CAPTURE NUANCES IN FINANCIAL REGULATION

Lawrence G. Baxter[*]

INTRODUCTION

In early May 2012, a select group of America's most powerful bankers was ushered into a meeting with the Governor most responsible for bank regulation at the Board of Governors of the Federal Reserve System ("Fed").[1] The bankers were there to express their concerns about far-reaching proposed regulations designed to promote financial stability and reduce their banking organizations' exposure and potential for creating systemic risk. Such meetings are ordinarily held in secret, but a notice and an agenda for this one were leaked to the media, apparently angering that most secretive of financial agencies.[2]

Few events could more perfectly illustrate the close relationship between the Fed and the nation's leading bankers. One commentator concluded in advance of the meeting that the purpose of this "unusual pow-wow" was, in short, "to protect these banks' cushy bottom lines, consequences to the overall economy be damned."[3] This cynical conclusion added to a popular refrain that the Fed has been "captured" by the industry it regulates.[4]

---

* Professor of the Practice of Law, Duke Law School. Developed from a paper for the *Wake Forest Law Review* Spring Symposium, March 30, 2012, entitled *The Asymmetry of Administrative Law: The Lack of Public Participation and the Public Interest*. I am grateful to the participants in the symposium for their helpful comments.

1. The Governor was Daniel Tarullo, who has the lead role on regulatory policy among the Governors at the Fed.

2. *See* Donna Borak, *FAQ: The Story Behind the Tarullo-CEOs Meeting on Stress Tests*, AM. BANKER (May 1, 2012), http://www.americanbanker.com/issues/177_84/faq-tarullo-ceo-meeting-stress-tests-1048939-1.html.

3. Akshat Tewary, *Big Banks Version of May Day*, AM. BANKER (May 2, 2012), http://www.americanbanker.com/bankthink/Tarullo-meeting-Federal-Reserve-counterparty-limit-1048954-1.html.

4. The claim has become very common in academic and popular literature. It was perhaps most elegantly put by Simon Johnson, *The Quiet Coup*, ATLANTIC, May 2009, at 46, 48–50. For a more recent example, see, for example, Lawrence G. Baxter, *Capture in Financial Regulation: Can We Channel it Toward the Common Good?*, 21 CORNELL J.L. & PUB. POL'Y 175 (2011); Daron Acemoglu & Simon Johnson, *Who Captured the Fed?*, N.Y. TIMES ECON. BLOG (Mar. 29, 2012), http://economix.blogs.nytimes.com/2012/03/29/who-captured-the-fed/.

Yet, reality seems to have been somewhat different. In the first place, the bankers were permitted to express their views, but, under a long-standing Fed rule, neither the Governor nor Fed staff was permitted to respond. The Fed made it clear that no responses specific to the bankers' views would be given and that the bankers' views "were just one perspective the Fed was considering."[5] The bankers certainly had much to fear from the proposed rules—enough to divert the time of their CEOs for half a day in efforts to dilute their regulatory impact. Shortly before this meeting, the Governor conducting the meeting made a public speech[6] calling for regulatory reform; a similar speech by the Governor of the Fed's British counterpart,[7] the Bank of England, had already caused anguish in the industry.[8]

Perhaps this whole affair could be dismissed as a charade, but if it was, the charade was extraordinarily elaborate. It seems that something much more complicated than capture is at work, even in big bank regulation and even within the close relationship big bankers undoubtedly have with their regulators.[9]

5. Zachary Goldfarb & Brady Dennis, *Fed's Tarullo Emerges as Banks' Key Federal Foe on Regulating Risk*, WASH. POST (May 18, 2012), http://www.washingtonpost.com/business/economy/feds-tarullo-emerges-as-banks-key-federal-foe-on-regulating-risk/2012/05/18/gIQA9MhCYU_story.html; *see also* Dan Fitzpatrick et al., *Well, That Was Awkward . . . Bank Chiefs' Regulatory Concerns Met With Official Silence*, WALL ST. J. (May 2, 2012), http://online.wsj.com/article/SB10001424052702303877604577380492611498890.html.

6. Daniel K. Tarullo, Member, Fed. Reserve Sys. Bd. of Governors, Regulatory Reform Since the Financial Crisis: Remarks to the Council on Foreign Relations 8 (May 2, 2012), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20120502a.pdf (insisting on "rigorous implementation" of a wide suite of reforms); *see also* Donna Borak, *Fed's Tarullo: Risk of 'Too Big to Fail' Rises Without Dodd-Frank*, AM. BANKER (May 2, 2012), http://www.americanbanker.com/issues/177_85/tarullo-dodd-frank-too-big-to-fail-1048965-1.html (reporting on similar views expressed by Chairman Ben Bernanke the week before).

7. *See* Sir Mervyn King, *The Today Lecture 2012*, BBC TODAY PROGRAMME (May 2, 2012), http://news.bbc.co.uk/today/hi/today/newsid_9718000/9718062.stm.

8. *See, e.g.*, Liam Halligan, *Bankers' Vitriol has Masked Sir Mervyn King's Uncomfortable Message*, TELEGRAPH (May 5, 2012), http://www.telegraph.co.uk/finance/comment/liamhalligan/9248115/Bankers-vitriol-has-masked-Sir-Mervyn-Kings-uncomfortable-message.html (describing the angry reaction of bankers to King's expression of regret that the Bank of England was not more severe on banks in the run up to the Financial Crisis of 2008 ("Crisis")). For the United States situation, see, for example, Goldfarb & Dennis, *supra* note 5.

