (1) the overall structure of the U.S. financial regulatory system, (2) effects of fragmentation and overlap on agencies' oversight activities, and (3) the collaborative efforts and relevant authorities of agencies involved in systemic risk oversight.

[1]Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2]The Dodd-Frank Act requires FSOC to identify risk to the financial stability of the United States and respond to emerging threats to the stability of the U.S. financial system. Pub. L. No. 111-203, § 112(a), 124 Stat. 1376, 1394 (2010). In this report we use the terms "risks to financial stability," "threats to financial stability," and "systemic risks" interchangeably. Systemic risk refers to the possibility that a single event could broadly affect the entire financial system, causing widespread losses rather than just losses at one or a few institutions.

To examine the overall structure of the financial regulatory system, we reviewed financial regulatory statutes, including the Dodd-Frank Act. We divided the financial regulatory structure into the following sectors based on agencies' missions: (1) safety and soundness oversight of depository institutions, (2) consumer protection oversight, (3) securities and derivatives markets oversight, (4) insurance oversight, and (5) systemic risk oversight. In addition, for each sector we reviewed agencies' documents to identify the financial institutions and entities under their jurisdictions and the types of oversight activities each conducts. We also interviewed agency officials and representatives of industry and policy organizations that represent a range of experiences, views, and perspectives. We used procedures outlined in GAO's *Fragmentation, Overlap, and Duplication: An Evaluation and Management Guide* to help us analyze the information we obtained and identify areas of fragmentation and overlap in the U.S. financial regulatory structure.[3]

To identify the effects of fragmentation and overlap on agencies' oversight activities, we held four discussion groups, reviewed past GAO reports, and reviewed reports from U.S. agencies and international regulatory bodies. The discussion groups, which consisted of a diverse group of former regulatory officials, industry and advocacy group representatives, and experts, covered the following areas:

- the supervision of bank and thrift holding companies and their depository subsidiaries by the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (Federal Reserve), Office of the Comptroller of the Currency (OCC), and state banking supervisors;

- consumer protection oversight conducted by the Bureau of Consumer Financial Protection, also known as the Consumer Financial Protection Bureau (CFPB), and the federal prudential regulators—FDIC, the Federal Reserve, the National Credit Union Administration (NCUA), and OCC;

- the regulation of swaps and security-based swaps by the Commodity Futures Trading Commission (CFTC) and the Securities and

[3]GAO, *Fragmentation, Overlap, and Duplication: An Evaluation and Management Guide,* GAO-15-49SP (Washington, D.C.: Apr. 14, 2015).

Exchange Commission (SEC);[4] and

- the supervision of insurance groups by state insurance regulators and the Federal Reserve.

We chose these topics because either the Dodd-Frank Act altered the regulatory structure in the area or the issue had been widely identified as a potential cause of the 2007-2009 financial crisis. In each discussion group, we asked participants to help identify (1) areas of fragmentation and overlap in agencies' responsibilities for the specific topic and the effects of fragmentation and overlap on agencies' oversight activities and (2) possible approaches to help mitigate any negative effects from the fragmentation and overlap. Our discussion groups were not designed to achieve agreement or consensus among participants. Rather, we sought participants' help to identify areas of fragmentation and overlap and the effects they have in each of the four topic areas. We interviewed relevant agency officials after the discussion groups were held to get their perspectives on the areas identified by discussion group participants. We also reviewed our previous reports to identify instances in which we have reported on fragmentation and overlap in the financial regulatory structure and its effects. Additionally, we reviewed recent assessments of the U.S. regulatory structure conducted by the Financial Stability Board (FSB), the International Monetary Fund (IMF), and the Federal Insurance Office (FIO).[5] Finally, we assessed the current regulatory structure and the

[4]In general, the Dodd-Frank Act defines a swap to include, among other things, an agreement that provides for the exchange of one or more payments based on the value or level of one or more assets, liabilities, or indices or other financial or economic interests or property of any kind that transfers, in whole or in part, the financial risk associated with a future change in the value or level without also conveying a current or future ownership interest in an asset or liability that incorporates the financial risk transferred. Pub. L. No. 111-203, § 721(a)(21), 124 Stat. 1376, 1666 (2010). Financial and nonfinancial firms use swaps and other over-the-counter derivatives to hedge risk, or speculate, or for other purposes. Swaps include interest rate swaps, commodity-based swaps, currency swaps, and broad-based credit default swaps. Security-based swaps include single-name and narrow-based credit default swaps and equity-based swaps.

[5]The Group of Twenty—a forum for international cooperation on global economic and financial issues, whose members include 19 countries and the European Union—established FSB in 2009 as the successor to the Financial Stability Forum to coordinate at the international level the work of national financial authorities and international standard-setting bodies in order to develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies. IMF is an organization of 188 member jurisdictions whose primary purpose is to safeguard the stability of the international monetary system.

effects of fragmentation and overlap within it against the characteristics of an effective and efficient regulatory structure that we identified in a January 2009 report in which we developed a framework for evaluating proposals for reforming the regulatory structure.[6]

To examine the collaborative efforts and relevant authorities of agencies involved in systemic risk oversight—which includes monitoring the financial system to identify systemic risks and mitigating those risks—we first identified agencies with explicit systemic risk authorities, goals, or activities by reviewing the Dodd-Frank Act, our previous reports, and agencies' strategic plans, websites, and other documents, and by interviewing federal and state financial agencies. We consequently focused our assessment on the systemic risk monitoring and identification activities of FSOC's Systemic Risk Committee, as the FSOC committee where interagency staff meet to identify, monitor, and analyze systemic risks; the Office of Financial Research (OFR); and the Federal Reserve; as those were the three entities that were actively monitoring the broader financial system with the purpose of identifying and analyzing potential systemic risks. We analyzed, among other things, annual reports, strategic documents, bylaws, and other public and internal documents from FSOC, OFR, and the Federal Reserve from 2011 to 2015, as well as agendas and presentations from monthly FSOC Systemic Risk Committee meetings held between July 2012 and August 2014. We evaluated these three agencies' actions against federal internal control standards and our key interagency collaboration practices, as well as best practices identified by IMF on systemic risk monitoring.[7] In addition, we interviewed staff from FSOC member agencies who participated in Systemic Risk Committee discussions, including staff from OFR and the Federal Reserve. We also interviewed academics and industry experts who served on OFR's Financial Research Advisory Council. Finally, to assess FSOC's and FSOC member agencies' authorities to mitigate

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[6]GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System,* GAO-09-216 (Washington, D.C.: Jan. 8, 2009).

[7]GAO, *Standards for Internal Control in the Federal Government,* GAO-14-704G (Washington, D.C.: September 2014) and GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999) and *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies,* GAO-06-15 (Washington, D.C.: Oct. 21, 2005). International Monetary Fund, *Staff Guidance Note on Macroprudential Policy* (Washington, D.C.: December 2014) and *Key Aspects of Macroprudential Policy*, IMF Policy Paper (Washington D.C.: June 2013).

identified systemic risks, we reviewed the Dodd-Frank Act, FSOC annual report recommendations, and FSOC's proposed Section 120 recommendation.[8] We also interviewed participants in FSOC's Financial Market Utilities and Payment, Clearing, and Settlement Activities Committee to understand FSOC's authority to designate payment, clearing, or settlement (PCS) activities as systemically important and actions the committee has taken to implement this authority. We evaluated FSOC's authorities against our January 2009 framework and against IMF's best practices for systemic risk oversight.[9] Appendix I contains a detailed description of our scope and methodology.

We conducted this performance audit from April 2014 to February 2016 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

The federal laws related to financial regulation set forth specific authorities and responsibilities for regulators. Although these authorities typically do not explicitly link such responsibilities to overall goals of financial regulation, we have grouped them into four broad categories based on the principal goal of the regulatory activity:

- *Monitor the safety and soundness of institutions.* Because markets sometimes lead financial institutions to take on excessive risks that can have significant negative effects on consumers, investors, and taxpayers, regulators oversee, among other things, risk-taking activities to promote the safety and soundness of financial institutions.

[8] Dodd-Frank Act §120 grants FSOC the authority to issue recommendations to a regulator to apply new or heightened standards for a financial activity or practice conducted by a bank holding company or nonbank financial company under the regulator's jurisdiction if FSOC makes certain determinations concerning the risks of the activity.

[9] GAO-09-216. International Monetary Fund, *Staff Guidance Note on Macroprudential Policy* (Washington, D.C.: December 2014); *Key Aspects of Macroprudential Policy*, IMF Policy Paper (Washington D.C.: June 2013); and *Macroprudential Policy: An Organizing Framework*, IMF Policy Paper (Washington D.C.: March 2011).

- *Ensure adequate consumer and investor protections.* Financial institutions' incentives to maximize profits can in some cases lead to sales of unsuitable or fraudulent financial products, or unfair or deceptive acts or practices. In response, regulators take steps to address informational disadvantages that consumers and investors may face, ensure consumers and investors have sufficient information to make appropriate decisions, and oversee business conduct and sales practices to prevent fraud and abuse.

- *Ensure the integrity and fairness of markets.* Some market participants may seek to manipulate markets to obtain unfair gains in a way that is not easily detectable by other participants. In response, regulators set rules for and monitor markets and their participants to prevent fraud and manipulation, limit problems in asset pricing, and help ensure efficient market activity.

- *Act to ensure the stability of the overall financial system.* Because shocks to the system or the actions of financial institutions can lead to instability in the broader financial system and real economy, regulators act to reduce systemic risk.

Although these goals have traditionally been their primary focus, financial regulators are also often tasked with achieving other goals as they carry out their activities. These goals can include promoting economic growth, capital formation, and competition in our financial markets. Regulators have also taken actions with an eye toward helping ensure that regulated U.S. financial institutions are competitive with institutions in other sectors or with others around the world. In other cases, financial institutions may be required by law or regulation to foster social policy objectives, such as fair access to credit and increased homeownership.

Overview of GAO's Fragmentation, Overlap, and Duplication Work

In 2010, Congress included a provision in statute for GAO to identify programs, agencies, offices, and initiatives with duplicative goals and activities within departments and government-wide and report to Congress annually.[10] Since March 2011, we have issued annual reports

[10]Pub. L. No. 111-139, § 21, 124 Stat. 8, 29 (2010), 31 U.S.C. § 712 Note.

to Congress in response to this requirement.[11] The annual reports describe areas in which we found evidence of fragmentation, overlap, or duplication among federal programs. As shown in figure 1, fragmentation refers to circumstances in which more than one federal agency is involved in the same broad area of national need and opportunities exist to improve service delivery. In this case, the broad area of national need is regulation of the financial system (which also includes oversight by state regulators and industry self-regulatory organizations (SRO)).[12] Overlap occurs when multiple agencies or programs have similar goals, engage in similar activities or strategies to achieve them, or target similar beneficiaries. In the context of financial regulation, overlap in the regulatory structure could refer to several circumstances, such as when multiple regulatory bodies (federal, state, or SROs)

- are involved in the same financial regulatory goal (e.g., safety and soundness or consumer protection);
- engage in similar activities or strategies, such as writing regulations or examining financial institutions to achieve the same financial regulatory goal; or
- perform related regulatory functions for the same or similar financial institutions or entities.

Duplication occurs when two or more agencies or programs are engaged in the same activities or provide the same services to the same beneficiaries. In the case of financial regulation, duplication would occur when more than one agency oversees the same financial institution or

[11]For more information on GAO's work on fragmentation, overlap, and duplication in the federal government, see GAO, *2015 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits,* GAO-15-404SP (Washington, D.C.: Apr. 14, 2015); *2014 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits,* GAO-14-343SP (Washington, D.C.: Apr. 8, 2014); *2013 Annual Report: Actions Needed to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits,* GAO-13-279SP (Washington, D.C.: Apr. 9, 2013); *2012 Annual Report: Opportunities to Reduce Duplication, Overlap and Fragmentation, Achieve Savings, and Enhance Revenue,* GAO-12-342SP (Washington, D.C.: Feb. 28, 2012); and *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue,* GAO-11-318SP (Washington, D.C.: Mar. 1, 2011).

[12]An SRO is a nongovernmental organization that generally has the power to create and enforce industry regulations and standards.

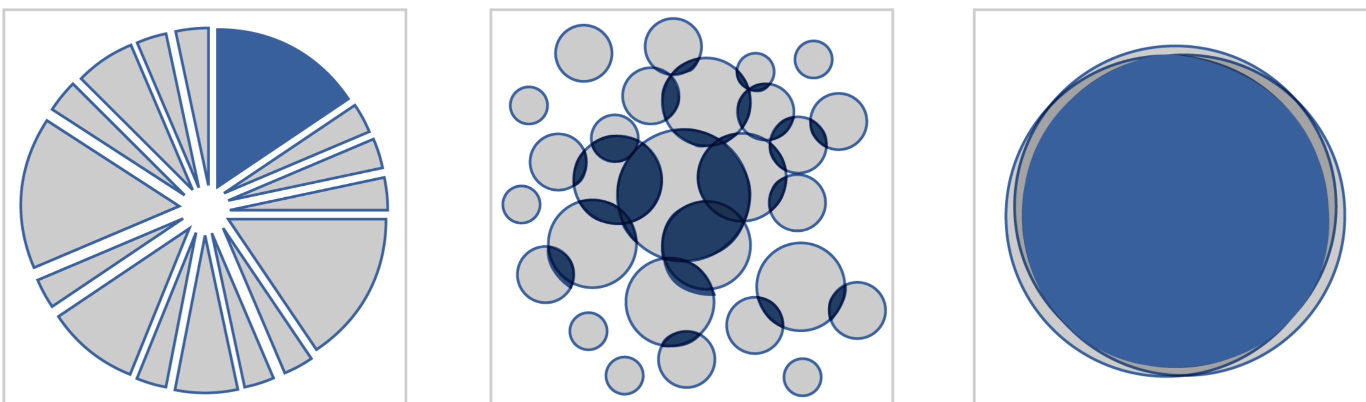
entity and engages in the same activities. As in all of GAO's work in this area, overlap and fragmentation might not necessarily lead to actual duplication, and some degree of overlap and duplication may at times be justified.

Figure 1: Definitions of Fragmentation, Overlap, and Duplication

Fragmentation refers to those circumstances in which more than one federal agency (or more than one organization within an agency) is involved in the same broad area of national need and opportunities exist to improve service delivery.

Overlap occurs when multiple agencies or programs have similar goals, engage in similar activities or strategies to achieve them, or target similar beneficiaries.

Duplication occurs when two or more agencies or programs are engaged in the same activities or provide the same services to the same beneficiaries.



Source: GAO. | GAO-16-175

The Financial Regulatory Structure Is Fragmented among Multiple Agencies with Overlapping Regulatory Authorities

The United States financial regulatory system is fragmented and complex. Today's financial regulatory system was built over more than a century, evolving over time in response to financial crises and market developments.[13] Most recently, in response to the 2007-2009 financial crisis, the Dodd-Frank Act took a number of steps intended to, among other things, promote the stability of the financial system and expand protections for consumers and investors. In doing so, the act (1) abolished the Office of Thrift Supervision (OTS), the former regulator of thrifts and thrift holding companies, and transferred its authorities to other depository institution and holding company regulators; (2) created CFPB, a new federal consumer financial protection regulator; (3) created FSOC; and (4) created OFR and FIO, two additional nonregulatory offices housed in the Department of the Treasury (Treasury) with mandates that include certain responsibilities related to monitoring systemic risk.[14]

After approximately 150 years of piecemeal changes, the U.S. financial regulatory structure is fragmented among multiple agencies with varying primary missions. These missions can generally be categorized as safety and soundness oversight, consumer protection oversight, securities and derivatives markets oversight, insurance oversight, systemic risk oversight, and consolidated supervision.[15] Table 1 provides a description of these broad regulatory missions.

[13]See appendix II for the history of the development of the U.S. financial regulatory structure.

[14]We use the term "thrifts" to refer to federal and state savings associations and the term "thrift holding companies" to refer to savings and loan holding companies that control a thrift or another thrift holding company.

[15]Other areas within the financial regulatory system are housing finance oversight and the farm credit system. This report does not include assessments of fragmentation and overlap in housing finance oversight as they relate to the supervisory duties of the Federal Housing Finance Agency because the agency generally does not share oversight responsibilities over the government-sponsored enterprises—Fannie Mae and Freddie Mac—and the Federal Home Loan Banks. For more information on housing finance market developments and challenges and a framework for assessing reforms, see GAO, *Housing Finance System: A Framework for Assessing Potential Changes,* GAO-15-131 (Washington, D.C.: Oct. 7, 2014). We also did not evaluate fragmentation and overlap in the farm credit system because the Farm Credit Administration is the sole regulator of the system. Appendix II contains additional information on these areas of the financial system.

Table 1: Broad Financial Regulatory Missions

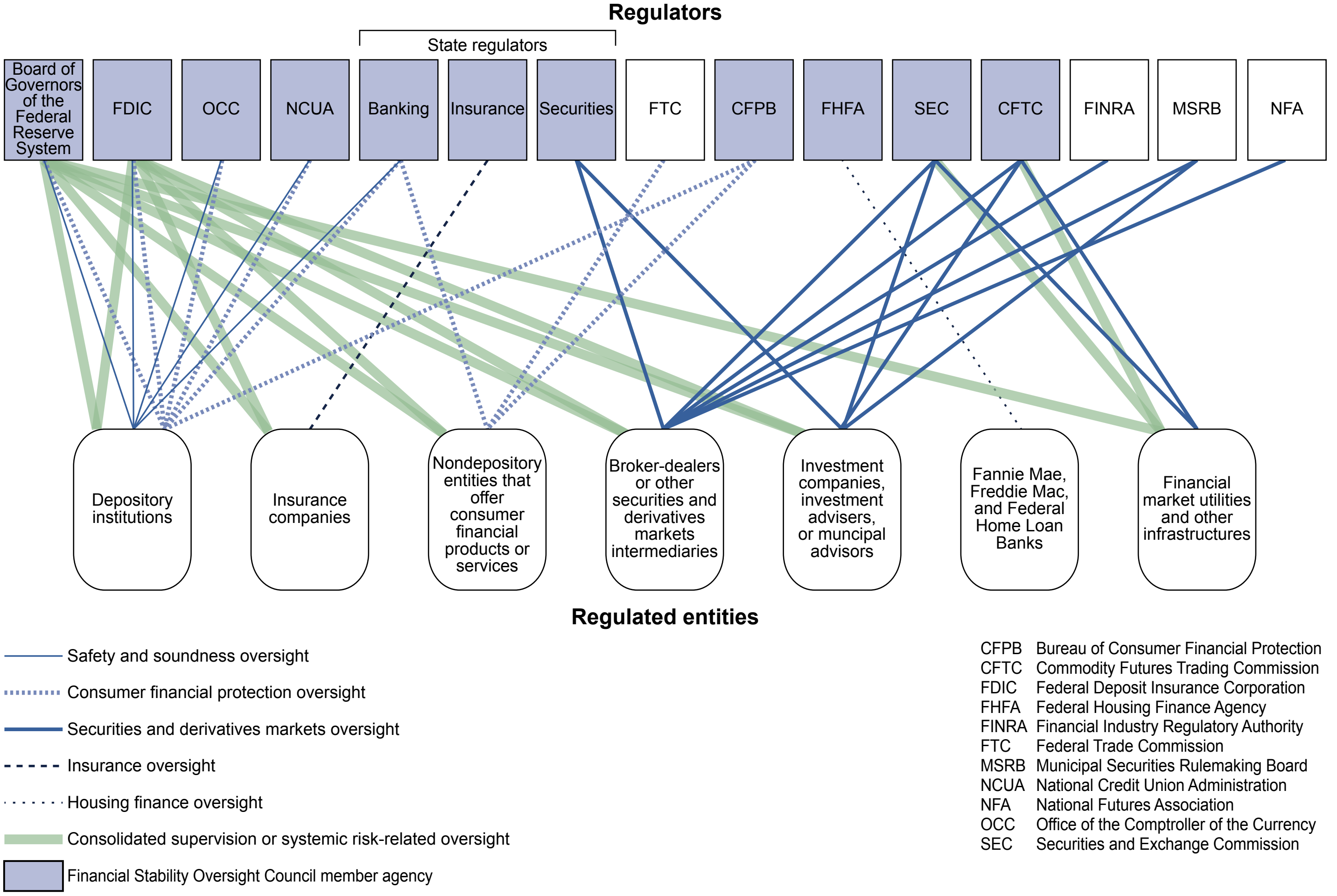
Safety and soundness of depository institutions. Safety and soundness refer to a broad range of issues that relate to the health of a financial institution, including capital requirements, risk management, the quality and diversification of an institution's portfolio, liquidity and funds management, and adequate procedures for internal controls. To achieve their safety and soundness goals, regulators establish capital requirements and conduct on-site examinations and off-site monitoring to assess an institution's financial condition, operational security, and governance, and monitor compliance with applicable laws, regulations, and guidance. Regulators also take enforcement actions, and those who charter institutions may close them based on statutory grounds that include insolvency, illiquidity, and unsafe and unsound condition to transact business.
Consumer protection oversight. Consumer protection oversight generally involves ensuring that consumers have access to markets for consumer financial products and services and that these markets are fair, transparent, and competitive. Regulation covers the offering and provision of consumer financial products and services under consumer protection laws. Depository institutions and certain nondepository institutions are subject to examination by federal, and sometimes state, regulators to help ensure their compliance with consumer protection laws and regulations.
Securities and derivatives markets oversight. Much of the regulation of the securities markets (i.e., debt and equities markets) focuses on integrity of the capital-raising process for companies, resolving conflicts of interest in that process, and requiring full disclosure of material information in order to protect investors and other market users. The prices of stocks traded on the exchanges are generally not regulated; rather, the organization and membership of the exchanges and trading activities are regulated in an attempt to prevent fraud, maintain the integrity of the markets, protect investors, and facilitate capital formation. Securities markets oversight also includes regulation of the asset management industry which includes investment companies and investment advisers in order to protect investors, promote informed investment decisions, and facilitate appropriate innovation in investment products and services. Oversight also includes the establishment and maintenance of standards for fair, orderly, and efficient markets; the facilitation of prompt and accurate clearance and settlement of securities transactions; and the safeguarding of securities and funds. As such, securities market participants, including broker-dealers, self-regulatory organizations (such as stock exchanges and clearing agencies), and transfer agents, are regulated. Much of the regulation of the derivatives markets (i.e., futures and swaps markets) focuses on protecting the integrity of price discovery and risk transfer (i.e., hedging) for financial instruments as well as commodities (such as energy and agricultural commodities). Derivatives prices are generally not regulated except in emergency situations. The organization and membership of the trading platforms and clearinghouses, rules for trading and clearing, conflicts of interest, or price manipulation by market participants are regulated in an attempt to prevent fraud, maintain the integrity of the prices publicly reported, and the risks transferred through these markets.
Insurance oversight. Insurance regulation is structured around several key functions, including company licensing, producer licensing, product regulation, market conduct, solvency and capital requirements, prudential regulation, and consumer services. U.S. insurers are subject to regulation in their state of domicile and in the other states where they are licensed to sell insurance. State regulators protect consumers by ensuring that insurance policy provisions comply with state law, are reasonable and fair, and do not contain major gaps in coverage that might be misunderstood by consumers and leave them unprotected. Periodic financial examinations investigate a company's accounting methods, procedures, and financial statement presentation, and they verify and validate what is presented in the company's annual statement to ascertain whether the company is in good financial standing. In addition, examinations help to identify issues that may develop in the future at the insurer. Market regulation attempts to help ensure fair and reasonable insurance prices, products, and trade practices in order to protect consumers.
Systemic risk oversight and consolidated supervision. Systemic risk oversight includes monitoring the financial system to identify and analyze threats to financial stability and mitigating those threats. This oversight can include enhanced supervision of financial institutions and other financial entities that may present a threat to financial stability. The goal of consolidated supervision, among other things, is to provide a comprehensive and enterprisewide approach to supervision that extends beyond legal entity-based supervision of certain subsidiaries. Consolidated supervision can provide for an understanding of the financial and managerial strength and risks within the consolidated organization as a whole, and it provides the ability to address significant management, operational, capital, or other deficiencies within the overall organization before they pose a threat to subsidiary depository institutions or to U.S. financial stability, in certain instances. Holding companies may have subsidiaries such as banks, thrifts, securities firms, commodities trading firms, or insurers.

Source: GAO. | GAO-16-175

Under the current regulatory structure (see fig. 2), financial institutions or entities may fall under the regulatory authority of multiple regulators within and across these oversight categories.

Figure 2: U.S. Financial Regulatory Structure, 2016

Interactive instructions: **Hover over regulators, entities, or legend items for an isolated view.**



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.

Although the regulatory structure is complex, U.S. regulators and financial market participants have noted it also has provided some benefits. For example, they have noted that the structure has contributed to the development of U.S. capital markets and to overall growth and stability in the U.S. economy. Some noted that the presence of multiple regulators for depository institutions can also lead to competition among them, which helps promote regulatory innovation, providing businesses with an opportunity to move to regulators whose approaches better match the businesses' operations. In addition, in some cases, potential benefits might result from having multiple regulators overseeing an institution. For example, representatives of state banking and credit union regulators, and consumer advocacy organizations, have noted that concurrent jurisdiction—between two federal regulators or a federal and state regulator—can provide needed checks and balances against individual financial regulators who have not always reacted appropriately and in a timely way to address problems at institutions. They also noted that states may move more quickly and more flexibly to respond to activities causing harm to consumers. Further, banking officials have stated that having multiple federal banking regulators in the U.S. system has resulted in diversity, inventiveness, and flexibility in the banking system, which are important for responding to changes in market share and in technology. Fragmentation and overlap, however, can lead to inefficiencies and inconsistencies in oversight and regulatory gaps, which we examine later in this report. The following sections describe the fragmentation and overlap that exist in this complex regulatory structure.

Safety and Soundness and Consumer Protection Oversight

Depository Institutions

As shown in figure 2, currently four federal prudential regulators—the Federal Reserve, OCC, FDIC, and NCUA—as well as state banking regulators oversee their respective depository institutions for safety and soundness. CFPB regulates the offering and provision of consumer financial products or services. For depository institutions with over $10 billion in assets and their affiliates, CFPB, pursuant to the Consumer Financial Protection Act of 2010 (Title X of the Dodd-Frank Act), has exclusive examination authority as well as primary enforcement authority for the Federal consumer financial laws.[16] CFPB has rulemaking authority for these statutes. The regulation of safety and soundness for depository institutions depends on the type of charter an institution chooses (commercial bank, thrift, or credit union) and the origin of the charter (federal or state). Table 2 explains the basic functions of the four federal prudential regulators.

Table 2: Federal Prudential Regulators and Their Basic Functions

Agency	Basic function
Office of the Comptroller of the Currency	Charters and supervises national banks, federal thrifts, and federally-chartered branches and agencies of foreign banks.
Board of Governors of the Federal Reserve System	Supervises state-chartered banks that opt to be members of the Federal Reserve System; bank and thrift holding companies, and the nondepository institution subsidiaries of those institutions; and nonbank financial companies designated by the Financial Stability Oversight Council for consolidated supervision and enhanced prudential standards. Supervises state-licensed branches and agencies of foreign banks and regulates the U.S. nonbanking activities of foreign banking organizations. Supervises Edge corporations pursuant to the Edge Act and certain designated financial market utilities (such as a clearinghouse) pursuant to the Dodd-Frank Act.[a]
Federal Deposit Insurance Corporation	Supervises state-chartered banks that are not members of the Federal Reserve System, as well as state savings banks and thrifts; insures the deposits of all banks and thrifts that are approved for federal deposit insurance; has the authority to conduct backup examinations for any insured institution; resolves all failed insured banks and thrifts and, if appointed receiver by the Secretary of the Treasury, has authority to resolve certain large bank holding companies and nonbank financial companies.
National Credit Union Administration	Charters and supervises federally-chartered credit unions and insures savings in federal and most state-chartered credit unions.

Source: GAO. | GAO-16-175

[a]Edge Act corporations are established as separate legal entities and may conduct a range of international banking and other financial activities in the United States. Pub. L. No. 66-106, 41 Stat. 378 (1919) (codified as amended at 12 U.S.C. § 611).

The Dodd-Frank Act reduced fragmentation in the safety and soundness oversight of depository institutions by eliminating OTS and transferring its oversight responsibilities for federal thrifts to OCC, for state-chartered

[16]The Dodd-Frank Act defines Federal consumer financial laws to include the Consumer Financial Protection Act of 2010 (Title X of the Dodd-Frank Act) itself, and a number of other consumer laws and the implementing regulations. 12. U.S.C. § 5481 (14). For example, Federal consumer financial laws include the Equal Credit Opportunity Act, the Truth in Lending Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act.

thrifts to FDIC, and for thrift holding companies to the Federal Reserve.[17] Before the Dodd-Frank Act implementation, the prudential regulators regulated depository institutions for both safety and soundness and consumer protection. Two major criticisms of this consumer protection system were raised by proponents for consolidation of the authority to regulate consumer financial protection. First, proponents noted that the regulatory system allowed financial institutions to choose the charter type so that they would be regulated by the most accommodating regulator. Second, proponents maintained that banking regulators were primarily concerned with safety and soundness, and only secondarily with consumer protection. The Dodd-Frank Act helped to reduce fragmentation in consumer financial protection oversight by consolidating authority for a number of consumer financial protection laws that had been handled by seven different agencies.[18] Unlike the prudential regulators, CFPB has the primary mission of consumer protection. However, the Dodd-Frank Act also limits the authority of CFPB to regulate certain institutions. For example, the act fragmented consumer protection supervision and enforcement for depository institutions, based on a depository institution's size. Specifically, while most consumer protection oversight responsibilities were transferred from the prudential regulators to CFPB for depository institutions with more than $10 billion in assets and their affiliates, prudential regulators retained authority for certain consumer protection laws for these institutions. In addition, the prudential regulators continue to supervise institutions with assets of $10 billion or

[17]OTS chartered and supervised federally-chartered thrifts, supervised thrift holding companies, and served as the supervisor for state-chartered thrifts. Rulemaking authority for federal thrifts previously vested in OTS was transferred to OCC. Rulemaking authority for thrift holding companies was transferred to the Federal Reserve. Other authorities were transferred to OCC, FDIC, and the Federal Reserve. 12 U.S.C. § 5412.

[18]The seven agencies were the Federal Reserve, OCC, FDIC, OTS, NCUA, Federal Trade Commission (FTC), and the Department of Housing and Urban Development. The Dodd-Frank Act gave CFPB authority in connection with a number of federal consumer protection laws.

less for consumer protection.[19] This allocation of authority based on size was apparently grounded in policy considerations including concerns with the disruption that additional examinations may cause for smaller depositories and the greater effect that compliance costs could have for smaller institutions.[20] Finally, the Dodd-Frank Act provided that state banking regulators can bring proceedings against institutions chartered, incorporated, or licensed in their states to enforce the Consumer Financial Protection Act of 2010 and CFPB rules issued thereunder.[21] State banking regulators also have authority to enforce state consumer protection laws.

