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IN FOCUS

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Introduction to Financial Services: "Regulatory Relief"

The 119th Congress is considering whether to provide "regulatory relief" in the area of financial services. This *In Focus* gives a broad overview of the policy trade-offs inherent in relief and the forms that relief proposals could take. It does not cover specific proposals but instead provides a framework for evaluating any proposal, whether it is targeted at banking, securities, derivatives, or insurance. CRS takes no position on specific regulatory relief proposals or the relative balance between costs and benefits achieved in the current regulatory structure.

Policy Trade-Offs

In determining whether to provide regulatory relief, a central question is whether an appropriate trade-off has been struck between the benefits and costs of regulation.

Benefits. Financial regulation has different objectives and potential benefits, including enhancing the safety and soundness of certain institutions; protecting consumers and investors from fraud, manipulation, and discrimination; and promoting financial stability while reducing systemic risk. A financial regulatory system that delivers a baseline level of stability and trust among financial agents is a precondition to a healthy financial system that can generate robust economic growth.

Regulators employ different tools to achieve these goals. Regulators issue rules and guidance, supervise and examine institutions to verify that the rules are followed, and take enforcement actions (such as imposing fines) when the regulations are not followed. In other cases, regulators require companies or individuals to meet certain standards and receive licenses before engaging in particular business practices. The specific goals regulators attempt to achieve and the tools they use vary by market. For example, risk management is emphasized for banking regulation, while disclosure is a priority in securities regulation.

Costs. The costs associated with government regulation—rulemaking, supervision, and enforcement—are referred to as *regulatory burden*. Regulatory requirements are often imposed on providers of financial services, so financial institutions are often the focus of discussions about regulatory burden. But costs associated with regulation can flow through the providers and ultimately be borne, in part, by different entities, including financial institutions, consumers, the government, and the economy at large. For example, a provider may respond to increased regulatory burden by raising the prices it charges to customers. If regulatory burden reduces the long-term availability of credit, it would have a negative effect on business investment and economic growth.

Regulatory burden may manifest itself in different forms. *Operating costs* are the costs the company must bear in order to adhere to the regulation, such as employee training. Some regulations create one-time operating costs borne upfront, while others are recurring costs that exist as long as the requirement is in effect. *Opportunity costs* are the costs associated with forgone business opportunities because of additional regulation. A lender may, for example, make fewer mortgages because new regulations make mortgage lending more expensive and instead perform a different type of lending that is now more profitable.

Trade-offs. Regulatory relief may face trade-offs between reducing regulatory burden and potentially reducing the benefits of regulation. The trade-offs are not limited only to the effects on the direct recipients of relief—usually the providers of financial services—but also to the effects on consumers, investors, particular markets, and market stability more broadly.

The presence of regulatory burden does not necessarily mean that a regulation is undesirable or should be repealed. A regulation can have benefits that could outweigh its costs, but the presence of costs means, tautologically, that regulation causes regulatory burden. The concept of regulatory burden can be contrasted with the phrase *unduly burdensome*. Whereas regulatory burden is about the costs associated with a regulation, *unduly burdensome* refers to the balance between benefits and costs. *Unduly burdensome* could be defined as when costs are in excess of benefits or when the same benefits could be achieved at a lower cost. But the presence of regulatory burden does not mean that all regulations are unduly burdensome.

Policymakers consider these trade-offs and evaluate the broader effects of regulation that could be either positive or negative, such as how a requirement would impact innovation, the price of credit, and the availability of credit. For example, efforts to protect consumers against potential actions taken by banks may drive up the cost for a bank to provide certain services and result in that activity migrating to a less regulated part of the financial system or to foreign jurisdictions with lower regulatory standards. However, trade-offs are not always present. If regulation makes an unstable system more stable, it could reduce cost and increase the availability of credit.

Statutory Requirements to Consider Regulatory Burden

Congress has required regulators to consider ways to minimize regulatory burden within the rulemaking process. For example, the Paperwork Reduction Act requires regulators to report the hours that institutions will spend complying with their requests for information. This "paperwork burden" is just one component of regulatory burden, however.

Pursuant to the Regulatory Flexibility Act, financial regulators are required to include in a rulemaking an assessment of the rule's impact on "small entities," which includes—but is not limited to—small financial institutions. An agency is required to make an assessment about possible alternatives and projected costs of the rule, however, only if it believes that the rule will have a "significant economic impact on a substantial number of small entities."