9. This is not to say that undue influence is *never* at work. Sometimes laxity in supervision seems to leave one with no explanation other than either regulatory incompetence or undue favoritism. *See, e.g.*, Shahien Nasiripour, *US Regulator Under Fire for JPMorgan Oversight*, FIN. TIMES (May 21, 2012), http://www.ft.com/intl/cms/s/0/fcc68db4-9f7c-11e1-8b84-00144feabdc0.html

The *Wake Forest Law Review*, in its Spring 2012 Symposium, invited participants to consider, among many fascinating questions relating to the problems of participation in the administrative process, whether "the domination of industry interests necessarily results in agency capture?" This Article focuses specifically on the capture question as it might apply to financial regulation, and in this context the question is quite problematic. It will be suggested that in the world of financial regulation, particularly "bank" regulation, the concept of "capture" loses much of its analytic power for two principal reasons. First, no single regulator is involved, and those that are engaged have different, very important missions. Their respective susceptibility to capture ought inevitably to vary. Capture of all of them by any one group of financial interests, however large, seems implausible. Second, the quasi-public role of banks—particularly, but not only, large banks—renders the supposed government/private enterprise distinction, upon which the notion of "capture" depends,[10] quite enigmatic and volatile. As a result, exactly *who* can capture *whom*, and exactly *what* is to be captured, is very hard, and perhaps sometimes simply impossible, to discern.[11]

If these are accurate descriptions of the regulatory environment, then "capture" is a very unsteady concept for assessing whether the public interest is being served in financial regulation. "Public participation" also becomes difficult to apply as a normative criterion because there are many "public participations" and many forums of participation.

There are two traditional normative approaches to combating perceived capture by one interest group of the regulatory regime for all the groups. The first, a "pro-market" approach, is to avoid or reduce agency involvement as much as possible, on the expectation that regulatory agencies can be—and, in the view of many, are inevitably going to be—captured by the most powerful industry interests. Such an approach would increase reliance on market discipline on the assumption that markets are, or could be, less

#axzz1vVZLSSwJ (discussing the failure by JPMorgan's primary regulator, the Office of the Comptroller of the Currency ("OCC"), to catch the buildup of risk that led to a massive trading loss on the part of the bank, and quoting one commentator as saying that "[t]here's some sort of cultural and ideological capture at the OCC").

10. *See infra* text accompanying notes 60–68.

11. Capture theory is simplistic in other respects as well. For example, it is unable to differentiate between excessive industry influence, on the one hand, and less conspiratorial explanations of agency performance such as incompetence or mere lack of resources. An additional embarrassment for capture theorists is the role played by many obviously independent regulators who have earned public recognition for standing up to both industry and other regulators. *See infra* text accompanying notes 31–43, 131.

susceptible to discreet industry dominance. The second, a "pro-regulatory" approach, would increase rulemaking safeguards (such as transparency, independence from industry, and rigorous isolation of regulatory decisions), which are designed to prevent, or at least minimize, the opportunity for improper influence by particular groups.[12] This Article builds on a view of the process of agency policy formation to conclude that avoidance of "capture" (or undue influence by one set of interests) should properly embrace both approaches.[13]

In place of an either/or approach, we should focus on attempting to strike the right balance of market discipline and agency processes. In order to understand the overall process, Part I of this Article briefly characterizes financial policy formation as the outcome of contests between all the participants involved, all acting in their own interests as "agents" in a complex adaptive system. Part II describes the multiple-part system of regulatory agencies involved in the formation of financial regulatory policy in the United States, a system that inevitably introduces a diversity of agency views and tends to inhibit the formation of a single regulatory view that might be captured. Part III considers the "quasi-public" role played by banks, even small banks, that is usually overlooked in debates about agency capture, yet which greatly complicates any assessment of the role banks play in relation to government. Put quite simply, they are not merely "private" market actors, and it is therefore often appropriate for them to engage very closely with government, sometimes even at the cost of appearing to "be in bed with their regulators." Part IV of the Article considers the ways in which undue sectoral influence might be averted in the process of policy formation and how a balanced overall result—one that takes

12. For sophisticated reviews of the various ways in which "capture" has been used, sometimes to further ideological ends, see, for example, Daniel Carpenter & David Moss, *Introduction* to PREVENTING CAPTURE: SPECIAL INTEREST INFLUENCE IN REGULATION AND HOW TO LIMIT IT (Daniel Carpenter & David Moss eds.) (forthcoming 2012); Stefano Pagliari, *Introduction* to THE MAKING OF GOOD FINANCIAL REGULATION: TOWARD A POLICY RESPONSE TO REGULATORY CAPTURE (Stefano Pagliari ed., 2012), *available at* http://www.icffr.org/assets/pdfs/June-2012/ICFR-Regulatory-Capture-Book-25-June---The-Making-.aspx; Jørgen Grønnegaard Christensen, *Public Interest Regulation Reconsidered: From Capture to Credible Commitment* (Jerusalem Papers in Regulation & Governance, Working Paper No. 19, Jul. 2010), *available at* http://regulation.upf.edu/dublin-10-papers/1J1.pdf (reviewing the logic of the three major theories underlying public interest regulation, namely public interest theory, capture theory, and credible commitment).

