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**Financial Institutions  
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# Foreword

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This report was prepared primarily to inform Congressional members and key staff of ongoing assignments in the General Accounting Office's Financial Institutions and Markets issue area. This report contains assignments that were ongoing as of October 2, 1995, and presents a brief background statement and a list of key questions to be answered on each assignment. The report will be issued quarterly.

This report was compiled from information available in GAO's internal management information systems. Because the information was downloaded from computerized data bases intended for internal use, some information may appear in abbreviated form.

If you have questions or would like additional information about assignments listed, please contact James Bothwell, Director; Helen Hsing, Associate Director; or Thomas McCool, Associate Director, on (202) 512-8678.

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## *Financial Institutions and Markets*

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### **ENSURING EFFECTIVE REGULATION**

**TITLE: FEDERAL RESPONSES TO FINANCIAL CRISES (233391)**

**BACKGROUND :** Linkages among financial and market sectors make it easier for local disturbances to spread widely and rapidly throughout the financial system. Responsibility related to defusing threats to system stability is shared among U.S. agencies with different agendas and different authorities to act.

**KEY QUESTIONS :** 1) What were the problems that led to financial crises in the past 20 years? 2) What players (public and private) responded--what did each do, why, how did they interact, what uncertainties existed? 3) What can be learned from past federal responses to these financial crises?

**TITLE: ADMINISTRATIVE LAW JUDGES PROGRAMS (233397)**

**BACKGROUND :** SEC's and CFTC's Administrative Law Judges (ALJs) conduct hearings in administrative proceedings. Press reports indicate that CFTC routinely reverses or scales back penalties imposed by its ALJs. Additionally, SEC anticipates increased workloads for its ALJs in FY 1992 and beyond.

**KEY QUESTIONS :** (1) What are the roles of Administrative Law Judges (ALJ) offices in the SEC and CFTC, the regulatory framework in which they operate, and the operation and staffing of the offices (including budget, training, background of ALJs, etc)? (2) What are the outcomes of cases and appeals?

**TITLE: FARM CREDIT SYSTEM: FEDERAL INSURANCE PROGRAM ISSUES (233403)**

**BACKGROUND :** The Farm Credit System Insurance Corporation (FCSIC) administers a federal insurance program for System banks. The local lending associations that cooperatively own these banks now hold most System capital. However, FCSIC cannot tap association capital to shore up troubled banks.

**KEY QUESTIONS :** 1) To what extent should local System lending associations be required to participate with System banks in Farm Credit System Insurance Corporation's (FCSIC) insurance program? 2) How much flexibility should FCSIC have to set insurance premiums?

### **ENSURING EFFECTIVE REGULATION**

**TITLE: SURVEY OF THE FEDERAL RESERVE SYSTEM'S FINANCIAL TRENDS AND OPERATIONS (233416)**

**BACKGROUND :** The Federal Reserve System (FRS) is the nation's central bank & sets monetary/ economic policy, supervises/regulates banks, & provides services to banks & the public. The FRS also provides an important source of federal revenue, last year it earned nearly \$17 billion. The FRS is unique, however, since its member banks are owned by the private sector--not the gov't.

**KEY QUESTIONS :** 1) What has been the Fed. Reserve System's (FRS) expense/revenue trends for the last 5 yrs.? 2) Does FRS have reasonable procedures for operating areas such as prsnl., travel, ethics, and oversight? 3) How does FRS budget/operations compare with other bnkng. agencies? 4) Are there issues affecting the operating areas that could impact FRS finances during the next svrl. yrs.?

**TITLE: REVIEW OF THE COMMODITY FUTURES TRADING COMMISSION'S USE OF ITS AUTHORITY TO EXEMPT CONTRACTS FROM FEDERAL REGULATION (233442)**

**BACKGROUND :** Under the Futures Trading Practices Act of 1992, CFTC may exempt any contract from its regulation, provided the contract is consistent with the public interest & will not adversely affect CFTC's ability to oversee the regulated markets. CFTC has exempted 3 over-the-counter (OTC) contracts & has issued a proposed rule to exempt certain exchange-traded contracts.

**KEY QUESTIONS :** Q1: What standards has the Commodity Futures Trading Commission (CFTC) developed and applied to exempt swaps, hybrids, and energy contracts? Q2: Do these standards provide CFTC with a coherent framework within which to review future exemptive proposals?

