

March 1995

# Financial Institutions and Markets Issue Area Plan

## Fiscal Years 1996-98





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# Foreword

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The Financial Institutions and Markets issue area is one of the General Accounting Office's 35 issue areas. Relying heavily on consultation with congressional committees, as well as with industry, academia, agency officials and other experts on the issues, GAO develops issue area plans to ensure that its limited resources are directed toward the most important concerns of the Congress.

For each issue area, GAO's strategic plan describes the significance of the issues, our objectives, and the focus of our work. GAO serves as a source of timely, accurate information, and unbiased analysis for decisionmakers in the Congress and executive agencies. Our work results in such products as reports, briefings, and testimonies.

The Financial Institutions and Markets issue area does program and performance evaluation work in the financial sector generally focusing on establishing a regulatory framework for financial institutions to act prudently while allowing for a robust, competitive financial services industry. The area covers the Treasury Department, the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Office of Federal Housing Enterprise Oversight, the Farm Credit Administration, and the National Credit Union Administration.

GAO has recently issued reports examining interstate banking, the credit card industry, banks' insider lending activities, the Federal Home Loan Bank system, the Farm Credit System, and the risks of financial derivatives to individual firms and the financial system.

The principal issues in the financial institutions and markets area are

- enhancing financial system efficiency,
- maintaining financial system integrity, and
- facilitating choices about financial services.

The pages that follow describe key planned work on these pivotal issues.

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**Foreword**

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Because events may significantly affect even the best of plans, our planning process allows for updating the plan and responding quickly to emerging issues. If you have any questions or suggestions about this plan, please call me at (202) 512-8678.

A handwritten signature in black ink that reads "James L. Bothwell". The signature is written in a cursive style with a large initial "J".

James L. Bothwell  
Director  
Financial Institutions and Markets

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# Table I: Key Issues

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| Issue  | Significance  |
|--|---|
| <b>Enhancing financial efficiency:</b> How can the United States modernize the regulatory framework to effectively adapt to changes in, and enhance the efficiency of, the financial system?   | Banks, insurers, and securities firms, stimulated by advances in technology and increased demands of savers and borrowers, are offering products and services that cross traditional industry demarcations. Expanding international financial activity is also bringing new opportunities and challenges to U.S. firms. Both the Congress and regulators are reacting to these developments by proposing changes to bring industry limits and regulatory powers in line with the evolving financial world.  |
| <b>Managing risks to maintain system integrity:</b> How can the regulatory framework establish programs and policies that enhance risk management and maintain the safety, soundness, and integrity of the overall financial system? | The financial system provides products and services to meet customers' needs in part by placing individual firm capital at risk. Firms, exchanges, and others develop risk management systems to better anticipate, monitor, and manage their risks. The task of the federal financial regulator is to monitor financial firms and the management systems to minimize risk to the overall system. To perform this task effectively, the regulatory structure needs to embody the proper combination of market discipline and traditional oversight. |
| <b>Facilitating choices about financial services:</b> How can the regulatory framework ensure that customers receive services, disclosure, and protection commensurate with their financial situation and sophistication?            | With increased competition and product proliferation in the financial sector, customers face a bewildering array of financial services. Customers may not have the information necessary to compare competing financial products and do not necessarily have sufficient understanding to make rational financial decisions. The Congress and financial regulators are faced with competing demands to protect unwary buyers from abusive sales practices and to minimize regulatory burden.   |