13. *Cf.* Christensen, *supra* note 12 (advocating an approach to the formulation of public policy that takes the notion of "public interest" seriously but does not assume an objective "public interest"; rather, the important element in the process is to ensure a "wide inclusion of both regulated and third party interests").

into consideration the interests of all the stakeholders affected—might realistically be promoted. These recommendations are not novel, but they retain their merit at a time when debates about financial regulatory policy have tended to become highly adversarial and, in the end, unconstructive.

I. PUBLIC POLICY FORMATION IN THE CONTESTED ARENA

As a working definition, "capture" is defined here as "the heavily disproportionate influence by one of the interest groups covered by a regulatory framework to the improper disadvantage, or exclusion, of other groups also intended to be embraced, restricted or protected by the regulatory regime."[14] Using this definition, if ever there were an apparent example of the appearance of massive industry capture of the government, the world of financial regulation would be it. Yet, a complexity view of this world suggests an environment rather more nuanced than this "winners and losers" model invoked by traditional capture analysis.

The financial market provides a prime example of a complex adaptive system.[15] Global and domestic financial systems consist of a wide diversity of participants (or "agents") all interacting with each other in sophisticated networks, in large part without central direction, and evolving in a constant state of flux. It is equally applicable to the process of financial policy formation, in which

14. Of course this definition begs many questions, such as what is meant by "disproportionate" or "improper." This Article, however, proceeds upon the assumption that answers to these questions are inherently contested and very seldom clearly determined by the legislature—which is precisely why we have processes for reaching the outcome, delegation of details to the agencies, and the anticipation of ever-changing circumstances in the financial markets, which anticipation is embodied in the discretionary nature of the rulemaking and adjudication powers delegated to the regulators.

15. Complex adaptive systems share a number of common characteristics. They are not merely complicated; instead they are complex in the sense that they comprise a diverse variety of "agents" or actors all interacting with each other in a constantly evolving ecology that might or might not endure over time. Those that do endure have the quality of resilience or robustness, but, even if robust, a complex adaptive system also has the danger of developing self-criticality or the potential for sudden collapse. To be properly understood, the interactions of all the agents—in the case of financial markets, industry players, consumers, supporting utilities, *and* the regulators—must be taken into account through the application of a variety of disciplines ranging from game theory to network science. For an introductory review of how complexity theory is being applied to the understanding of financial systems, see, for example, Lawrence G. Baxter, *Betting Big: Value, Caution and Accountability in an Era of Large Banks and Complex Finance*, 31 REV. BANKING & FIN. L. 765 (2011–12) (Part III and the references cited therein). For a general introduction to the subject, see generally MELANIE MITCHELL, COMPLEXITY: A GUIDED TOUR (2009).

regulators (even legislatures and courts) are themselves agents interacting not only with the agents of industry, consumers, and other organizations but also with each other.[16] In effect, public policy is developed in an *arena of contest*—through a process Professor Thomas McGarity has aptly described as a "blood sport."[17]

In this view, finance comprises a complex ecology. The policies generated by legislatures and agents are shaped by the contesting forces of many diverse players. No matter how hard and firm the rules erected to structure and control financial markets might be, the policies shaping and implementing these rules are never static. Instead they are dynamic, buffeted by and reacting in their interpretation to the actions and reactions of the agents impacted by them. This is not to say that rules and agency decisions are ineffective; on the contrary, they are forces that themselves influence, with varying degrees of specificity (depending on how clear and simple they are), the actions of participants in the market. But they compete with many other forces to produce outcomes.

An important conclusion to be drawn from this "complexity" view of financial regulation is that the policies resulting from this dynamic interaction are not linear. They are themselves in flux and adaptive, for good or ill, and they are continually being shaped by a variety of forces. In a suitably diverse and resilient financial ecology, improper influence by any one set of agents or interest groups would be ephemeral and perpetually subject to the dynamic forces of market competition, counterefforts by other interest groups, and contestation among agencies with differing interests and views of financial policy.[18]

This way of looking at the process does not mean that the danger of improper influence, or ultimate "capture," is not real.

16. *See* Mark A. Chinen, *Governing Complexity*, in GLOBALIZATION AND GOVERNANCE 55, 59–64 (Laurence Boulle ed. 2011) (discussing the application of complexity science to understanding public policy, and citing the leading works in the field); Robert Geyer, *Beyond the Third Way: The Science of Complexity and the Politics of Choice*, 5 BRIT. J. POL. & INT'L REL. 237, 243 (2003) (outlining the characteristics of complex systems, including the rich interactions within them). *See generally* ORG. FOR ECON. CO-OPERATION & DEV. GLOBAL SCIENCE FORUM, REPORT ON APPLICATIONS OF COMPLEXITY SCIENCE FOR PUBLIC RELATIONS: NEW TOOLS FOR FINDING UNANTICIPATED CONSEQUENCES AND UNREALIZED OPPORTUNITIES (2009).

