September 2020

BANK SUPERVISION

FDIC Could Better Address Regulatory Capture Risks

GAO Highlights

Highlights of GAO-20-519, a report to congressional requesters

Why GAO Did This Study

FDIC supervises about 3,300 financial institutions to evaluate their safety and soundness. Some analyses by academic researchers have identified regulatory capture in supervision as one potential factor contributing to the 2007–2009 financial crisis. Regulatory capture is defined as a regulator acting in the interest of the regulated industry rather than in the public interest.

GAO was asked to review regulatory capture in financial regulation. This report examines FDIC's (1) processes for encouraging transparency and accountability in the bank examination process, (2) processes to minimize potential conflicts of interest among examination staff, and (3) agency-wide efforts to address the risks of regulatory capture and compromised independence. GAO reviewed FDIC's policies and enterprise risk management framework, analyzed bank examination workpapers, and interviewed supervisory staff.

What GAO Recommends

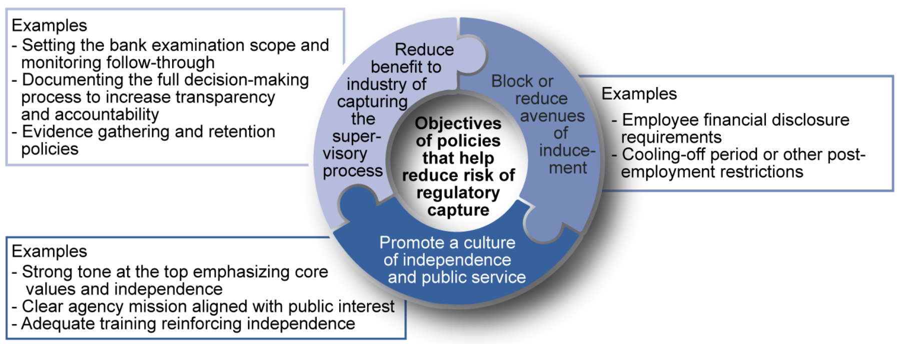
GAO is making four recommendations to FDIC related to managing the risk of regulatory capture, including improving documentation of banks' progress at addressing FDIC recommendations and revising examiner-departure processes. FDIC neither agreed nor disagreed with these recommendations, but described actions it would take in response to them. FDIC's actions, if fully implemented, would address two of the four recommendations.

View GAO-20-519. For more information, contact Michael Clements at (202) 512-8678 or clementsm@gao.gov.

What GAO Found

The Federal Deposit Insurance Corporation (FDIC) has designed policies to address the risk of regulatory capture by reducing the potential benefit to industry of capturing the examination process, reducing avenues of inducement, and promoting a culture of independence and public service (see figure).

Framework for Reducing Risk and Minimizing Consequences of Regulatory Capture



Source: GAO. | GAO-20-519

FDIC has several policies for documenting bank examination decisions that help promote transparent decision-making and assign responsibility for decisions. Such policies are likely to help reduce benefits to industry of capturing the examination process. However, GAO found that some examinations were not implemented consistent with FDIC policies and that gaps in FDIC policies limited their effectiveness. For example, GAO found that managers sometimes did not clearly document how they concluded that banks had addressed recommendations. By improving adherence to agency policies, FDIC management could better address threats to capture in the examination process.

GAO found that FDIC has policies to address potential conflicts of interest that could help block or reduce avenues of inducement. For example, FDIC has post-employment conflict-of-interest policies designed to prevent former employees from exerting undue influence on FDIC and to reduce industry's ability to induce current FDIC employees with prospective employment arrangements. One such policy requires the agency to review the workpapers of examiners-in-charge who accept employment with banks they examined in the prior 18 months. However, FDIC has not fully implemented a process for identifying when to review the workpapers of departing examiners to assess whether independence has been compromised. In particular, FDIC does not have a process for collecting information about departing employees' future employment. By revising its examiner-departure processes, the agency could better identify when to initiate workpaper reviews.

FDIC has identified regulatory capture as a risk as part of its enterprise risk management process. The agency has documented 11 mitigation strategies that could help address that risk. Identified mitigation strategies include rotating examiners-in-charge, national examination training, and ethics requirements.