Multiple forms of overlap exist among the agencies that perform safety and soundness and consumer protection oversight of depository institutions. For example, state banking regulators share oversight of the safety and soundness of state-chartered banks with FDIC and the Federal Reserve.[22] Further, FDIC administers the Deposit Insurance Fund, which insures the deposits of all banks and thrifts that are approved for federal deposit insurance. In this role, FDIC has backup supervisory authorities over all banks and thrifts that are federally insured. This responsibility creates overlap between FDIC's authorities and those of the Federal Reserve and OCC as the primary prudential regulators of insured

[19]While the primary consumer protection supervisory and enforcement powers over banks, thrifts, and credit unions with $10 billion or less in assets largely remain in those institutions' prudential regulators, on a sampling basis, CFPB may participate in examinations of these smaller depository institutions that are conducted by the prudential regulator to assess compliance with Federal consumer financial laws. The prudential regulators must involve the CFPB examiner in the entire examination process for any institution included in the sample and consider CFPB's input concerning the scope of the examination, the conduct of the examination, the contents of the examination report, the designation of matters requiring attention, and examination ratings. 12 U.S.C. § 5516(c). In these instances, additional overlap between CFPB and the prudential regulators exists.

[20]*See generally Creating a Consumer Financial Protection Agency: Hearing on H.R. 3126 Before the Senate Committee on Banking, Housing and Urban Affairs*, 111th Cong. 274 (2009) and Congressional Research Service, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, R42572 (Washington, D.C.: Jan. 14, 2014).

[21]12 U.S.C. § 5552(a)(1).

[22]Because NCUA only supervises federally-chartered credit unions, there is no overlap in the general supervision of credit unions between NCUA and state credit union regulators.

institutions.[23] While NCUA supervises only federally-chartered credit unions, it is the deposit insurer for both federal credit unions and most state-chartered credit unions. Therefore, its role as deposit insurer creates overlap with state credit union regulators.[24] Overlap also exists in the consumer protection oversight of depository institutions with more than $10 billion in assets. That is, because the primary federal prudential regulator (FDIC, the Federal Reserve, NCUA, or OCC) of these institutions retained authority to oversee their compliance with certain consumer protection laws, two federal agencies are responsible for reviewing these institutions' compliance with consumer protection laws.[25] Additionally, overlap exists because state regulators have authority to enforce the provisions of the Consumer Financial Protection Act of 2010 or regulations issued under those provisions, with respect to state-chartered entities or entities licensed to do business in the state, which may also be overseen by their prudential regulator or CFPB for the same purpose. Finally, the Federal Reserve has consolidated supervision authorities over most holding companies that own or control a bank or thrift and their subsidiaries.[26] Consolidated supervision authorities create additional overlap because, among other things, the Federal Reserve can provide oversight to the holding company's subsidiary depository institutions, in addition to the oversight provided by the depository

[23]FDIC does not directly supervise other insured depository institutions. Its authority in connection with other depository institutions is different from that of the primary federal regulator in that it has backup examination authority that is concerned with evaluating and mitigating exposure of the deposit insurance fund to insured depository institutions.

[24]NCUA administers the National Credit Union Share Insurance Fund, which insures savings in federal credit unions and most state-chartered credit unions.

[25]For example, the prudential regulators retained responsibility for enforcing depository institutions' compliance with Section 5 of the Federal Trade Commission Act, the Fair Housing Act, and the Servicemembers Civil Relief Act regardless of an institution's size. FDIC and NCUA officials told us that very few of their regulated entities are under CFPB supervision. According to CFPB data, as of September 30, 2015, only 37 state-chartered depository institutions overseen by FDIC and 5 federal credit unions overseen NCUA had more than $10 billion in assets and were under CFPB supervision.

[26]The Bank Holding Company Act of 1956 provides for all bank holding companies, including financial holding companies, to be supervised on a consolidated basis by the Federal Reserve. As amended by the Dodd-Frank Act, the Home Owners Loan Act provides for the consolidated supervision of thrift holding companies by the Federal Reserve. Bank holding companies and thrift holding companies may become or be treated as financial holding companies, respectively, and thereby engage in a range of financial activities broader than those otherwise permitted for bank holding companies.

institution's primary prudential regulator.[27] Figure 3 shows some examples of regulatory overlap for safety and soundness and consumer protection purposes for three types of depository institutions: (1) a national bank with more than $10 billion in assets; (2) a state-member bank that is not a member of the Federal Reserve system, is not an affiliate of a depository institution with more than $10 billion in assets, and has less than $10 billion in assets; and (3) a state-chartered bank that is a member of the Federal Reserve system and has more than $10 billion in assets.

[27] In general, the Federal Reserve has authority to examine bank holding companies and their subsidiaries in order to inform the Federal Reserve of the nature of the operations and financial condition of the bank holding company and the subsidiary; the financial, operational and other risks within the bank holding company system that may pose a threat to the safety and soundness of the bank holding company or of any depository institution subsidiary or the stability of the financial system of the United States; and the systems of the bank holding company for monitoring and controlling these risks. 12 U.S.C. § 1844(c)(2)(A).

Figure 3: Examples of Overlap in the Safety and Soundness and Consumer Protection Oversight for Certain Depository Institutions

Source: GAO. | GAO-16-175

Note: Depending on the types of financial activities in which a financial institution engages, additional financial regulators may be involved in their oversight.

Nondepository Entities

Responsibilities for overseeing certain nondepository financial entities, which can offer consumers financial products and other services similar to those provided by banks, is fragmented among CFPB, the Federal Trade Commission (FTC), and state banking regulators.[28] With the creation of CFPB, the Dodd-Frank Act closed a gap in consumer protection oversight by providing supervisory oversight to CFPB for certain nondepository financial entities, including certain kinds of mortgage market participants, private student lenders, and payday loan lenders, for the purposes of enforcing the consumer financial protection laws. Such entities generally lacked federal supervisory oversight prior to the act and generally are not overseen by federal prudential regulators for safety and soundness purposes, but some are subject to federal consumer financial and state consumer protection laws. In addition, the Dodd-Frank Act gave CFPB supervisory authority over "larger participants" in markets for consumer financial products or services as CFPB defines by rule.[29] FTC retained its consumer protection enforcement authorities over most nondepository entities, including mortgage companies, mortgage brokers, finance companies, auto dealers, payday lenders, debt collectors, and others.[30] Overlap exists between CFPB's and FTC's authorities for certain nondepository entities including those involved in mortgage servicing, lending, and assistance; debt collection; and payday lending. In addition, state banking regulators may also license and conduct oversight of certain nondepository financial entities, such as those engaged in

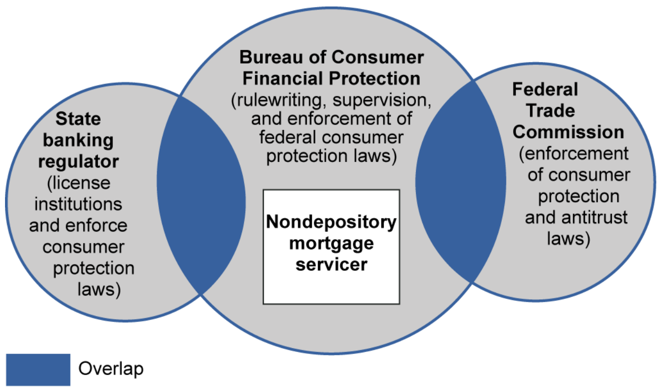
[28]The Federal Reserve also has supervision authorities over nondepository subsidiaries of bank holding companies.

[29]12 U.S.C § 5514(a)(1)(B). CFPB has issued final rules under this authority, defining nonbank larger participants of the consumer reporting market, the consumer debt collection market, the student loan servicing market, the international money transfer market, and the automobile financing market, which brought those entities under CFPB's supervision authority. Title X also contains additional authorities and responsibilities for CFPB that are not outlined here.

[30]FTC does not have jurisdiction over depository institutions, except in some instances FTC has enforcement authority over state-chartered credit unions. Under the FTC Act, FTC has investigative and law enforcement authorities to protect consumers from unfair, deceptive, or fraudulent practices in most sectors of the economy. FTC also enforces other consumer protection laws, including financial consumer protection laws such as the Equal Credit Opportunity Act, the Truth in Lending Act, and the Electronic Fund Transfer Act.

mortgage origination and servicing, for consumer protection purposes.[31] State banking regulator oversight creates additional overlap in the consumer protection oversight of nondepository entities. Figure 4 provides an example of the overlap that can exist among agencies involved in overseeing a nondepository mortgage servicer.

Figure 4: Example of Overlap in Consumer Protection Oversight for a Nondepository Mortgage Servicer



Source: GAO. | GAO-16-175

Note: Depending on the types of financial activities in which a financial institution engages, additional financial regulators may be involved in their oversight.

Securities and Derivatives Markets Oversight

The securities and derivatives markets are regulated under a combination of self-regulation (subject to oversight by the appropriate federal regulator) and direct oversight by SEC and CFTC, respectively. State securities regulators also play a role in overseeing the securities market.

[31] In March 2015, the Conference of State Banking Supervisors (CSBS) and the American Association of Residential Mortgage Regulators issued proposed regulatory prudential standards for nonbank mortgage servicers that are licensed and operating in the states. Mortgage servicers are institutions that perform duties, such as sending borrowers monthly account statements, answering customer-service inquiries, collecting monthly mortgage payments, maintaining escrow accounts for property taxes and hazard insurance, and forwarding proper payments to the mortgage owners. The proposal includes a set of baseline standards and enhanced standards, which states can chose whether and how to adopt. The baseline standards would be applied to all nonbank mortgage servicers and the enhanced standards may be appropriate for large, complex nonbank mortgage servicing companies. The public comment period for the proposed prudential standards closed on June 23, 2015. CSBS has reviewed the comments but does not have a timeline for when it expects the proposal to be finalized. We have ongoing work evaluating, among other things, the oversight framework for nonbank mortgage servicers.

SEC regulates the securities markets, including participants such as securities exchanges, broker-dealers, investment companies, and certain investment advisers and municipal advisors. SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. SEC also oversees SROs—including securities exchanges, clearing agencies, and the Financial Industry Regulatory Authority (FINRA)—that have responsibility for overseeing securities markets and their members; establishing the standards under which their members conduct business; monitoring business conduct; and bringing disciplinary actions against members for violating applicable federal statutes, SEC's rules, and their own rules. In the securities markets, SROs, such as a national securities exchange or association, are regulators that have responsibility for much of the day-to-day oversight of the securities markets and broker-dealers under their jurisdiction. CFTC is the primary regulator of the derivatives markets and its mission is to protect market users and the public from fraud, manipulation, abusive practices, and systemic risk related to derivatives subject to the Commodity Exchange Act (CEA), and to foster open, competitive, and financially sound futures markets. CFTC oversees the registration of intermediaries and relies on SROs, including the futures exchanges and the National Futures Association, to establish and enforce rules governing member behavior.[32] The Dodd-Frank Act closed gaps that existed in the regulatory structure by expanding the jurisdictional authorities of CFTC and SEC and creating a new oversight regime for the swaps and security-based swaps markets. The act also required advisers to certain private funds—such as hedge funds and private equity funds—to register with SEC.

Overlap exists in the oversight of securities and derivatives markets in several ways, including the entities being overseen and those providing the oversight.

- *Investment adviser oversight*. Oversight of investment advisers is divided between SEC and state securities regulators depending on

[32]Members of the National Futures Association include futures commission merchants, commodity pool operators, commodity trading advisors, introducing brokers, designated contract markets, swap execution facilities, commercial firms, and banks.

the amount of assets an investment adviser manages.[33] Investment advisers who manage $100 million or more in assets generally must register with SEC and are subject to SEC regulation. Most small and mid-sized investment advisers who manage up to $100 million in assets are overseen by state securities regulators. State securities regulators' authorities for these small and mid-sized advisers may also overlap because the advisers may be required to register with and be subject to oversight by one or more state securities regulators.

- *Security futures oversight*. CFTC and SEC have overlapping authority for security futures products, which generally refers to futures on single securities and narrow-based security indexes. Both agencies jointly regulate this product.

- *Swaps and security-based swaps oversight*. Regulation of the swaps and security-based swaps market is generally divided between CFTC and SEC, respectively. The Dodd-Frank Act authorizes CFTC to regulate swaps and SEC to regulate security-based swaps and both agencies are responsible for issuing rules for their respective products and market participants. However, CFTC's and SEC's authorities to regulate mixed swaps—security-based swaps that have a commodity component—overlap. The agencies share authority over mixed swaps and issue joint rules for this product.

- *SRO oversight*. SRO oversight creates overlap with the authorities of SEC and CFTC because market participants are subject to the oversight of both their relevant federal regulator and one or more SRO. The Municipal Securities Rulemaking Board (MSRB) is another SRO that, among other things, develops rules for broker-dealers engaged in underwriting, trading, and selling municipal securities with the goals of protecting investors and issuers and promoting a fair and efficient marketplace.[34] MSRB also writes rules regulating municipal advisors that, among other things, provide advice to or on behalf of municipal entities with respect to the issuance of municipal securities. MSRB's authorities overlap with those of FINRA and SEC because it

[33]An investment adviser is defined, in part, to mean any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. 15 U.S.C. § 80b-2(a)(11).

[34]Municipal securities are debt instruments that state and local governments issue to finance transportation, housing, hospitals, education, and diverse other projects.

relies on both of them to examine municipal securities broker-dealers and to enforce its rules because it does not have the authority to enforce the rules it writes. Further, both MSRB and SEC register municipal securities broker-dealers.

- *State securities regulator oversight*. Some state securities regulators' authorities overlap with those of SEC. State securities regulators are responsible for, among other things, licensing securities firms and investment professionals, such as broker-dealers and investment advisers; registering certain securities offerings; and, along with SEC, investigating securities fraud.[35]

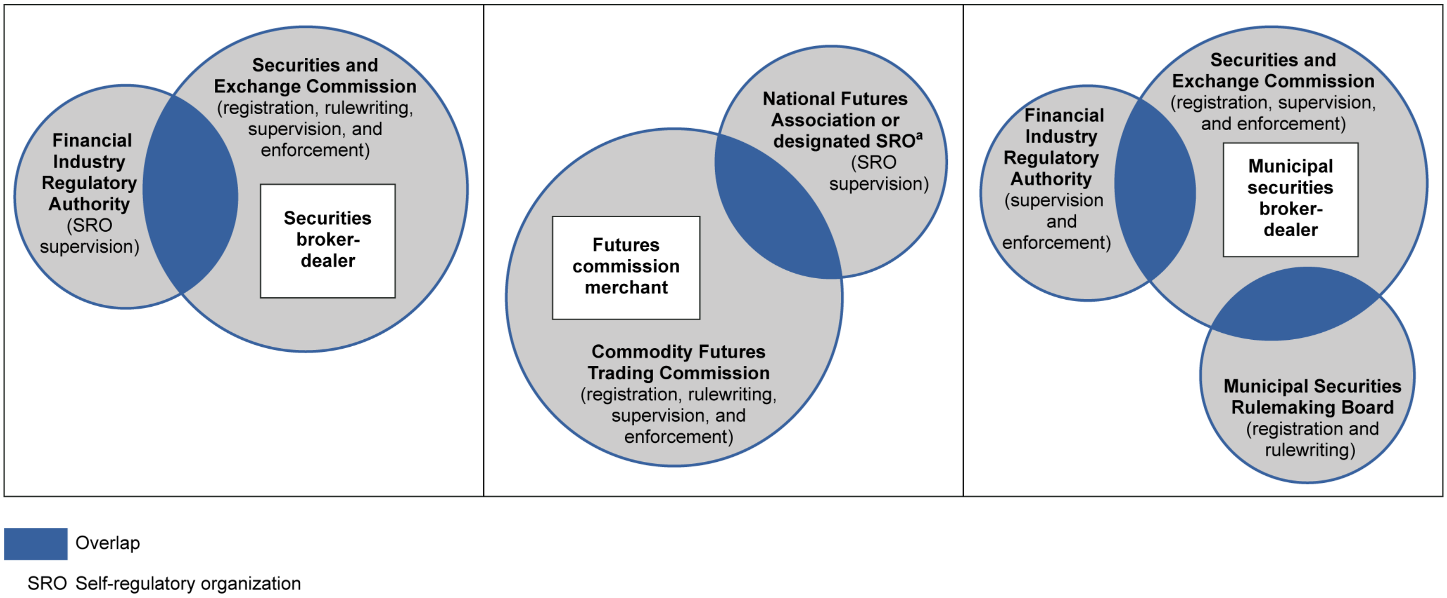
- *Other oversight*. Additional overlap with the Federal Reserve may exist for derivatives and securities market participants overseen by CFTC or SEC that operate as part of a bank or thrift holding company under consolidated supervision by the Federal Reserve.

Figure 5 illustrates examples of the regulatory overlap that exists for securities and futures market intermediaries, including a securities broker-dealer, a futures commission merchant, and a municipal securities broker-dealer.[36]

[35]The National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996), pre-empted state securities registration requirements for all but a subset of small securities products and limited state supervision of broker-dealers, but left intact the right of states to investigate securities fraud.

[36]Futures commission merchants are individuals or organizations that do both of the following: solicit or accept orders to buy or sell, among other instruments, futures contracts, options on futures, or swaps, and accept money or assets from customers to support such orders. 7 U.S.C. § 1a(28).

Figure 5: Examples of Overlap in the Securities and Derivatives Markets Oversight for Certain Market Intermediaries



Source: GAO. | GAO-16-175

Note: Depending on the types of financial activities in which a financial institution engages, additional financial regulators may be involved in their oversight.

[a]When a futures commission merchant is a member of more than one SRO, the SROs may decide among themselves which of them will assume primary responsibility for these regulatory duties and, upon approval of the plan by CFTC, be appointed the "designated self-regulatory organization" for that futures commission merchant.

Insurance Oversight

The business of insurance is regulated primarily at the state level in the United States and, therefore, is fragmented among 56 state insurance regulators.[37] State regulators oversee insurers for financial solvency and policyholder protection, among other things. The National Association of Insurance Commissioners (NAIC) is the voluntary association of the heads of insurance departments from the 56 insurance jurisdictions. While NAIC does not regulate insurers, it does provide services to the insurance regulators, including providing data to help regulators analyze insurance sales and practices and coordinating regulatory efforts by

[37]In 1944, a U.S. Supreme Court decision determined that insurance was interstate commerce, which could then have allowed for federal regulation, but Congress passed the McCarran-Ferguson Act in 1945 to reaffirm the power of the states to regulate insurance companies. The 56 insurance regulators include the insurance commissioners in the 50 states, the District of Columbia, and five U.S. territories.

providing guidance, model laws and regulations, and information-sharing tools, among other things. Both FIO and the Federal Reserve also have authorities related to the U.S. insurance sector, which creates overlap. The Dodd-Frank Act created FIO, which does not have general supervisory or regulatory authority over the business of insurance. However, it does have targeted authority under the Dodd-Frank Act to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system.[38] FIO also coordinates federal efforts and develops federal policy on prudential aspects of international insurance matters, among other things.[39] The Federal Reserve can oversee insurance companies that are owned by bank or thrift holding companies, that are bank or thrift holding companies, or have been designated by FSOC for enhanced supervision by the Federal Reserve. Insurance companies designated by FSOC are subject to consolidated supervision by the Federal Reserve and enhanced prudential standards.[40] In these cases, overlap exists between the Federal Reserve and the state insurance regulator.[41] Figure 6 shows examples of regulatory overlap that can exist for an insurance company that is part of a thrift holding company and an insurance company that has been designated by FSOC for enhanced supervision by the Federal Reserve.

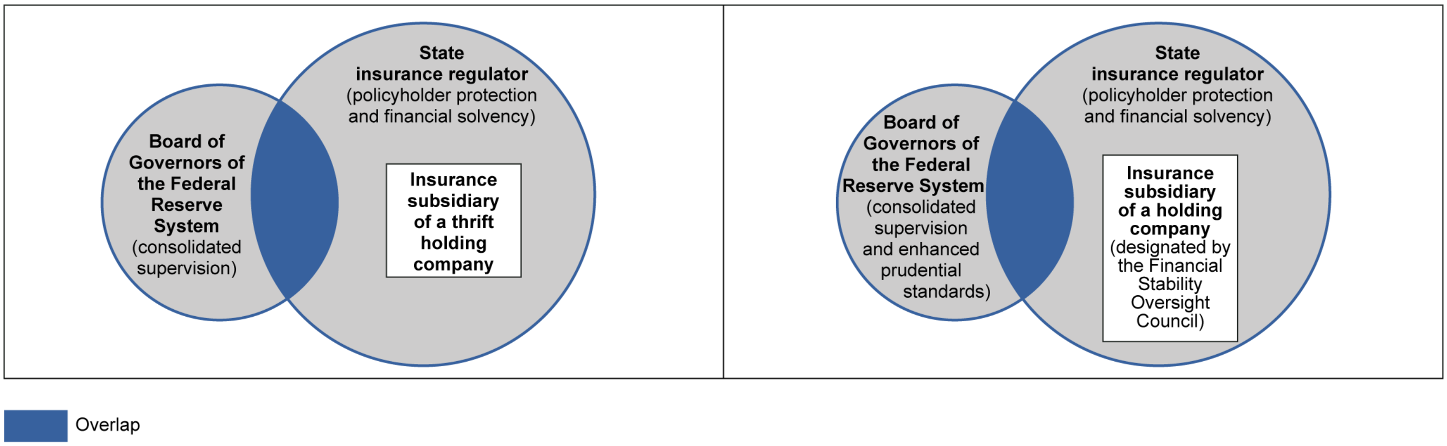
[38] 31 U.S.C § 313(c)(1)(A).

[39] 31 U.S.C. § 313(c)(1)(E). The Dodd-Frank Act also provided FIO with a variety of other authorities related to systemic risk.

[40] The Dodd-Frank Act gave the Federal Reserve authority to establish enhanced prudential standards for large bank holding companies and nonbank financial companies supervised by the Federal Reserve. Pub. L. No. 111-203, § 165, 124 Stat. 1376, 1423 (2010) (codified at 12 U.S.C. §5365).

[41] The Federal Reserve has indicated that it does not intend to regulate the manner in which insurance is provided by insurance companies or the types of insurance they provide. Instead, it has said that consolidated supervision and capital requirements that consider the risks across the entire firm will supplement existing legal-entity supervision by the states. See Mark E. Van Der Weide, Deputy Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, *The State of the Insurance Industry and Insurance Regulations*, testimony before the Senate Committee on Banking, Housing, and Urban Affairs, 114th Cong., 1st sess., April 28, 2015.

Figure 6: Examples of Overlap in Oversight for Certain Types of Insurance Company Subsidiaries



Source: GAO. | GAO-16-175

Note: Depending on the types of financial activities in which a financial institution engages, additional financial regulators may be involved in their oversight.

Systemic Risk Oversight and Consolidated Supervision

The Dodd-Frank Act established a systemic risk oversight framework within the fragmented regulatory structure. The act generally did not assign systemic risk oversight authorities to any existing agency; rather, it placed responsibility for identifying and responding to systemic risks with the collective group of regulators through the creation of FSOC. FSOC is chaired by the Secretary of the Treasury and its members include the heads of CFPB, CFTC, FDIC, the Federal Reserve, the Federal Housing Finance Agency (FHFA), NCUA, OCC, SEC, OFR, and FIO; representatives from the state banking, securities, and insurance regulators; and an insurance expert appointed by the President of the United States.[42] The Dodd-Frank Act also created OFR to support FSOC's activities and, similar to FIO, gave it certain systemic risk monitoring mandates. We discuss both OFR's and FIO's activities in more detail later in this report.

[42]The council meets at least quarterly to fulfill its systemic risk mandate. Treasury staff provide administrative and analytical support to FSOC, which has created a number of staff committees that meet regularly and help advance the council's various tasks and goals. For additional information on FSOC's structure, see GAO, *Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions,* GAO-12-886 (Washington, D.C.: Sept. 11, 2012).

The Dodd-Frank Act also aimed to address systemic risks from large, complex financial institutions through consolidated supervision by the Federal Reserve and the imposition of enhanced prudential standards. Prior to the enactment of the Dodd-Frank Act, the Federal Reserve had consolidated supervision authorities for all bank holding companies, and with the elimination of OTS, the Federal Reserve also became responsible for the supervision of thrift holding companies. The act also expanded the Federal Reserve's consolidated supervision authorities for systemic risk purposes by (1) giving it consolidated supervision authority over nonbank financial companies designated by FSOC, (2) requiring it to establish enhanced prudential standards for nonbank financial companies designated by FSOC and bank holding companies with $50 billion or more in total consolidated assets, and (3) requiring these standards to be more stringent than those applicable to financial companies that do not present similar risks to U.S. financial stability. All forms of consolidated supervision by the Federal Reserve create overlap with authority of the primary regulators of the holding company's regulated subsidiaries. These subsidiaries may include banks, thrifts, securities firms, commodities trading firms, or insurers which are already overseen by other regulators, as described earlier.

The Dodd-Frank Act gives FDIC certain authorities to effectively plan and manage an orderly resolution of a failing financial company that poses a significant risk to the financial stability of the United States, which creates overlap. For example, the act requires bank holding companies that have total consolidated assets of $50 billion or more as well as nonbank financial companies designated by FSOC to periodically submit resolution plans and credit exposure reports to the Federal Reserve and FDIC for review. The Federal Reserve and FDIC must each review the information in the plans and if they arrive at a joint determination that their plans are not credible or would not facilitate an orderly resolution in bankruptcy, the agencies can jointly impose sanctions.[43] Second, the act also gives FDIC authority, if appointed receiver by the Secretary of the Treasury, to liquidate or resolve certain systemically important firms—including those under Federal Reserve consolidated supervision—whose failure and resolution under otherwise applicable law would have serious adverse effects on U.S. financial stability.

[43]We have work underway on the processes used to review the resolution plans and plan to issue the report in 2016.

Lastly, the Dodd-Frank Act also gave FSOC the authority to designate financial market utilities and PCS activities as systemically important. Financial market utilities include payment systems, central securities depositories, and central counterparties that provide the infrastructure to clear and settle payments and other financial transactions, some of which are overseen by SEC and CFTC.[44] Under the Dodd-Frank Act, the Federal Reserve must prescribe (or consult in the establishment of) enhanced risk-management standards for operations related to PCS activities conducted by a designated financial market utility and the conduct of designated activities by financial institutions. The act also allows either SEC or CFTC to prescribe such standards for designated clearing agencies and financial institutions engaged in designated activities when the agency is the primary supervisor, but the agency must consult with the Federal Reserve and FSOC before doing so.[45] Generally, the act provides the Federal Reserve with an enhanced role with respect to designated financial market utilities and entities conducting designated PCS activities for which it is not the primary supervisor. Consequently, such designations can create overlap. For example, the Federal Reserve has the authority to participate in any examination of a designated financial market utility led by the entity's primary supervisor and to review proposed changes to a designated financial market utility's rules, procedures, or operations that could materially affect the nature or level of risk presented by the designated financial market utility.

[44]Financial market utilities are multilateral systems that provide the infrastructure for transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the system. Financial market utilities are a subset of financial market infrastructures, which are systems used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions.

[45]The Dodd-Frank Act allows the Federal Reserve to object to CFTC or SEC standards if the Federal Reserve concludes that they are insufficient to prevent or mitigate significant risks to the financial markets or financial stability of the United States. CFTC or SEC must explain why the requirements are sufficient or submit an explanation describing actions to be taken in response to the Federal Reserve's determination. If it determines that the response submitted by CFTC or SEC is insufficient, FSOC can require CFTC or SEC to establish stricter standards. 12 U.S.C. § 5464(a)(2)(B)-(E).

Complex Structure Creates Inefficiencies and Inconsistencies and Limits International Coordination

Extensive fragmentation and overlap in the regulatory structure create various inefficiencies and inconsistencies in regulators' oversight activities. Prior to the passage of the Dodd-Frank Act, we reported on numerous examples of the negative effects of fragmentation and overlap in safety and soundness, consumer protection, securities and derivatives markets, and insurance oversight. In 2009, we established a framework for evaluating regulatory reform proposals that describes nine characteristics that should be reflected in a new regulatory system.[46] While changes made by the Dodd-Frank Act were consistent with some of these characteristics, the act did not address three that would likely help to reduce the negative effects of fragmentation and overlap in the structure. In particular, the current regulatory structure does not always ensure (1) efficient and effective oversight, (2) consistent financial oversight, and (3) consistent consumer and investor protections.[47] Because regulatory reforms, including the Dodd-Frank Act, have not fully addressed these characteristics and fragmentation and overlap remain, challenges persist in each sector.[48] In most of the examples cited below from our previous work, agencies have taken actions to help mitigate the negative effects of fragmentation and overlap that we identified and have addressed our previous concerns. However, the past examples, coupled

[46]The nine characteristics are: clearly defined regulatory goals; appropriately comprehensive; systemwide focus; flexible and adaptable; efficient and effective; consistent consumer and investor protection; regulators provided with independence, prominence, authority, and accountability; consistent financial oversight; and minimal taxpayer exposure. See appendix III for additional information on these characteristics. In addition, see GAO-09-216.

[47]Our framework describes these characteristics as follows (1) efficient and effective oversight includes eliminating overlapping federal regulatory missions where appropriate, and minimizing regulatory burden without sacrificing effective oversight; (2) consistent financial oversight is when similar institutions, products, risks, and services are subject to consistent regulation, oversight, and transparency; and (3) consistent consumer and investor protections are when consumers and investors receive consistent, useful information, as well as legal protections for similar financial products and services. See GAO-09-216.

[48]As mentioned previously, we held four discussion groups to help us identify the current effects of fragmentation and overlap on agencies' oversight activities. The discussion groups consisted of former regulatory officials, industry and advocacy group representatives, and experts, and they covered (1) the supervision of bank and thrift holding companies and their subsidiaries by FDIC, the Federal Reserve, OCC, and state banking supervisors; (2) consumer protection oversight conducted by CFPB and the federal prudential regulators; (3) the regulation of swaps and security-based swaps by CFTC and SEC; and (4) the supervision of insurance groups by state insurance regulators and the Federal Reserve.

with more recent examples of the negative effects of fragmentation and overlap, demonstrate a pattern of inconsistencies and inefficiencies that continue to persist because of the fragmented regulatory structure. We and others have suggested changes that could help to mitigate the negative effects of fragmentation and overlap that exist in the regulatory structure.