17. *See generally* Thomas O. McGarity, *Administrative Law as a Blood Sport: Policy Erosion in a Highly Partisan Age*, 61 DUKE L.J. 1671 (2012) (describing how extreme partisanship has attracted high spending on the part of the players/stakeholders and has attracted new stakeholders to the process). I would only differ from Professor McGarity in arguing that this contestation is *inherent* to the process and has only become more visible and more distasteful now because popular political division seems to have deepened dramatically.

18. In the end, the objective should be to prevent the field of contest from becoming so tilted that a meaningful contest cannot take place.

Indeed, it is likely to be the natural ambition of all the agents in the process. But such a view helps us focus on the elements important to the continuing resilience, market efficiency, and democratic health of the financial system as a whole.

II. THE REGULATORY POLICY MATRIX

A major factor complicating capture analysis, and perhaps even mitigating the dangers of capture in financial regulation, is the oft-criticized, highly matrixed financial regulatory structure.[19] America still has a vibrant "dual banking" system. Although the biggest banks tend to be federally chartered national banks, many thousands of banks are still chartered by state banking agencies. The biggest differences in the relative powers of national and state-chartered banks have been considerably reduced over recent decades, but banks do still have a real choice, and they still make it.[20] The ability to make the choice, not only between federal and state charters but, until recently, between different *types* of federal charters,[21] has given rise to the fear, empirically unsubstantiated,[22]

19. *See* Elizabeth F. Brown, *E Pluribus Unum—Out of Many, One: Why the United States Needs a Single Financial Services Agency*, 14 U. MIAMI BUS. L. REV. 1, 5–6 (2005) (describing and criticizing the complicated structure of financial regulation in the United States, including the involvement of well over 115 federal and state regulators). Numerous commentators and assessments have long blamed the multiplicity of regulators for the failure to anticipate the problems at specific institutions and the escalation of risk leading to the Crisis. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-61, FINANCIAL REGULATION: INDUSTRY CHANGES PROMPT NEED TO RECONSIDER U.S. REGULATORY STRUCTURE, at abstract (2004), *available at* http://www.gao.gov/new.items/d0561.pdf (describing numerous instances of disagreements among the financial regulatory agencies and attributing to this disagreement a failure to apply "consistent, comprehensive regulation").

20. *See, e.g.*, Barbara Rehm, *Natural Selection? Questioning the Future of The Dual Banking System*, AM. BANKER (Dec. 1, 2011), http://www.americanbanker.com/magazine/121_12/dual-system-future-1044216-1.html (discussing the evolution of the dual banking system in light of recent regulatory reforms).

21. A financial institution wishing to engage in banking can choose either a bank charter or a savings and loan charter ("thrift" charter). While the former is the more traditional form, a thrift charter has offered more attractive powers in some circumstances. Banks are chartered by either a state banking commissioner or the Office of the Comptroller of the Currency ("OCC"). Until recently, savings and loan associations were chartered by either a state regulator or the Office of Thrift Supervision ("OTS"), a separate agency within the United States Treasury. The Dodd-Frank Act eliminated the OTS and transferred the federal chartering powers for thrifts to the OCC. Dodd-Frank Wall Street Reform and Consumer Protection Act, §§ 311–313, 12 U.S.C. §§ 5411–5413 (Supp. IV 2010).

22. *See* Dain C. Donelson & David Zaring, *Requiem for a Regulator: The Office of Thrift Supervision's Performance During the Financial Crisis*, 89 N.C. L. REV. 1777, 1796–1811 (2011) (evaluating the impact of competition for

of a "race to the bottom," in terms of which states and the federal government compete for charters by granting wider powers to banks or relaxing regulatory standards. So this dual system itself can affect the relevance of "capture." On the one hand, the dual system could increase the possibility of capture to the extent that state-chartered banks might be able to exercise influence over relatively weak state regulators, or national banks might be able to concentrate their influence on one federal regulator. On the other, the differing constituencies and varying views of state and national chartering and supervisory authorities introduce a diversity of interests that would make it more difficult for any one sector of the industry to ensure that its preferences would dominate the regulator.

The dual system has also given rise to conflicting interests that help provide balance in the contest for influence. Most small banks, for example, are state chartered, and their interests are represented vigorously through various organizations, including the Conference of State Bank Supervisors[23] and the Independent Community Bankers of America.[24] In recent years, the interests of these organizations have clearly been at odds with those representing the very big banks. These divergent interests have made a difference in both legislative and regulatory outcomes[25] and still function as

charters and finding no significant differences in returns between institutions that converted federal thrift charters to bank charters and vice versa). The OTS was heavily criticized for being a weak regulator, perhaps even captured by the industry it regulated (savings and loan associations). A number of the largest financial institutions ("FIs") that collapsed or had to be bailed out during the Crisis, including American International Group ("AIG"), IndyMac, and Washington Mutual, were under OTS supervision. Among the criticisms leveled at the OTS was the suggestion that lax OTS rules encouraged FIs to flip their charters in order to avoid more rigorous regulation and to gain the favor of a "captured" regulator. Yet, as the authors show, the evidence that charter flips actually did produce advantages is mixed at best. *Id.*

23. *See generally* CONF. ST. BANK SUPERVISORS, http://www.csbs.org/Pages/default.aspx (last visited Sept. 4, 2012).

24. *See generally* INDEP. COMMUNITY BANKERS AM., http://www.icba.org/ (last visited Sept. 4, 2012).