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**Table I: Key Issues**

| Objectives  | Focus of work   |
|---|---|
| <p>—Identify how efficiently financial services such as savings, credit, and payments are met by the evolving financial products and the various financial firms and government-sponsored enterprises that supply them.</p>                                   | <p>—Securitization policy</p> <p>—Effective and efficient clearance and payments systems</p>  |
| <p>—Identify and evaluate legal or regulatory provisions that impede competition among suppliers of financial services or the workings of the marketplace to improve competition.</p>   | <p>—Bank powers and industry demarcation: bank holding companies—who can do what with insured deposits; and banks affiliated with securities, insurance, and nonfinancial companies</p>                                 |
| <p>—Analyze the regulatory framework’s ability to adapt so as to minimize regulatory overlaps, gaps, or inconsistencies under present and proposed legal and regulatory structures.</p>   | <p>—Rationalized and consolidated supervision of financial firms in a world of greater functional regulation</p>  |
| <p>—Evaluate the effectiveness of risk-based capital standards in improving the safety and soundness of financial institutions.</p>   | <p>—Risk-based capital as an incentive to better management</p>   |
| <p>—Identify and evaluate the effects of U.S. laws and regulations on the location (domestic vs. foreign) of financial activities and overall risks to the U.S. financial system.</p>   | <p>—Alternative ways of</p> <ul style="list-style-type: none"> <li>•structuring bank securities and other nontraditional activities and</li> <li>•managing and containing risk wherever it is</li> </ul>                |
| <p>—Evaluate federal regulators’ efforts to implement laws and develop methods or processes to control system risk and ensure safety and soundness.</p>   | <p>—Evaluation of bank, credit union, securities, insurance, and government-sponsored-enterprise regulators’ risk management oversight</p>  |
| <p>—Identify the types of information and means of disclosure that will allow the market and/or regulators to evaluate the risk profile of a financial firm or industry.</p>  | <p>—Comparison of methods and approaches to measure and disclose value at risk for financial firms</p>  |
| <p>—Identify effective and efficient regulatory approaches to facilitate consumers’ ability to make informed choices, including greater disclosure about financial products, fiduciary, and suitability requirements imposed on financial intermediaries.</p> | <p>—Regulatory or market impediments that hinder the system’s ability to meet needs of</p> <ul style="list-style-type: none"> <li>•small business</li> <li>•minority entrepreneurs</li> <li>•depressed areas</li> </ul> |
| <p>—Advise the Congress on the effectiveness of the implementation of consumer protection laws.</p>   | <p>—Sales practices for over-the-counter and mortgage-backed derivatives, structured notes, and life insurance products</p>   |
| <p>—Contribute to prevention of fraud and market abuse by identifying patterns of abusive practices to be restricted by regulators.</p>   | <p>—Functional comparisons of financial products</p>  |
| <p>—Identify ways to standardize information available to customers to facilitate comparisons.</p>  | <p>—Information necessary so customers can understand and monitor risk</p>  |

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# Table II: Planned Major Work

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| <b>Issue</b>                                | <b>Planned major job starts</b>   |
|---|---|
| <b>Maintain financial system efficiency</b> | <ul style="list-style-type: none"><li>—Analyses of the government's role in securitization of assets</li><li>—Effects of increased privatization of clearance and payments on the Federal Reserve's traditional role</li><li>—Analyses of the financial services holding company structure to determine whether it is the best way of organizing and regulating financial services activity</li><li>—Regulatory consolidation of the Securities and Exchange Commission/Commodity Futures Trading Commission—Office of the Comptroller of the Currency/Office of Thrift Supervision/Federal Reserve/Federal Deposit Insurance Corporation</li><li>—Privatization of housing government-sponsored enterprises—Freddie Mac and Fannie Mae</li></ul> |
| <b>Maintain system integrity</b>            | <ul style="list-style-type: none"><li>—Implementation of prompt corrective action in undercapitalized banks</li><li>—Analyses of asset-backed derivative and structured note activity; oversight of government-sponsored enterprises and risk-management issues</li><li>—Adequacy of mutual fund oversight</li><li>—Evaluation of stress test model for Fannie Mae and Freddie Mac</li><li>—Cross-industry comparison of risk-based capital standards and evaluation of alternative approaches</li><li>—Implications of clearance and settlement risks inherent in growing international linkages between financial markets</li><li>—Implications of removing separation between banking and commerce</li></ul>                                   |
| <b>Facilitate financial choices</b>         | <ul style="list-style-type: none"><li>—Analyses of sales practices for over-the-counter derivatives</li><li>—Analyses of sales practices for investment/life insurance products</li><li>—Implications of similar financial products subject to different disclosure and regulatory requirements depending on the industry</li><li>—Adequacy of mutual fund risk and net asset value disclosures</li></ul>   |

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# Table III: GAO Contacts

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|---------------------|--|----------------------------------|
| Director            | James L. Bothwell  | (202) 512-8678                   |
| Associate Directors | Helen H. Hsing<br>Thomas J. McCool   | (202) 512-8678<br>(202) 512-8678 |
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