Multiple Regulators Can Result in Inefficient and Inconsistent Safety and Soundness and Consumer Protection Oversight

Since the mid-1990s, we have stated that having multiple depository institution regulators can cause inconsistencies and inefficiencies in the oversight of these institutions. Inconsistent practices can result in different conclusions about the safety and soundness of an institution, difficulties tracking violations and identifying emerging trends, and different levels of protection provided to consumers. Further, fragmentation in safety and soundness and consumer protection oversight has delayed regulatory action on matters of emerging risk because of difficulties regulators face in reaching agreement and the time it takes for them to coordinate their efforts. While the regulators do coordinate in many areas to try to reduce the negative effects of fragmentation and overlap, the fragmented structure continues to create a significant responsibility on the part of the regulators to cooperate and effectively coordinate their activities.[49]

Inconsistent Oversight

Our past work evaluating regulators' examination activities has shown inconsistencies in their efforts. For example, from 1990 through 1993, we identified significant inconsistencies in examination policies and practices among FDIC, OCC, OTS, and the Federal Reserve, including differences in examination scope, frequency, and documentation and examination guidance and regulations. We found that methods for assessing loan loss reserves varied among the regulators and the lack of a generally accepted method for assessing loss reserves made it difficult for the regulators to successfully challenge management's estimates when the

[49]For the purposes of this section, we focused on the division of consumer protection responsibilities between CFPB and the prudential regulators and did not evaluate the effects of overlap between CFPB's and FTC's authorities because FTC does not conduct the same types of oversight activities as those conducted by CFPB and the prudential regulators. FTC is not a regulator under the definition used in this report and does not have supervisory authority over entities, but rather generally has investigative and law enforcement authorities, and rulewriting authority under certain statutes. We also did not evaluate the effects of overlap between CFPB and the state banking regulators. State banking officials told us that the vast majority of states do not examine for compliance with federal financial consumer protection laws.

examiners thought reserves were inadequate.[50] As a result, we recommended that the federal bank and thrift regulatory agencies establish examination policies, as applicable, to develop and implement a sound methodology for evaluating the adequacy of loan loss reserves and reserving methods.[51] In 2006 we also found that although the federal prudential regulators had worked to develop interagency procedures to help ensure consistency for Bank Secrecy Act (BSA) examinations, the regulators' guidance and terminology for the classification of BSA compliance problems differed. We found that these differences could, among other things, make it difficult for banking regulators to have a comprehensive overview of BSA compliance at their institutions and for Treasury's Financial Crimes Enforcement Network (FinCEN)—the overall administrator of BSA—to have a comprehensive overview across regulators.[52] We recommended that FinCEN and the prudential regulators

[50]GAO, *Bank and Thrift Regulation: Improvements Needed in Examination Quality and Regulatory Structure*, GAO/AFMD-93-15 (Washington, D.C.: Feb. 16, 1993).

[51]At the time the report was issued, OTS and OCC generally agreed with our recommendations, while FDIC generally disagreed. The Federal Reserve said it would carefully evaluate the findings and recommendations, but did not specify what action it may take. In December 1993, FDIC, the Federal Reserve, OCC, and OTS issued the *Interagency Policy Statement on the Allowance for Loan and Lease Losses*. The document established uniform interagency guidance for review of overall loan loss reserves and provides guidance to institutions on maintaining an adequate loan loss reserve. We closed these recommendations as implemented because they were, at least partially, responsive to our recommendations. There have been further updates to accounting standards and interagency guidance on this issue since this report was issued in 1993.

[52]GAO, *Bank Secrecy Act: Opportunities Exist for FinCEN and the Banking Regulators to Further Strengthen the Framework for Consistent BSA Oversight,* GAO-06-386 (Washington, D.C.: Apr. 28, 2006). The regulatory system for BSA involves several different federal agencies. Under delegated authority from the Secretary of the Treasury, FinCEN is the administrator of BSA. FinCEN has the authority under 31 U.S.C. § 5318(a)(3) to examine financial institutions for compliance with BSA and regulations promulgated under BSA at 31 C.F.R. Chapter X, as well as to take enforcement actions for violations of BSA and the implementing regulations under 31 U.S.C. §§ 5320-23. The Secretary of the Treasury delegated BSA examination authority to each federal prudential regulator with respect to banking organizations supervised by that regulator. 31 C.F.R. § 1010.810 (b)(1)-(5).The federal prudential regulators have separate authority pursuant to 12 U.S.C. §§ 1786 and 1818 to ensure that banking organizations comply with all laws and regulations, including BSA.

jointly assess the feasibility of developing a uniform classification system for BSA noncompliance.[53]

We have also found inconsistencies in the prudential regulators' oversight of compliance with federal consumer protection laws prior to the passage of the Dodd-Frank Act.[54] For example, in 2009 we reported that the federal prudential regulators' fair lending oversight programs differed in their oversight procedures.[55] We found that each regulator used different approaches to screen data to identify lenders that may have violated fair lending laws. We also identified significant differences in the practices that the federal prudential regulators employed to make referrals to the Department of Justice and in the number of referrals they made. We concluded that despite the federal prudential regulators' having issued joint interagency fair lending examination guidance and having engaged in various coordination efforts, federal enforcement agencies and prudential regulators faced challenges in consistently, efficiently, and effectively overseeing and enforcing fair lending laws due in part to the fragmented U.S. financial regulatory structure. We suggested that Congress may wish to take steps to help ensure that consumers are adequately protected by, among other things, addressing the potentially inconsistent oversight provided by the federal prudential regulators.[56]

[53]At the time the report was issued, FinCEN and the regulators supported these recommendations and said they were committed to ongoing interagency coordination to address them. In response to our recommendation, FinCEN and the regulators concluded that no additional examiner guidance was needed at that time, but the Federal Financial Institutions Examination Council's BSA working group agreed to discuss these issues on a quarterly basis. We have closed this recommendation as implemented. In addition, in July 2007, the Federal Reserve, FDIC, OCC, OTS, and NCUA issued the *Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements*.

[54]The prudential regulators also had responsibilities for overseeing all of their regulated institutions' compliance with consumer protection laws prior to the passage of the Dodd-Frank Act.

[55]GAO, *Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts,* GAO-09-704 (Washington, D.C.: July 15, 2009).

[56]At the time the report was issued, the agencies and regulators generally agreed with the report's analysis. The Dodd-Frank Act included improvements in the supervision of holding company subsidiaries and examination and enforcement of mortgage brokers. This matter for congressional consideration has been closed as implemented.

While Congress addressed some of our concerns through consolidating rulemaking and other authorities over consumer financial products and services under CFPB, the Dodd-Frank Act maintained a divided consumer protection regulatory regime for depository institutions. As a result, the potential for inconsistencies continues to exist in the way depository institutions are overseen for compliance with consumer protection laws and the level of protections provided to consumers. In particular, CFPB and the federal prudential regulators have similar but different regulatory authorities related to unfair or deceptive acts or practices. Prudential regulators enforce Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices for depository institutions of any size that they supervise. The Dodd-Frank Act prohibits unfair, deceptive, or abusive acts or practices and CFPB enforces this for depository institutions with more than $10 billion in assets.[57] This means that for depository institutions with more than $10 billion in assets that are overseen by both CFPB and a prudential regulator, both regulators can enforce their respective authorities and conflicts may arise in how the two regulators interpret and apply them. Further, because CFPB and each of the prudential regulators can enforce their respective authorities against their regulated institutions, participants in our consumer protection discussion group stated that the potential for differences in interpretations and applications of the authorities can occur, which could result in depository institutions being held to different standards. Officials from the Federal Reserve, FDIC, OCC, and CFPB told us that they coordinate on issues related to unfair or deceptive acts or practices prior to or during examinations, or when enforcement actions are necessary. FDIC officials also noted that they were not aware of any instances in which interpretations of these authorities differed between CFPB and the prudential regulators.

Inefficient Oversight

Inefficiency is another principal concern with the regulatory structure for safety and soundness and consumer protection oversight. For example, a long-standing issue in this area involves the overlapping authorities of the Federal Reserve and the primary prudential regulator in holding company examinations. In its holding company examinations, the Federal Reserve,

[57]State regulators have authority to investigate and enforce provisions of the Consumer Financial Protection Act of 2010, including the prohibition against unfair, deceptive, or abusive practices, against any state entity that is state-chartered, incorporated, licensed, or otherwise authorized to do business under state law. Before initiating any action, the state regulator generally must notify CFPB and CFPB may intervene in the action.

to the fullest extent possible, relies on reports and other supervisory information that the bank holding company or any subsidiary has provided to other regulatory agencies.[58] However the potential exists for the Federal Reserve, as supervisor of the holding company, to duplicate the work of the primary regulator of the subsidiary depository institution, which can result in an inefficient use of federal resources and increased regulatory burden for the institution. In 1994, we found that overlapping authority was a particularly significant problem in bank holding company regulation and that although the Federal Reserve and the primary regulators tried to coordinate their supervision and examination responsibilities, the efforts were not always successful.[59] In addition, in a 2007 report on consolidated supervision we found some duplication in the examinations of financial holding companies, despite OCC's and the Federal Reserve's efforts to coordinate.[60] Further, we found that while the Federal Reserve and OCC had and generally followed procedures to resolve differences, one firm had initially received conflicting information from the Federal Reserve and OCC about the firm's business continuity provisions. As a result of these findings, we recommended in March 2007 that the Federal Reserve identify additional ways to more effectively collaborate with primary bank and other functional supervisors (e.g., developing appropriate mechanisms to better define responsibilities and

[58]The Dodd-Frank Act gave the Federal Reserve the authority to examine depository institution subsidiaries' compliance with federal laws that the Federal Reserve has specific jurisdiction to enforce against the subsidiary. The Federal Reserve is also, to the fullest extent possible, to avoid duplication of examination activities, reporting requirements, and requests for information. The Federal Reserve is required to provide notice to and consult with the appropriate regulatory agency before commencing an examination of a depository institution subsidiary. Similar provisions were added to the Home Owners Loan Act for thrift holding companies.

[59]GAO, *Bank Regulation: Consolidation of the Regulatory Agencies*, GAO/T-GGD-94-106 (Washington: D.C.: Mar. 4, 1994).

[60]GAO, *Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration,* GAO-07-154 (Washington, D.C.: Mar. 15, 2007). In particular, because the holding companies manage some risks on an enterprisewide basis, OCC duplicated the Federal Reserve's assessment of the holding company's consolidated risk management activities or other activities outside of the national bank because it needed to assess the national bank's risk.

to monitor, evaluate, and report jointly on results).[61] However, in its September 2015 report on the Federal Reserve's major management challenges, the Federal Reserve Office of the Inspector General noted that the Federal Reserve still faces challenges in coordinating with other federal supervisory agencies in its role as the consolidated supervisor for bank, financial, and thrift holding companies.[62]

Further, participants in our discussion groups noted that they see overlap in agencies' data collection activities. In particular, participants noted overlap between the Federal Reserve and OCC and CFPB and OCC. For example, they explained that the Federal Reserve's data requests can be very similar to OCC's requests and that often the two requests will ask for the same data but in different formats. They said that providing data in multiple formats may be inefficient for an institution because often its information systems do not capture the data in the format requested, which can require staff to go to data files to create a dataset from scratch. Federal Reserve officials told us that in the agency's role as a consolidated supervisor, it first attempts to obtain any needed information from the primary regulator and only requests information from a depository institution subsidiary if the primary regulator does not have the information. CFPB staff told us that they are aware of the data that already exist from the primary prudential regulator of their supervised depository institutions. In addition, in our September 2014 report on consumer financial data collections, we found that CFPB has coordinated with the prudential regulators and shared consumer financial data through

[61]In our March 2007 report, we also made this recommendation to OTS and SEC, which also served as consolidated supervisors for thrift holding companies and consolidated supervised entities (CSE), respectively. CSEs were large complex firms that focus primarily on securities and chose to participate in SEC's CSE program. In 2008, SEC terminated its CSE program. In addition, the Dodd-Frank Act eliminated OTS and transferred its holding company supervision responsibilities to the Federal Reserve. The agencies generally agreed with these recommendations. Consistent with our recommendation, in July 2008, the Federal Reserve entered into a memorandum of understanding with SEC regarding collaboration and information sharing in areas of common supervisory interest. In addition, the Federal Reserve and SEC, as well as other functional regulators and international counterparties, also engaged in joint regulatory activities including management of counterparty credit risk exposure to hedge funds and industry-wide operational issues related to credit derivatives. We have closed this recommendation as implemented.

[62]Office of the Inspector General for the Board of Governors of the Federal Reserve System, *2015 List of Major Management Challenges for the Board* (Washington, D.C.: Sept. 30, 2015).

various formal agreements.[63] For example, in May 2012, CFPB and the prudential regulators entered into a memorandum of understanding (MOU) on supervisory coordination to facilitate their compliance with the Dodd-Frank Act's coordination requirements (described in more detail below) and, in 2013, CFPB entered into an agreement with OCC covering any sharing of information from their respective credit card collections.[64]

However, in our September 2014 report, we also found that despite the regulators' coordination efforts, some overlap still existed in agencies' collections of consumer financial data.[65] For example, four institutions that provided credit card data to CFPB also provided the same types of data to the Federal Reserve. In addition, we found overlap in the data collections of OCC and the Federal Reserve. Fifteen of the 16 national banks submitting credit card data to OCC submit similar data through eight holding companies to the Federal Reserve. We also found that 48 national bank affiliates that report mortgage data to OCC also report these data through their eight holding companies to the Federal Reserve.

Participants also noted that the Dodd-Frank Act's changes to the regulatory oversight of the thrift industry have created some additional regulatory burden for thrifts and thrift holding companies. Thrifts are now subject to oversight by two regulators—their primary prudential regulator (FDIC or OCC) and the Federal Reserve as their holding company regulator—rather than the sole oversight OTS provided to both the thrift and the holding company. They also said that this new regulatory overlap creates the same types of challenges for thrifts and thrift holding companies as those described previously for bank and bank holding companies. FDIC and OCC officials explained that they try to manage these new overlapping authorities with the Federal Reserve on thrift and thrift holding company examinations by using the same coordination processes that they use for bank and bank holding company examinations. For instance, they share supervisory strategies and data

[63] GAO, *Consumer Financial Protection Bureau: Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced,* GAO-14-758 (Washington, D.C.: Sept. 22, 2014).

[64] The Dodd-Frank Act requires CFPB and prudential regulators to coordinate their supervision of depository institutions with over $10 billion in assets and their affiliates to minimize regulatory burden.

[65] GAO-14-758.

requests with each other prior to beginning examinations in an effort to reduce duplication in examination activities and, in some cases, conduct joint examinations.

Fragmentation in consumer protection oversight between the prudential regulators and CFPB may result in inefficiencies such as duplication in examinations.[66] For example, examiners from both the prudential regulators and CFPB examine the compliance management systems of depository institutions under their mutual supervision.[67] In addition to reviewing these systems as part of their safety and soundness examination activities, prudential regulators also examine them as part of their efforts to help ensure compliance with other financial laws and provisions, including the Bank Secrecy Act and anti-money-laundering requirements. CFPB's Supervision and Examination Manual states that CFPB conducts its own independent compliance management system assessment to help ensure that its regulated entities maintain effective compliance management systems. Regulatory officials explained that differences can exist in the scope of compliance management system reviews by prudential regulators and CFPB, which can result in

[66]While our review identified duplication, as defined in this report, between CFPB and the prudential regulators' examination activities, in a June 2015 report on the extent to which CFPB and prudential regulators were coordinating their supervisory activities and avoiding duplication of regulatory oversight responsibilities, the Offices of the Inspector General (OIG) for FDIC, the Federal Reserve, CFPB, OCC, and NCUA did not identify duplication of oversight responsibilities. They concluded that the agencies were generally coordinating their regulatory oversight activities, but did identify some opportunities for enhanced coordination. However, the OIGs agreed that the objectives of their review could be addressed with a limited scope review rather than an audit or evaluation. As a result, the review was not conducted under government audit or evaluation standards. See Offices of the Federal Deposit Insurance Corporation, the Federal Reserve, the Consumer Financial Protection Bureau, Office of the Comptroller of the Currency, and the National Credit Union Administration Inspector General, *Coordination of Responsibilities Among the Consumer Financial Protection Bureau and the Prudential Regulators—Limited Scope Review*, Eval-15-004, 2015-SR-X-009, OIG-CA-15-017, and OIG-15-08 (Washington, D.C.: June 2015).

[67]A compliance management system refers to the method by which a supervised entity establishes its compliance responsibilities; communicates those responsibilities to employees; ensures that responsibilities for meeting legal requirements and internal policies are incorporated into business processes; reviews operations to ensure responsibilities are carried out and legal requirements are met; and takes corrective action and updates tools, systems, and materials as necessary.

inconsistences in regulators' ratings of the systems.[68] Differences in ratings can cause confusion for a depository institution regarding the effectiveness of its system. Officials told us that the prudential regulators and CFPB are working on ways to clarify how an institution should interpret each regulator's assessment and that, to the extent possible, the agencies are trying to coordinate their discussions of findings with supervised institutions.

Delays in Regulatory Action

In addition, a fragmented regulatory structure for safety and soundness and consumer protection can create difficulties for agencies in trying to reach consensus on various issues. We testified in March 1994 that the practice of trying to reduce inconsistency in regulators' oversight by having all the bank regulatory agencies adopt a common rule or guidance resulted in a cumbersome interagency process for developing new rules and guidance.[69] Although regulatory officials acknowledged the need for agency coordination, we also found that the efforts to develop uniform policies and procedures took months, involved scores of people, and still failed to result in uniformity. Further, in some cases, regulators' efforts to respond to increased risks were slowed in part because of the need for multiple regulators to reach agreement and coordinate their response. This was the case in the mid 2000s, when regulators began to recognize the increased risks associated with new mortgage products. We found that prudential regulators began crafting regulatory guidance to strengthen lending practices and improve disclosures for these loan products in late 2005.[70] The regulators completed their first set of such standards in September 2006, with respect to the disclosure of risks associated with nontraditional mortgage products, and a second set, applicable to subprime mortgage loans, in June 2007.[71] Some industry

[68]For example, OCC officials said that their compliance management system reviews are very broad and look across many platforms of an institution to examine for a number of laws, including financial laws (e.g., the Bank Secrecy Act) which remain under the jurisdiction of the prudential regulators. On the other hand, CFPB officials told us that CFPB goes through a prioritization process each year to determine the areas in which it will conduct compliance management system reviews and where follow-up is needed. This may result in CFPB reviewing the compliance management system for compliance with one or two specific consumer protection laws.

[69]GAO/T-GGD-94-106.

[70]GAO-09-216.

[71]71 *Fed. Reg.* 58609 (Oct. 4, 2006) "Interagency Guidance on Nontraditional Mortgage Product Risks"; 72 *Fed. Reg.* 37569 (July 10, 2007) "Statement on Subprime Mortgage Lending."

observers and consumer advocacy groups criticized the amount of time it took for regulators to reach agreement and issue these changes, noting that the second set of guidance was released well after many subprime lenders had already gone out of business.

Agencies Engage in Coordination in an Effort to Manage Fragmentation

The prudential regulators, CFPB, FTC, and state banking regulators also engage in a variety of coordination activities, such as establishing interagency groups to facilitate coordination and communicating informally on a variety of issues. Some of the main coordination mechanisms the regulators use for safety and soundness and consumer protection oversight include the following:

- Prudential regulators, CFPB, and state banking regulators formally coordinate examination policies through the Federal Financial Institutions Examination Council (FFIEC).[72] FFIEC is a forum for the development of uniform standards and principles and it can make recommendations to promote uniformity in the supervision of financial institutions. It also serves as a forum for dialogue between federal and state bank supervisory agencies. Prudential regulators also engage in a number of coordination activities to avoid duplication that could result from their overlapping examination authorities. For example, when exercising its backup examination authority, FDIC coordinates with the primary federal prudential regulator and generally participates with them during its onsite examination activities. In addition, as mentioned previously, the Federal Reserve is required to rely on reports of examination made by other regulatory agencies in its role as the holding company supervisor. The Federal Reserve is also required to consult with regulators before commencing an examination of a subsidiary and to avoid, to the fullest extent possible, duplication of examination activities. The Federal Reserve also coordinates with the federal prudential regulators by engaging in information sharing agreements and coordinating examination

[72]The Financial Institutions Regulatory and Interest Rate Control Act of 1978 established FFIEC as a vehicle through which bank regulators could communicate formally. Pub. L. No. 95-630, Title X, 92 Stat. 3641, 3694. While NCUA is a member of FFIEC, it does not possess all the same authorities as the other prudential regulators. For example, NCUA lacks authority to examine the third-party service providers of its regulated credit unions. In July 2015, we suggested that Congress consider granting NCUA authority to examine third-party technology service providers for credit unions. See GAO, *Cybersecurity: Bank and Other Depository Regulators Need Better Data Analytics and Depository Institutions Want More Usable Threat Information,* GAO-15-509 (Washington, D.C.: July 2, 2015).

schedules, among other things.

- The Riegle Community Development and Regulatory Improvement Act of 1994 required the prudential regulators to coordinate examinations with each other and with state banking regulators in order to minimize the disruptive effect of examinations resulting from multiple examinations. The Federal Reserve, FDIC, and the Conference of State Banking Supervisors (on behalf of state banking departments) signed an agreement aimed at providing a seamless supervisory process and minimizing regulatory burden, among other things.[73] The agreement allows for examinations to be conducted jointly by state and federal regulators, although they also can alternate examination responsibilities. In 2013, the Conference of State Banking Supervisors and CFPB also developed a supervisory coordination framework that establishes the process for how state regulators and CFPB will share supervision of nondepository financial services providers and covered depository institutions with more than $10 billion in assets.

- Agencies sometimes develop formal agreements and MOUs. For example, CFPB and the prudential regulators have an MOU on supervisory coordination which specifies various ways in which CFPB and the prudential regulators are to coordinate their examination activities, including establishing guidelines for coordinated examinations and expectations for sharing information. CFPB and FTC also have an MOU to coordinate efforts to protect consumers and to help reduce duplication of federal law enforcement and regulatory efforts.

Separate but Interconnected Markets Create Challenges for Regulation of Products

Over time, separate regulation of the securities and futures markets has created confusion about which agency has jurisdiction and has raised concerns about duplicative or inconsistent regulation of entities that engage in similar activities. These concerns, in turn, have raised questions about whether separate regulatory agencies remain appropriate. The U.S. securities and futures markets are regulated by

[73]The Conference of State Banking Supervisors is a nationwide organization of financial regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands, which provides state supervisors a national forum to coordinate supervision and develop policy related to their regulated entities. It also provides training to state banking and financial regulators and represents its members before Congress and the federal financial regulatory agencies.

different agencies—SEC and CFTC, respectively—in part because they are separate markets serving different primary purposes. However, we have long reported that, although their primary purposes still differ, the securities and futures markets have become increasingly interconnected, and the distinction between a financial product as a security or a future has become increasingly difficult to determine as more and more products are developed that combine characteristics of both securities and futures.[74]

As early as the 1970s, the emergence of derivative products with characteristics of both securities and futures led to periodic disputes concerning which agency should have regulatory jurisdiction over them. These disputes have at times consumed significant agency resources and resulted in lengthy delays in introducing product innovations to the markets. For example, in January 2005 the Chicago Board Options Exchange filed a proposal with SEC to list and trade a new option on an exchange-traded fund holding investments involving gold, but introduction of this product was delayed by over 3 years as CFTC and SEC could not reach agreement on jurisdiction.[75] Moreover, in April 2010, we found that the futures and securities markets had also increasingly overlapped in terms of market participants, raising concerns about duplicative or inconsistent regulation of entities that engage in similar activities.[76] For example, exchanges that list and trade security futures are subject to the jurisdiction of both CFTC and SEC, and financial intermediaries generally must register with both CFTC and SEC if they serve investors trading in instruments subject to the jurisdiction of the two agencies.

[74]For example, see GAO, *Financial Market Regulation: Benefits and Risks of Merging SEC and* CFTC, GAO/T-GGD-95-153 (Washington, D.C.: May 3, 1995); *Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure,* GAO-05-61 (Washington, D.C.: Oct. 6, 2004), and *Financial Regulation: Industry Trends Continue to Challenge the Federal Regulatory Structure,* GAO-08-32 (Washington, D.C.: Oct. 12, 2007).

[75]In this sentence, the term “exchange-traded fund” is not referencing an exchange-traded fund that is registered as an investment company with SEC under the Investment Company Act of 1940.

[76]GAO, *Financial Regulation: Clearer Goals and Reporting Requirements Could Enhance Efforts by CFTC and SEC to Harmonize Their Regulatory Approaches,* GAO-10-410 (Washington, D.C.: Apr. 22, 2010).

In addition, in its June 2009 white paper on financial regulatory reform, Treasury noted that the regulatory structure can cause economically equivalent instruments to be regulated differently, depending on which agency has jurisdiction.[77] For example, many futures products and financial options regulated as securities are functionally similar. Further, Treasury noted that jurisdictional distinctions may have unnecessarily limited competition between markets and exchanges. Under existing law, financial instruments with similar characteristics may be forced to trade on different exchanges that are subject to different regulatory regimes. Given the challenges created by the bifurcated regulation of the two similar markets, Treasury stated that the broad public policy objectives of futures and securities regulation are the same and that many of the differences in the regulation of the markets are no longer justified.

CFTC and SEC have worked together to resolve jurisdictional disputes and address other emerging areas of overlap in their respective oversight of futures and securities markets. For example, in 1981 CFTC and SEC developed the Shad-Johnson Jurisdictional Accord, which was enacted into law in 1983 and clarified the agencies' jurisdictions over securities-based options and futures. Among other things, the accord confirmed SEC's jurisdiction over securities-based options, including stocks and stock indexes; provided CFTC with jurisdiction over futures (and options thereon) on certain securities and securities indexes; and prohibited futures trading on single stocks, as well as on securities indexes that did not meet specific requirements.[78] Similarly, pursuant to the Commodity Futures Modernization Act of 2000, the two agencies worked together to jointly create margin requirements for single stock futures when the act lifted the ban on futures on single stocks and narrow-based securities indexes, allowing them to be traded on securities or futures exchanges but subject to joint regulation of CFTC and SEC. Another example is an

[77]The Department of the Treasury, *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation* (Washington, D.C.: June 17, 2009).

[78]This agreement was codified in the Securities Acts Amendments of 1982, which amended the federal securities laws, and in the Futures Trading Act of 1982, which amended the Commodity Exchange Act. The accord allowed CFTC to approve a stock index futures contract for trading if CFTC found that the contract was (1) settled in cash; (2) not readily susceptible to manipulation; and (3) based on an index that was a widely published measure of and reflected the market as a whole or a substantial segment of the market, or else was comparable to such a measure. For more information about the Shad-Johnson Jurisdictional Accord, see GAO, *CFTC and SEC: Issues Related to the Shad-Johnson Jurisdictional Accord*, GAO/GGD-00-89 (Washington, D.C.: Apr. 6, 2000).

MOU the two agencies developed in 2008 with the goal of creating a closer relationship on a broad range of issues affecting their jurisdictions.[79] The MOU identified points of contact for coordination, outlined a protocol for addressing novel derivative products, and generally contemplated enhanced information sharing between the two agencies on areas of mutual interest.

As previously discussed, the Dodd-Frank Act closed a regulatory gap by establishing a new regulatory framework for swaps and security-based swaps, which expanded the responsibilities of both agencies.[80] The act authorizes CFTC to regulate swaps—which represent the vast majority of the market—and SEC to regulate security-based swaps, and the agencies share authority over mixed swaps—security-based swaps that have a commodity component. Both agencies are responsible for issuing rules to address the act's requirements, as well as jointly defining terms relating to jurisdiction, such as swap and security-based swap, and terms relating to market intermediaries, and issuing joint rules for mixed swaps. To help ensure regulatory consistency and comparability across the rules, the Dodd-Frank Act required SEC and CFTC to coordinate and consult with each other and prudential regulators, to the extent possible, before starting a rulemaking or issuing an order on swaps, security-based swaps, swap entities, or security-based swap entities.[81] In December 2014 we found that CFTC and SEC coordinated on their swaps and

[79]SEC and CFTC, *Memorandum of Understanding Between the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission Regarding Coordination in Areas of Common Regulatory Interest* (Washington, D.C.: Mar. 11, 2008).

[80]The Dodd-Frank Act generally (1) provides for the registration and regulation of swap dealers and major swap participants; (2) imposes mandatory clearing requirements on swaps but exempts certain end users that use swaps to hedge or mitigate commercial risk; (3) requires swaps subject to mandatory clearing to be executed on an organized exchange or swap execution facility (unless no facility makes the swap available for trading); and (4) requires all swaps to be reported to a registered swap data repository or, if no such repository will accept the swap, to CFTC or SEC, and subjects swaps to post-trade transparency requirements (real-time public reporting of swap data).

[81]For the purposes of Title VII, these regulators are the Federal Reserve, OCC, FDIC, Farm Credit Administration, and Federal Housing Finance Agency. Section 712(a)(4) of the Dodd-Frank Act exempts from this requirement orders issued in connection with or arising from a violation of any provision of the Commodity Exchange Act or the securities laws, or in certain administrative hearings.

security-based swaps rulemakings as required by the Dodd-Frank Act.[82] However, we also found substantive differences exist between certain of the agencies' rules.[83] For example, CFTC and SEC have issued guidance and rules, respectively, specifying the cross-border application of provisions in the Dodd-Frank Act. Among other things, CFTC guidance and SEC rules address the scope of the term "U.S. persons." Although their definitions are similar in several areas, there are several differences. To illustrate, CFTC and SEC similarly consider a legal entity, such as a partnership, corporation, or trust, that is organized or incorporated under U.S. laws or that has its principal place of business in the United States as a U.S. person. However, CFTC also considers U.S. persons to include collective investment vehicles that are majority owned by U.S. persons, but SEC includes only collective investment vehicles established in the United States.

We also found a lack of coordination between CFTC and SEC in the timetables for finalizing their swaps rulemakings. For example, as of December 2015, CFTC had adopted rules covering most areas of its regulatory framework for swaps.[84] In contrast, SEC had finalized rules

[82]Pursuant to the Dodd-Frank Act, the regulators issued a joint rulemaking defining swap and security-based swap dealers and major swap and major security-based swap participants in May 2012, and another defining the products that would be regulated under Title VII in August 2012. Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30,596 (May 23, 2012); Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,208 (Aug. 13, 2012). See GAO, *Dodd-Frank Regulations: Regulators' Analytical and Coordination Efforts [Reissued on December 18, 2014,* GAO-15-81 (Washington, D.C.: Dec. 18, 2014).

[83]GAO-15-81. In July 2015 CFTC issued proposed rules applicable to the cross-border application of margin requirements for uncleared swaps. These proposed rules differ from the existing Cross-Border Guidance and would establish new definitions of U.S. person solely for purposes of the application of margin rules. CFTC noted that the proposed definition of "U.S. person" is similar to the definition of "U.S. person" used by SEC in the context of cross-border security-based swaps. Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements; Proposed Rule, 80 Fed. Reg. 41,376, 41,382 (July 14, 2015).

[84]CFTC has identified 38 regulatory areas where rules are needed to regulate the swaps marketplace, as mandated under the Dodd-Frank Act. For example, these regulatory areas include registration of swap dealers and major swap participants, clearing requirements, and data recordkeeping and reporting requirements. As of December 2015, CFTC had finalized rules or guidelines in 33 of the 38 self-identified regulatory areas.

covering fewer areas.[85] Market participants said that the differences in the timing of rules and the differences in the rules themselves between the two agencies could lead to operational challenges for market participants, as well as uncertainty and regulatory inefficiencies and burden. The mitigation of any negative market effects resulting from differences in the agencies' rules will likely require that CFTC and SEC continue to coordinate after all of the rules are finalized. Officials from CFTC told us that they intend to evaluate the effect of their final rules on the market and plan to revisit their rules if they find conflicts arising from differences between their rules and those of SEC.