25. For example, smaller banks and their holding companies have been able to secure more lenient treatment in the case of certain kinds of regulation, such as slightly broader investment powers (trust-preferred securities), more lenient capital compliance requirements, enhanced systemic risk supervision (holding companies with consolidated assets of less than $50 billion), and oversight by the Consumer Financial Protection Board ("CFPB") (banks with assets of less than $10 billion are not subject to direct oversight by the CFPB). In light of the number of other new regulations introduced by Dodd-Frank, whether these exemptions confer net benefits is the subject of fierce debate.

criteria for choosing a state charter over a federal one, or vice versa.[26]

Of course the sheer scale of modern banks and the fact that big banks are now regulated almost exclusively at the federal level[27] suggest that concerns with capture and deficiencies in public participation ought to focus on federal financial regulation. Yet even at the federal level there is a complicated regulatory framework that can, and often does, work to prevent, or at least make it very difficult for, the strongest financial sectors to exercise undue influence. The Fed has emerged as the central regulator for large financial conglomerates, including foreign financial organizations operating in the United States.[28] At the same time, the primary regulator for national banks continues to be the Comptroller of the Currency,[29] whose Office (the "OCC") is located within the Treasury Department but whose head is separately appointed by the President.[30] And the interests of the Treasury

26. *See* Esther L. George, President and Chief Exec. Officer, Fed. Reserve Bank of Kan. City, Perspectives on 150 Years of Dual Banking, Speech to the Conference of State Bank Supervisors (May 22, 2012) *available at* http://www.kc.frb.org/publicat/speeches/2012-george-ga-csbs-05-22.pdf (explaining the resilience of the dual banking system and why it still offers real choices).

27. Although seventy-four percent of banking charters (including thrifts) are issued at the state level, see CONFERENCE OF STATE BANK SUPERVISORS, 2011 ANNUAL REPORT 14 (2012), *available at* http://www.csbs.org/news/presentations/annualreports/Documents/2011FINALCSBSANNUALREPORT.pdf, nationally chartered banks (including thrifts) own seventy-six percent of all commercial banking assets in the United States. *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, 2011 ANNUAL REPORT, at cover insert (2012), *available at* http://www.occ.treas.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf.

28. The Fed has long had direct supervisory authority over state-chartered banks that became members of the Federal Reserve System; national banks were directly regulated by the Comptroller of the Currency and continue to be so regulated. *See infra*. Since the passage of the Bank Holding Company Act in 1956, the Fed has also had significant supervisory jurisdiction over the *holding companies* that might own one or more national banks. Two major elements of the Dodd-Frank Act have now ensured that the Fed is positioned to become the primary regulator for banking conglomerates. The first is the "enhanced" supervisory powers conferred on the Fed, Dodd-Frank Wall Street Reform and Consumer Protection Act §§ 115 & 165, 12 U.S.C. §§ 5325 & 5365 (Supp. IV 2010), over bank holding companies with consolidated assets of $50 billion or greater, and non-bank financial organizations designated as systemically important financial institutions ("SIFIs") by the Financial Stability Oversight Council in terms of section 113. The second is the Collins Amendment to the Dodd-Frank Act in section 171, in terms of which the Fed must apply very important capital and leverage ratios across the holding company structure (prior to Dodd-Frank such ratios were applied only to the depository institution subsidiaries of these conglomerates).

29. National Bank Act, 12 U.S.C. §§ 1–16 (2006).

30. *Id.* § 2.

Department and the Fed, while often seemingly unified, are in reality often at odds.[31] Indeed, the OCC and the larger Treasury Department itself are not always in mutual agreement on matters of financial policy and regulation.[32]

Even more importantly, there is a third major regulator, the Federal Deposit Insurance Corporation ("FDIC"), with regulatory authority over almost all financial conglomerates that have banks or savings associations within their corporate combinations—and this means all banks of significance in the United States.[33] The FDIC manages the deposit insurance fund and is the receiver or liquidator for all insured depository institutions (banks and savings associations)[34] and potentially all systemically important financial institutions, even if they are not banks.[35] These roles often place the FDIC in stark opposition to the OCC or the Fed, and sometimes both. The FDIC has an interest in preventing reckless bank activities that might endanger depositors and the deposit insurance fund, whereas the OCC, for example, has an interest in promoting and expanding the national banking industry, just as the state regulators have an interest in promoting the state banking system. It is therefore not surprising that the OCC and the Fed, on the one hand, and the FDIC on the other, have clashed over what bank

31. For one of many examples, see, for example, Donna Borak, *OCC Joins Other Agencies in Fight Against Debit Interchange Limit*, AM. BANKER (Mar. 8, 2011), http://www.americanbanker.com/issues/176_46/occ-agencies-fight-debit-interchg-limit-1034149-1.html (describing strong differences of opinion between the Fed, on the one hand, and the OCC, FDIC, and even the Fed Chairman, on the other, regarding the setting of debit card interchange fees).