**TITLE: STUDY OF THE FEDERAL DEPOSIT INSURANCE CORPORATION IMPROVEMENT ACT OF 1991 (FDICIA) PROVISIONS FOR PROMPT CORRECTIVE ACTION AND STANDARDS FOR SAFETY AND SOUNDNESS (233448)**

**BACKGROUND :** GAO was instrumental in inserting the Prompt Corrective Action (PCA) provisions into the FDIC Improvement Act (FDICIA). Since FDICIA's passage in 1991, concerns have been raised that regulators have not actively taken PCA actions and that additional tripwires are needed to improve the condition of problem banks and protect the insurance funds from losses.

**KEY QUESTIONS :** 1) Are the regulations implementing FDICIA Sec's 131 & 132 in place & adequate to meet congressional intent? 2) Are regulators promptly imposing Prompt Corrective Action (PCA) enforcement actions on institutions having capital and/or safety and soundness problems? 3) Have PCA actions improved problem institutions and protected the depository insurance funds?

**ENSURING EFFECTIVE REGULATION**

**TITLE: REVIEW OF THE NASD INVESTOR HOTLINE (233460)**

**BACKGROUND :** The Penny Stock Reform Act of 1990 mandates a toll-free NASD Hotline to provide investors with broker disciplinary history information. Congressional hearings, the press and GAO reports have raised concerns about the accuracy of the Hotline information and its effectiveness in protecting investors.

**KEY QUESTIONS :** 1) How accessible is the Hotline's toll-free number to investors? 2) How accurate is the Hotline information? 3) How useful is the information to the investor? 4) What methods are used to inform investors of the Hotline number?

**TITLE: UPDATE OF OTC DERIVATIVES REPORT (233468)**

**BACKGROUND :** In May 1994, we issued a report on derivative financial products. Since then there has been widespread press coverage of and congressional interest in large losses attributed to derivatives. Legislation has been introduced and regulators and the FASB have taken numerous actions related to derivatives.

**KEY QUESTIONS :** 1. Since May 1994, what changes have there been in the nature and extent of the use of derivative products? 2. What lessons can be learned from recent losses? 3. How have regulators and the FASB responded to derivatives developments?

**TITLE: GOVERNMENT-SPONSORED ENTERPRISES: OVERSIGHT OF DERIVATIVES ACTIVITY (233470)**

**BACKGROUND :** Government-sponsored enterprises (GSEs) issue and use derivative products. One particular product, structured notes, played a role in Orange County's bankruptcy. These notes are designed to pay returns based on changes in some underlying index. At year end 1994, GSE structured notes totaled over \$100 billion. Questions have been raised about oversight of such GSE activity.

**KEY QUESTIONS :** (1) What are the benefits and risks of issuing structured notes? (2) What are the GSEs' duties for disclosing information to investors and ensuring suitability of investors? (3) What is the nature and extent of federal regulators' oversight of GSEs? (GSEs include Fannie Mae, Freddie Mac, Sallie Mae, Farm Credit System, and Federal Home Loan Bank System).

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### ENSURING EFFECTIVE REGULATION

**TITLE: COMPARISON OF RISK BASED CAPITAL REQUIREMENTS ACROSS FINANCIAL SERVICES INDUSTRIES (233478)**

**BACKGROUND :** GAO has reported how inadequate capital requirements hindered prompt regulatory action in major bank, thrift, and insurance failures. New risk based capital requirements for banks and insurers still may not adequately reflect all solvency risks. Capital requirements, which vary across financial services industries, could create competitive disparities.

**KEY QUESTIONS :** 1) How do capital requirements and regulatory uses of capital compare across financial services industries? 2) How do regulators measure and assess capital adequacy?

**TITLE: REVIEW OF CFTC AND SEC ENFORCEMENT PRACTICES AND CAPABILITIES (233481)**

**BACKGROUND :** On May 3, 1995 we testified on the benefits and risks of merging the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). The requester is asking for additional details on the enforcement practices and capabilities of CFTC as part of its deliberations on whether to merge SEC and CFTC.

**KEY QUESTIONS :** (1) What enforcement powers and procedures does CFTC have and how do they compare to SEC's? (2) How effective are CFTC's enforcement practices and capabilities compared to SEC's and how can they be improved?

