Highlights of GAO-05-61, a report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

October 2004

FINANCIAL REGULATION

Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure

Why GAO Did This Study

In light of the passage of the 1999 Gramm-Leach-Bliley Act and increased competition within the financial services industry at home and abroad, GAO was asked to report on the current state of the U.S. financial services regulatory structure. This report describes the changes to the financial services industry, focusing on banking, securities, futures, and insurance; the structure of the U.S. and other regulatory systems; changes in regulatory and supervisory approaches; efforts to foster communication and cooperation among U.S. and other regulators; and the strengths and weaknesses of the current regulatory structure.

What GAO Recommends

While GAO is not recommending a specific alternative regulatory structure, Congress may wish to consider ways to improve the regulatory structure for financial services, especially the oversight of complex, internationally active firms. Options to consider include consolidating within regulatory areas and creating an entity primarily to oversee complex, internationally active firms, while leaving the rest of the regulatory structure in place. Federal financial regulators provided comments on these options.

www.gao.gov/cgi-bin/getrpt?GAO-05-61.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Thomas J. McCool at (202) 512-8678 or mccoolt@gao.gov.

What GAO Found

The financial services industry has changed significantly over the last several decades. Firms are now generally fewer and larger, provide more and varied services, offer similar products, and operate in increasingly global markets. These developments have both benefits and risks, both for individual institutions and for the regulatory system as a whole. Actions that are being taken to harmonize regulations across countries, especially the Basel Accords and European Union Financial Services Action Plan, are also affecting U.S. firms and regulators. While the financial services industry and the international regulatory framework have changed, the regulatory structure for overseeing the U.S. financial services industry has not. Specialized regulators still oversee separate functions—banking, securities, futures, and insurance—and while some regulators do oversee complex institutions at the holding company level, they generally rely on functional regulators for information about the activities of subsidiaries. In addition, no one agency or mechanism looks at risks that cross markets or industry segments or at the system and its risks as a whole.

Although a number of proposals for changing the U.S. regulatory system have been put forth, the United States has chosen not to consolidate its regulatory structure. At the same time, some industrial countries—notably the United Kingdom—have consolidated their financial regulatory structures, partly in response to industry changes. Absent fundamental change in the overall regulatory structure, U.S. regulators have initiated some changes in their regulatory approaches. For example, starting with large, complex institutions, bank regulators, in the 1990s, sought to make their supervision more efficient and effective by focusing on the areas of highest risk. And partly in response to changes in European Union requirements, SEC has issued rules to provide consolidated supervision of certain internationally active securities firms on a voluntary basis. Regulators are also making efforts to communicate in national and multinational forums, but efforts to cooperate have not fully addressed the need to monitor risks across markets, industry segments, and national borders. And from time to time regulators engage in jurisdictional disputes that can distract them from focusing on their primary missions.

GAO found that the U.S. regulatory structure worked well on some levels but not on others. The strength and vitality of the U.S. financial services industry demonstrate that the regulatory structure has not failed. But some have questioned whether a fragmented regulatory system is appropriate in today's environment, particularly with large, complex firms managing their risks on a consolidated basis. While the structure of the agencies alone cannot ensure that regulators achieve their goals—agencies also need the right people, tools, and policies and procedures—it can hinder or facilitate their efforts to provide consistent, comprehensive regulation that protects consumers and enhances the delivery of financial services.