32. *See, e.g.*, Letter from George W. Madison, Gen. Counsel, Dep't of the Treasury, to John Walsh, Acting Comptroller of the Currency, Office of the Comptroller of the Currency (June 27, 2011), *available at* http://cdn.americanbanker.com/media/pdfs/TreasuryOCC_062811.pdf (criticizing the OCC's proposed rulemaking relating to federal preemption of state consumer protection standards); *see also* Victoria McGrane, *Treasury Assails OCC on Draft Rule*, WALL ST. J. (June 29, 2011), http://online.wsj.com/article/SB10001424052702303627104576414191405604726.html.

33. The FDIC insures over 7000 depository institutions. *See* FDIC, 2011 ANNUAL REPORT 4 (2012), *available at* http://www.fdic.gov/about/strategic/report/2011annualreport/AR11final.pdf. FDIC insurance covers almost eighty percent of all insured deposits in the United States. *Id.* at 130.

34. Credit unions are separately insured by the National Credit Union Share Insurance Fund, and if they fail, the National Credit Union Administration acts as receiver. While not insignificant in national financial policy, credit unions are not covered in the discussion in this article.

35. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 204(b), 12 U.S.C. § 5384(b) (Supp. IV 2010) (noting that the FDIC is appointed as receiver for "covered financial companies" placed into liquidation upon a determination that their impending failure could pose a significant threat to the financial stability of the United States).

activities and investments should be permitted or prohibited.[36] Similarly, the Fed and the FDIC have clashed over policy governing bank capital requirements because the Fed and the FDIC are not always in agreement over where the balance between safety and soundness, on the one hand, and credit expansion, on the other, should be struck.[37]

A new regulatory perspective has also been introduced as a result of the addition of the new Consumer Financial Protection Board ("CFPB"),[38] which adds a consumer protection focus to the investor protection and financial exchanges regulation traditionally provided by the Securities and Exchange Commission ("SEC")[39] and Commodity Futures Trading Commission ("CFTC").[40] Together these agencies provide yet another center of divergent interest on matters of financial regulatory policy, and they, too, can and do differ, sometimes vehemently, on regulatory policy.[41] They are

36. *See, e.g.*, Joe Nocera, *Sheila Bair's Bank Shot*, N.Y. TIMES MAG. (July 9, 2011), http://www.nytimes.com/2011/07/10/magazine/sheila-bairs-exit-interview.html (describing numerous disagreements between the FDIC under the chairmanship of Sheila Bair and the OCC and other agencies). One well-publicized example was the disagreement between the FDIC and the Fed over whether large banks should be permitted to move their derivatives businesses into their insured depository institutions in order to reduce the amount of collateral they would need to post. *See* Bob Ivry et al., *BofA Said to Split Regulators over Moving Merrill Derivatives to Bank Unit*, BLOOMBERG (Oct. 18, 2011), http://www.bloomberg.com/news/2011-10-18/bofa-said-to-split-regulators-over-moving-merrill-derivatives-to-bank-unit.html.

37. As the Crisis developed, the FDIC vigorously disagreed with the Fed over whether to permit banks to continue using trust-preferred securities as a means of raising capital. In the end, the FDIC's concerns were proven well founded. *See, e.g.*, Greg Gordon & Kevin G. Hall, *How the Fed Let Small Banks Take on Too Much Debt, Then Fail*, MCCLATCHY NEWSPAPERS (Dec. 22, 2010), http://www.mcclatchydc.com/2010/12/22/v-print/105708/fed-could-have-saved-many-smaller.html.

38. The CFPB (legislatively designated the "Bureau of Consumer Financial Protection") was created by section 1011 of the Dodd-Frank Act. *See* CONSUMER FIN. PROTECTION BUREAU, http://www.consumerfinance.gov/ (last visited Sept. 4, 2012).

39. Securities and Exchange Act of 1934, Pub. L. No. 73-291, § 4, 48 Stat. 881 (1934); *see* U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/index.htm (last visited Sept. 4, 2012).

40. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 201, 88 Stat. 1389 (1974); *see* U.S. COMMODITY FUTURES TRADING COMMISSION, http://www.cftc.gov/index.htm (last visited Sept. 4, 2012).

41. *See, e.g.*, Kevin Wack, *Closed-Door Battle over Volcker Spills into Public View*, AM. BANKER (May 21, 2012), http://www.americanbanker.com/issues/177_98/Gary-Gensler-Mary-Schapiro-Volcker-Rule-JPMorgan-Chase-1049494-1.html (describing the deep differences—a "long running, closed-door battle"—between the CFTC, on the one hand, and the Fed, OCC, FDIC, and SEC, on the other, over how vigorously to enforce the Volcker Rule, which prohibits proprietary trading by banks). *See generally* Eugene F. Maloney, *Banks and the SEC: A Regulatory Mismatch*, 25 ANN. REV. BANKING & FIN. L.

focused on market conduct and, as such, perform something of the umpireal role that would make regulatory capture a particularly acute concern. The CFPB has been fiercely opposed by the banking industry and other credit providers[42] because some in the industry have feared the additional regulatory burdens the new agency would bring. In reality, however, it might be less the burden of new regulation that bankers fear and more the different center of interest and specialized enforcement focus that the new agency will represent.[43]

Finally, the international layer should not be overlooked. The Basel Committee on Banking Supervision ("BCBS"),[44] the Financial Stability Board ("FSB"),[45] and to some extent even the International Monetary Fund ("IMF"),[46] all play a substantial role in influencing

---

443, 454–58 (2006) (discussing numerous examples of the differences in philosophical outlook between the banking agencies and the SEC).