**TITLE: HEARING ON FEDERAL HOME LOAN BANK SYSTEM REFORM (233482)**

**KEY QUESTIONS :** Among other issues this testimony will address Federal Home Loan Bank System operational activities, investment practices, facilitation of home ownership, and regulation.

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### **CONSUMER PROTECTION & ACCESS TO SERVICES**

**TITLE: BANK'S COMPLIANCE WITH CONSUMER PROTECTION LAWS (233410)**

**BACKGROUND :** GAO has been asked to assess the efficiency and effectiveness of banks' and thrifts' compliance with the Community Reinvestment Act (CRA) and related fair lending laws. These laws require banks and thrifts to help meet the credit needs of their communities and ensure fair and nondiscriminatory access to credit.

**KEY QUESTIONS :** 1) How effective are the data and methodologies used to assess compliance and enforcement of the Community Reinvestment Act and related fair lending laws? (2) How efficient are the processes used to implement and enforce these laws? (3) How can compliance and enforcement be improved?

**TITLE: SURVEY OF CONTROLS OVER INITIAL PUBLIC OFFERINGS OF SECURITIES (233430)**

**BACKGROUND :** SEC processed over 500 equity initial public offerings valued at over \$40 billion in 1993. Recent press accounts allege that insiders have access to IPOs to the exclusion of the general investing public.

**KEY QUESTIONS :** 1) Do initial public offering (IPO) practices by large and small underwriters ensure that all investors are treated fairly and given equal access to information and trading opportunities? 2) Should SEC amend its rules to require the disclosure of the disciplinary actions by underwriters for violating IPO related rules?

**TITLE: OTC DERIVATIVES SALES PRACTICES (233441)**

**BACKGROUND :** During recent hearings, questions were raised on the adequacy of over-the-counter (OTC) derivatives sales practices. Corporations, governments, and other entities have reported large losses using OTC derivatives. Some have blamed those losses on dealer sales practices.

**KEY QUESTIONS :** 1) How widespread is the usage of complex Over-The-Counter (OTC) compared with mortgage-backed derivative products or structured notes? 2) What is the nature and extent of sales practice problems associated with these products? 3) What corrective actions, if any, are appropriate?



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### CONSUMER PROTECTION & ACCESS TO SERVICES

**TITLE: REVIEW OF AUDIT TRAIL COMPLIANCE (233462)**

**BACKGROUND :** The Futures Trading Practices Act of 1992 (FTPA) requires implementation of enhanced audit trail requirements by the futures exchanges. The Commodity Futures Trading Commission (CFTC) reviewed the exchanges' efforts to meet the enhanced requirements and issued a report on November 28, 1994. The Act requires that GAO comment on the CFTC report.

**KEY QUESTIONS :** Q1: Has CFTC issued any rules or guidance since FTPA was enacted and did these address the act's intent? Q2: What progress have the exchanges made in meeting the new audit trail standards? Q3: What methodology did CFTC use to assess compliance with audit trail standards? Q4: How do the exchanges and CFTC use audit trail data to identify trade practice abuse?

**TITLE: THE FAIR LENDING LAWS AND THEIR ENFORCEMENT (233463)**

**BACKGROUND :** In response to persistent reports that lending discrimination is a major problem in the financial services industry, Congress has begun to question the effectiveness of bank regulation and oversight in the fair lending area and the zeal with which the Equal Credit Opportunity Act, the Fair Housing Act, and the Home Mortgage Disclosure Act have been enforced.

**KEY QUESTIONS :** (1) How is credit discrimination defined? (2) What is the magnitude of the problem? (3) How effectively are the Equal Credit Opportunity Act, the Fair Housing Act, and the Home Mortgage Disclosure Act being implemented and enforced? (4) Are there ways to improve voluntary compliance with these laws?

**TITLE: A COMPARISON OF NON-TRADITIONAL LIFE INSURANCE PRODUCTS WITH PRODUCTS SOLD BY OTHER PROVIDERS (233469)**

**BACKGROUND :** The predominant source of revenue for the life insurance industry derives from selling investment-oriented products rather than traditional life insurance. These products are often similar to those sold by other financial institutions, although subject to regulatory policies and supervision that can be very different.

**KEY QUESTIONS :** 1) How do the products sold by life insurers compare with other financial products? 2) Are differences among products reflective of consumer needs or regulatory structure?