Participants in our discussion group questioned the utility of having separate regulatory regimes for swaps and security-based swaps, particularly given that CFTC regulates the vast majority of the market (over 90 percent according to their estimates). Further, they noted that market participants do not distinguish between the two products because they are functionally identical and can be used for similar purposes. Participants expressed concern that inconsistency in the regulatory regimes for these products might present market participants with market and operational challenges, as market participants use the same trading and compliance systems to trade both swaps and security-based swaps. For example, participants could see no benefit to differences in how swaps and security-based swaps are cleared and traded and said that these systems should be identical. However, participants told us that firms will likely have to spend more resources to comply with both rules than they would spend complying with one set of rules, creating opportunities for regulatory and economic inefficiencies.

Participants in our discussion group told us firms have spent large amounts of time and money putting their systems in place to comply with CFTC's rules. Because SEC has not finalized all of its major rules yet, the extent to which they will differ from CFTC's rules is uncertain. If SEC's final rules include different requirements than CFTC's rules, market participants will have to further revise their infrastructure, trading systems,

[85]SEC has identified 29 regulatory areas where rules are needed to regulate the security-based swaps marketplace, as mandated under the Dodd-Frank Act. For example, these regulatory areas include identification of major security-based swap participants, clearing agencies for security-based swaps, and duties of securities-based swap data repositories. As of December 2015, SEC had finalized rules in 18 of the 29 self-identified regulatory areas.

and documentation systems. Further, one industry association we spoke with noted that if firms are unable to use the systems they have already built after SEC issues its rules, they might avoid security-based swap transactions. For example, firms might decide they are better off handling certain trades in the futures markets rather than the swaps markets because of differences in the way the markets may end up being regulated. While some participants thought that joint rulemaking would have helped to solve these issues, others pointed out that it would have taken too long for the regulators to agree on the rules and that the systemic risks present before the financial crisis would have continued to exist.

CFTC's and SEC's efforts to develop the regulatory framework for swaps illustrate the same types of challenges the agencies have faced historically in separately regulating the interconnected markets. In its March 2008 white paper on financial regulatory reform, Treasury noted that the realities of the current marketplace have significantly diminished, if not entirely eliminated, the original reason for the regulatory bifurcation between the futures and securities markets.[86] It stated that product and market participant convergence, market linkages, and globalization have rendered regulatory bifurcation of the futures and securities markets untenable, potentially harmful, and inefficient. To address this issue, it recommended that CFTC and SEC should be merged to provide unified oversight and regulation of the futures and securities industries. In addition, in its November 2012 report investigating the bankruptcy of MF Global—a large, globally active company with a commodity and securities broker-dealer—the House of Representatives Committee on Financial Services, Subcommittee on Oversight and Investigation, found that SEC and CFTC failed to share critical information about the company with one another.[87] The report states that the failure to coordinate regulatory oversight of the company meant that the agencies missed several opportunities to share critical information with one another. The subcommittee recommended that, given this failure to coordinate and the

[86]The Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure* (Washington, D.C.: Mar. 31, 2008).

[87]As a result of being both a commodity and securities broker-dealer, MF Global was regulated by both CFTC and SEC, as well as industry SROs. U.S. House of Representatives, *Staff Report Prepared for Rep. Randy Neugebauer, Chairman, Subcommittee on Oversight & Investigations Committee on Financial Services* (Washington, D.C: Nov. 15, 2012).

reality that futures products, markets, and market participants have converged, Congress explore whether customers and investors would be better served if SEC and CFTC streamline their operations or merge into a single agency that would have oversight of the securities and derivatives markets as a whole. Similarly, over a decade ago, in 1995, we suggested that Congress should analyze the benefits and risks of merging the two agencies and noted that a merger could increase regulatory effectiveness and efficiency.[88]

Fragmentation Has Created Inefficiency in Insurance Oversight and Could Hinder Effective Insurance Group Supervision

Fragmentation in the insurance regulatory structure has, in some instances, led to inefficient oversight of individual insurers and could create challenges to the effective oversight of insurance groups.[89] We have reported in the past on ways in which the state-based insurance regulatory structure has resulted in inefficient oversight of insurers, including uneven consumer protection and increased costs. State insurance regulators and NAIC have attempted to address these inefficiencies in oversight through initiatives aimed at achieving uniformity and reciprocity, such as through state adoption of NAIC model laws, but not all states have fully participated in these efforts.[90] Further, as a result of the financial crisis, concerns arose as to state insurance regulators' ability to comprehensively oversee all risks posed to insurance companies, particularly those originating in subsidiaries of a multijurisdictional insurance group. Although states have adopted, or are expected to adopt, NAIC model laws and regulations intended to help expand state regulators' authority over insurance groups, questions exist as to whether these efforts will grant insurance regulators consistent and effective authority over these entities.

[88] GAO/T-GGD-95-153.

[89] We use the term "insurance group" to refer to a group of affiliated companies, one or more of which is an insurance company.

[90] Reciprocity is the extent to which state regulators accept other states' regulatory actions, such as granting insurance licenses or approving products for sale in the insurance market, and do not require insurers to meet additional requirements in order to conduct insurance business in their state. Uniformity is the extent to which states have implemented either the same, or substantially similar, regulatory standards and procedures. Generally, a model act or law is meant as a guide for subsequent legislation by states. State legislatures may adopt model acts in whole or in part, they may modify them to fit their needs, or they may opt not to adopt them. Model laws become legally binding only upon enactment as law or regulation by state legislatures, governors, and/or insurance regulators.

Uneven Consumer Protection and Increased Costs to Insurers

The fragmented regulatory structure can be inefficient, resulting in increased costs to industry participants and consumers. For example, we have found that the product review and approval processes for certain types of insurance products that are sold on a multistate or nationwide basis were not uniformly conducted.[91] As a result, we found that the lack of uniform product approval processes makes it difficult for insurers that operate in multiple states to achieve timely and cost-effective approval because they must submit applications with different requirements in each state in which they wish to operate. This creates inefficiencies, which may result in higher costs for insurers and, in turn, consumers, and may also inhibit the introduction of new products. In 2002, to improve the speed and efficiency of product approval, NAIC and state regulators developed an interstate agreement to standardize procedures for approval for certain lines of insurance and for participating states. In April 2009, we found that while the agreement provided for a more centralized and streamlined process, several key states had not joined the agreement because, according to industry officials, those states believed that their product approval processes provided better consumer protections than those of the agreement. As a result, we recommended that NAIC and state regulators work with the insurance industry to further identify differences in the ways state regulators review and approve product filings.[92] Although NAIC and state regulators have taken steps to address the lack of uniformity in product approval, NAIC cannot force states to adopt its initiatives, and the success of any of its initiatives is reliant upon the common consent of the states. While 10 more jurisdictions have joined the agreement since our 2009 report, as of

[91]During product approval processes, regulators review insurers' products and rates, in some cases, before they enter the market for sale to consumers. Regulators review policy forms, which are legal contracts that describe the characteristics of the products insurers intend to sell and the rates or prices they intend to charge, and then grant or deny product approval. GAO, *Insurance Reciprocity and Uniformity: NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval, and Market Conduct Regulation, but Challenges Remain,* GAO-09-372 (Washington, D.C.: Apr. 6, 2009).

[92]At the time the report issued, NAIC agreed with our recommendation. Consistent with our recommendation, in 2013, NAIC worked with regulators and industry through a task force to identify ways to improve the efficiency of product filing submission, review, and approval.

December 2015, seven states, the District of Columbia, and four U.S. territories continued to operate outside of the agreement.[93]

Producer licensing—the licensing of agents and brokers who sell insurance—is also an area of the insurance industry where fragmentation has led to inefficient oversight as well as uneven consumer protection. Since 2002, we have reported that the processes for licensing producers have varied across states, resulting in increased costs for insurers because they must follow different application processes and standards to meet individual state requirements.[94] To improve reciprocity in producer licensing, NAIC developed the Producer Licensing Model Act in 2000, which set licensing standards for states to follow.[95] However, we found in April 2009 that several key states had generally not accepted licenses granted by states with less stringent licensing standards.[96] For example, while criminal background checks are not required for reciprocal licensing arrangements between states, state insurance regulators have responsibility to review insurance applications and prevent criminals from being licensed. We found that some states that conduct background checks that include fingerprinting have been unwilling to reciprocate with states that conduct background checks that do not include fingerprinting. These regulators told us that they would be weakening consumer protections by accepting the licensing decisions of states that do not perform background checks that include fingerprinting. Although NAIC's producer licensing initiatives have resulted in increased reciprocity among states over time, neither universal reciprocity nor uniformity in producer licensing has been achieved through NAIC initiatives and common consent of the states. We found that while the lack of uniformity and reciprocity did not preclude producers from obtaining a license in multiple states, producers experienced increased costs and inefficiencies because

[93]State-based insurance regulation in the United States is comprised of 56 jurisdictions including the 50 states, the District of Columbia, and five U.S. territories.

[94]GAO, *State Insurance Regulation: Efforts to Streamline Key Licensing and Approval Processes Face Challenges,* GAO-02-842T (Washington, D.C.: June 18, 2002).

[95]In 1999, Congress passed the Gramm-Leach-Bliley Act, which encouraged at least 29 states to meet reciprocity or uniformity conditions within 3 years of the act's passage in order to avoid preemption of certain state producer licensing laws and the potential formation of a federal regulatory body for insurers. To help meet the requirements of the act, NAIC developed the Producer Licensing Model Act to promote a framework for reciprocal producer licensing relationships among states.

[96]GAO-09-372.

they had to follow different application processes and standards to meet individual state requirements. In response to these findings, we suggested that Congress may wish to explore ways to ensure that all state insurance regulators could conduct nationwide criminal background checks as part of their producer licensing and consumer protection functions.[97] In 2015, congressional intervention was taken to try to achieve reciprocity. The National Association of Registered Agents and Brokers Reform Act of 2015 was enacted in January 2015 and created a national clearinghouse for producers licensed in one state to operate in all states through a membership system. The act stipulates that the establishment and membership in the association will take effect no sooner than January 2017.

Challenges to Comprehensive Risk Oversight

While actions taken by state and federal regulators and NAIC helped to limit the effects of the 2007-2009 financial crisis on insurers and policyholders, concerns arose as to state insurance regulators' ability to comprehensively oversee all risks posed to insurance companies, particularly those originating in subsidiaries of a multijurisdictional insurance group.[98] In particular, the state-based insurance regulatory structure may potentially limit state insurance regulators' ability to comprehensively oversee all risks posed to insurance companies. Insurance supervision in the United States is generally at the legal entity level where the contract with the policyholder is held, rather than the holding company or group level, in cases where a company owns one or more insurance companies. Therefore, although state insurance regulators have the authority to supervise individual insurance companies in their states, they have traditionally lacked the legal authority to directly supervise a company that might own an insurer, or to directly supervise a noninsurance affiliate or any affiliate domiciled and operating outside of the state. Instead, states approach group supervision through a review of the holding company system. Although NAIC has revised its insurance holding company model law several times since first passing it in 1969,

[97]NAIC generally agreed with this matter for congressional consideration. The enactment of the National Association of Registered Agents and Brokers Reform Act of 2015 established the National Association of Registered Agents and Brokers which, among other things, requires insurance producers to successfully pass a criminal background check in order to become members. This matter for congressional consideration has been closed as implemented.

[98]GAO, *Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis,* GAO-13-583 (Washington, D.C.: June 27, 2013).

the general principles of group supervision have remained the same. Described as a "windows and walls" approach, group supervision provides state regulators "windows" to scrutinize group activity and assess its potential effect on the ability of the insurer to pay its claims and "walls" to protect the capital of the insurer by requiring the insurance commissioner's approval of material related-party transactions. However, concerns about the effectiveness of group supervision arose during the 2007-2009 financial crisis when a number of insurers received extraordinary financial support from governmental entities. For example, one of the largest U.S. holding companies that had substantial insurance operations, American International Group, Inc. (AIG), suffered large losses. These losses were driven in large part by certain activities conducted by noninsurance affiliates and life insurance subsidiaries.[99] In its insurance modernization report, FIO said that inherent limitations of state law, stemming from the lack of legal authority to supervise noninsurance affiliates or those located outside of the state, have constrained state regulators in conducting oversight over or obtaining information on the operations of subsidiaries in a multijurisdictional insurance group.[100]

Since the crisis, steps have been taken to enhance authorities in this area. First, the Dodd-Frank Act partly addresses this limitation by requiring the Federal Reserve to establish enhanced prudential standards

[99]The key sources of financial trouble for AIG were primarily held in two noninsurance subsidiaries. First, the company conducted its credit default swap business through the AIG Financial Products subsidiary, whereby AIG Financial Products would enter into bilateral contracts that were sold over the counter and transfer credit risks from one party to another. Second, the AIG Securities Lending Corporation conducted securities lending activity, through which AIG's insurance subsidiaries authorized AIG Securities Lending Corporation to act on their behalf to loan securities to other financial institutions in exchange for cash collateral. Both of these programs strained AIG's liquidity and ultimately required federal financial assistance from the Federal Reserve and Treasury to avoid bankruptcy. Prior to the Dodd-Frank Act, OTS was AIG's consolidated supervisor. For additional information on federal financial assistance provided to AIG during the 2007-2009 financial crisis, see GAO, *Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group, Inc.,* GAO-11-616 (Washington, D.C.: Sept. 30, 2011); *Troubled Asset Relief Program: Third Quarter 2010 Update of Government Assistance Provided to AIG and Description of Recent Execution of Recapitalization Plan,* GAO-11-46 (Washington, D.C.: Jan. 20, 2011); and *Troubled Asset Relief Program: Government's Exposure to AIG Lessens as Equity Investments Are Sold,* GAO-12-574 (Washington, D.C.: May 7, 2012).

[100]Federal Insurance Office, *How To Modernize and Improve the System of Insurance Regulation in the United States* (Washington, D.C.: December 2013).

for nonbank financial companies—including insurance organizations—that FSOC designates for supervision by the Federal Reserve.[101] Second, NAIC developed initiatives in 2010 intended to enhance state regulators' "windows" to scrutinize group activity. These initiatives include revisions to NAIC's Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (holding company model laws) of 2010—and the introduction of another model law, the Risk Management and Own Risk and Solvency Assessment Model Act. The holding company model laws revisions are aimed at (1) expanding state regulators' ability to look at all entities in an insurance group; (2) enhancing state regulators' rights to access information, especially regarding the examinations of entities within the group; (3) enhancing state regulators' ability to participate in supervisory colleges; and (4) requiring insurers to identify and report their enterprise risk within the entire holding company system to the regulator in an annual filing.[102] Additional risk reporting is required from all U.S. insurers or their holding company through the Risk Management and Own Risk and Solvency Assessment Model Act, which sets out legal requirements for the development of a risk management framework. It also requires insurers to analyze all reasonably foreseeable and relevant material risks, such as underwriting, credit, and liquidity risks, that could affect an insurer's ability to meet its consumer obligations and to disclose those risks to state regulators by submitting an own risk and solvency assessment summary report. To encourage states to adopt the revised model laws, NAIC made adoption a requirement for states to maintain their NAIC accreditation effective January 1, 2016, for the revised Insurance Holding Company System Regulatory Act and effective

[101]As of January 2016, four nonbank financial companies, AIG, General Electric Capital, Prudential Financial, and MetLife, had received this designation. Of these, three (AIG, Prudential Financial, and MetLife) are insurance groups. As mentioned previously, the Federal Reserve also serves as the holding company supervisor for thrift holding companies previously overseen OTS—some of which have insurance subsidiaries. In this capacity, the Federal Reserve has authority to review the activities of any subsidiary in the thrift holding company structure. According to IMF, as of April 2015, the Federal Reserve supervised 15 insurance groups—4 of the largest in the United States—with its authorities to oversee thrift holding companies.

[102]The International Association of Insurance Supervisors defines a supervisory college as a forum for cooperation and communication between the involved supervisors established for the fundamental purpose of facilitating the effectiveness of supervision of entities which belong to an insurance group; facilitating both the supervision of the group as a whole on a group-wide basis and improving the legal entity supervision of the entities within the insurance group.

January 1, 2018, for the Risk Management and Own Risk and Solvency Assessment Model Act.[103] NAIC officials stated that they have found that, while model laws establish the standards for state regulators to follow, its accreditation program has helped to successfully drive uniformity among states in certain areas.

As of January 2016, NAIC determined that all 56 U.S. insurance jurisdictions had adopted the revised Insurance Holding Company System Regulatory Act, 34 jurisdictions had adopted the revisions to the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions, and 35 jurisdictions had implemented the Own Risk and Solvency Assessment requirement. NAIC staff noted that the Insurance Holding Company System Regulatory Act is the model law that provides states with the authority to carry out group supervision and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions provides details on how insurers should format certain reports that they submit to insurance regulators. NAIC staff noted that not all jurisdictions have adopted the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions, but NAIC staff said that this should not affect the effectiveness of group supervision since they believe that the act provides broad authority for the state to examine any information on the insurer and any other entities within the holding company structure.

Opinions vary on how likely NAIC's initiatives are to improve state insurance regulators' effectiveness in overseeing all risks posed to insurance companies. Some participants in our discussion group said that regulators should be able to more proactively supervise insurance companies at the group level once the initiatives are implemented. However, despite their adoption by states, it is not clear whether the model laws will grant state insurance regulators the authority to oversee affiliates because one state's laws do not extend beyond its borders to entities in another state. For example, FIO, in its insurance modernization report, questioned whether the initiatives will grant insurance regulators

[103]The NAIC Accreditation Program was established to develop and maintain standards to promote effective insurance company financial solvency regulation, particularly with respect to regulation of multistate insurers. Accreditation is a certification given to a state insurance department once it has demonstrated that it has met and continues to meet an assortment of legal, financial, and organizational standards as determined by a committee of its peers.

effective authority over noninsurance affiliates or holding companies, given that direct state regulatory authority is limited to the state-licensed legal entity.[104] NAIC officials disagreed with this perspective, stating that while questions may exist as to whether states have direct regulatory authority over noninsurance affiliates, they can still drive changes in behavior with their authorities, such as requirements for approval of material transactions. Further, the effectiveness of NAIC's initiatives is uncertain because of differences that may arise in the specific ways states may implement them. For example, states may make changes to NAIC's model laws, and the specific provisions of states' insurance laws may limit or alter states' ability to obtain information on noninsurance affiliates of the insurance group, limiting their ability to fully evaluate risks. NAIC officials noted that they do not expect the revisions states have made to the model laws to affect the effectiveness of the intent of the model laws. They noted that the revisions have been minor—for example, revisions have been made to accommodate state statutory drafting conventions.

In recent assessments of U.S. insurance regulation and supervision, FSB, IMF, and FIO made observations on the negative effects of the fragmented insurance regulatory structure. For example, FSB's 2013 assessment of the post-Dodd-Frank U.S. regulatory structure found that, among other things, significant additional work is needed to promote greater regulatory uniformity in the insurance sector.[105] It noted that because NAIC is not a supervisory authority and state laws must only be "substantially similar" to NAIC's model laws, divergent approaches between states can occur, which may affect the consistency of supervision applied to large insurance groups with national and international reach. Similarly, FIO stated that the state-based system of insurance regulation in the United States is inherently limited in its ability to regulate uniformly and efficiently, and IMF pointed out that NAIC continues to promote uniform standards of state regulation but that it

[104]Federal Insurance Office, *How To Modernize and Improve the System of Insurance Regulation in the United States* (Washington, D.C.: December 2013).

[105]Financial Stability Board, *Peer Review of the United States* (Basel, Switzerland: August 2013).

cannot enforce convergence.[106] While we have made recommendations to NAIC and state insurance regulators to improve uniformity and reciprocity in the past, the costs and benefits of further increases in reciprocity and uniformity must be considered. Regulators, insurers, and consumers may not benefit if achieving uniformity occurred by simply lowering standards across states. At the same time, it may not be feasible to achieve reciprocity and uniformity across states by meeting the highest standard achieved by any one state.

Several suggestions have been made by both U.S. agencies and international bodies that Congress should consider pursuing reforms to the insurance regulatory system that would promote more regulatory consistency at the national level. While many options include an expanded federal role, variations exist in the suggested level of federal involvement. In both its 2008 and 2009 white papers on financial regulatory reform, Treasury recommended creating an optional federal charter for insurers to increase uniformity in insurance regulation.[107] An optional federal charter could provide for a system of federal chartering, licensing, regulation, and supervision. It could also provide that the current state-based regulation of insurance would continue for those not electing to be regulated at the national level. FIO has also said that federal involvement of some kind in insurance regulation is necessary and would improve uniformity, efficiency, and consistency, but that the ideal solution would not necessarily be for the federal government to displace state regulation completely. Rather, it stated that consideration should be given to whether there are areas in which federal involvement in regulation under the state-based system is warranted and what kind of federal involvement would best provide for attaining policy objectives.[108] In their assessments of the U.S. regulatory structure, both FSB and IMF

[106]Federal Insurance Office, *How To Modernize and Improve the System of Insurance Regulation in the United States* (Washington, D.C.: December 2013) and International Monetary Fund, *Financial Sector Assessment Program: Detailed Assessment of Observance of Insurance Core Principles,* IMF Country Report No. 15/90 (Washington, D.C.: April 2015).

[107]The Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure* (Washington, D.C.: Mar. 31, 2008) and *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation* (Washington, D.C.: June 17, 2009).

[108]Federal Insurance Office, *How To Modernize and Improve the System of Insurance Regulation in the United States* (Washington, D.C.: December 2013).

also noted that increased federal involvement may help improve uniformity. FSB said that consideration should be given to a more federal and streamlined structure and IMF suggested that expanding the federal role by assigning regulatory responsibilities to an independent agency with a national mandate might help improve consistency in insurance regulation.

Regulatory Structure Complicates U.S. Coordination Internationally

The U.S. regulatory structure can also complicate regulators' efforts to coordinate internationally with other regulators. In 2004, we found that a key development that has significantly challenged the existing regulatory structure was the increasingly global nature of financial markets over the past few decades.[109] Globalization of financial markets has required U.S. regulators to coordinate with each other and with their international counterparts to effectively adapt to industry changes. However, coordination and consensus among U.S. regulators has sometimes been difficult to achieve, in part, because the regulatory structure consists of multiple regulators in each financial sector with differing regulatory perspectives based on their statutory missions. To assist international coordination efforts, international bodies consisting of regulators from numerous countries develop financial reforms and set industry standards.[110] Multiple U.S. financial regulators participate in a variety of international bodies, including the Basel Committee on Banking Supervision (Basel Committee), the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissioners (IOSCO). The Basel Committee is the primary global standard-setter for the prudential regulation of banks, and FDIC, the Federal Reserve, and OCC are members. IAIS is responsible for developing principles and standards for the supervision of the insurance sector, and U.S. members include NAIC, FIO, the Federal Reserve, each of the 50 U.S. state insurance regulators, and regulators from the District

[109] GAO-05-61.

[110] In general, many of these bodies operate on a consensus basis and have no legally binding authority. Thus, financial reform agreements reached by these bodies must be adopted voluntarily by their member jurisdictions, such as through legislative or regulatory changes (or both), to take effect.

of Columbia and the 5 U.S. territories.[111] IOSCO sets global standards for the securities sector to protect investors; ensure fair, efficient, and transparent markets; and reduce systemic risks. Both CFTC and SEC are members of IOSCO.

We have previously reported on instances in which the fragmented U.S. regulatory structure has precluded the ability of financial regulators to convey a single U.S. position in international discussions. For example, in the Basel Accords process for developing international capital standards for banks, each federal regulator involved oversees a different set of institutions and represents an important regulatory perspective, which made reaching domestic consensus on some issues difficult. Although U.S. regulators generally agreed on the broad underlying principles at the core of Basel II, including increased risk sensitivity of capital requirements and capital neutrality, in an October 2004 report we found that they sometimes had difficulty agreeing on certain aspects of the process.[112] We also found that the sometimes conflicting views expressed by U.S. regulators made it difficult for other countries to understand the U.S. position and that Congress had informed the bank regulatory agencies that it thought that the discord surrounding Basel II had weakened the U.S. negotiating position. Congress believed this resulted in an agreement that was less than favorable to U.S. financial institutions. However, regulatory officials we spoke to for our 2004 report also told us that the final outcome of the Basel II negotiations was better than it would have been with a single U.S. representative because of the agencies' varying perspectives and expertise. More recently, one regulator told us that the additional capital safeguards embedded in the U.S. implementation of Basel II appear to have enabled U.S. institutions to

[111]NAIC was a founding member of IAIS in 1994. FIO became a member of IAIS in 2011, after the Dodd-Frank Act created the office and gave it a range of authorities, including coordinating on international insurance matters and representing the United States in IAIS, as appropriate. Pub. L. No. 111-203, § 502, 124 Stat. 1376, 1580 (codified at 31 U.S.C. § 313). The Federal Reserve became a member in 2013, after FSOC designated some insurers for enhanced supervision by the Federal Reserve. According to the Federal Reserve, some of the insurance holding companies subject to Federal Reserve supervision are internationally active firms that compete with other global insurers to provide insurance products to businesses and consumers around the world. As part of its supervisory activities for these firms, the Federal Reserve collaborates with its regulatory counterparts internationally and, as part of this role, the Federal Reserve joined IAIS.

[112]GAO-05-61. Basel II refers to the risk-based capital framework issued in June 2004 by the Basel Committee.

recover more quickly from the crisis than some of their foreign counterparts.

Since the Dodd-Frank Act was enacted, U.S. regulators have continued to face challenges in their efforts to coordinate internationally. In addition to the individual state insurance regulators, the Federal Reserve is also involved in the supervision of insurance holding companies. Further, the Dodd-Frank Act established FIO and provided it authority to, among other things, represent the United States, as appropriate, at IAIS and to coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters. As a result of this fragmentation, complications have arisen in efforts to effectively represent U.S. interests in international forums focused on the supervision of internationally active insurance groups.[113] In a June 2015 report examining the development of international capital standards for these groups, we found that initially, after the Federal Reserve and FIO joined IAIS, U.S. IAIS members did not collaborate effectively or speak with a unified voice on international capital standards for insurers.[114] Similarly, in 2015, IMF reported that state insurance regulators and the Federal Reserve had different focuses and potential conflicts between their objectives regarding group-wide supervision.[115] IMF found that the state insurance regulators focused on policyholder protection, while the Federal Reserve, in relation to insurance consolidated supervision, focuses on protecting depositors and risks to financial stability. IMF also noted that state regulators' objectives are not clearly and consistently defined in law and agency officials told us that when FIO and the Federal Reserve joined IAIS, they did not have official policies guiding their work in IAIS or in collaboration with other U.S. IAIS members on international capital standards. U.S. IAIS members and stakeholders pointed to areas of public disagreement between FIO and NAIC on issues including FIO's

[113]According to IAIS, insurance groups qualify as internationally active insurance groups if they (1) write premiums in not fewer than three international jurisdictions and have at least 10 percent of gross premiums written outside of their home jurisdiction and (2) have at least $50 billion in total assets, or have at least $10 billion in gross written premiums.

[114]GAO, *International Insurance Capital Standards: Collaboration among U.S. Stakeholders Has Improved but Could Be Enhanced,* GAO-15-534 (Washington, D.C.: June 25, 2015).

[115]International Monetary Fund, *United States: Financial Sector Assessment Program: Detailed Assessment of Observance of Insurance Industry Core Principles*, IMF Country Report No. 15/90 (Washington, D.C.: April 2015).

potential role in supervisory colleges and the general need for certain capital standards.

This lack of a unified U.S. view initially was thought by industry participants to have reduced U.S. influence in IAIS, and some insurers indicated that this was one factor that enabled foreign regulators to strongly influence initial IAIS work on capital standards. While we concluded in our 2015 report that U.S. IAIS members had increased their focus on collaborating with each other and with U.S. stakeholders, and were aiming to establish a more unified U.S. view, we stated that in the multilateral setting of IAIS, U.S. members could better advance U.S. interests and concerns with a more unified voice and that room for improvement remained. As a result, we recommended that FIO, the Federal Reserve, and NAIC enhance future collaborative interagency efforts by following additional leading practices for collaboration, such as taking steps to sustain leadership in the collaborative efforts over the long term.[116] We see this as particularly important, given that the tenure of high-level officials who participate in the U.S. collaborative efforts is not guaranteed through the upcoming implementation of international capital standards. Further, even with improved collaboration by FIO, the Federal Reserve, and NAIC, we found that there is some uncertainty about the legal mechanisms that would be used by states to implement the standards in the United States. NAIC officials told us that implementation of new capital standards in the United States would likely require individual states to pass legislation that incorporates the standards. As we discussed previously, fragmentation in U.S. insurance regulation complicates uniform adoption of standards among the states.

[116]FIO concurred with the recommendation, stating that it would build on existing collaboration efforts. The Federal Reserve and NAIC did not indicate if they concurred or disagreed with the recommendation. As of January 2016, the recommendation remains open.

Concerns Have Not Been Fully Addressed

The Dodd-Frank Act has helped to mitigate some of the negative effects of fragmentation and overlap in the regulatory structure, but we and others continue to have concerns.[117] For example, depository institutions choose to operate under the state or federal charter that best accommodates their business and strategic needs and are allowed to change their charter if they have legitimate reasons for doing so. While we have noted that this can provide some benefits to depository institutions, in its June 2009 white paper on financial regulatory reform, Treasury stated that the presence of multiple federal supervisors and the ability of firms to easily change their charter can lead to weaker regulation.[118] For example, it stated that prior to the Dodd-Frank Act significant differences between thrift holding company and bank holding company supervision and regulation created arbitrage opportunities—that is, opportunities for institutions to exploit variations in how agencies implement regulatory responsibilities to minimize regulatory scrutiny. For example, although the Federal Reserve imposed leverage and risk-based capital requirements on bank holding companies, OTS did not impose any capital requirements on thrift holding companies, such as AIG.[119] AIG suffered significant financial losses during the crisis and required federal assistance to mitigate systemic risk concerns. According to Treasury, AIG

[117]For example, see Bipartisan Policy Center, *Dodd-Frank's Missed Opportunity: A Road Map for a More Effective Regulatory Structure* (Washington, D.C.: April 2014); International Monetary Fund, *Financial Sector Assessment Program: Detailed Assessment of Observance of the Basel Core Principles for Effective Banking* Supervision, IMF Country Report No. 15/89 (Washington, D.C.: April 2015); International Monetary Fund, *United States: Financial Sector Assessment Program: Detailed Assessment of Observance of Insurance Industry Core Principles*, IMF Country Report No. 15/90 (Washington, D.C.: April 2015); and The Volcker Alliance, *Reshaping the Financial Regulatory System: Long Delayed, Now Crucial* (New York: NY: April 2015).

[118]The Department of the Treasury, *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation* (Washington, D.C.: June 17, 2009).

[119]AIG was a thrift holding company by virtue of its ownership of a federal savings bank and was under consolidated supervision of OTS. In a March 2007 report, we found differences in policies and approaches used by the Federal Reserve and OTS for consolidated supervision. We concluded that these agencies could perform consolidated supervision more efficiently and effectively by adopting management practices in the areas of performance management and collaboration. We recommended that the agencies foster more systematic collaboration to promote supervisory consistency, particularly for firms that provide similar services. As indicated previously, at the time of this report SEC also served as a consolidated supervisor for consolidated supervised entities, but SEC terminated this program in 2008. This recommendation was also made to SEC. Each of the three agencies addressed this recommendation, and the recommendation is closed as implemented. For more information, see GAO-07-154.