42. For a collection of articles reporting on the partisan positions for and against the CFPB, see *Bureau of Consumer Financial Protection (C.F.P.B.)*, N.Y. TIMES, http://topics.nytimes.com/top/reference/timestopics/organizations/c/consumer_financial_protection_bureau/index.html (last updated Aug. 10, 2012).

43. Apart from a new standard by which to assess the acceptability of consumer financial services (whether a product or service is "unfair, deceptive or abusive" standard, as defined in section 1031 of the Dodd-Frank Act), most of the powers possessed by the CFPB were already within the scope of authority of other financial regulators and were simply transferred from them. It is the reinvigorated *focus* on these powers that is probably one of the biggest reasons for resistance to them.

44. The BCBS was created in 1974 as a committee of the Bank for International Settlements. It has no formal legal powers, but its influence has become central to modern banking, and its latest iteration of minimum bank capital and liquidity standards—Basel III—is one of the most important points of reference for modern financial regulation. *See Basel Committee on Banking Supervision*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/bcbs/index.htm (last visited Sept. 4, 2012); *see also infra* note 48.

45. The FSB was created by the G20 nations in 2009 as a response to the Crisis. It was upgraded from an earlier, rather anemic committee (the Financial Stability Forum) that had been formed in the wake of the Asian Financial Crisis of the late 1990s. The FSB now plays a major role in shaping regulatory thinking on the so-called Global-Systemically Important Financial Banks and Financial Institutions ("G-SIFIs"), whose thinking contributes to and influences the way in which domestic regulators approach important elements of financial regulation. On the FSB, see *History*, FIN. STABILITY BOARD, http://www.financialstabilityboard.org/about/history.htm (last visited Sept. 4, 2012); *see also infra* note 48.

46. The IMF and World Bank jointly conduct a Financial Sector Assessment Program ("FSAP") in terms of which the quality of financial regulation applied by member countries is reviewed as a peer assessment process. *See* IMF, FACTSHEET: THE FINANCIAL SECTOR ASSESSMENT PROGRAM (FSAP) 1–2 (2012), *available at* http://www.imf.org/external/np/exr/facts/pdf/fsap.pdf. *See generally* CHRIS BRUMMER, SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM: RULEMAKING IN THE 21ST CENTURY 157 (2011).

domestic regulatory policy. Basel III[47] and the new Global-Systemically Important Financial Banks and Financial Institutions ("G-SIFIs") surcharges,[48] emanating from the BCBS and the FSB, provide important examples of policy pressure that has helped shape, and has been shaped by, the views of the Fed and Treasury Department via a mechanism that has come to be described in international relations theory as a transnational regulatory network ("TRN").[49]

This hodgepodge of regulatory structures is often criticized as being irrational and incomprehensive.[50] There are certainly huge elements of the financial industry, including hedge funds and mutual funds among many others, that are tightly connected to the banking industry but are not fully covered by regulation in ways that would ensure against "leakage" and regulatory arbitrage.[51] However, in the opinion of this author, the call for a single federal banking regulator has so far been resisted for good reason. A divergence of regulatory opinion is probably far more valuable as an assurance against major regulatory mistakes than whatever benefits the real or imagined coherence of a single regulator might bring. And this divergence of expressions of the public interest through the mechanism of multiple, powerful regulators might well constitute an important safeguard against excessive industry influence.

III. GOVERNMENT & FINANCIAL INSTITUTIONS: A COMPLICATED EMBRACE

The Financial Crisis of 2008 ("Crisis") certainly seems to have produced many potential illustrations of capture. The phone logs of the then-President of the New York Federal Reserve Bank, Timothy

47. *See generally* BASEL COMM. ON BANKING SUPERVISION, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS (2011), *available at* http://www.bis.org/publ/bcbs189.pdf.

48. *See generally* FIN. STABILITY BD., POLICY MEASURES TO ADDRESS SYSTEMATICALLY IMPORTANT FINANCIAL INSTITUTIONS (2011), *available at* http://www.financialstabilityboard.org/publications/r_111104bb.pdf.

49. The literature on TRNs is now extant. For a critical assessment, see generally Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 YALE J. INT'L L. 113 (2009).

50. *See, e.g.*, *supra* note 19.

51. Perhaps most important is the vast ecology of financial institutions ("FIs") that comprise the so-called "shadow banking industry." These are FIs such as hedge funds, broker-dealers, mutual funds, insurance companies (such as AIG), and other non-insured depository institutions that complement and interconnect with the traditional banking and investment industry. *See generally* ZOLTAN POZSAR ET AL., SHADOW BANKING (2010); Steven L. Schwarz, *Regulating Shadow Banking*, 31 REV. BANKING & FIN. L. 619 (2012); Erik F. Gerding, The Shadow Banking System and its Legal Origins (Jan. 24, 2012) (unpublished manuscript), *available at* http://ssrn.com/abstract=1990816.