Each financial regulator has different statutory requirements for performing *cost-benefit analyses*, but broadly speaking, they have a varied set of requirements for considering costs and benefits of their regulations and are not subject to the same requirements as executive agencies are. Because quantitative analyses are not required for all rules, it is not possible to sum up the expected costs of all regulations and quantify the overall magnitude of regulatory burden.

Cost-benefit analyses can be quite difficult to perform for financial regulations. The costs may be more concentrated or tangible and therefore easier to quantify, whereas the benefits may be more diffused and not materialize for an extended period of time. For example, how does one quantify that a regulation decreases the likelihood of a financial crisis? Despite the challenges of quantifying financial rules, some believe a more rigorous analysis would help minimize regulatory burden and encourage more cost-effective regulations.

Forms of Regulatory Relief

Some regulatory relief proposals can be characterized as *forward-looking*—focusing on how to reduce the burden associated with future rulemakings, such as strengthening existing cost-benefit analysis requirements on financial regulators to bring them in line with executive agency standards. Alternatively, regulatory relief can be *backward-looking*—modifying existing regulations.

Regulations can stem from statutory requirements, regulatory or judicial interpretation of statute, or regulators' broad discretionary powers. If policymakers choose to provide regulatory relief, they could do so through several different channels.

Legislation could be enacted that would affect a regulation in a specific way. Typically, in the area of financial regulation, Congress sets the broad goals of regulation in statute and leaves it to regulators to fill in the details. However, there are also recent examples of statutory changes to specific details of regulations that regulators have issued. Some may oppose such targeted changes on the grounds that Congress is overriding regulator discretion and lacks the expertise to properly make detailed, technical regulatory judgments. Congress might nevertheless determine that narrow intervention is justified because regulators have misinterpreted its will or are not properly weighing other relevant policy objectives. Congress can pursue regulatory relief through regular order or by using two special legislative tools featuring expedited procedures. First, the Congressional Review Act can be used to invalidate recently enacted rules. Second, reconciliation is intended to be limited to provisions that change direct (mandatory) spending or revenues—provisions affecting financial regulators funding might meet these criteria, but other regulatory actions are unlikely to.

In other instances, regulators already have authority to adjust regulations on their own without additional authority from Congress. To do so, they would typically have to issue a new rule, following the requirements of the Administrative Procedure Act. Generally speaking, changes via rulemaking would originate from the agency that originally promulgated the rule. In the case of financial regulations, these agencies are independent from the Administration, limiting the Administration's ability to require them (through executive order, for example) to pursue regulatory relief. Regulators could make changes regulation-by-regulation, or they could reassess regulations in a more comprehensive manner. For example, under the Economic Growth and Regulatory Paperwork Reduction Act, the banking regulators review regulations every 10 years to identify regulations that are "outdated, unnecessary, or unduly burdensome." (A review is currently being conducted.) In some cases, an agency can reverse its guidance more easily than its rules.

Affected parties also sometimes sue agencies to overturn regulations. The Supreme Court's 2024 *Loper* decision eliminated judicial deference to agencies when they interpret ambiguous laws, potentially making future legal challenges more frequent and successful.

In addition, policymakers determine to whom—if anyone—relief should be provided. Relief could be provided to either all firms to which a regulation applies or only a subset of firms based on firm size, firm type, or the activities a firm performs.

Policymakers would also consider how relief should be provided—for example, by repealing entire provisions, providing exemptions from specific requirements, or tailoring a requirement so that it still applies but in a less burdensome way. Examples of different forms of tailoring are streamlining the regulation, applying the regulation only to entities above a minimum size or volume, and grandfathering existing firms or types of instruments from the regulation.

CRS Resources

CRS Report R44869, *Financial Regulatory Relief: Approaches for Congress, Regulators, and the Administration*, coordinated by Marc Labonte

CRS Report R44813, *Cost-Benefit Analysis and Financial Regulator Rulemaking*, by David W. Perkins and Maeve P. Carey

CRS In Focus IF10023, *The Congressional Review Act (CRA): A Brief Overview*, by Maeve P. Carey and Christopher M. Davis

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