(as well as some large U.S.-based investment banks) chose to own depository institutions—thrifts—that were not considered “banks” under the Bank Holding Company Act, thereby allowing them to avoid the more rigorous oversight regime applicable to bank holding companies.[120]

The Dodd-Frank Act and the prudential regulators have tried to address regulatory arbitrage concerns. First, the Dodd-Frank Act generally prohibits charter conversions by a national bank or a federal thrift to a state bank or state thrift, or by a state bank or thrift to a national bank or federal thrift, while a depository institution is subject to any formal enforcement action or memorandum of understanding that involves a significant supervisory matter.[121] Second, in 2009, FFIEC issued a statement restricting proposed conversions by institutions that have less than satisfactory examination ratings or are subject to serious enforcement actions, among other things.[122] According to the prudential and state banking regulators, FFIEC’s statement covers a broader range of circumstances than the Dodd-Frank Act does. Further, by eliminating OTS and placing thrift holding companies under consolidated supervision of the Federal Reserve, the Dodd-Frank Act removed the option for firms to choose their consolidated supervisor based on the type of depository institution subsidiary the firm owns. In addition, because the Dodd-Frank Act transferred oversight authorities for federal thrifts from OTS to OCC, the only remaining potential arbitrage opportunity for federally-chartered institutions is to switch to a state charter. While all of these actions help to reduce opportunities for regulatory arbitrage through charter conversions, depository institutions still have a choice between more than one primary regulator. This allows depository institutions in good standing to continue to choose among charter types, and it creates the potential for arbitrage risks to continue. According to IMF, a large number of well-rated depository institutions currently fall outside the scope of both the Dodd-Frank Act and FFIEC statement on charter conversions. IMF states that there continues to be a steady stream of conversions in both directions,

[120]The Department of the Treasury, *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation* (Washington, D.C.: June 17, 2009).

[121]Pub. L. No. 111-203, § 612, 124 Stat. 1376, 1612 (2010).

[122]Federal Financial Institutions Examination Council, *Statement on Regulatory Conversion* (Washington, D.C.: July 1, 2009).

although the numbers are not large in absolute terms.[123] For example, according to Reports of Condition and Income (Call Report) data, approximately 300 depository institutions out of more than 6,500 institutions went through a charter conversion from 2011 through 2014.[124]

Further, IMF found that the Dodd-Frank Act reforms did not fundamentally address the fragmented nature of the U.S. financial regulatory structure and that the problems inherent in a system with multiple regulators with distinct but overlapping mandates remain. While IMF's April 2015 assessment found that cooperation among the prudential regulators has improved, it also stated that the supervisory structure of safety and soundness regulators involves substantial duplication of supervisory effort, carries a significant burden of ensuring cooperation and coordination, and runs the ongoing risk of inconsistent messages from the regulators. Further, it noted that new challenges exist for the prudential regulators with delineating their responsibilities in relation to those of CFPB. For example, the division of responsibilities between safety and soundness and consumer protection does not allow the prudential regulators to fully focus on safety and soundness matters because they retained their consumer protection oversight responsibilities for depository institutions with assets of $10 billion or less, as well as for certain consumer protection issues in institutions above that threshold. IMF noted that in other countries and regions, the establishment of a specialized consumer regulator has freed the bank supervisor to focus on safety and soundness matters. In those jurisdictions, the bank supervisor responds to operational and reputational risks associated with a bank's poor performance in dealing with customers, but it does not generally become involved in particular consumer matters.

[123]International Monetary Fund, *Financial Sector Assessment Program: Detailed Assessment of Observance of the Basel Core Principles for Effective Banking* Supervision, IMF Country Report No. 15/89 (Washington, D.C.: April 2015).

[124]This number does not reflect charter conversions resulting from mergers and acquisitions or credit union charter conversions; nor does it reflect institutions that choose to end their status as a depository institution. The Consolidated Reports of Condition and Income (Call Reports) are a primary source of financial data used for the supervision and regulation of banks and thrifts. They consist of a balance sheet, an income statement, and supporting schedules. The Report of Condition schedules provide details on assets, liabilities, and capital accounts. The Report of Income schedules provide details on income and expenses.

As evidenced by the examples in each financial sector described above, the U.S. regulatory structure historically has created and continues to create challenges to effectively overseeing the financial services industry. While agencies coordinate extensively to mitigate the effects of fragmentation and overlap, this coordination requires considerable effort that, in a more efficient system, could be directed toward other activities. Fragmentation and overlap limit the structure's ability to achieve three characteristics for an effective regulatory system that we identified in our framework for evaluating regulatory proposals. Our framework calls for a regulatory system that provides (1) efficient and effective oversight, (2) consistent financial oversight, and (3) consistent consumer and investor protections. The fragmented regulatory structure with overlapping authorities also makes it difficult to hold regulators accountable for meeting regulatory goals—an additional characteristic we identified in our framework.[125] In the past, we have suggested to Congress ways in which the financial regulatory structure could be altered to address the challenges stemming from fragmentation and overlap. In 1996, we suggested that the regulatory structure could be modernized by reducing the number of federal agencies with responsibility for the oversight of depository institutions, which we stated should help improve the consistency of oversight and reduce regulatory burden.[126] In 2004, we suggested that Congress consider ways to improve the regulatory structure and provided the following options.[127] First, the regulatory structure could be consolidated within "functional" areas, such as banking, securities, insurance, and futures.[128] The two changes at the federal level that would be needed to accomplish this restructuring would be the consolidation of the depository institution regulators and, if Congress wishes to provide a federal charter option for insurance, the

[125] GAO-09-216.

[126] GAO, *Bank Oversight Structure: U.S. and Foreign Experience May Offer Lessons for Modernizing U.S. Structure,* GAO/GGD-97-23 (Washington, D.C.: Nov. 20, 1996).

[127] GAO-05-61.

[128] "Functional" regulation is when financial products or activities are generally regulated according to their function, no matter who offers the product or participates in the activity. The functional regulator approach is intended to provide consistency in regulation and avoid the potential need for regulatory agencies to develop expertise in all aspects of financial regulation.

creation of an insurance regulatory entity.[129] Second, the regulatory structure could be based on a regulation by objective, sometimes known as the "twin peaks model." This option would require consolidating financial regulatory authority into two regulators, whereby one regulator would oversee safety and soundness and another would be a conduct-of-business regulator for financial institutions. The third option would be to combine all financial regulators into a single entity, creating one regulator to oversee all financial institutions. While the most recent regulatory reform—the Dodd-Frank Act—did make some changes to the regulatory structure, much of the structure remained the same. As a result, we continue to see negative effects created by fragmentation and overlap that challenge the effectiveness of the financial regulatory system.

Limitations in Agencies' Collaboration and FSOC's Authorities May Hinder Systemic Risk Oversight Efforts

The Dodd-Frank Act addressed the lack of systemic risk oversight by placing responsibility for identifying and responding to threats to financial stability, or systemic risks, on a collective group of federal and state regulators and others through the creation of FSOC. The Dodd-Frank Act also created OFR to support FSOC's activities and gave it broad systemic risk monitoring mandates (see table 3). These reforms aim to create ways to monitor, identify, and mitigate systemic risks within a regulatory structure that continues to be fragmented among numerous agencies. As a result, they create the potential for unnecessary duplication in activities or gaps in systemic risk oversight. FSOC's Systemic Risk Committee is the council's main staff-level vehicle for collaboration on systemic risk monitoring and identification efforts across the many federal and state financial regulators. However, the committee does not have full and consistent access to existing monitoring tools or other outputs developed by OFR and Federal Reserve. These two agencies conduct broad-based systemic risk monitoring efforts that use quantitative and qualitative information to monitor the breadth of the financial system for potential threats to financial stability.[130] The agencies have articulated similar goals with respect to their systemic risk monitoring activities. However, they have engaged in these efforts largely independently and their actions

[129]A federal charter option for insurance could allow insurance companies to decide whether to be subject to state or federal regulation, similar to the chartering system for depository institutions.

[130]As of January 2016, federal financial regulators other than the Federal Reserve did not conduct broad-based assessments of systemic risks. However, they did conduct their own assessments of risk within their regulatory jurisdictions and participated in FSOC.

have not been consistent with key practices for collaboration. While FSOC's mission includes responding to systemic risks, it has limited authorities to do so. The Dodd-Frank Act left financial regulatory agencies responsible for overseeing financial entities and activities. FSOC's designation authorities do allow FSOC to respond to risks arising from specific entities, but these authorities are limited with respect to risks that arise from financial activities spanning multiple entities. In these instances, FSOC can recommend but not compel regulatory action even with broad consensus among FSOC members. As a result, FSOC may lack the tools needed to comprehensively respond to systemic risks that may emerge.

Table 3: Financial Stability Oversight Council's (FSOC) and Certain Federal Agencies' Select Authorities/Missions Related to Systemic Risk Oversight

	Systemic risk monitoring and identification[a]	Systemic risk mitigation
FSOC[b]	• Identify risks to financial stability that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies. • Determine whether the failure or a disruption of a financial market utility or the conduct of a payment, clearing or settlement activity could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. • Monitor the financial services marketplace in order to identify potential threats to financial stability. • Identify gaps in regulation that could pose risks to financial stability. • Issue an annual report to Congress that includes potential emerging threats to financial stability.	• Designate nonbank financial companies for consolidated supervision by the Board of Governors of the Federal Reserve System (Federal Reserve) and enhanced prudential standards. • Designate financial market utilities and payment, clearing, and settlement activities as or likely to become systemically important. Designated utilities and payment, clearing, and settlement activities become subject to certain robust risk management and safety and soundness standards under the oversight of a supervisory agency or the Federal Reserve. • Issue recommendations to primary financial regulatory agencies to apply new or heightened standards for a financial activity or practice conducted by bank holding companies or nonbank financial companies under the agencies' jurisdictions. • Make recommendations in its annual reports to, among other things, enhance financial market stability.
Office of Financial Research (OFR)	• Develop and maintain metrics and reporting systems for the risks to U.S. financial stability. • Monitor, investigate, and report on changes in systemwide risk to FSOC and to Congress. • Issue an annual report to Congress that includes potential emerging threats to U.S. financial stability. • Evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by FSOC member agencies.	N/A

	Systemic risk monitoring and identification[a]	Systemic risk mitigation
Federal Insurance Office (FIO)	• Monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system. • Recommend to FSOC that it designate an insurer as an entity subject to regulation as a nonbank financial company supervised by the Federal Reserve.	N/A
Federal Reserve	• May develop analytic techniques to identify, measure, and monitor risks to the financial stability of the United States, as part of its requirement to conduct supervisory stress-tests of certain financial companies.	• Supervise bank holding companies with $50 billion in assets or more and nonbank financial companies designated by FSOC, and establish enhanced prudential standards, such as stress tests and resolution plans, to prevent or mitigate risks to financial stability. • Prescribe (or consult in the establishment of) enhanced risk-management standards for a designated financial market utility or entity conducting designated payment, clearing, or settlement activities for which the Federal Reserve or another federal agency is the agency that has primary jurisdiction over the entity.
Federal Deposit Insurance Corporation (FDIC)		• With the Federal Reserve, review resolution plans from bank holding companies with $50 billion in assets or more and nonbank companies designated by FSOC. • Resolve large financial companies whose failure and resolution under otherwise applicable Federal or State law may have serious adverse effects on financial stability in the United States.
Commodity Futures Trading Commission (CFTC), Securities and Exchange Commission (SEC)		• May prescribe enhanced risk-management standards for a designated financial market utility or entity conducting a designated payment, clearing, and settlement activity for which it is has primary jurisdiction.

Source: Dodd-Frank Act and GAO analysis. | GAO-16-175

[a]As of January 2016, federal financial regulatory agencies other than the Federal Reserve did not conduct broad-based assessments of systemic risks. However, they did conduct their own assessments of risk within their own regulatory jurisdictions and participated in FSOC.

[b]FSOC members include the Secretary of the Treasury, who chairs the council, and the heads of the Bureau of Consumer Financial Protection, CFTC, FDIC, Federal Reserve, the Federal Housing Finance Agency, the National Credit Union Administration, the Office of the Comptroller of the Currency, SEC, FIO, and OFR; representatives from the state banking, securities, and insurance regulators; and an independent insurance expert. FSOC member agency staff participate in FSOC committees to help fulfill FSOC's mission to identify risks to financial stability and respond to emerging threats.

FSOC'S Systemic Risk Committee Has Improved Interagency Collaboration but Does Not Have Access to Key Information

Interagency Collaboration in Systemic Risk Monitoring

As mentioned earlier, through the creation of FSOC—whose members include the heads of the federal financial regulatory agencies and are collectively referred to as principals—the Dodd-Frank Act addressed the lack of systemic risk oversight by making financial regulators and others collectively responsible for identifying systemic risks. FSOC's functional committees help the council carry out its authorities.[131] FSOC's committees generally comprise staff from each of its member agencies. In addition to the functional committees, FSOC's Deputies Committee is made up of senior officials designated by principals and is responsible for overseeing the work of the other committees. Further, the FSOC Secretariat—a dedicated policy office in Treasury's Office of Domestic Finance—coordinates the work of the committees and assists FSOC's chairperson (the Secretary of the Treasury) in carrying out his or her responsibilities. The Systemic Risk Committee is FSOC's main staff-level vehicle for collaboration on systemic risk monitoring and identification efforts across federal and state financial regulators. The committee is tasked with (1) monitoring and analyzing financial markets, the financial system, and issues related to financial stability to support FSOC's mission to identify and respond to risks and emerging threats, (2) facilitating information sharing and coordination among FSOC member staff and member agencies to help identify and respond to risks to financial stability, (3) supporting FSOC's responsibilities to annually report to and testify before Congress, and (4) coordinating with other FSOC committees on issues of common interest, as appropriate.[132] Treasury

[131] As of January 2016, FSOC's functional committees were the Data Committee; Financial Market Utilities and Payment, Clearing, and Settlement Activities Committee; Nonbank Financial Companies Designations Committee; Regulation and Resolution Committee; and the Systemic Risk Committee.

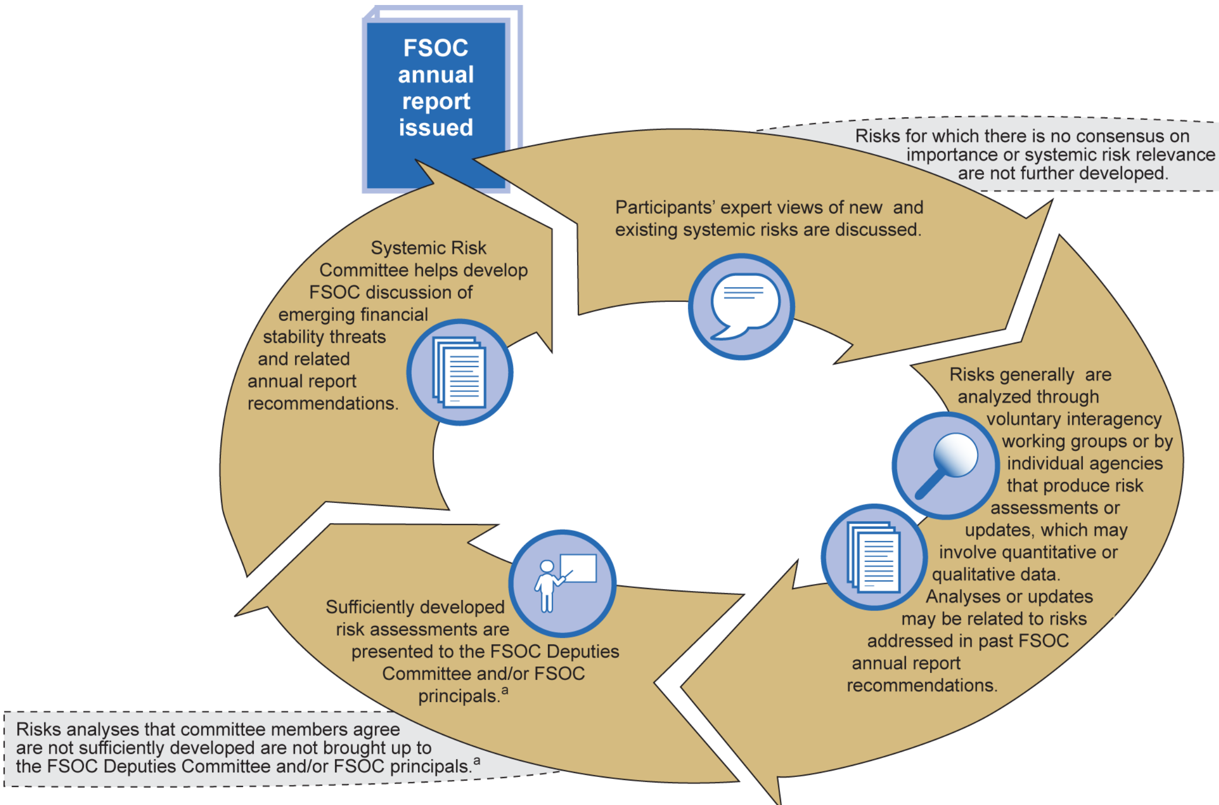
[132] Other FSOC committees also perform analysis of systemic risks related to their own missions. For example, FSOC's Nonbank Financial Companies Designations Committee and Financial Market Utilities and Payment, Clearing, and Settlement Activities Committee both are tasked with analyzing potential risks and providing recommendations to FSOC related to potential designations under titles I and VIII of the Dodd-Frank Act, respectively.

has administrative responsibility for coordinating the activities of the Systemic Risk Committee, which generally holds monthly meetings.

The Systemic Risk Committee's process for identifying, monitoring, and reporting on systemic risks is consensus based (see fig. 7). FSOC member agency staff generally agreed that the committee provides a venue for a regular and collaborative exchange of ideas and information about particular risks and a unique opportunity to learn in greater depth about risks from the point of view of other regulators. They generally agreed that the agenda, set by FSOC Secretariat staff, is flexible and members feel free to bring up any topics they deem important for interagency discussion. Our review of committee documents from July 2012 through August 2014 found that member agency staff generally organized in working groups to analyze specific potential systemic risks or provided updates on certain issues using both quantitative and qualitative information. Analyses or updates may be related to risks addressed in past FSOC annual report recommendations. Additionally, since we reported on FSOC processes in 2012, the work of the Systemic Risk Committee has become more tightly integrated into FSOC's annual reports, as represented in figure 7.[133] Staff from several FSOC member agencies stated that they benefited from committee analyses and presentations, which can pool information on a given risk from across the financial regulatory spectrum. Member agencies also generally stated that participation in the Systemic Risk Committee and other FSOC activities helped them build informal communication channels and good working relationships among staff across the agencies, which was not always common before the creation of FSOC and the committee.

[133] GAO-12-886.

Figure 7: Financial Stability Oversight Council's (FSOC) Systemic Risk Committee Process for Identifying, Monitoring, and Reporting on Systemic Risks



Source: GAO analysis of FSOC documentary and testimonial evidence. | GAO-16-175

[a]FSOC's Deputies Committee oversees the work of the other interagency staff committees. The members of the Deputies Committee are designated by each FSOC member. FSOC members are also referred to as principals and are generally the heads of each of the FSOC member agencies.

Use of Systemic Risk Monitoring Information

While FSOC's Systemic Risk Committee produces analyses of identified potential systemic risks using both quantitative and qualitative information, the current process for identifying potential new systemic risks continues to rely primarily on participants sharing their expert views on potential threats at the Systemic Risk Committee for consideration. That is, to identify new threats, Systemic Risk Committee members raise any new systemic risk concerns that they may have and, if there is sufficient consensus to study the issue further, they volunteer and organize in working groups to collaboratively produce risk assessments (see fig. 7).[134] However, as part of this process, the committee does not have full and consistent access to existing systemic risk monitoring tools or other outputs developed by OFR and the Federal Reserve, and legal data-sharing obstacles may impede access to additional monitoring information produced by OFR or other agencies.

Both OFR and the Federal Reserve conduct broad-based systemic risk monitoring efforts. In 2013, OFR released a prototype of its Financial Stability Monitor, a quantitative systemic risk monitoring tool that OFR describes as its benchmark tool for assessing risks across the system. The monitor uses publicly and commercially available data to provide a snapshot of potential weaknesses in broad areas of the financial system that may threaten financial stability. OFR shared early versions of the Financial Stability Monitor with the Systemic Risk Committee prior to its first public release in OFR's December 2013 annual report. Since that time, OFR has refined, broadened, and deepened the monitor and also began providing semiannual updates through its website and annual reports, but has only presented the updates and revised assessments to FSOC principals and the Deputies Committee and not the Systemic Risk Committee.

As seen in table 4, the Financial Stability Monitor is part of a suite of monitors that OFR is developing.[135] OFR staff said that to the extent that the monitors that are still in development contain disaggregated confidential information, they could not be shared widely with Systemic Risk Committee members even after they are completed. OFR staff and others stated that data-sharing agreements, which are designed to protect confidentiality and market integrity, generally include restrictions on how an agency may share information it receives from another agency with third parties. OFR staff said that at this time, monitors that use disaggregated confidential information could only be shared with certain

[134]Systemic Risk Committee agendas show that sometimes there is time allotted for discussion of new potential threats during committee meetings.

[135]Other monitors in development include some that examine particular market segments or asset classes, such as hedge funds, money market funds, and credit default swaps. According to OFR and Treasury staff, as of January 2016, OFR shared its Financial Markets Monitor monthly with the Systemic Risk Committee. However, this monitor is a review of themes and developments in financial markets and is not intended to measure or identify systemic risks. As is the case with the Financial Stability Monitor, the monitor uses only publicly and commercially available data. OFR also began making the Financial Markets Monitor available for the public on its website in February 2015.

FSOC member agency staff—generally FSOC deputies and principals—who sign specific agreements or where consent is given by the information provider. Several committee participants told us that Systemic Risk Committee meetings are open to any member agency staff, and OFR staff stated that current OFR agreements involving confidential information do not allow OFR to share such information with Systemic Risk Committee members at large unless it is anonymized or properly aggregated per the terms of the agreement. For example, even though OFR has authority to obtain data from FSOC member agencies, staff from SEC, which shares some of its data with OFR, stated that when providing data to OFR or others, SEC must ensure that its own statutory and other requirements for data sharing are followed.

Table 4: Office of Financial Research (OFR) Monitors Related to Financial Stability, January 2016

Monitor	Frequency of updates and assessments	Description	Data informing the monitor
Financial Stability Monitor	Semiannual	Provides a snapshot of weaknesses in the financial system based on indicators in five functional areas of risk: macroeconomic, market, credit, funding and liquidity, and contagion. The monitor is not designed to predict the timing or severity of a financial crisis but to identify, at a high level, underlying vulnerabilities that may predispose the system to a crisis.	Public data, commercially acquired data, and industry analyses
Financial Markets Monitor	Monthly	Provides an overview of major developments and emerging trends in global capital markets.	Public data, commercially acquired data, and industry sources
Money Market Fund Monitor	Monthly	Examines individual funds and the industry as a whole on the basis of credit, interest rate, and liquidity risk. Each risk category is analyzed based on portfolio statistics and holdings.	Supervisory confidential information from the Securities and Exchange Commission (SEC), publicly available with a time lag[a]
Credit Default Swaps Monitor	To be determined	Provides analytics on various financial stability metrics in the credit default swap market, such as excessive market concentration and interconnectivity, through the use of risk metrics and visual assessment techniques.	Privately acquired confidential data from the Depository Trust & Clearing Corporation and commercially acquired data
Hedge Fund Monitor	To be determined	Provides analytics on potential risks that could arise out of the hedge fund industry.	SEC confidential supervisory information and commercially acquired data
Correlation Monitor	Daily	Explores cross asset correlations through interactive visualizations	Public data, commercially acquired data

Source: Office of Financial Research. | GAO-16-175

[a]According to OFR staff, OFR obtains form N-MFP information from SEC on monthly schedules of portfolio holdings of money market funds. As of January 2016, SEC published these data publicly with

a 60 day lag. However, in August 2014 SEC eliminated the lag on public availability of these data, which OFR staff stated are intended to be publicly available in April 2016.

Note: According to OFR staff, as of January 2016, the Financial Stability Monitor and the Financial Markets Monitor are the only monitors in production. The remaining monitors are still under development.

The Federal Reserve also conducts frequent, broad-based systemic risk monitoring. However, the agency does not systematically share comprehensive results of its monitoring efforts with the Systemic Risk Committee, as these are intended for internal use to inform Federal Reserve policy, according to Federal Reserve staff. For example, Federal Reserve staff produce a quarterly assessment to provide the Federal Reserve Board with regular, confidential systemic risk assessments to inform Federal Reserve policy, including monetary policy.[136] Federal Reserve staff stated that such assessments or their underlying analyses may contain confidential supervisory information, including data from supervisory stress tests.

Federal internal control standards call for the use of relevant, reliable, and timely information from internal or external sources to achieve the entity's responsibilities.[137] In addition, according to IMF, efforts to monitor the financial system for systemic risks must be based on a continuous assessment of evolving risks that uses quality qualitative and quantitative information.[138] IMF guidance states that, because sources of systemic risk can shift and indicators cannot capture all information, systemic-risk-related policy is generally better supported by guided discretion, where key indicators can help signal when adjustments might be appropriate but decisions are based on judgment that takes into account all available information. Such judgment requires access to both quantitative and qualitative information. In addition, our key collaboration practices call for identifying and addressing needs by leveraging resources, such as

[136]Federal Reserve staff stated that the agency has met with FDIC and OCC staff to discuss their assessments as part of the agencies' coordination efforts regarding the implementation of countercyclical capital buffer requirements on certain regulated entities.

[137]See GAO/AIMD-00-21.3.1 and GAO-14-704G. We updated the standards in 2014. The new standards, which became effective on October 1, 2015, call for the use of quality information to achieve an entity's objectives.

[138]International Monetary Fund, *Staff Guidance Note on Macroprudential Policy* (Washington, D.C.: December 2014) and *Key Aspects of Macroprudential Policy*, IMF Policy Paper (Washington D.C.: June 2013).

leveraging OFR's and Federal Reserve's broad-based systemic risk monitoring efforts for Systemic Risk Committee use.[139]

Both OFR and the Federal Reserve officials stated that participation of key staff in the Systemic Risk Committee allows for the proper sharing of information on systemic risks identified by their respective efforts. OFR staff stated that by participating in the committee they are ensuring that staff assessments based on OFR monitors are being considered by all member agencies at Systemic Risk Committee meetings. Treasury and OFR staff also stated that once OFR finalized the Financial Stability Monitor, they deemed it more appropriate to present it to the FSOC principals and deputies, as risks are also discussed at those meetings. For their part, Federal Reserve staff stated that their participation in the Systemic Risk Committee is a built-in mechanism that helps ensure proper flow of information related to new risks between the Federal Reserve and the committee without the need to share the agency's internal assessments, reports, or other information. They stated that the Federal Reserve would have to carefully consider data confidentiality and other concerns when sharing such internal documents outside the agency. They also stated that when the Systemic Risk Committee analyzes specific threats that have been identified, Federal Reserve staff have shared analyses or metrics relevant to those threats.

However, participation of key OFR or Federal Reserve staff on the Systemic Risk Committee does not provide reasonable assurance that the committee has access to information that could better equip committee members to identify new potential risks to the system. For example, OFR staff presenting updated assessments of the Financial Stability Monitor or other systemic risk monitoring tools or outputs to FSOC principals or deputies is useful, but should not replace staff-level discussions of such information at the Systemic Risk Committee. Similarly, while sharing relevant metrics or specific analyses with the Systemic Risk Committee is appropriate, the committee is currently not fully benefitting from the frequent, broad-based systemic risk monitoring efforts already underway within the Federal Reserve. Systemic Risk Committee participants can dedicate time as a group to interpreting, assessing, and comparing existing financial stability assessments and can enrich the value of the monitors with their own points of view that,

[139] GAO-06-15.

together, encompass regulatory perspectives over all regulated financial entities and activities. Such an exercise could, for instance, allow staff to identify information within their own agencies that could improve the monitoring efforts and make them more useful for the purposes of the committee. Lastly, if the nature of open participation of FSOC member agency staff at the Systemic Risk Committee presents serious impediments to meaningful sharing and discussion of confidential supervisory and other information, other arrangements may help overcome such impediments. OFR staff said that although legal constraints preclude them from sharing some monitors' underlying data widely at the Systemic Risk Committee, they could share this information with a small group, as they have done in other settings. For example, they could distribute numbered copies of the documents containing raw data if consistent with law and data-sharing agreements with the providing agencies. This could facilitate sharing information with a subset of the Systemic Risk Committee, but quality deliberation depends on the full participation of all relevant staff. The Systemic Risk Committee may not always require disaggregated, confidential information to carry out its responsibilities, but at times disaggregated data could be crucial for identifying systemically relevant interdependencies between financial entities or markets supervised by different regulators under the existing fragmented regulatory structure. Without better access to systemic risk monitoring tools and other outputs, the Systemic Risk Committee may identify and advance the analysis of only a subset of systemic risks in a timely manner and may identify others too late or miss others altogether.

OFR's and Federal Reserve's Collaboration in Their Systemic Risk Monitoring Activities Is Limited

OFR and Federal Reserve both conduct broad-based systemic risk monitoring activities that aim to identify threats across the financial system. However, the two agencies have developed these efforts largely independently from one another, leading to lost collaborative opportunities that could improve their ability to identify systemic risks and reduce the potential for unnecessary duplication. OFR is responsible for monitoring, investigating, and reporting on changes in systemwide risk levels and patterns to FSOC and to Congress, as well as developing and maintaining independent analytical capabilities and computing resources to be used, among other things, to monitor, investigate, and report on systemic risks.[140] OFR also has authority to collect data from financial institutions and receive data from FSOC member agencies, and one of its goals is to produce tools and analyses that are widely used and critical to monitoring and assessing financial stability. To address this goal, OFR developed the Financial Stability Monitor for assessing systemic risks across the system.

After the 2007-2009 financial crisis, the Federal Reserve expanded its strategic goals and activities around systemic risk monitoring. The Dodd-Frank Act gave the Federal Reserve the authority to develop analytic techniques needed to identify, measure, and monitor systemic risks as part of its stress testing responsibilities.[141] Federal Reserve senior officials have publicly stated that financial stability responsibilities are part of the agency's role as the central bank of the United States. The agency also highlighted the importance of expanding and improving its systemic risk monitoring capabilities in its 2012-2015 Strategic Framework. As a result, the Federal Reserve pooled staff expertise from across the agency and the Federal Reserve Banks and developed procedures to periodically produce internal assessments of financial stability that inform Federal Reserve policy.

In comparing OFR's Financial Stability Monitor to the Federal Reserve's financial stability monitoring program, we found that, while there are some differences in the analytical approaches and the implementation of their efforts, they also have many shared features and similar broad systemic risk goals.[142]

[140]We have ongoing work that provides a more comprehensive examination of OFR's major activities and challenges it faces in carrying out its mission, which we anticipate issuing in 2016.

