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Introduction to Financial Services: The Regulatory Framework

This In Focus provides a brief introduction to the federal agencies that regulate U.S. financial markets. For more detail, see CRS Report R44918, *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, by Marc Labonte.

The Financial System

Financial firms match the available funds of savers and investors with borrowers and others seeking to raise funds in exchange for future payments. The products, instruments, and markets used to facilitate this matching are numerous, and they are overseen by a complex system of regulators. The financial system is often divided into banking, insurance, and securities markets. Securities are financial contracts that pledge to make payments from the issuer to the holder and are generally traded on markets. Contracts take the form of debt (a borrower and creditor relationship) and equity (an ownership relationship).

Financial activity is inherently risky, but without risk-taking, businesses could not expand or innovate, and households would only be able to purchase durable goods, education, and housing that could be financed out of current income. Financial regulation aims to balance the benefits of finance with the risks that it poses.

The Financial Regulatory Framework

Table 1 lists the federal financial regulators and whom they regulate. It categorizes those regulators as follows:

- **Depository regulators** regulate institutions—commercial banks, thrifts (savings associations), and credit unions—that accept customer deposits.
- **Securities markets regulators** regulate securities products, markets, and market participants. For regulatory purposes, securities markets can be divided into derivatives (whose value is based on an underlying commodity, financial indicator, or financial instrument) and other types of securities.
- **Government-sponsored enterprise (GSE) regulators** were created by Congress as privately owned institutions with limited missions and charters to support the mortgage and agricultural credit markets. It also created dedicated regulators exclusively to oversee the GSEs, some of which were consolidated by the Housing and Economic Recovery Act of 2008 (P.L. 110-289).
- **A consumer protection regulator**—namely, the Consumer Financial Protection Bureau—was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) in 2010 to consolidate and expand jurisdiction over

various consumer protection laws for certain financial products.

These regulators regulate financial institutions, markets, and products using licensing, registration, rulemaking, supervisory, enforcement, and resolution powers. Financial regulation aims to achieve diverse goals, which vary from regulator to regulator: market efficiency and integrity, consumer and investor protections, capital formation or access to credit, taxpayer protection, illicit activity prevention, and financial stability. Different types of regulation—prudential (safety and soundness), disclosure, standard setting, competition, and price and rate regulations—are used to achieve these goals.

Other entities that play a role in financial regulation are self-regulatory organizations, interagency bodies, state regulators, and international regulatory fora. Federal regulators generally play a secondary role in insurance markets, where state regulation predominates.

Regulatory Fragmentation

The financial regulatory system is fragmented, with multiple overlapping regulators and a dual state-federal regulatory system. The system evolved piecemeal, as Congress responded to emerging issues, punctuated by major changes in response to historical financial crises. The 2007-2009 financial crisis also led to changes to the regulatory system. To address the fragmented nature of the system, the Dodd-Frank Act created the Financial Stability Oversight Council (FSOC), a council of regulators and experts chaired by the Treasury Secretary.

In practice, regulatory jurisdiction over institutions is typically based on charter type, not function. This means that a similar activity being conducted by two different types of firms can be regulated differently by different regulators. A financial firm may be subject to more than one regulator because it may engage in multiple financial activities. For example, a firm may be overseen by an institution regulator and by an activity regulator when it engages in a regulated activity and by a market regulator when it participates in a regulated market.

Drawbacks to the fragmented regulatory system are the potential for jurisdictional gaps, which may cause regulatory myopia, and overlaps, which may cause redundant regulation. These gaps and overlaps could be exploited by financial firms to elude regulation or benefit from a “race to the bottom” in regulatory standards between competing regulators. Advantages to the fragmented system include more specialized and knowledgeable regulators. In addition, overlapping regulators could reduce the likelihood of blind spots or groupthink in regulation.

Table I. Federal Financial Regulators and Whom They Regulate

Regulatory Agency	Institutions Regulated	Other Notable Authority
<i>Depository Regulators</i>		
Federal Reserve	Bank holding companies and certain subsidiaries (e.g., foreign subsidiaries), financial holding companies, securities holding companies, and savings and loan holding companies Primary federal regulator of state banks that are members of the Federal Reserve System, foreign banking organizations operating in the United States, Edge corporations, and any firm or payment or clearing system designated as systemically significant by the FSO	Operates discount window (“lender of last resort”) for depositories; operates certain payment systems; conducts monetary policy
Office of the Comptroller of the Currency (OCC)	National banks, U.S. federal branches of foreign banks, and federally chartered thrift institutions	
Federal Deposit Insurance Corporation (FDIC)	Federally insured depository institutions Primary federal regulator of state banks that are not members of the Federal Reserve System and state-chartered thrift institutions	Operates deposit insurance for banks; resolves failing banks
National Credit Union Administration (NCUA)	Federally chartered or federally insured credit unions	Operates deposit insurance for credit unions; resolves failing credit unions
<i>Securities Markets Regulators</i>		
Securities and Exchange Commission (SEC)	Securities exchanges, broker-dealers; clearing and settlement agencies; investment funds, including mutual funds; investment advisers, including hedge funds with assets over \$150 million; and investment companies Nationally recognized statistical rating organizations Security-based swap (SBS) dealers, major SBS participants, and SBS execution facilities Corporations selling securities to the public	Approves rulemakings by self-regulated organizations
Commodity Futures Trading Commission (CFTC)	Futures exchanges, futures commission merchants, commodity pool operators, commodity trading advisors, derivatives, clearing organizations, and designated contract markets Swap dealers, major swap participants, swap execution facilities, and swap data repositories	Approves rulemakings by self-regulated organizations
<i>Government-Sponsored Enterprise Regulators</i>		
Federal Housing Finance Agency (FHFA)	Fannie Mae, Freddie Mac, and Federal Home Loan Banks	Acting as conservator (since Sept. 2008) for Fannie and Freddie
Farm Credit Administration (FCA)	Farm Credit System, Farmer Mac	
<i>Consumer Protection Regulator</i>		
Consumer Financial Protection Bureau (CFPB)	Nonbank mortgage-related firms, private student lenders, payday lenders, and larger “consumer financial entities” determined by the CFPB Statutory exemptions for certain markets Rulemaking authority for consumer protection for all banks; supervisory authority for banks with over \$10 billion in assets	

Source: CRS Report R44918, *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, by Marc Labonte.

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