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### CONSUMER PROTECTION & ACCESS TO SERVICES

**TITLE: IMPLEMENTATION AND EFFECTIVENESS OF BANK HOLDING COMPANY ACT PROHIBITIONS ON BANKS TYING OF CREDIT AND RELATED SERVICES (233474)**

**BACKGROUND :** The Bank Holding Company Act Amendments of 1970, Sec. 106(b) prohibits banks from tying products and services with those of affiliated companies. The requestors expressed concern that banks have increasingly tied credit to a customer's use of a bank's, or an affiliate's, underwriting and insurance services. Banks believe regulatory barriers should be removed.

**KEY QUESTIONS :** 1) How have conditions leading to Sec. 106(b) of the Bank Holding Company Act changed since 1970? 2) How do bank regulators detect, prevent, and respond to tying violations? 3) Can these processes and procedures be improved?

**TITLE: REVIEW OF MANAGEMENT SYSTEMS, REGULATORY AND SRO REQUIREMENTS AND PROCEDURES TO ENSURE EQUITABLE TREATMENT OF WOMEN BY SECURITIES BROKERS (233477)**

**BACKGROUND :** Media reports have alleged that securities dealers discriminate against women. Sales reps allegedly spend less time, discuss more conservative products to women, and often fail to get needed data for suitability purposes from both sexes. Regulators', self regulatory organizations', and firms' procedures to combat such behavior may be insufficient.

**KEY QUESTIONS :** (1) What internal controls do broker dealers have to ensure women are not discriminated against? (2) What procedures do self regulatory organizations (SROs) use to monitor registered representatives? (3) What authority does the Securities and Exchange Commission (SEC) have, and what actions has it taken to deal with alleged or actual broker discriminatory behavior?

**TITLE: EXAMINATION OF STATES' INSURANCE AGENT LICENSING SYSTEM (233479)**

**BACKGROUND :** Insurance and securities regulators rely on licensing to screen out incompetent/unethical sellers. State licensed agents sell over 98 percent of all life insurance policies. Agents selling life insurance in a state must be licensed by that state. Sellers of securities, including variable insurance, must be Nat'l Assoc. of Securities Dealers registered.

**KEY QUESTIONS :** 1) How does state-by-state insurance agent licensing and National Association of Securities Dealers registration for sellers of securities differ? 2) What is the role of insurance/securities companies in licensing/registration? 3) How and what data do insurance and securities regulators share?

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### **ORGANIZATION & EFFCNCY OF FINANCIAL REGS**

**TITLE: SEC OVERSIGHT OF MUTUAL FUND INDUSTRY (233392)**

**BACKGROUND :** The mutual fund industry and banks' involvement in mutual fund sales have been growing at a record pace. Currently, banks account for nearly 15 percent of mutual fund sales and about 10 percent of mutual fund assets. Congress is concerned about the practices banks follow in the sale of mutual funds and with the regulatory framework for overseeing banks' mutual fund activities.

**KEY QUESTIONS :** (1) To what extent are banks involved in establishing and selling mutual funds? (2) What sales and disclosure practices are being followed by banks in the offer of mutual funds? (3) What is the regulatory framework for overseeing sales of mutual funds by banks and can it be improved?

**TITLE: INTERSTATE BANKING AS IT APPLIES TO THE BRANCHES AND AGENCIES OF FOREIGN BANKS (233428)**

**BACKGROUND :** Recent studies have shown that foreign banks hold a relatively large share of the U.S. commercial banking market, especially of commercial and industrial loans. Although there are likely many reasons for this, there is concern that U.S. laws and regulations give foreign banks a competitive advantage over domestic banks operating in the U.S.

**KEY QUESTIONS :** 1) Under what forms of organization do foreign banks operate in the U.S. and how are most organized? 2) Do U.S. banking laws and regulations apply to foreign banks operating in the U.S.? 3) What roles do foreign banks play in the U.S. economy? 4) Do differences in regulation of U.S. and foreign shell branches give foreign banks advantage(s) in U.S. markets?

**TITLE: COMPARISON OF FOREIGN BANKING SYSTEMS TO THE UNITED STATES (233435)**

**BACKGROUND :** The requester wants objective information about the bank regulatory structures in other countries, specifically the role of central banks, to help in considering various US regulatory consolidation proposals.