[141]Section 165(i)(1) of the Dodd-Frank Act requires the Federal Reserve to conduct stress tests of nonbank financial companies designated by FSOC and bank holding companies with $50 billion or more in assets to assess whether they have sufficient capital necessary to absorb losses as a result of adverse financial conditions. The act also specifies that the Federal Reserve may develop and apply such other analytic techniques as are necessary to identify, measure, and monitor risks to the financial stability of the United States.

[142]While OFR has other monitors, we chose to compare OFR's Financial Stability Monitor to the Federal Reserve's monitoring program because it is OFR's only monitor that aims to evaluate risks to the financial system as a whole. OFR's other tools focus on assessing risks in specific areas of the financial system and can complement the aggregate perspective of the Financial Stability Monitor.

- The primary intent of both agencies' efforts is to identify weaknesses or vulnerabilities in the financial system that, given a shock or series of shocks, could result in material disruptions in financial and economic activity.[143] Both agencies' efforts measure vulnerabilities using, among other things, quantitative metrics (or indicators) that cover similar areas of the financial system and similar types of risk—for example, financial leverage and valuations in equity and property markets. OFR's Financial Stability Monitor uses public and commercially acquired data to provide a snapshot of vulnerabilities in the financial system generally by highlighting sharp movements of key risk indicators from their historical means. The monitor is visualized in a heat map based on indicators of five broad areas of risk: macroeconomic, market, credit, funding/liquidity, and contagion. OFR staff then conduct further analysis on areas of concern flagged by the monitor. Consequently, OFR's assessments of the monitor are accompanied by additional data to support deeper analysis on various potential risks. According to Federal Reserve staff, the Federal Reserve's financial stability monitoring program is also informed by indicators and consists of over a dozen input reports containing in-depth analyses of vulnerabilities in the banking, shadow banking, asset market, and nonfinancial sectors.[144] The reports use a broad range of metrics that focus on financial system vulnerabilities, including leverage, maturity transformation, interconnectedness, complexity, and pricing of risk. According to Federal Reserve staff, their program is informed by public and commercially available data, confidential supervisory data such as stress test data, as well as qualitative information on risks regarding entities the Federal Reserve oversees.

[143]Vulnerabilities are weaknesses that transmit and amplify shocks. Vulnerabilities include credit or asset price bubbles, lax loan underwriting standards, insufficient bank capital or liquidity buffers to absorb losses or withdrawals, and risk exposure through a maturity mismatch between assets and liabilities. A triggering event, or shock, could be political or economic, such as turmoil in a region or the collapse of a market, or even a natural disaster.

[144]A description of the conceptual framework for the Federal Reserve monitoring program was made public in a report. See Tobias Adrian, Daniel Covitz, and Nellie Liang, *Financial Stability Monitoring,* Federal Reserve Bank of New York Staff Report No. 601 (February 2013, revised June 2014). According to that paper, shadow banking involves financial intermediation activities without an explicit government backstop. Some examples include securitized credits, mortgages, and loans facilitated by securities broker-dealers in markets outside of the traditional banking system.

- Both agencies aim to understand how financial vulnerabilities could allow apparently isolated shocks to spread—or propagate—across the financial system. OFR officials stated that their systemic risk monitoring goals include understanding the propagation of threats, and OFR stated in its December 2014 annual report that it is working to improve the Financial Stability Monitor by incorporating methods that take into account channels that can transmit or amplify shocks through the financial system. Federal Reserve staff stated that they analyze how vulnerabilities could interact with relevant shocks. An official added that the efforts focus on vulnerabilities that the Federal Reserve can affect through its own policy or mitigation tools.

- Both OFR and the Federal Reserve aim to have forward-looking tools to identify where the build-up of vulnerabilities can provide early insight into emerging systemic risks. For example, OFR completed a back-testing exercise to assess the potential of the Financial Stability Monitor to capture extreme financial or market events, identify turning points, and provide early warning signals of stress.[145] The Federal Reserve's program is similarly intended to be forward-looking—that is, indicators in the Federal Reserve's program are designed to capture vulnerabilities before they materialize in the form of market stress or crisis.

OFR and the Federal Reserve also are engaged in distinct but related stress-testing activities stemming from the Dodd-Frank Act.[146] OFR is mandated to evaluate and report on stress tests. The Federal Reserve is mandated to conduct supervisory stress tests of nonbank financial companies designated by FSOC and bank holding companies with $50 billion or more in assets, as well as prescribe, or help prescribe, scenarios for company-run stress tests for these and other companies. The Federal Reserve issued its first round of Dodd-Frank Act mandated supervisory stress test results in March 2013, and OFR has since assessed the

[145]To assess the quality of the underlying indicators in the monitor, OFR tested each indicator for its ability to capture extreme events such as market peaks and troughs, identify turning points, and give early warning signals of stress at a reasonable horizon during prior crises.

[146]We have ongoing work evaluating the Federal Reserve's stress testing activities, which we anticipate issuing in 2016.

Federal Reserve's stress test activities in its annual reports and promoted research to advance stress testing methodologies.[147]

To some extent, OFR and the Federal Reserve have taken steps to share aspects of their financial stability monitoring programs with each other. For example, during the development phase of the Financial Stability Monitor, OFR staff stated that they sought expert input on the monitor from the Federal Reserve, among others, and periodically discussed the monitor with Federal Reserve staff once it was published in the 2013 OFR Annual Report. As explained earlier, OFR has presented updated assessments of its monitor to FSOC's Systemic Risk Committee, deputies, or principals, all of which include representatives from the Federal Reserve. Federal Reserve staff stated that both agencies coordinate on an ad hoc basis on their broad financial stability programs, as they encounter areas where additional information collection might be warranted. They added that staff involved in the Federal Reserve's financial stability monitoring program are also part of FSOC's Systemic Risk Committee and raise issues that are relevant or of interest to other FSOC member agencies as appropriate, including content from their assessments of financial stability. In addition, to address its mandate to evaluate stress tests, OFR is in the process of obtaining certain Federal Reserve stress test data, which it plans to use to advance research in this area.[148]

[147] OFR research generally presents stress test methodologies that aim at analyzing the stability of the financial system as a whole. See, for example, Office of Financial Research, *Dynamical Macroprudential Stress Testing Using Network Theory*, OFR Working Paper #15-12 (June 18, 2015); *Process Systems Engineering as a Modeling Paradigm for Analyzing Systemic Risk in Financial Networks*, OFR Working Paper #15-01 (Feb. 11, 2015); and *Stress Tests to Promote Financial Stability: Assessing Progress and Looking to the Future,* OFR Working Paper #0010 (July 18, 2013).

[148] OFR's Financial Research Advisory Committee, whose membership includes academics, financial market experts, and former regulators, recommended that OFR explore the Federal Reserve's stress test data to, among other things, identify the build-up of systemic risk in asset classes and/or sectors, and highlight systemwide vulnerabilities and pressure points in response to prescribed market shocks. OFR has requested stress-test data from the Federal Reserve to fulfill its stress-tests evaluation mandate. As of January 2016, OFR had not yet received access to the data, but the Federal Reserve announced in September 2015 that it plans to share the data with OFR in light of the assurances of confidentiality from OFR. See Proposed Agency Information Collective Activities; Comment Request, 80 Fed. Reg. 55621 (Sept. 16, 2015).

However, OFR and the Federal Reserve have developed and implemented their systemic risk monitoring efforts largely independently from one another. For example, OFR and Federal Reserve staff have not engaged in a formal process to learn from each other's detailed analytical and technical approaches for identifying vulnerabilities, measuring them, or modeling and measuring propagation channels given specific shocks to the financial system. The Federal Reserve has publicly released a conceptual framework for its monitoring program, but OFR does not have access to internal Federal Reserve assessments, underlying reports, or metrics.[149]

OFR's and the Federal Reserve's actions have not been consistent with our key collaboration practices.[150] These practices state, among other things, that to achieve a common outcome, agencies should establish mutually reinforcing or joint strategies and identify and address needs by leveraging resources. They further recommend that agencies engaging in collaborative efforts work together to define and agree on their respective roles and responsibilities.[151] OFR and the Federal Reserve believe the current nature and level of their collaboration are appropriate, and both agencies stated that they believe that their participation in FSOC's Systemic Risk Committee ensures communication between the two agencies about their systemic risk monitoring efforts.

Separate entities monitoring systemic risk from different perspectives could help reduce the likelihood that potential systemic risks will not be identified in time. As such, viewpoints, analytical tools, and conclusions

[149]See Tobias Adrian, Daniel Covitz, and Nellie Liang, *Financial Stability Monitoring,* Federal Reserve Bank of New York Staff Report No. 601 (February 2013, revised June 2014).

[150]Collaboration can be broadly defined as any joint activity that is intended to produce more public value than could be produced when the organizations act alone. See GAO-06-15.

[151]In 2012 we found that the systemic risk monitoring activities of FSOC's Systemic Risk Committee were not sufficiently systematic or comprehensive, and we recommended that FSOC and OFR clarify responsibility for implementing requirements to monitor threats to financial stability across FSOC and OFR, including member agencies, to better ensure that the monitoring and analysis of the financial system are comprehensive and not unnecessarily duplicative (see GAO-12-886). FSOC Secretariat staff disagreed with our recommendation and stated that agencies have defined specific roles and responsibilities for themselves when developing analyses of identified threats on a voluntary basis. As of January 2016, this recommendation remained open.

need not be harmonized across agencies. Further, Federal Reserve staff said that multiple assessments of financial stability based on different assumptions and methodologies are useful in assessing systemic risks and can help avoid common blindspots shared by regulators and market participants. However, failure to use some key collaboration practices could result in OFR and the Federal Reserve missing opportunities to leverage each other's resources, including expertise, qualitative and market knowledge or insights, and distinct authorities (for example, authorities to receive supervisory data from financial regulatory agencies). It also could lead to unnecessarily duplicative analytical work. Further, by failing to collaborate more effectively, the agencies may miss opportunities to identify important and mutually beneficial ways to improve their current and planned systemic risk monitoring and identification activities and find ways to share useful tools or other outputs with FSOC's Systemic Risk Committee. Going forward, OFR and the Federal Reserve also could miss opportunities to leverage resources or act more strategically regarding other areas of growing common interest, such as research on stress testing and the propagation of risk. Engaging in certain collaborative practices, such as articulating individual and common goals for their systemic risk monitoring activities, could help the agencies make progress toward their goals and monitor that progress. This could formalize communications between the two agencies to help ensure comprehensiveness in systemic risk surveillance, intentional overlapping analyses or activities, sufficiently diverse analytical approaches, and reduced risk of duplication. It also could establish mechanisms to help ensure relevant new tools or other outputs are fully and consistently incorporated in FSOC Systemic Risk Committee deliberations.

FSOC's Systemic Risk Mitigation Authorities Are Limited and Remain Unclear

While FSOC's mission includes responding to systemic risks, it has limited authorities to do so. The Dodd-Frank Act left financial regulatory agencies responsible for overseeing financial entities and activities.[152] The act does allow FSOC to respond to certain potential systemic risks primarily through its authorities to designate certain entities or payment, clearing, and settlement (PCS) activities that may pose a threat to financial stability for enhanced supervision by a specific federal regulator

[152]FSOC's own authorities do not divest its members of their existing authorities.

(designation authorities).[153] However, FSOC's designation authorities, by statute, cannot be used to address certain types of risks, and the full scope of FSOC's designation authorities remains untested and unclear to date. FSOC has other nondesignation authorities that allow it to make recommendations to individual regulators to address specific risks, but these recommendations are nonbinding.

FSOC's nondesignation authorities include Section 120 recommendations and annual report recommendations.

- **Section 120 recommendations.** Per section 120 of the Dodd-Frank Act, FSOC may issue recommendations to a primary financial regulatory agency to apply new or heightened standards for a financial activity or practice conducted by financial companies under the regulator's jurisdiction. If no primary regulator exists, FSOC can recommend appropriate legislation to Congress. As of January 2016, FSOC had proposed to use this authority once. FSOC issued for public comment a proposed Section 120 recommendation to SEC to implement reforms in money market mutual funds in order to address structural weaknesses in this market.[154] This authority is broad in scope, as it can be used to address a financial activity or practice conducted by financial companies. The authority can provide clarity and public accountability for an identified risk by allowing FSOC to state which regulator should respond to the risk and how it should do so. However, the recommendations are nonbinding, and regulators can choose either to comply with FSOC's Section 120 recommendations or not to comply and explain the reason for

[153]FSOC has other authorities that could mitigate systemic risk such as upon a determination by the Federal Reserve that a designated nonbank financial company or a bank holding company with $50 billion or more in assets supervised by the Federal Reserve poses a grave threat to U.S. financial stability, a two-thirds vote by FSOC triggers the Federal Reserve to undertake multiple actions including limiting the company's ability to merge, acquire or consolidate with another company and restricting the company's ability to offer financial products. Pub. L. No. 111-203, § 121(a), 124 Stat. 1376, 1410 (2010).

[154]FSOC issued this proposed Section 120 recommendation in November 2012, offering specific alternatives that SEC could adopt to reform money market mutual funds. In summer 2014, SEC adopted final rulemakings to address risks of investor runs in money market mutual funds. FSOC intends to review and consider the effects of these reforms and their broader implications for financial stability once they are implemented.

noncompliance.[155]

- **Annual report recommendations.** The Dodd-Frank Act also requires FSOC to report annually and testify before Congress on recommendations to enhance financial stability, and FSOC has included such recommendations in its annual reports. FSOC annual report recommendations can be broad and do not necessarily identify specific systemic risk mitigation actions for member agencies on specific timelines, and identified agencies are not required to respond to them.

In addition, FSOC has three distinct designation authorities that, if invoked, require certain federal agencies to impose enhanced standards on designated entities or financial institutions conducting designated activities. FSOC can designate (1) nonbank financial companies for consolidated supervision by the Federal Reserve and enhanced prudential standards, (2) financial market utilities as systemically important, and (3) PCS activities as systemically important.[156] FSOC has a Nonbank Financial Companies Designations Committee and a Financial Market Utilities and PCS Activities Committee that develop analyses and conduct other work for such designations. As of January 2016, FSOC had designated four nonbank financial companies and eight financial market utilities. Federal Reserve must prescribe enhanced prudential standards for designated nonbank financial companies, and the Federal Reserve, SEC, or CFTC must prescribe enhanced risk management standards for

[155] A final Section 120 recommendation to an agency requires that the agency impose the recommended reforms, or within 90 days, explain in writing why the agency determined not to follow the recommendation.

[156] A PCS activity is an activity carried out by one or more financial institutions to facilitate the completion of financial transactions. The Dodd-Frank Act defines a financial transaction to include funds transfers, securities contracts, contracts of sale of a commodity for future delivery, forward contracts, repurchase agreements, swaps, security-based swaps, swap agreements, security-based swap agreements, foreign exchange contracts, financial derivatives contracts, and any similar transaction that FSOC determines to be a financial transaction. When conducted with respect to a financial transaction, PCS activities may include (1) the calculation and communication of unsettled financial transactions between counterparties; (2) the netting of transactions; (3) provision and maintenance of trade, contract, or instrument information; (4) the management of risks and activities associated with continuing financial transactions; (5) transmittal and storage of payment instructions; (6) the movement of funds; (7) the final settlement of financial transactions; and (8) other similar functions that FSOC may determine applicable.

designated financial market utilities.[157] These two entity-specific designation authorities help FSOC address fragmentation in systemic risk oversight by making one regulator primarily accountable for mitigating systemic risks from the designated entities and requiring enhanced supervision. While FSOC is a key player in the Dodd-Frank Act's mechanism to extend enhanced supervision over financial entities, the assigned federal financial regulator has the authority to impose requirements on designated entities and ultimately mitigate threats.

As of January 2016, FSOC had not yet designated any PCS activities as systemically important. Unlike the other designation authorities, such designation could apply to all financial institutions that engage in the designated activity and would require SEC, CFTC, or Federal Reserve to impose enhanced risk management standards on those financial institutions. However, the scope of FSOC's PCS activities designation authority (PCS designation authority) is limited by the statutory definition of PCS activities. The Dodd-Frank Act excludes certain pre-trade and other non-PCS activities from this definition, some of which could be associated with systemic risk.[158] Staff from SEC, CFTC, Federal Reserve, and Treasury told us that, to date, FSOC's Financial Market Utilities and PCS Activities Committee has focused on understanding risks from financial market utilities, such as central counterparty clearing agencies or organizations, monitoring these risks, and updating FSOC member staff on their status. They stated the committee has not yet discussed how FSOC would use this authority or the scope of this authority. Consequently, the extent to which statutory scope constraints on this authority could impair FSOC's ability to respond to certain threats involving multiple entities remains unclear. Staff from SEC, CFTC, and Federal Reserve stated that, thus far, they have been able to address identified risks primarily through their own supervisory authorities or FSOC's other designation authorities.

[157]For more information on FSOC's nonbank designation authorities and the processes it uses in making designations, see GAO, *Financial Stability Oversight Council: Further Actions Could Improve the Nonbank Designation Process,* GAO-15-51 (Washington, D.C.: Nov. 20, 2014).

[158]The Dodd-Frank Act excludes any offer or sale of a security or any quotation, order entry, negotiation or other pre-trade activity or execution activity, as well as public reporting of swap transactions from the definition of a PCS activity.

According to our framework for evaluating regulatory reform proposals, a financial system should include a mechanism for identifying, monitoring, and also managing risks to the financial system regardless of the source of the risk or the institutions from which the risk originates.[159] In addition, according to IMF, a strong institutional framework is essential to help ensure that macroprudential policy—policy that aims to enhance the stability of the financial system—can work effectively by, among other things, assigning an appropriate range and reach of policy tools to the macroprudential authority, in this case FSOC. Recognizing that financial systems evolve dynamically, IMF states that limiting systemic risks requires authorities that foster the ability to act. That is, the macroprudential authority needs powers to ensure regulatory responses and bring important entities into the financial regulatory umbrella as needed.[160]

Although FSOC's mission is to identify and mitigate systemic risks, FSOC's designation authorities have limited scope and represent a gap in the post-Dodd-Frank mechanisms for the mitigation of systemic risks. In particular, FSOC's collective designation authorities may not allow it to comprehensively address systemic risks that could arise from the financial activities of multiple entities. By statute, FSOC's PCS designation authority excludes certain types of activities, and its scope remains untested and unclear to date. Thus, there may be risks that arise from widely conducted financial activities that FSOC cannot address through its PCS designation authority and for which entity-by-entity designation may not be effective or feasible. In those cases, FSOC can recommend regulatory action, but it cannot act or compel action even with a broad consensus among FSOC members. In the event that regulators do not or cannot act to mitigate systemic threats, FSOC's authorities to respond are limited. As a result, FSOC may lack the tools needed to comprehensively address systemic risks that may emerge. In addition, without requisite authorities, holding FSOC accountable for addressing threats to financial stability will be difficult.

[159] GAO-09-216.

[160] International Monetary Fund, *Staff Guidance Note on Macroprudential Policy* (Washington, D.C.: December 2014); *Key Aspects of Macroprudential Policy*, IMF Policy Paper (Washington D.C.: June 2013); and *Macroprudential Policy: An Organizing Framework*, IMF Policy Paper (Washington D.C.: March 2011).

Conclusions

The U.S. financial regulatory structure is complex, with responsibilities fragmented among a number of regulators that have overlapping authorities. While the current structure allows for effective financial regulation in some key areas, recent changes may not have addressed long-standing fragmented and overlapping regulatory authorities and their effects on regulators' oversight activities. Fragmentation, overlap, and duplication also introduce significant challenges for efficient and effective oversight of financial institutions and activities. Fragmentation and overlap in the structure have resulted in inefficiencies in the regulatory process; inconsistencies in how regulators conduct oversight activities over similar types of institutions, products, and risks; the potential for duplication in regulators' oversight activities; and differences in the levels of protection provided to consumers. Further, the existence of multiple regulators makes it difficult to ensure that agencies are held accountable for failures to act in accordance with regulatory goals. The Dodd-Frank Act implemented a number of key reforms intended to address significant weaknesses and gaps in the regulatory system, including closing gaps in systemic risk and swaps oversight; consolidating supervision of large, complex institutions under the Federal Reserve; and expanding protections for consumers and investors. However, for the most part, the act left the regulatory structure unchanged. In the framework we developed in 2009 for evaluating regulatory reform proposals, we noted that an effective regulatory system would address certain structural shortcomings created by fragmentation and overlap. While coordination and collaboration among regulators help to manage some of the negative effects of fragmentation and overlap, the sheer number of regulatory bodies and differences in their regulatory approaches continue to make coordination challenging and time-consuming. In addition, issues related to fragmentation and overlap in the structure have continued to surface as new agencies created by the Dodd-Frank Act and existing agencies work together.

Within the area of systemic risk oversight, the Dodd-Frank Act addressed challenges by keeping the independence of the system's multiple regulators and by placing responsibility for identifying and responding to systemic risks on a collective group of regulators through the creation of FSOC. This approach to systemic risk oversight requires consistent and highly effective interagency collaboration. Further, although federal internal control standards and IMF guidelines for systemic risk monitoring call for the use of quality quantitative and qualitative information, FSOC's Systemic Risk Committee is not fully and consistently informed by OFR and the Federal Reserve's monitoring tools or other outputs. Both OFR and the Federal Reserve now monitor the financial system for systemic risk, with each agency devoting staff and resources to developing broad-based systemic risk surveillance efforts. However, despite having similar monitoring goals, OFR's and the Federal Reserve's actions have not been consistent with key practices for collaboration that we have previously identified. This limitation in their collaborative efforts represents lost opportunities for leveraging resources to further their systemic risk monitoring goals and improving their collective ability to identify new and emerging threats to the system. It also could lead to unnecessarily duplicative analytical work. We recognize the importance and value of the agencies' independent activities and conclusions regarding systemic risk and believe that this should be preserved as the agencies work to improve their collaborative efforts. Finally, as we have noted in the past, regulatory systems should include a mechanism for identifying, monitoring, and also managing risks to the financial system. In addition, IMF has stated that macroprudential entities require authorities to foster the ability to act and ensure regulatory responses. FSOC's designation authorities can bring certain entities or activities that may pose threats to financial stability into the regulatory purview and require enhanced oversight. However, limitations in its designation authorities raise questions about FSOC's ability to effectively respond to different kinds of systemic risks, particularly those whose origins are not entity-specific. These limitations also make it difficult to hold FSOC accountable for maintaining financial stability.

Matters for Congressional Consideration

We are suggesting two matters for congressional consideration. First, Congress should consider whether additional changes to the financial regulatory structure are needed to reduce or better manage fragmentation and overlap in the oversight of financial institutions and activities to improve (1) the efficiency and effectiveness of oversight; (2) the consistency of consumer and investor protections; and (3) the consistency of financial oversight for similar institutions, products, risks, and services. For example, Congress could consider consolidating the number of federal agencies involved in overseeing the safety and soundness of depository institutions, combining the entities involved in overseeing the securities and derivatives markets, transferring the remaining prudential regulators' consumer protection authorities over large depository institutions to CFPB, and the optimal role for the federal government in insurance regulation, among other considerations.

Second, Congress should consider whether legislative changes are necessary to align FSOC's authorities with its mission to respond to systemic risks. Congress could do so by making changes to FSOC's mission, its authorities, or both, or to the missions and authorities of one or more of the FSOC member agencies to support a stronger link between the responsibility and capacity to respond to systemic risks. In doing so, Congress could solicit information from FSOC on the effective scope of its collective designation authorities, including any gaps.

Recommendations for Executive Action

We are making three recommendations for executive action.

First, to help regulators address regulatory fragmentation and improve FSOC's ability to identify emerging systemic risks, we recommend that as OFR develops and refines its financial stability monitoring tools, it should work with FSOC to determine ways in which to fully and regularly incorporate current and future monitors and assessments into Systemic Risk Committee deliberations, including, where relevant, those that present disaggregated or otherwise confidential supervisory information.

Second, to help regulators address regulatory fragmentation and improve FSOC's ability to identify emerging systemic risks, we recommend that the Federal Reserve work with FSOC to regularly incorporate the comprehensive results of its systemic risk monitoring activities into Systemic Risk Committee deliberations.

Third, to more efficiently and effectively monitor the financial system for systemic risks and reduce the risk of unnecessary duplication, we recommend that OFR and the Federal Reserve jointly articulate individual and common goals for their systemic risk monitoring activities, including a plan to monitor progress toward articulated goals, and formalize regular strategic and technical discussions around their activities and outputs to support those goals.

Agency Comments

We provided a draft of this report to CFTC, CFPB, Federal Reserve, FDIC, FIO, FSOC, FTC, NAIC, NCUA, OCC, OFR, and SEC. CFTC, NCUA, Federal Reserve, and OFR provided written comments that have been reproduced in appendixes V - VIII, respectively. CFTC noted that while the securities and derivatives markets are interconnected, they remain separate and serve distinct functions within the financial system. In addition, CFTC stated that it has worked and continues to work closely with SEC. Our report discusses areas that these agencies have worked together in the past to resolve jurisdiction disputes and address areas of overlap in the oversight of their respective markets, as well as recent examples of their coordination efforts on the swaps and security-based swaps rulemakings. However, the report also notes that, despite these efforts, there were still substantive differences between certain of the agencies' rules and in the timing of the rules, which create the potential for inefficiencies in the way the markets are overseen. For example, several differences exist in CFTC's and SEC's definition of the term "U.S. persons." CFTC's written comments are reproduced in appendix V.

In written comments provided by NCUA (reproduced in appendix VI), NCUA disagreed with our suggestion that Congress consider whether additional changes are needed to the regulatory structure and stated that consideration of changes to the regulatory structure would need to include a careful review of the costs and benefits. We maintain that changes to the regulatory structure could help to reduce and better manage fragmentation and overlap in the oversight of financial institutions and activities. The report documents several instances where the structure produced inconsistent, inefficient and ineffective oversight. The costs and benefits of any options for improving and modernizing the structure would have to be part of any consideration of additional changes to the regulatory structure but would not preclude considering other options as we suggest.

In written comments provided by the Federal Reserve and OFR (reproduced in appendix VII and appendix VIII, respectively), both agencies agreed with our recommendations to them. In response to our recommendation that the Federal Reserve work with FSOC to regularly incorporate the comprehensive results of its systemic risk monitoring activities into Systemic Risk Committee deliberations, the Federal Reserve stated that close collaboration with FSOC and the Systemic Risk Committee is essential to improving the council's ability to identify emerging systemic risks. The Federal Reserve also noted that it has actively participated in Systemic Risk Committee deliberations and has provided presentations, data, and staff observations relating to systemic risk matters to the committee since its inception. We note in the report that when the Systemic Risk Committee analyzes specific threats that have been identified, Federal Reserve staff have shared analyses or metrics relevant to those threats. While the sharing of such information is useful, the committee still lacks access to information from the broad-based systemic risk monitoring efforts at the Federal Reserve, which could better equip committee members in identifying new potential risks to the system. In response to our third recommendation that OFR and the Federal Reserve jointly articulate individual and common goals for systemic risk monitoring activities, the Federal Reserve also agrees that communication with OFR is a key aspect of monitoring the financial system for systemic risks, particularly given OFR's access to a broad range of data not available to other regulators. It noted that it has, and plans to continue to, consult with OFR, and it plans to continue to work with OFR to make the communication more formal. The Federal Reserve also noted that it did not understand the report's use of the word "tools" when referring to the systemic risk monitoring efforts of the Federal Reserve. Our use of this term was intended to simplify the many diverse systemic risk monitoring outputs of both OFR and the Federal Reserve. To clear up any confusion, where appropriate, we added "or other outputs" after the word "tools" in the report.

In its written comments, OFR agreed with our recommendation to work with FSOC to determine ways in which to fully and regularly incorporate current and future monitors and assessments into Systemic Risk Committee deliberations. OFR indicated that it has initiated conversations with Treasury FSOC staff on best practices for distribution of the results of current monitoring tools. It indicated that as future monitoring tools are finalized it plans to also work with FSOC staff to determine ways in which its tools can be incorporated into FSOC discussions. OFR noted that because certain data provided to supervisory regulators have legislatively mandated confidentiality requirements, tools developed using such data are only distributed to FSOC principals and deputies. As we noted in the report, OFR's efforts to share its tools outside of the FSOC principals and deputies may be constrained by current confidentiality requirements. However, our recommendation encourages OFR to seek ways in which such tools, or assessments resulting from those tools, can be fully and appropriately incorporated into Systemic Risk Committee discussions, without violating confidentially requirements. OFR also agreed with our recommendation that it and the Federal Reserve should improve the ways in which they collaborate on their systemic risk monitoring efforts. In response to the recommendation, OFR stated that it has also initiated discussion with the Federal Reserve on how best to address our recommendation while continuing to execute the agencies' respective missions.

In its written response, NCUA also noted that it had concerns with our recommendations to OFR and the Federal Reserve. Regarding our recommendations to OFR and the Federal Reserve that the agencies work with FSOC to determine ways in which to incorporate the results of their systemic risk monitoring activities into Systemic Risk Committee deliberations, NCUA said that our recommendations underestimate the costs and other issues relating to dissemination of supervisory data. NCUA stated that it believes this may be more costly than helpful to monitoring systemic risks. However, we maintain that it is vital that FSOC's Systemic Risk Committee—the council's main vehicle for collaboration on systemic risk monitoring and identification efforts—have access to the tools and other outputs developed by these agencies. The committee's leveraging of this information helps to reduce fragmentation in systemic risk monitoring and identification, and could help identify systemic risks that may otherwise be missed. NCUA also questioned the usefulness of our recommendation that the Federal Reserve and OFR jointly articulate individual and common goals for their systemic risk monitoring activities, and stated that wide disagreement remains within the financial community and across regulators about what constitutes financial stability and how it should be measured. NCUA believes that having a range of options provided to FSOC in this circumstance is an advantage, and not a cost. Our recommendation does not require OFR and the Federal Reserve to agree upon and choose one approach to systemic risk monitoring. Rather, we acknowledge in the report the importance and value of the agencies' independent activities and conclusions regarding systemic risk and note that this should be preserved as OFR and the Federal Reserve work to improve their collaborative efforts. However, in response to technical comments we received from Federal Reserve staff, we clarified the wording of the recommendation to clarify our intent. Initially, the recommendation stated that the Federal Reserve and OFR should work to develop and maintain a joint strategy for their systemic risk monitoring activities. Federal Reserve staff thought that the term "joint strategy" might imply that we intended for the two agencies to conduct a monitoring program jointly, which they believed would compromise the two agencies' independence in conducting their own work in this area. In response, we clarified the wording of the recommendation to emphasize that collaboration requires the agencies to jointly articulate both individual and common goals related to systemic risk monitoring.

CFPB, FDIC, the Federal Reserve, FIO, FTC, NAIC, OCC, OFR and Treasury FSOC Secretariat staff provided technical comments, which we have incorporated, as appropriate.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees and members and other interested parties. In addition, the report will be available at no charge on our website at http://www.gao.gov. Should you or your staff have questions concerning this report, please contact me at (202) 512-8678 or evansl@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IX.

