U.S. GOVERNMENT ACCOUNTABILITY OFFICE

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Comptroller General
of the United States

Accessible Version

August 1, 2023

The Honorable Martin J. Gruenberg

Chairman

Federal Deposit Insurance Corporation

550 17th St., N.W.

Washington, D.C. 20429

Priority Open Recommendations: Federal Deposit Insurance Corporation

Dear Chairman Gruenberg:

The purpose of this letter is to provide an update on the overall status of the Federal Deposit Insurance Corporation's (FDIC) implementation of our recommendations and to call your continued personal attention to areas where open recommendations should be given high priority.[1] In November 2022, we reported that, government-wide, 77 percent of our recommendations made 4 years ago were implemented.[2] FDIC's implementation rate for these recommendations was 97 percent. As of June 2023, FDIC had 12 open recommendations. Fully implementing these open recommendations could significantly improve FDIC's efforts to more effectively oversee risks to consumers and the safety and soundness of the U.S. banking system.

Since our June 2022 letter, FDIC has not implemented our one priority recommendation. We ask that you direct your attention to this open priority recommendation, which is related to financial technology (fintech). We are also adding one new priority recommendation related to the oversight of blockchain technology. This brings the total number of priority recommendations to two. (See enclosure for the list of recommendations.)

The two priority recommendations fall into the following two areas:

Financial technology. Fintech lenders may analyze large amounts of alternative data on borrower characteristics, such as information from bank accounts, when determining borrowers' creditworthiness. We recommended that the FDIC, other federal banking regulators, and the Consumer Financial Protection Bureau communicate the appropriate use of alternative data in

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[1]Priority recommendations are those that we believe warrant priority attention from heads of key departments or agencies. They are highlighted because, upon implementation, they may significantly improve government operations—for example, by realizing large dollar savings; eliminating mismanagement, fraud, and abuse; or making progress toward addressing a high-risk or duplication issue.

[2]GAO, *Performance and Accountability Report: Fiscal Year 2022*, GAO-23-900398 (Washington, D.C.: Nov. 15, 2022).

the underwriting process with banks that engage in third-party relationships with fintech lenders. Implementing our priority recommendation in this area could better position federally regulated banks to manage the risks associated with partnering with fintech lenders that use these data.

Blockchain technology. Recent volatility, bankruptcies, and instances of fraud in the crypto asset markets illustrate the harm consumers and investors may face without adequate protections. We recommended that the FDIC and other financial regulators jointly establish or adapt an existing formal coordination mechanism to identify and address blockchain-related risks. If such a mechanism is implemented, FDIC and other financial regulators would be able to collectively identify risks posed by blockchain-related products and services and develop and implement a regulatory response in a timely manner. (See enclosure for the recommendations and actions needed to implement them).

In light of recent bank failures and federal banking regulators' emergency response, we also urge you to revisit FDIC's prompt corrective action framework. In 2011, we recommended that FDIC and other regulators consider adopting noncapital triggers that would require early and forceful regulatory actions tied to unsafe banking practices.[3] The regulators considered noncapital triggers, but have not added them to the framework. We continue to maintain that incorporating noncapital triggers would encourage earlier action and give the regulators and banks more time to address deteriorating conditions.

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In April 2023, we issued our biennial update to our High-Risk List. This list identifies government operations with greater vulnerabilities to fraud, waste, abuse, and mismanagement. It also identifies the need for transformation to address economy, efficiency, or effectiveness challenges.[4] One of our high-risk areas—modernizing the U.S. financial regulatory system—relates directly to FDIC. Specifically, we urge your attention to the effective and efficient oversight of financial institutions and activities.

In addition, several other government-wide high-risk areas also have direct implications for FDIC and its operations. These include (1) improving the management of IT acquisitions and operations, (2) improving strategic human capital management, (3) managing federal real property, (4) ensuring the cybersecurity of the nation,[5] and (5) managing the government-wide personnel security clearance process.

We urge your attention to these government-wide, high-risk issues related to FDIC. Progress on high-risk issues has been possible through the concerted actions and efforts of Congress, the Office of Management and Budget, and the leadership and staff in agencies, including within FDIC. In March 2022, we issued a report on key practices to successfully address high-risk

[3]GAO, *Bank Regulation: Modified Prompt Corrective Action Framework Would Improve Effectiveness*, GAO-11-612 (Washington, D.C.: June 23, 2011).

[4]GAO, *High-Risk Series: Efforts Made to Achieve Progress Need to Be Maintained and Expanded to Fully Address All Areas*, GAO-23-106203 (Washington, D.C.: Apr. 20, 2023).

[5]With regard to cybersecurity, we also urge you to use foundational information and communications technology supply chain risk management practices set forth in our December 2020 report, GAO, *Information Technology: Federal Agencies Need to Take Urgent Action to Manage Supply Chain Risks,* GAO-21-171 (Washington, D.C.: Dec. 15, 2020).

areas, which can be a helpful resource as your agency continues to make progress to address high-risk issues.[6]

In addition to your continued attention on these issues, Congress plays a key role in providing oversight and maintaining focus on our recommendations to ensure they are implemented and produce their desired results. Legislation enacted in December 2022 includes a provision for GAO to identify any additional congressional oversight actions that can help agencies implement priority recommendations and address any underlying issues relating to such implementation.[7]

There are various strategies Congress can use in addressing our recommendations, such as incorporating them into legislation. Congress can also use its oversight processes to incentivize FDIC to act on our recommendations and monitor its progress. For example, Congress can hold hearings focused on FDIC's progress in implementing GAO's priority recommendations, or take other actions to provide incentives for FDIC to act. Congress also plays a key role in addressing any underlying issues related to the implementation of these recommendations. For example, Congress can pass legislation providing an agency explicit authority to implement a recommendation or requiring an agency to take certain actions to implement a recommendation.