**KEY QUESTIONS :** 1)How are foreign bank regulatory systems structured? 2)How do the various participants charged with regulating, supervising, and examining, work together to carry out their various responsibilities? 3)How do the foreign systems compare to the current US system? 4)How do the foreign systems relate to the US regulatory consolidation proposals?

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### **ORGANIZATION & EFFCNCY OF FINANCIAL REGS**

**TITLE: REVIEW OF FEDERAL DEPOSIT INSURANCE CORPORATION OPERATIONS AND THE IMPLICATIONS OF BANK REGULATORY CONSOLIDATION (233438)**

**BACKGROUND :** FDIC experienced significant growth in the 1980s due to unprecedented bank failures. However, with current improvements in the health of the banking industry FDIC is now downsizing its organization. At the same time, the effectiveness of the total bank regulatory structure is being debated as to its relevance in today's complex financial environment.

**KEY QUESTIONS :** (1) How will FDIC's missions, strategies, priorities, and programs be reflected in its downsized operations and processes? (2) How will FDIC's major operating divisions (Supervision, Resolutions, and Depositor and Asset Services) complement each other in serving FDIC's mission? (3) How would the 3 integrate into a consolidated reg. structure?

**TITLE: FEDERAL HOME LOAN BANK SYSTEM COMMENTS ON PROPOSED LEGISLATION TO REFORM AND UPDATE THE SYSTEM (233464)**

**BACKGROUND :** In 1994, GAO issued a major report, the Federal Home Loan Bank System: Reforms Needed to Promote Its Safety, Soundness, and Effectiveness (GGD-94-38). This assignment will allow us to prepare testimony based on that report.

**KEY QUESTIONS :** How should the Federal Home Loan Bank System be reformed?

**TITLE: EFFECTS THE INTERSTATE BANKING AND BRANCHING ACT WILL HAVE ON REPORTED LENDING AND DEPOSIT DATA (233467)**

**BACKGROUND :** The Interstate Banking and Branching Act requires GAO to review the act's effect on the lending and deposit information currently provided to the regulators and the Congress. The primary concern is that consolidated bank reporting will not provide information about loans and deposits at the state and regional level.

**KEY QUESTIONS :** Will the Interstate Banking and Branching Act result in a material loss of information that depository institutions currently provide to the regulators and the Congress?

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### ORGANIZATION & EFFCNCY OF FINANCIAL REGS

**TITLE: EXAMINATION OF THE BANKING REGULATORY STRUCTURE IN JAPAN (233475)**

**BACKGROUND :** The Japanese regulatory structure regulates the largest banks in the world. Our work on foreign banking regulatory systems has concentrated on major European and North American regulatory structures. To provide additional perspective, on worldwide bank regulatory structures, we are reviewing the Japanese bank regulatory structure.

**KEY QUESTIONS :** 1) What is the structure of the Japanese bank regulatory system? 2) How do the participants in the regulatory structure work together to carry out their responsibilities? 3) What role(s) does the Bank of Japan play in this structure including (a) the development and implementation of monetary policy and (b) financial crises resolution?

### CREDIT ALLOCATION & CAPITAL FORMATION

**TITLE: EFFECTS OF PRIVATIZATION OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION (233420)**

**BACKGROUND :** As Gov't. Sponsored Enterprises (GSEs), Fannie Mae & Freddie Mac received certain benefits from, & are restricted in certain ways by their federal charters. These charters also give rise to potential risks to the taxpayer & may grant competitive advantages to these entities. A statutory mandate requires GAO to review issues involved with removing federal sponsorship of these GSEs.

**KEY QUESTIONS :** 1) How desirable and feasible would it be to repeal Fannie Mae's and Freddie Mac's (GSEs) federal charter? 2) What would be the legal and regulatory effects? 3) What would be the effects on the secondary market for mortgage loans? 4) What would be the effect on the GSEs' required capital and its cost? 5) What would be the effect on housing availability and affordability?

**TITLE: MUTUAL FUNDS: BANK PROFITABILITY (233421)**

**BACKGROUND :** The banking industry is losing some deposit business, and the earnings therefrom, to mutual funds. At the same time, a number of banks are generating earnings by providing mutual funds services themselves.

**KEY QUESTIONS :** (1) What is the profitability to banks of providing mutual funds services? (2) Is this profitability greater than the earnings lost because of competition with mutual funds? This is part of a body of work responding to requests on bank relationships with mutual funds.



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