Lawrance Evans, Jr.
Director, Financial Markets and Community Investment

List of Requesters

The Honorable Shelley Moore Capito
United States Senate

The Honorable Sean Duffy
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives

The Honorable Randy Neugebauer
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
Committee on Financial Services
House of Representatives

The Honorable Patrick McHenry
House of Representatives

Appendix I: Objectives, Scope, and Methodology

This report examines (1) the overall structure of the U.S. financial regulatory system, (2) effects of fragmentation and overlap on agencies' oversight activities, and (3) the collaborative efforts and relevant authorities of agencies involved in systemic risk oversight.

Structure of the U.S. Financial Regulatory System

To examine the overall structure of the U.S. financial regulatory system, we reviewed financial regulatory statues, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and the Dodd-Frank Act legislative history. We divided the financial regulatory structure into the following sectors based on agencies' missions: (1) safety and soundness oversight of depository institutions, (2) consumer protection oversight, (3) securities and derivatives markets oversight, (4) insurance oversight, and (5) systemic risk oversight. This report does not include assessments of fragmentation and overlap in housing finance oversight as they relate to the supervisory duties of the Federal Housing Finance Agency because the agency generally does not share oversight responsibilities over the government-sponsored enterprises—Fannie Mae and Freddie Mac—and the Federal Home Loan Banks. Additionally, other entities and activities involved in housing finance markets are subject to consumer financial protection, safety and soundness, and securities and derivatives oversight, which we do analyze in the report. We also did not evaluate fragmentation and overlap in the farm credit system because the Farm Credit Administration is the sole regulator of the system. For each sector we reviewed the relevant financial agencies' websites and documents, including strategic plans, performance plans and annual reports, supervisory manuals, and rulemakings to identify financial institutions and entities under their jurisdictions and the types of oversight activities each conducts. We also reviewed reports on financial regulatory reform conducted by U.S. agencies, international regulatory bodies, policy organizations, and previous GAO reports that identified areas of fragmentation and overlap within the financial regulatory structure.[1] We interviewed agency officials, including officials from the Board of Governors of the Federal Reserve System (Federal Reserve), the Commodity Futures Trading Commission (CFTC), the Bureau of Consumer Financial Protection (CFPB), the Federal Deposit Insurance Corporation (FDIC), the Federal Insurance Office (FIO), the Federal Trade Commission, the U.S. Department of the Treasury (Treasury), the Office of the Comptroller of the Currency (OCC), the Office of Financial Research (OFR), the National Credit Union Administration (NCUA), and the Securities and Exchange Commission (SEC). We also interviewed officials from self-regulatory organizations (SRO) and associations of state supervisors, including the Financial Industry Regulatory Authority, the National Futures Association, the Conference of State Bank Supervisors, the North American Securities Administrators Association, and the National Association of Insurance Commissioners, and representatives of industry and policy organizations. We selected industry and policy organizations that represented the different areas of the financial system or had expertise in evaluating areas of the financial regulatory structure. We used procedures outlined in GAO's *Fragmentation, Overlap, and Duplication: An Evaluation and Management Guide* to help us analyze the information we obtained and identify areas of fragmentation and overlap in the U.S. financial regulatory structure.[2]

[1]For example, The Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure* (Washington, D.C.: Mar. 31, 2008); The Department of the Treasury, *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation* (Washington, D.C.: June 17, 2009); International Monetary Fund, *United States: Publication of Financial Sector Assessment Program Documentation—Financial System Stability Assessment* (Washington: D.C.: July 2010); International Monetary Fund, *United States: Publication of Financial Sector Assessment Program Documentation—Reports on Observance and Codes* (Washington: D.C., July 2010); Financial Stability Board, *Peer Review of the United States* (Basel, Switzerland: August 2013); GAO, *Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure,* GAO-05-61 (Washington, D.C.: Oct. 6, 2004); *Financial Regulation: Industry Trends Continue to Challenge the Federal Regulatory Structure,* GAO-08-32 (Washington, D.C.: Oct. 12, 2007); *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System,* GAO-09-216 (Washington, D.C.: Jan. 8, 2009); and *Financial Regulatory Reform: Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act,* GAO-13-180 (Washington, D.C.: Jan. 16, 2013).

[2]GAO, *Fragmentation, Overlap, and Duplication: An Evaluation and Management Guide,* GAO-15-49SP (Washington, D.C.: Apr. 14, 2015).

Effects of Fragmentation and Overlap on Oversight Activities

To identify the effects of fragmentation and overlap on agencies' oversight activities, we held four discussion groups, reviewed past GAO reports, and reviewed reports from U.S. agencies and international regulatory bodies. We held the discussion groups in November 2014 on the following four topics: (1) the supervision of bank and thrift holding companies and their depository subsidiaries by FDIC, the Federal Reserve, OCC, and state banking supervisors; (2) consumer protection oversight conducted by CFPB and the federal prudential regulators—FDIC, Federal Reserve, NCUA, and OCC; (3) the regulation of swaps and security-based swaps by CFTC and SEC; and (4) the supervision of insurance groups by state insurance regulators and the Federal Reserve.[3] We chose the specific topics to cover in the discussion groups either because the Dodd-Frank Act altered the regulatory structure in the area or because the issue had been widely identified as a potential cause of the 2007-2009 financial crisis. In each discussion group, we asked participants a series of questions to help identify: (1) areas of fragmentation and overlap in regulators' responsibilities for the specific topic, (2) positive and negative effects of fragmentation and overlap on regulators' oversight activities, and (3) approaches to help mitigate any negative effects fragmentation and overlap might have. Each discussion group consisted of former regulatory officials, industry and advocacy group representatives, and experts. We helped ensure balance in the composition of participants in each discussion group by selecting a mix of participants with different perspectives and limiting the number of participants in each category to help ensure that each type of participant was equally represented. Appendix IV contains a list of the individuals who participated in the discussion groups. Our discussion groups were not designed to achieve agreement or consensus among participants. Rather, we sought participants' help to identify areas of fragmentation and

[3]In general, the Dodd-Frank Act defines a swap to include, among other things, an agreement that provides for the exchange of one or more payments based on the value or level of one or more assets, liabilities, or indices or other financial or economic interests or property of any kind that transfers, in whole or in part, the financial risk associated with a future change in the value or level without also conveying a current or future ownership interest in an asset or liability that incorporates the financial risk transferred. Pub. L. No. 111-203, § 721(a)(21), 124 Stat. 1376, 1666 (2010). Financial and nonfinancial firms use swaps and other over-the-counter derivatives to hedge risk, or speculate, or for other purposes. Swaps include interest rate swaps, commodity-based swaps, currency swaps, and broad-based credit default swaps. Security-based swaps include single-name and narrow-based credit default swaps and equity-based swaps. We use the term "insurance group" to refer to a group of affiliated companies, one or more of which is an insurance company.

overlap and the effects they have in each of the four topic areas. We had recordings of the discussion groups transcribed and reviewed the transcripts for each group and summarized what participants told us.

After the discussion groups were held, we interviewed relevant officials at the agencies to obtain their perspectives on the fragmentation and overlap identified by discussion group participants and to understand any efforts the regulators were taking to coordinate with other regulators to mitigate negative effects. We also reviewed our previous reports to identify instances in which we have reported on fragmentation and overlap in the financial regulatory structure and its effects. Additionally, we reviewed recent assessments of the U.S. regulatory structure conducted by the Financial Stability Board (FSB), the International Monetary Fund (IMF), and FIO from August 2013 to July 2015.[4] We chose to review assessments conducted by these organizations because they represent international and domestic entities that, respectively, have agreed with their member jurisdictions, or are mandated by their executive board or Congress, to assess parts of the U.S. financial regulatory structure relevant to this review. Finally, we assessed the current regulatory structure and the effects of fragmentation and overlap within it against the characteristics of an effective and efficient regulatory structure that we identified in a January 2009 report in which we developed a framework for evaluating proposals for reforming the regulatory structure.[5] Appendix III contains the nine characteristics we identified in our framework.

Fragmentation in Systemic Risk Oversight

We chose to evaluate agencies’ systemic risk oversight activities for the following reasons: (1) the lack of systemic risk responsibilities among regulators was considered by Congress and others to be significant in the 2007-2009 financial crisis; (2) systemic risk is a new area of focus in the

[4]The Group of Twenty—a forum for international cooperation on global economic and financial issues, whose members include 19 countries and the European Union—established FSB in 2009 as the successor to the Financial Stability Forum to coordinate at the international level the work of national financial authorities and international standard-setting bodies in order to develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies. IMF is an organization of 188 member jurisdictions whose primary purpose is to safeguard the stability of the international monetary system.

[5]GAO-09-216.

financial regulatory structure, resulting from new responsibilities for regulators and agencies contained in the Dodd-Frank Act; and (3) offices with financial stability goals were created within certain regulatory agencies as well as the Financial Stability Oversight Council (FSOC), which has a mandate to monitor and respond to threats to systemic risk. To examine the collaborative efforts and relevant authorities of agencies involved in systemic risk oversight—which includes monitoring the financial system to identify systemic risks and mitigating those risks—we first identified agencies with explicit systemic risk authorities, goals, or activities by reviewing the Dodd-Frank Act, our previous reports, and agencies' strategic plans, websites, and other documents, and by interviewing federal and state financial agencies. We consequently focused our assessment of fragmentation and overlap on the systemic risk monitoring and identification activities of FSOC, OFR, and the Federal Reserve, as those were the three entities that were actively monitoring the broader financial system with the purpose of identifying and analyzing potential systemic risks.

We approached our evaluation of systemic risk monitoring and identification activities of FSOC, OFR, and the Federal Reserve in the following way. First, we evaluated FSOC's systemic risk monitoring efforts. We focused our assessment on the work of FSOC's Systemic Risk Committee, as the FSOC committee where interagency staff meet to identify, monitor, and analyze systemic risks. To conduct this work, we reviewed FSOC's annual reports (2011-2015), bylaws and committee charters, and Systemic Risk Committee agendas and presentations for their monthly meetings held between July 2012 and August 2014. We reviewed previous GAO work evaluating FSOC and the Systemic Risk Committee's efforts.[6] We also interviewed staff from FSOC member agencies who participated in Systemic Risk Committee discussions. We evaluated the committee's actions against federal internal control standards and GAO's key interagency collaboration practices, as well as

[6]GAO, *Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions,* GAO-12-886 (Washington, D.C.: Sept. 11, 2012).

best practices identified by the International Monetary Fund for systemic risk monitoring.[7]

Second, we compared OFR's and the Federal Reserve's systemic risk monitoring and identification efforts because they are the only two agencies that have established initiatives to create broad-based systemic risk monitoring tools or other outputs. Further, we focused our analysis of OFR's efforts primarily on evaluating its Financial Stability Monitor because it is OFR's only monitor that aims to evaluate risk to the financial system as a whole.[8] To determine similarities and differences in the two agencies' programs we analyzed, among other things, (1) for OFR, OFR's annual reports (2012 through 2015), 2015-2019 Strategic Plan, documents associated with the Financial Stability Monitor, and select research papers; and (2) for the Federal Reserve, the Federal Reserve's 2012-2015 Strategic Framework, Financial Stability Monitoring staff report No. 601, samples of the Federal Reserve's internal quarterly financial stability assessments, and relevant speeches from the Federal Reserve Board Governors.[9] In addition, we interviewed officials from OFR and the Federal Reserve's Office of Financial Stability and Policy Research and academics and industry experts who served on OFR's Financial Research Advisory Council, as well as an expert from the Systemic Risk Council.[10] Finally, we evaluated how OFR and the Federal Reserve

[7]GAO, *Standards for Internal Control in the Federal Government,* GAO-14-704G (Washington, D.C.: September 2014) and GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999); *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies,* GAO-06-15 (Washington, D.C.: Oct. 21, 2005). International Monetary Fund, *Staff Guidance Note on Macroprudential Policy* (Washington, D.C.: December 2014) and *Key Aspects of Macroprudential Policy*, IMF Policy Paper (Washington D.C.: June 2013).

[8]OFR's other tools focus on assessing risks in specific areas of the financial system and can complement the aggregate perspective of the Financial Stability Monitor.

[9]Federal Reserve, *2012-2015 Strategic Framework, and* Tobias Adrian, Daniel Covitz, and Nellie Liang; *Financial Stability Monitoring,* Federal Reserve Bank of New York Staff Report No. 601 (February 2013, revised June 2014).

[10]OFR's Financial Research Advisory Committee—whose membership includes academics, financial market experts, and former regulators—provides advice to OFR, bringing diverse perspectives to inform OFR's research and data agendas and helping OFR to fulfill its mission. The Systemic Risk Council is a private sector, nonpartisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to systemic risk in the United States. According to its website, it has been formed to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability.

collaborate in their systemic risk monitoring efforts and assessed their actions against interagency collaboration best practices identified by GAO.[11]

Finally, to assess FSOC's and FSOC member agencies' authorities to mitigate identified systemic risks, we reviewed the Dodd-Frank Act, FSOC annual report recommendations, and FSOC's proposed Section 120 recommendation. We also interviewed FSOC member agency staff who participated in FSOC's Financial Market Utilities and Payment, Clearing, and Settlement Activities Committee to understand FSOC's authority to designate payment, clearing, and settlement activities as systemically important and actions the committee has taken to implement this authority. We evaluated FSOC's authorities against our January 2009 framework and against IMF's best practices for systemic risk oversight.[12]

We conducted this performance audit from April 2014 to February 2016 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.

[11] GAO-06-15.

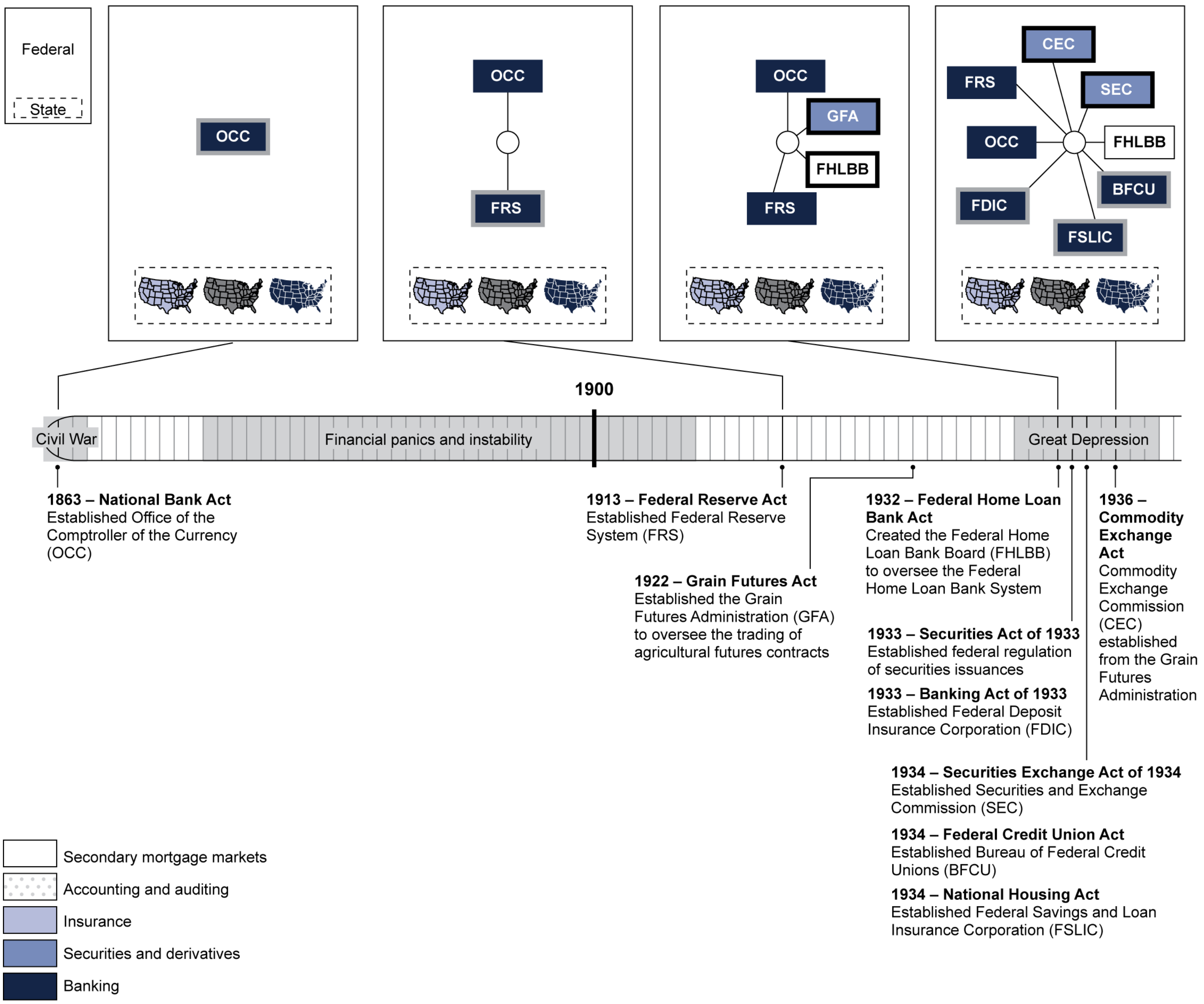
[12] GAO-09-216. International Monetary Fund, *Staff Guidance Note on Macroprudential Policy* (Washington, D.C.: December 2014); *Key Aspects of Macroprudential Policy*, IMF Policy Paper (Washington D.C.: June 2013); and *Macroprudential Policy: An Organizing Framework*, IMF Policy Paper (Washington D.C.: March 2011).

Appendix II: History of the U.S. Financial Regulatory Structure

The U.S. financial regulatory structure has evolved in various sectors and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) made some changes to the financial system.[1] Figure 8 illustrates the history of the U.S. financial regulatory structure over about the last 150 years and shows how it has become complex and fragmented.

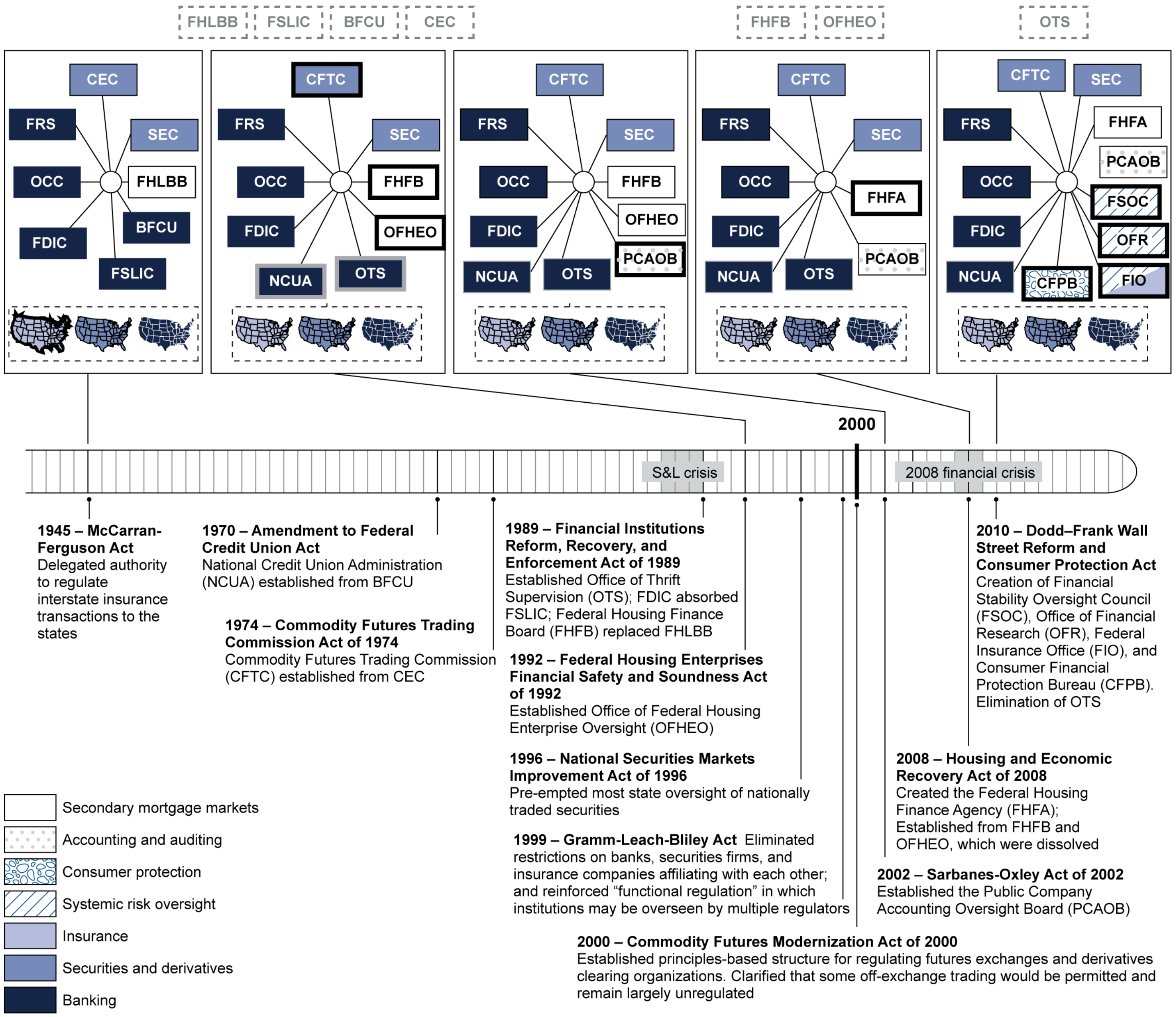
[1]Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Figure 8: Formation of U.S. Financial Regulatory Structure (1863-2015)



Source: GAO. | GAO-16-175

Part 1 of 2



Source: GAO. | GAO-16-175

Part 2 of 2

Depository Institution Oversight

Banks

Since the early days of our nation, banks have allowed citizens to store their savings and used these funds to make loans to spur business development. Until the middle of the 1800s, banks were chartered by states, and state regulators supervised their activities, which primarily consisted of taking deposits and issuing currency. However, the existence of multiple currencies issued by different banks, some of which were more highly valued than others, created difficulties for the smooth functioning of economic activity. In an effort to finance the nation’s Civil War debt and reduce financial uncertainty, Congress passed the National Bank Act of 1863, which provided for issuance of a single national currency. This act also created the Office of the Comptroller of the Currency (OCC), which was to oversee the national currency and improve banking system efficiency by granting banks national charters to operate and conducting oversight to ensure the sound operations of these banks.

In the years surrounding 1900, the United States experienced troubled economic conditions and several financial panics, including various instances of bank runs as depositors attempted to withdraw their funds from banks whose financial conditions had deteriorated. To improve the liquidity of the U.S. banking sector and reduce the potential for such runs, Congress passed the Federal Reserve Act of 1913. This act created the Federal Reserve System, which consists of the Board of Governors of the Federal Reserve System (Federal Reserve) and 12 Federal Reserve Banks, which are congressionally chartered semiprivate entities that undertake a range of actions on behalf of the Federal Reserve, including supervision of banks and bank holding companies and lending to troubled banks. The Federal Reserve was given responsibility to act as the federal supervisory agency for state-chartered banks—banks authorized to do business under charters issued by states—that are members of the Federal Reserve System.[2] In addition to supervising and regulating member banks including state-chartered banks, the Federal Reserve also develops and implements national monetary policy and provides financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation’s payments system.

[2]Staff at the Federal Reserve Banks act as supervisors in conjunction with the Board.

Several significant changes to the U.S. financial regulatory system again were made as a result of the turbulent economic conditions in the late 1920s and 1930s. In response to numerous bank failures that resulted in the severe contraction of economic activity of the Great Depression, the Banking Act of 1933 created the Federal Deposit Insurance Corporation (FDIC), which administers a federal program to insure the deposits of participating banks. Subsequently, FDIC's deposit insurance authority expanded to include thrifts.[3] Additionally, FDIC provides primary federal oversight of any insured state-chartered banks that are not members of the Federal Reserve System. Finally, FDIC has backup examination and enforcement authority over all of the institutions it insures in order to mitigate losses to the deposit insurance funds.

Thrifts and Credit Unions

The economic turmoil of the 1930s prompted the creation of federal regulators for other types of depository institutions, including thrifts and credit unions.[4] These institutions previously had been subject to oversight only by state authorities. However, the Home Owners' Loan Act of 1933 empowered the newly created Federal Home Loan Bank Board to charter and regulate federal thrifts, and the Federal Credit Union Act in 1934 created the Bureau of Federal Credit Unions to charter and supervise credit unions.[5] Congress amended the Federal Credit Union Act in 1970 to establish the National Credit Union Administration (NCUA), which is responsible for chartering and supervising federally-chartered credit unions, as well as insuring deposits in these and state-chartered credit

[3]Thrifts, also known as savings and loans, are financial institutions that accept deposits and make loans, particularly for home mortgages. Until 1989, thrift deposits were federally insured by the Federal Savings and Loan Insurance Corporation, which was created by the National Housing Act of 1934. After experiencing solvency problems in connection with the savings and loan crisis of the 1980s, FSLIC was abolished and its insurance function was transferred to FDIC.

[4]Credit unions are member-owned financial institutions that generally offer their members services similar to those provided by banks.

[5]Home Owners' Loan Act of 1933, 48 Stat. 128 (1933). The administration of the Federal Credit Union Act was originally vested in the Farm Credit Administration (48 Stat. 1216 (1934)) Executive Order No. 9148, dated April 27, 1942 (7 F.R. 3145), transferred the functions, powers, and duties of the Farm Credit Administration to FDIC. Effective July 29, 1948, the powers, duties, and functions transferred to FDIC were transferred to the Federal Security Agency. (Pub. L. No. 80-813, 62 Stat. 1091 (1948)) Reorganization Plan No. 1 of 1953, effective April 11, 1953, abolished the Federal Security Agency and transferred the Bureau of Federal Credit Unions, together with other agencies of the Federal Security Agency, to the Department of Health, Education, and Welfare. (18 Fed. Reg. 2053 (April 11, 1953)).

unions.[6] Oversight of these state-chartered credit unions is managed by 47 state regulatory agencies, represented by the National Association of State Credit Union Supervisors.[7]

From 1980 to 1990, over 1,000 thrifts failed at a cost of about $100 billion to the federal deposit insurance funds. In response, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 replaced the Federal Home Loan Bank Board and, among other things, established the Office of Thrift Supervision (OTS) to improve thrift oversight.[8] The Dodd-Frank Act shuttered OTS and transferred supervision of: (1) thrift holding companies and their nondepository subsidiaries to the Federal Reserve, (2) federal thrifts to OCC, and (3) state thrifts to FDIC.[9]

Securities and Derivatives Markets Oversight

Securities

Prior to the 1930s, securities markets were overseen by various state securities regulatory bodies and the securities exchanges themselves. In the aftermath of the stock market crash of 1929, the Securities Exchange Act of 1934 created a new federal agency, the Securities and Exchange Commission (SEC), and gave it authority to regulate the securities markets and register and oversee securities broker-dealers, as well as securities exchanges, to strengthen securities oversight and address inconsistent state securities rules.[10] In addition to regulation by SEC and

[6]Pub. L. No. 91–206, 80 Stat. 49 (1970) created NCUA as an independent agency and transferred all of the functions of the Bureau of Federal Credit Unions to the new administration.

[7]Federally insured state credit unions also are subject to supervision by NCUA.

[8]Pub. L. No. 101-73, 103 Stat. 183 (1989).

[9]Pub. L. No. 111-203, § 312(b), 124 Stat. 1376, 1521 (2010).

[10]The Securities Act of 1933 (1933 Act), 48 Stat. 74, 15 U.S.C. § 78a, had assigned federal supervision of securities to the Federal Trade Commission (FTC) by, among other things, requiring that securities offerings subject to the act's registration requirements be registered with FTC. See 1933 Act, §§ 2, 5, 6 (1933). In the Securities Exchange Act of 1934, Congress replaced FTC's jurisdiction by transferring its powers, duties, and functions under the 1933 Act to SEC. See Securities Exchange Act of 1934, 48 Stat. 881, §§ 3(a), 210 (1934). SEC has the responsibility of administering all the securities laws, including the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the Sarbanes-Oxley Act of 2002.

state agencies, securities markets and the broker-dealers that accept and execute customer orders in these markets are regulated by industry self-regulatory organizations (SRO), including the securities exchanges and the Financial Industry Regulatory Authority, which are funded by the participants in the industry. Among other things, these SROs establish rules governing their members and conduct examinations related to market integrity and investor protection. SEC also registers and oversees investment companies and advisers, approves rules for the market participants and activities it oversees, and conducts examinations of broker-dealers and mutual funds. State securities regulators—represented by the North American Securities Administrators Association—are generally responsible for registering certain securities products and, along with SEC, investigating securities fraud.[11] SEC is also responsible for overseeing the financial reporting and disclosures that companies issuing securities must make under U.S. securities laws. The Dodd-Frank Act also expanded regulatory oversight to hedge and private equity funds by generally requiring the investment advisers to these funds to register with SEC and become subject to examinations.

SEC is also authorized to issue and oversee U.S. accounting standards for entities subject to its jurisdiction, but it has delegated the creation of accounting standards to a private-sector organization, the Financial Accounting Standards Board, which establishes generally accepted accounting principles. Further, in 2006 Congress passed the Credit Rating Agency Reform Act of 2006, which established limited SEC oversight of credit rating agencies, requiring their registration and certain

[11]The National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 316 (1996) pre-empted state securities registration requirements for all but a subset of small securities products and limited state supervision of broker-dealers, but it left intact the right of states to investigate securities fraud.

recordkeeping and reporting requirements.[12] The Dodd-Frank Act imposed further requirements on the credit rating agencies regarding accountability and transparency that SEC must administer.

Derivatives

Oversight of the trading of futures contracts, which allow their purchasers to buy or sell a specific quantity of a commodity for delivery in the future, has also changed over the years in response to changes in the marketplace. Under the Grain Futures Act enacted in 1922, the trading of futures contracts was overseen by the Grain Futures Administration, an office within the Department of Agriculture, reflecting the nature of the products for which futures contracts were traded.[13] However, futures contracts were later created for nonagricultural commodities, including energy products such as oil and natural gas, metals such as gold and silver, and financial products such as Treasury bonds and foreign currencies. In 1974, a new independent federal agency, the Commodity Futures Trading Commission (CFTC), was created to oversee the trading of futures contracts.[14] Like SEC, CFTC relies on SROs, including the futures exchanges and the National Futures Association, to establish and enforce rules governing member behavior. In 2000, the Commodity Futures Modernization Act of 2000 established a principles-based structure for the regulation of futures exchanges and derivatives clearing organizations, and it clarified that some off-exchange derivatives

[12] Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291, 120 Stat. 1327 (2006). Under the act, a credit rating agency seeking to be treated as a nationally recognized statistical rating organization (NRSRO) must apply for, and be granted, registration with SEC, make public in its application certain information to help persons assess its credibility, and implement procedures to manage the handling of material nonpublic information and conflicts of interest. In addition, the act provides SEC with rulemaking authority to prescribe the form of the application (including requiring the furnishing of additional information); the records an NRSRO must make and retain; the financial reports an NRSRO must furnish to SEC on a periodic basis; the specific procedures an NRSRO must implement to manage the handling of material nonpublic information; the conflicts of interest an NRSRO must manage or avoid altogether; and the practices that an NRSRO must not engage in if SEC determines they are unfair, coercive, or abusive. The act expressly prohibits SEC from regulating the rating agencies' methodologies or the substance of their ratings. Pub. L. No. 109-291 § 4(a).