Copies of this report are being sent to the Director of the Office of Management and Budget and the appropriate congressional committees. In addition, the report will be available on our website at http://www.gao.gov.

I appreciate FDIC's continued commitment to these important issues. If you have any questions or would like to discuss any of the issues outlined in this letter, please do not hesitate to contact me or Daniel Garcia-Diaz, Managing Director, Financial Markets and Community Investment, at garciadiazd@gao.gov or 202-512-8678. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Our teams will continue to coordinate with your staff on all 12 open recommendations, as well as those recommendations in the high-risk areas for which FDIC has a leading role. Thank you for your attention to these matters.

Sincerely yours,

Gene L. Dodaro

Comptroller General
of the United States

[6]GAO, *High-Risk Series: Key Practices to Successfully Address High-Risk Areas and Remove Them from the List*, GAO-22-105184 (Washington, D.C.: Mar. 3, 2022).

[7]James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Pub. L. No. 117-263, § 7211(a)(2), 136 Stat. 2395, 3668 (2022); H.R. Rep. No. 117-389 (2022) (accompanying Legislative Branch Appropriations Act, H.R. 8237, 117th Cong. (2022)).

Enclosure

cc: The Honorable Shalanda Young, Director, Office of Management and Budget

Enclosure

Priority Open Recommendations to the Federal Deposit Insurance Corporation

Financial Technology

Financial Technology: Agencies Should Provide Clarification on Lenders' Use of Alternative Data. GAO-19 -111. Washington, D.C.: December 19, 2018.

Year Recommendation Made: 2019

Recommendation: The Chairman of the Federal Deposit Insurance Corporation (FDIC) should, in coordination with the other federal banking regulators and the Consumer Financial Protection Bureau and with input from relevant stakeholders, communicate in writing to banks that engage in third-party relationships with fintech lenders on the appropriate use of alternative data in the underwriting process, including issues to consider when selecting types of alternative data to use.

Action Needed: FDIC agreed with the recommendation. In July 2021, FDIC, along with the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, proposed interagency guidance on third-party risk management. In June 2023, the regulators issued final interagency guidance on third-party risk management, but it did not include specific direction to banks that engage in third-party relationships with fintech lenders on the appropriate use of alternative data in the underwriting process. Rather, the guidance indicates that it is broadly applicable to all topics and third-party relationships and, accordingly, did not address specific topics, a use of alternative data, or specific types of third-party relationships, such as relationships with fintech companies. However, the guidance states regulators may issue additional guidance on specific topics in the future.

In March 2021, these agencies and the Consumer Financial Protection Bureau and National Credit Union Administration issued a request for information (RFI) on artificial intelligence, including machine learning. The comment period for the RFI ended on July 1, 2021, and the regulators were working on next steps for the RFI.

To fully implement our recommendation, FDIC needs to provide—in coordination with other federal banking regulators and the Consumer Financial Protection Bureau—finalized written communication that gives banks that engage in third-party relationships with fintech lenders specific direction on the appropriate use of alternative data in the underwriting process. Clear communication on this issue would give fintech lenders greater certainty about their compliance with consumer protection laws and help banks manage the risks associated with partnering with fintech lenders.

Director: Michael E. Clements, Financial Markets and Community Investment

Contact information: clementsm@gao.gov or 202-512-8678

Blockchain Technology

Blockchain in Finance: Legislative and Regulatory Actions Are Needed to Ensure Comprehensive Oversight of Crypto Assets. GAO-23-105346. Washington, D.C.: June 22, 2023.

Year Recommendation Made: 2023

Recommendation: The Chairman of the Federal Deposit Insurance Corporation should jointly establish or adapt an existing formal coordination mechanism with the Consumer Financial Protection Bureau, Commodity Futures Trade Commission, Board of Governors of the Federal Reserve System, National Credit Union Administration, Office of the Comptroller of the Currency, and Securities and Exchange Commission for collectively identifying risks posed by blockchain-related products and services and formulating a timely regulatory response. To facilitate these objectives, this mechanism could include formal planning documents that establish the frequency of meetings and processes for identifying risks and responding to them within agreed-upon time frames.

Action Needed: FDIC neither agreed nor disagreed with the recommendation. In addition, FDIC noted it has coordinated through venues including the Financial Stability Oversight Council, the President's Working Group, and some international organizations. However, the regulators' coordination efforts have not always addressed risks posed by crypto assets in a timely manner. We maintain that a formal coordination mechanism focused on collectively identifying risks posed by blockchain-related products and services and formulating timely regulatory responses could improve protections for consumers and investors, mitigate illicit finance and threats to financial stability, and promote responsible innovation and U.S. competitiveness.

Director: Michael E. Clements, Financial Markets and Community Investment

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