[13] The Grain Futures Act, Pub. L. No. 42-331, 42 Stat. 998 (1922). In 1936 the act was substituted with the "Commodity Exchange Act (CEA)," which, among other things, created the Commodity Exchange Commission, a predecessor agency to the Commodity Futures Trading Commission. Pub. L. No. 49-675, 49 Stat. 1491 (1936).

[14] Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974).

trading—in particular, trading on facilities only accessible to large, sophisticated traders—was permitted and would be largely unregulated or exempt from regulation.[15] In 2010, the Dodd-Frank Act established a new regulatory framework for swaps to reduce risk, increase transparency, and promote market integrity in swaps markets by, among other things, requiring that many trades are to be centrally cleared, and providing for greater public availability of trading information. To implement the act's reforms, SEC has jurisdiction over security-based swaps, SEC and CFTC share joint jurisdiction over mixed swaps, and CFTC has jurisdiction over all other types of swaps.

Insurance Oversight

Unlike most other financial services, insurance activities traditionally have been regulated at the state level. In 1944, a U.S. Supreme Court decision determined that the insurance industry was subject to interstate commerce laws, which could then have allowed for federal regulation, but Congress passed the McCarran-Ferguson Act in 1945 to explicitly return insurance regulation to the states.[16] As a result, 56 state, territorial, or other local jurisdiction authorities oversee insurance activities in the United States, although state regulations and other activities are often coordinated nationally by the National Association of Insurance Commissioners (NAIC).[17] The Dodd-Frank Act created the Federal Insurance Office (FIO), a non-regulatory agency designed to monitor

[15] A derivative is a financial instrument representing a right or obligation based on the value at a particular time of an underlying asset, reference rate, or index, such as a stock, bond, agricultural or other physical commodity, interest rate, currency exchange rate, or stock index. Derivatives contracts are used by firms around the world to manage market risk—the exposure to the possibility of financial loss caused by adverse changes in the values of assets or liabilities—by transferring it from entities less willing or able to manage it to those more willing and able to do so. Common types of derivatives include futures, options, forwards, and swaps and can be traded through an exchange, known as exchange-traded, or privately, known as over-the-counter.

[16] Up until 1944, insurance was not considered interstate commerce and, therefore, was not subject to federal regulation. In *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944) the Supreme Court held that Congress could regulate insurance transactions that truly are interstate. Congress subsequently enacted the McCarran-Ferguson Act, 59 Stat. 33 (1945), which provides that state laws apply to insurance unless they are specifically pre-empted by Congress. See 15 U.S.C. § 1011.

[17] NAIC is made up of the heads of the insurance departments of 50 states, the District of Columbia, and U.S. territories to provide a forum for the development of uniform policy when uniformity is appropriate.

certain aspects of the insurance industry.[18] FIO is not a regulator or supervisor, and its responsibilities include identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system. Additionally, the Dodd-Frank Act granted the Federal Reserve oversight over nonbank financial companies that are designated by the Financial Stability Oversight Council (FSOC) (discussed in more detail below) for enhanced prudential standards, including some containing insurance companies.[19]

Secondary Mortgage Markets

The recent financial crisis in the credit and housing markets prompted the creation of a new, unified federal financial regulatory oversight agency, the Federal Housing Finance Agency (FHFA), to oversee the government-sponsored enterprises Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.[20] Fannie Mae and Freddie Mac are private, federally chartered companies created by Congress to, among other things, provide liquidity to home mortgage markets by purchasing mortgage loans, thus enabling lenders to make additional loans. The system of 11 Federal Home Loan Banks provides funding to support housing finance and economic development.[21] Until enactment of the Housing and Economic Recovery Act of 2008, Fannie Mae and Freddie Mac had been overseen since 1992 by the Office of Federal Housing Enterprise Oversight (OFHEO), an agency within the Department of

[18]Pub. L. No. 111-203, § 502, 124 Stat. 1376, 1580 (2010).

[19]Pub. L. No. 111-203, § 113, 124 Stat. 1376, 1398 (2010). According to the Dodd-Frank Act, nonbank financial companies are domestic companies or foreign companies that predominantly are engaged in financial activities (such as insurance companies, consumer finance providers, commercial lenders, asset managers, and investment funds) but that are not bank holding companies or certain other types of firms (such as registered securities exchanges, clearing agencies, and swap execution facilities).

[20]Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, title I, subtitle A, 122 Stat. 2654, 2661 (2008).

[21]The Federal Home Loan Banks form a system of regional cooperatives, each with its own president and board of directors, located in different regions of the country. Their statutory mission is to provide cost-effective funding to members for use in housing, community, and economic development; to provide regional affordable housing programs, which create housing opportunities for low- and moderate-income families; to support housing finance through advances and mortgage programs; and to serve as a reliable source of liquidity for their membership. The Federal Home Loan Bank of Seattle merged with the Federal Home Loan Bank of Des Moines in 2015 reducing the system to 11 Federal Home Loan Banks.

Housing and Urban Development, and the Federal Home Loan Banks were subject to supervision by the Federal Housing Finance Board (FHFB), an independent regulatory agency.[22] OFHEO regulated Fannie Mae and Freddie Mac on matters of safety and soundness, while the Department of Housing and Urban Development regulated their mission-related activities. FHFB served as the safety and soundness and mission regulator of the Federal Home Loan Banks.

With respect to Fannie Mae and Freddie Mac, the Housing and Economic Recovery Act of 2008 gives FHFA such new regulatory authorities as the power to regulate the retained mortgage portfolios, to set more stringent capital standards, and to place a failing entity in receivership. In addition, the law provides FHFA with funding outside the annual appropriations process. In September 2008, Fannie Mae and Freddie Mac were placed in conservatorship, with FHFA serving as the conservator under powers provided in the 2008 act. In November 2008, the Federal Reserve announced plans to purchase mortgage-backed securities guaranteed by Fannie Mae and Freddie Mac on the open market.

Farm Credit System

The farm credit system is a nationwide network generally consisting of cooperatively organized banks and associations that are owned and controlled by their borrowers.[23] The system's entities provide credit and other services to agricultural producers and certain others. The Farm Credit Administration (FCA) is the independent federal agency that charters, regulates, and examines banks, associations, and related entities of the farm credit system, including examining the Federal

[22]OFHEO was created in title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, 106 Stat. 3672, 3941 (1992). In 1932, the Federal Home Loan Bank Act created the Federal Home Loan Bank System to provide liquidity to member entities to make home mortgages. Oversight of these responsibilities was later transferred to the Federal Housing Finance Board.

[23]The Farm Credit System started with the Federal Farm Loan Act of 1916 which established the Federal Land Banks. Pub. L. No. 64-158, 39 Stat. 360 (1916). The Federal Land Banks was the first component of what became the Farm Credit System. The Farm Credit Act of 1933 completed the establishment of the Farm Credit System. Pub. L. No. 73-75, 48 Stat. 257 (1933). The Farm Credit Act of 1971 gave banks and other entities more flexibility in lending to agriculture and authorized lending to, among others, rural homeowners. Pub. L. No. 92-181, 85 Stat. 583 (1971).

Agricultural Mortgage Corporation (Farmer Mac), to ensure a dependable source of credit for agriculture and rural America.[24]

The Farm Credit Amendments Act of 1985 amended FCA to give it increased oversight, regulatory, and enforcement powers similar to those of other federal financial regulatory institutions.[25] It required FCA to examine each direct-lending institution under its authority at least annually and to use its new enforcement authority to instill safety and soundness practices on troubled institutions and to take corrective actions against institutions for any regulatory violations. In 1987, Farmer Mac was established to create a secondary market for agricultural real estate and rural home mortgages, and in 1996, it was given further authority to purchase and pool loans and issue mortgage-backed securities with guaranteed payment of principal and interest, rather than guarantee such securities issued by other retail lenders.[26] Today the farm credit system is structured into 3 district farm credit banks, 76 agricultural credit associations, 2 federal land credit associations, and 1 agricultural credit bank.

Gramm-Leach-Bliley Act

Changes in the types of financial activities permitted for depository institutions and their affiliates have also shaped the financial regulatory system over time. Under the Glass-Steagall provisions of the Banking Act of 1933, financial institutions were prohibited from simultaneously offering commercial and investment banking services. However, in the Gramm-Leach-Bliley Act of 1999 (GLBA), Congress permitted financial institutions to fully engage in both types of activities and, in addition, provided a regulatory process allowing for the approval of new types of financial

[24]Farmer Mac is a government-sponsored enterprise with the mission of providing a secondary market for a variety of loans made to borrowers in rural America.

[25]Pub. L. No. 99-205, 99 Stat. 1678 (1985).

[26]Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (1987); Farm Credit System Reform Act of 1996, Pub. L. No. 104-105, 110 Stat. 162 (1996).

activity.[27] Under GLBA, qualifying financial institutions are permitted to engage in banking, securities, insurance, and other financial activities. When these activities are conducted within the same bank holding company structure, they remain subject to regulation by “functional regulators,” which are the federal authorities having jurisdiction over specific financial products or services, such as SEC or CFTC. As a result, multiple regulators now oversee different business lines within a single institution. For example, broker-dealer activities are generally regulated by SEC even if they are conducted within a large financial conglomerate that is subject to the Bank Holding Company Act, which is administered by the Federal Reserve. The functional regulator approach was intended to provide consistency in regulation, focus regulatory restrictions on the relevant functional area, and avoid the potential need for regulatory agencies to develop expertise in all aspects of financial regulation.

Accounting and Auditing

In addition to the creation of various regulators over time, the accounting and auditing environment for financial institutions and market participants—a key component of financial oversight—has also seen substantial change. In the early 2000s, various companies with publicly traded securities were found to have issued materially misleading financial statements. These companies included Enron and WorldCom, both of which filed for bankruptcy. When the actual financial conditions of these companies became known, their auditors were called into question, and one of the largest, Arthur Andersen, was dissolved after the Department of Justice filed criminal charges related to its audits of Enron. As a result of these and other corporate financial reporting and auditing scandals, the Sarbanes-Oxley Act of 2002 was enacted.[28] Among other things, Sarbanes-Oxley expanded public company reporting and disclosure requirements and established new ethical and corporate responsibility requirements for public company executives, boards of

[27]Gramm-Leach-Bliley Act, Pub. L. No. 106-102 (1999). Although originally precluded from conducting significant securities underwriting activities, bank holding companies were permitted to conduct more of such activities over the years. For example, in 1987, the Federal Reserve allowed the subsidiaries of bank holding companies to engage in securities underwriting activities up to 5 percent of their revenue. Over time, the Federal Reserve also expanded the types of securities that banks could conduct business in and raised the revenue limit to 10 percent in 1989 and to not exceed 25 percent in 1996 (effective in March 1997).

[28]Pub. L. No. 107-204, 116 Stat. 745 (2002).

directors, and independent auditors. The act also created the Public Company Accounting Oversight Board, to oversee the audits of public companies by public accounting firms. The activities of this board are, in turn, overseen by SEC.

Dodd-Frank Act

The 2007-2009 financial crisis threatened the stability of the U.S. financial system and the health of the U.S. economy. At the peak of the crisis, the federal government introduced unprecedented support for financial markets, providing hundreds of billions of dollars of capital and over a trillion dollars of emergency loans to financial institutions. Many households suffered as a result of falling asset prices, tightening credit, and increasing unemployment. The causes of the 2007-2009 crisis are complex and remain subject to debate and ongoing research. According to many researchers, around mid-2007, losses in the mortgage market triggered a reassessment of financial risk in other debt instruments and sparked the financial crisis. Uncertainty about the financial condition and solvency of financial entities resulted in a liquidity and credit crunch that made the financing on which many businesses and individuals depend increasingly difficult to obtain. By late summer of 2008, the ramifications of the financial crisis ranged from the failure of financial institutions to increased losses of individual savings and corporate investments.

Congress enacted the Dodd-Frank Act in 2010 with a key goal of the act being to promote the stability of the financial system. The act put forward a number of reforms to achieve this goal, such as provisions related to identifying and addressing systemic risk and enhancing supervision of large, complex financial institutions. Other reforms seek to expand protections for consumers and investors and expand oversight to entities that were previously less regulated. The following are some of the structural changes the act made that altered the U.S. financial regulatory system.

- The act established the Financial Stability Oversight Council (FSOC) to identify risks to the financial stability of the United States, promote market discipline, and respond to emerging threats to the stability of the U.S. financial system.
- The act established the Office of Financial Research (OFR) within the Department of the Treasury (Treasury) to support FSOC and its member agencies by improving the quality, transparency, and accessibility of financial data and information; conducting and sponsoring research related to financial stability and provide advice

on the impact of policies related to systemic risk; and developing tools for risk measurement and risk monitoring.[29]

- The act established the Bureau of Consumer Financial Protection, also known as the Consumer Financial Protection Bureau (CFPB), as an independent bureau within the Federal Reserve System and provided it with rulemaking, enforcement, supervisory, and other powers over many consumer financial products and services and many of the entities that sell them.[30] CFPB is also authorized to supervise certain nonbank financial companies and large banks and credit unions with over $10 billion in assets and their affiliates for consumer protection purposes.

[29]For additional information on FSOC and OFR, see GAO, *Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions,* GAO-12-886 (Washington, D.C.: Sept. 11, 2012).

[30]12 U.S.C. §§ 5481–5603.

Appendix III: GAO Framework for Evaluating Financial Regulatory Reforms

Characteristic	Description
Clearly defined regulatory goals	Goals should be clearly articulated and relevant.
Appropriately comprehensive	Financial regulations should cover all activities that pose risks or are otherwise important to meeting regulatory goals.
Systemwide focus	Mechanisms should be included for identifying, monitoring, and managing risks to the financial system regardless of the source of the risk.
Flexible and adaptable	A regulatory system that is flexible and forward looking allows regulators to readily adapt to market innovations and changes.
Efficient and effective	Effective and efficient oversight should be developed, including eliminating overlapping federal regulatory missions where appropriate and minimizing regulatory burden without sacrificing effective oversight.
Consistent consumer and investor protection	Consumers and investors should receive consistent, useful information, as well as legal protections for similar financial products and services.
Regulators provided with independence, prominence, authority, and accountability	Regulators should have independence from inappropriate influence, as well as prominence and authority to carry out and enforce statutory missions, and be clearly accountable for meeting regulatory goals.
Consistent financial oversight	Similar institutions, products, risks, and services should be subject to consistent regulation, oversight, and transparency.
Minimal taxpayer exposure	A regulatory system should foster financial markets that are resilient enough to absorb failures and thereby limit the need for federal intervention and limit taxpayers' exposure to financial risk.

Source: GAO. | GAO-16-175

Appendix IV: List of Discussion Group Participants

Bank and Thrift Holding Company Supervision

John Bowman	Former Acting Director Office of Thrift Supervision
Cecelia Calaby	Senior Vice President American Bankers Association
Richard Carnell	Associate Professor of Law Fordham University School of Law
Kieran Fallon	Former Associate General Counsel Federal Reserve Board
Richard Foster	Vice President and Senior Counsel for Regulatory and Legal Affairs Financial Services Roundtable
Aaron Klein	Director of the Financial Regulatory Reform Initiative Bipartisan Policy Center
Margaret Liu	Senior Vice President and Deputy General Counsel Conference of State Bank Supervisors

Consumer Financial Protection Oversight

Sandra Braunstein	Former Director Board of Governors of the Federal Reserve System
Leonard Chanin	Former Assistant Director Consumer Financial Protection Bureau
Lisa Donner	Executive Director Americans for Financial Reform
Ed Mierzwinski	Director of Consumer Programs U.S. PIRG
Benjamin Olson	Former Deputy Assistant Director Consumer Financial Protection Bureau

Richard Riese	Senior Vice President American Bankers Association
Jess Sharp	Managing Director, Center for Capital Markets and Competitiveness U.S. Chamber of Commerce
Heather Slavkin Corzo	Director AFL-CIO

Insurance Group Supervision

Holly Bakke	Principal Strategic Initiatives Management Group, LLC Former Commissioner New Jersey Department of Banking and Insurance
Dan Daveline	Director of Financial Regulatory Services National Association of Insurance Commissioners
Scott Harrington	Alan B. Miller Professor Wharton School of Business, University of Pennsylvania
Robert Hatch	Regulatory Counsel Financial Services Roundtable
Kelly Ireland	Senior Counsel American Council of Life Insurers
Alessandro Iuppa	Senior Vice President and Senior Policy Advisor Zurich Insurance Group Former Superintendent of Insurance Maine Bureau of Insurance
William Marcoux	Partner DLA Piper

Therese Vaughan	Former President and CEO National Association of Insurance Commissioners Former Commissioner State of Iowa Insurance Division
Robert Woody	Vice President Property Casualty Insurers Association of America

Swaps and Security-Based Swaps Regulation

Karen Barr	President and CEO Investment Adviser Association
David Blass	General Counsel Investment Company Institute
Audrey Costabile Blater	Director of Research International Swaps and Derivatives Association
Ronald Filler	Professor of Law New York Law School
Michael Greenberger	Professor of Law University of Maryland School of Law
John Ramsay	Former Acting Director, Division of Trading and Markets Securities Exchange Commission
Chester Spatt	Professor of Finance Carnegie Mellon University

Appendix V: Comments from the U.S. Commodity Futures Trading Commission

U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521
www.cftc.gov

Office of the Chairman

Timothy G. Massad
Chairman

January 21, 2016

Lawrance Evans, Jr.
Director
Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Evans:

Thank you for providing us the opportunity to review and comment on the GAO's draft report entitled *Financial Regulation: Complex and Fragmented Structure Could be Streamlined to Improve Effectiveness* (GAO-16-175). We appreciate the GAO's work on this important matter and the courtesy you have shown to the CFTC staff in conducting this study.

We previously transmitted separately a few specific comments on the factual portions of this draft report. As the draft report indicates, the securities and derivatives markets are regulated by different agencies because, while these markets are interconnected, they remain separate and serve distinct functions within a complex financial system. As the draft report also indicates, functional regulation is a collaborative process, and has worked well over the many decades that it has been in operation.

Last year marked the CFTC's 40th anniversary. Consistent with the CFTC's longstanding practice and our comments to GAO's 2010 report on harmonization efforts between the agencies, we continue to work closely with our colleagues at the SEC. We appreciate your longstanding interest in the financial services regulatory structure of the United States.

Thank you once again for the opportunity to review and comment on the draft report. I am committed to CFTC's regulatory processes and working closely and cooperatively with the SEC and the other members of the Financial Stability Oversight Council. GAO's continuing work in this area will assist us in our continuing effort to improve those processes as we administer the Commodity Exchange Act and implement the Dodd-Frank Act.

Sincerely,

Timothy G Massad

Appendix VI: Comments from the National Credit Union Administration

National Credit Union Administration
Office of the Executive Director

January 28, 2016

Ms. Christine Houle
Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

RE: Draft Report Entitled *Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness (GAO-16-175)*

Dear Ms. Houle:

Thank you for the opportunity to comment on GAO's draft report entitled *Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness*. We appreciate the importance of your work in this difficult area, and offer the following comments.

The report provides good outline of the current system of financial regulation in the United States. It should be emphasized, however, NCUA is the only federal agency with regulatory and supervisory authority over federal credit unions, in contrast with the banking regulators. In addition, as noted, NCUA is responsible for insuring most state chartered credit unions. We work directly with the state supervisory authorities for federally insured state chartered credit unions to minimize insurance losses to the National Credit Union Share Insurance Fund.

The report's substance does not support the assertion in the title that "Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness." While all institutional arrangements are imperfect and the current regulatory structure could always be improved, support for this particular statement should include estimates of the cost savings to the economy resulting from streamlining, or at least estimates of the costs of current complexity and fragmentation.

We appreciate the structure of the document, in which observations that point out the possibilities of duplication and inefficiency in the current structure are almost always followed by observations of an opposing point of view. This appears to be a benefit of using discussion groups to look at key issues. The comprehensive treatment enhances the usefulness of the document in helping to convey the difficulty of regulating the financial system. However, without a scale to judge the relative strength of the arguments, it is difficult to reach the conclusion implied by the title.

With respect to the recommendations, we could find no compelling evidence throughout the document that would lend additional support to the idea proposed by the example in the "Matters for Congressional Consideration" section, that Congress "...could consider consolidating the

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Ms. Christine Houle
January 28, 2016
Page Two

number of federal agencies involved with overseeing the safety and soundness of depository institutions…" Support for that consideration would appear to need a careful review of the costs and benefits of that action.

Further, we remain concerned that the recommendations for executive action, which include a proposal that financial system monitors including confidential supervisory information be shared more widely, underestimates the costs and other issues relating to the dissemination of supervisory data that may actually be more costly to the overall process than helpful.

The final recommendation that the OFR and the Federal Reserve work to "…develop and maintain a joint strategy for their systemic risk monitoring activities…" to "…reduce the risk of unnecessary duplication…" may not be useful. There is still wide disagreement within the financial community as well as across regulators about what constitutes financial stability and how it should be measured. Given the uncertainty in deciding even what should be measured, it may be more useful to encourage a wide array of approaches rather than to artificially choose an approach for the sake of reducing the appearance of duplication. Having a range of opinions provided to FSOC is an advantage in this circumstance, not a cost.

Thank you again for the opportunity to comment. Please contact us with any questions.

Sincerely,

Mark A. Treichel

Mark A. Treichel
Executive Director

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

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

OFFICE OF FINANCIAL STABILITY
POLICY AND RESEARCH

February 3, 2016

Lawrance Evans, Jr.
Director
Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Evans:

Thank you for providing the Board of Governors of the Federal Reserve System ("Federal Reserve") with an opportunity to review the final draft of the Government Accountability Office ("GAO") report titled: *Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness* (GAO-16-175). The GAO's report reviews the financial regulatory structure and discusses issues of fragmentation and overlap affecting the activities of the U.S. regulators in the areas of safety and soundness and consumer protection oversight, securities and derivatives markets oversight, insurance oversight, and systemic risk oversight and consolidated supervision. With respect to systemic risk oversight and consolidated supervision, the GAO's report makes two recommendations to the Federal Reserve:

> … Second, to help regulators address regulatory fragmentation and improve FSOC's ability to identify emerging systemic risks, we recommend that the Federal Reserve work with FSOC to regularly incorporate the comprehensive results of its systemic risk monitoring activities into Systemic Risk Committee deliberations.
>
> [and]
>
> … Third, to more efficiently and effectively monitor the financial system for systemic risks and reduce the risk of unnecessary duplication, we recommend that OFR and the Federal Reserve jointly articulate individual and common goals for their systemic risk monitoring activities, develop a plan to monitor progress toward articulated goals, and formalize regular strategic and technical discussions around their activities and outputs to support those goals.

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With respect to the GAO's recommendation that the Federal Reserve work with the Financial Stability Oversight Counsel ("FSOC") to regularly incorporate the comprehensive results of its systemic risk monitoring activities into Systemic Risk Committee ("SRC") deliberations, the Federal Reserve agrees that close collaboration with the FSOC and the SRC is essential to improving the FSOC's ability to identify emerging systemic risks. Consequently, since the creation of the FSOC and SRC as a result of the Dodd-Frank Act in 2010, the Federal Reserve has actively participated in the deliberations of the SRC and provided presentations, data, and staff observations relating to systemic risk matters. For example, for the past five years, the Federal Reserve has annually detailed senior level staff members for four month periods to assist the SRC in drafting the FSOC's annual report, and, in the process, incorporated the Federal Reserve's systemic risk assessments.

We also note that the Federal Reserve strives for transparency with respect to its framework and measures for assessing systemic risk both because engagement with the academic community improves these measures and because these measures are of broad interest. Recent examples include Adrian, et al (2013), who describe a framework and some measures for a monitoring program, and Aikman et al (2015), who describe formulas for measuring areas of particular concern in the financial system.[1]

The Federal Reserve has worked closely with the SRC to incorporate the results of our systemic risk monitoring activities into its deliberations, and the Federal Reserve will continue to work with the SRC and the FSOC to share information about systemic risk monitoring.

GAO also recommends that the Office of Financial Research ("OFR") and the Federal Reserve jointly articulate individual and common goals for their systemic risk monitoring activities, develop a plan to monitor progress toward articulated goals, and formalize regular strategic and technical discussions around their activities and outputs to support those goals. The Federal Reserve agrees that communication with the OFR is a key aspect of monitoring the financial system for systemic risks, particularly given the OFR's access to a broad range of data not available to other regulators. The Federal Reserve has consulted with the OFR since its establishment and will continue to consult with the OFR in the future about ways to share information and support the goal of financial stability. We will continue work with the OFR to make this communication more formal.

We note that, since its creation in 2010, the Federal Reserve has engaged in regular strategic and technical discussions with the OFR in a number of ways. The Federal Reserve participates, often as a host, in the OFR's annual conference; we worked with the OFR to put in place a permanent effort to collect data on repo and securities lending markets; and we are working with the OFR to share this information related to financial stability. Further, the Federal Reserve engages in strategic and technical

[1] See Tobias Adrian, Daniel Covitz, and Nellie Liang, *Financial Stability Monitoring,* Federal Reserve Bank of New York Staff Report No. 601, (Feb. 2013, updated Aug. 2014), http://www.federalreserve.gov/econresdata/notes/feds-notes/2014/financial-stability-monitoring-20140804.html. See Aikman, David, Michael T. Kiley, Seung Jung Lee, Michael G. Palumbo, and Missaka N. Warusawitharana (2015), *Mapping Heat in the U.S. Financial System*, Finance and Economics Discussion Series 2015-059, (June 24, 2015), Washington: Board of Governors of the Federal Reserve System, http://dx.doi.org/10.17016/FEDS.2015.059

discussions with the OFR on various topics, such as improvements to stress testing, and both the Federal Reserve and OFR participate at SRC and FSOC deputies meetings.

It is important to note that the field of systemic risk monitoring is one in which diversity of opinion and analysis is valuable, and "groupthink" can lead to blind spots in assessments of systemic risk. The Federal Reserve will strive to coordinate with the OFR in a manner that preserves and encourages each agency's independent views of systemic risk.

Finally, in general, the Draft Report suggests that the Federal Reserve has "tools" that are, in some way, not shared with the SRC.[2] As we have mentioned to GAO several times, including at the exit conference, we do not know what GAO means by the term "tools." We develop internal assessments based on data, experience, and research which focus on the particular and unique duties of the Federal Reserve. When the SRC takes up issues that the Federal Reserve has independently considered, we share our perspectives with the SRC members.

We appreciate the GAO's review of the Federal Reserve's systemic risk monitoring activities, for their professional approach to the review, and for the opportunity to comment.

Sincerely,

Nellie Liang, Director
Office of Financial Stability
Policy and Research

[2] For example, See Draft Report pages 55 ("However, the committee does not have full and consistent access to existing monitoring tools developed by OFR and Federal Reserve."), 60 ("Both OFR and the Federal Reserve have developed systemic risk monitoring tools."), and 66 ("Both OFR and the Federal Reserve aim to have forward-looking tools to identify where the build-up of vulnerabilities can provide early insight into emerging systemic risks.")

Appendix VIII: Comments from the Office of Financial Research

OFFICE OF FINANCIAL RESEARCH

Richard Berner, Director

February 9, 2016

Lawrance Evans Jr.
Director, Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Director Evans,

I am writing in response to GAO's draft report entitled, *Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness*, dated February 2016 ("the draft report"). The Office of Financial Research ("OFR" or "Office") appreciates the efforts of the GAO in preparing the draft report, and this letter provides OFR's official response.

The draft report reviews the overall structure of the US regulatory system, the effects of overlap and fragmentation on agencies' oversight activities and the collaborative efforts of agencies involved in systemic risk oversight. As you are aware, it is essential that several regulatory agencies are involved in and collaborate on such oversight in order to properly assess risks across the financial system. Indeed, most observers point to the absence of effective collaboration among financial regulators as a key factor magnifying the impact of the recent financial crisis. Thus, while agencies should limit duplication in work efforts as the report noted, some degree of overlap and duplication may be justified to foster effective collaboration and to provide a comprehensive picture of risks across financial institutions and financial markets.

As required by law, the OFR has been prudent to avoid duplicating the data collection efforts of financial regulators. If the OFR identifies supervisory or otherwise nonpublic data sets needed to assess and monitor threats to financial stability, the Office works with the appropriate regulatory agency or agencies to obtain or share the required data and to keep them secure. In cases where needed data do not exist because the information is not collected by any primary regulator, the OFR coordinates with the appropriate regulator(s) to fill the data gap, thus avoiding duplicative efforts and overburdening industry.

Using both publicly-available and nonpublic data, the OFR conducts a variety of research and analyses, including the development of tools to monitor vulnerabilities in the financial system. As noted in the report, OFR anticipates finalizing a variety of such monitors over the next year. The OFR takes seriously its responsibility to support the Council in monitoring vulnerabilities, and presents both the monitoring for tools and their results to the FSOC principals and deputies.

717 14th Street, NW, Washington, DC 20005

However, the OFR agrees with your recommendation to improve dissemination of such results within the Council. To improve distribution and discussion of the results of current OFR monitoring tools in the appropriate FSOC meetings, including the Systemic Risk Committee meetings, the OFR has initiated conversations with the staff of the Council on best practices for distribution. As future monitoring tools are finalized we will reach out to the Council's staff to determine ways in which OFR tools can be incorporated into FSOC discussions.

Some, but not all, of these results are made available to the public on our website. As you know, however, public distribution is limited because certain data provided to supervisory regulators have legislatively mandated confidentiality requirements which may prevent distribution outside of the FSOC principals and deputies. Tools developed using such data are only distributed to the FSOC principals and deputies. Thus, there are appropriate limits to sharing confidential data.

Your report found that the OFR and Federal Reserve ("FR") have developed similar systemic risk monitoring tools, and that there could be benefits from collaboration on such tools. We agree in principle; OFR and the FR both monitor financial stability. In practice, however, our respective approaches to monitoring, the specific financial stability monitors we each currently use, and the interpretation of results we and the FR derive from those tools may differ, in part reflecting our different missions and responsibilities. Nonetheless, the OFR and FR have initiated discussions on how best to address your recommendation while faithfully executing our respective missions.

We appreciate the opportunity to respond to your draft report. And we look forward to continuing to work with you as we continue to improve the ways we carry out our mission.

Sincerely,

Richard Berner

Richard Berner
Director

OFFICE OF FINANCIAL RESEARCH
717 14th Street, NW, Washington, DC 20005

Appendix IX: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the individual named above, the following staff also made key contributions to the report. Stefanie Jonkman (Assistant Director), Christine Houle (Analyst-in-Charge), Silvia Arbelaez-Ellis, Rachel DeMarcus, Max Glikman, Michael Hoffman, Risto Laboski, Marc Molino, Christopher Ross, Jessica Sandler, Jennifer Schwartz, and Andrew Stavisky. Other staff who contributed to this report include A. Nicole Clowers, Triana McNeil, Nancy Barry, Derry Henrick, Scott McNulty, and Patrick Ward.

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