Geithner, indicate that the captains of the financial industry talked regularly with him, on some occasions many times in a single day.[52] Subsequent records, disclosed under sanction of Congress or through Freedom of Information Act ("FOIA") lawsuits, indicate that the Federal Reserve System had itself arranged for huge, secret loans or other forms of emergency funding to be made available to domestic and foreign financial institutions on such terms that serious questions of political accountability were and continue to be raised.[53] Recently, controversy has raged around whether it is appropriate that prominent bankers, such as Jamie Dimon of JPMorgan Chase & Co., should be members of the Federal Reserve banks that are supposed to regulate their institutions.[54]

Since that time, and even long before, the revolving door between government and the financial industry has spun around at a breathtaking pace.[55] The volume of comment by industry

52. *See, e.g.*, Baxter, *supra* note 4, at 184–85 (citing examples); *see also infra* note 99 and accompanying text.

53. *See, e.g.*, Bob Ivry et al., *Secret Fed Loans Gave Banks Undisclosed $13B*, BLOOMBERG (Nov. 27, 2011), http://www.bloomberg.com/news/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income.html (describing massive, low-interest loans extended by the Fed to domestic and foreign banking organizations to help them recover from the Crisis. These loans were secret until the Fed was forced to disclose them as a result of court orders).

54. Local bankers have traditionally played a major role in the governance of the twelve district Federal Reserve banks, and to this day their nominees are Class A directors of the district banks. Class A directors constitute one-third of the total board. When JPMorgan Chase, one of the largest U.S. banks, suffered severe trading losses, numerous commentators and politicians were prompted to demand the resignation of the bank's chief executive officer, Jamie Dimon, from his position as a Class A director of the New York Federal Reserve Bank. *See* Donna Borak, *Dimon's Role on N.Y. Fed Board Sparks Fierce Debate*, AM. BANKER (May 18, 2012), http://www.americanbanker.com/issues/177_97/Jamie-Dimon-Chase-Fed-New-York-board-director-resign-1049463-1.html; *Directors of Federal Reserve Banks and Branches*, FED. RES. BOARD, http://www.federalreserve.gov/aboutthefed/directors/ (last updated July 25, 2012); *see also* Peter S. Goodwin, *Elizabeth Warren is Right: Jamie Dimon Needs to Resign from the N.Y. Fed*, HUFFINGTON POST (May 14, 2012), http://www.huffingtonpost.com/peter-s-goodman/elizabeth-warren-jamie-dimon_b_1515220.html? (reporting on calls for, and directly calling on, Dimon's resignation from his NY Fed position); Simon Johnson, *Dimon and the Fed's Legitimacy*, N.Y. TIMES ECON. BLOG (May 24, 2012), http://economix.blogs.nytimes.com/2012/05/24/dimon-and-the-feds-legitimacy/; Simon Johnson, *Jamie Dimon and the Fall of Nations*, N.Y. TIMES ECON. BLOG (May 31, 2012), http://economix.blogs.nytimes.com/2012/05/31/jamie-dimon-and-the-fall-of-nations/; Simon Johnson, *Jamie Dimon Should Resign from the Board of the New York Fed*, BASELINE SCENARIO (May 21, 2012), http://baselinescenario.com/2012/05/21/jamie-dimon-should-resign-from-the-board-of-the-new-york-fed/.

55. *See, e.g.*, SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 92–104 (2010) (citing

representatives during the rulemaking process implementing the Dodd-Frank Act[56]—a massive legislative reform designed to address the causes of the Crisis—has been disproportionate to the substantive input by other stakeholders in the process.[57] Finally, the raw political power of firms and agencies participating in the financial industry, from individual banks and their industry representatives to the giant government-sponsored enterprises ("GSEs") Fannie Mae and Freddy Mac, seems evident from their vast collective spending on lobbying, both in Congress and to the financial regulatory agencies.[58]

With all these issues and events, the appearance of undue industry influence certainly seems great. Yet, there are also many benign explanations for a good deal of industry influence peddling. The financial industry, perhaps unlike any other (with the possible exception of public utilities), possesses some fundamentally distinct characteristics that make its level of influence both inevitable and, to a certain degree, essential. It is not just that the financial business is exceptionally complicated; this can be said of many other businesses too, such as pharmaceutical development and manufacture and deep sea oil drilling. It is because, since the founding of the Republic, we have maintained an assumption that banking is or should be a "private" activity,[59] when in fact it has

---

many examples of what the authors call "The Wall Street-Washington Corridor").

56. Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5301 (Supp. IV 2010).

57. *See, e.g.*, KIMBERLY D. KRAWIEC, DON'T SCREW JOE THE PLUMMER: THE SAUSAGE-MAKING OF FINANCIAL REFORM (forthcoming 2012), *available at* http://scholarship.law.duke.edu/faculty_scholarship/2445/ (showing that although the numerical quantity of comments by members of the general public has been much greater, the *depth* of public comment by business interests is much more substantive). *See generally* Jason Webb Yackee & Susan Webb Yackee, *A Bias Toward Business? Group Influence on the U.S. Bureaucracy*, 68 J. POL. 128 (2006) (indicating that business input in the rulemaking process tends to be more influential than that of private citizens, particularly where expertise is required).

58. *See, e.g.*, *Bank Lobbying on Track to Reach Record High This Year: Analysis*, HUFFINGTON POST (Nov. 22, 2011), http://www.huffingtonpost.com/2011/11/21/bank-lobbying-record-high_n_1106350.html (reporting on lobbying outlays by financial institutions in 2011 for the purpose of resisting the rules implementing Dodd-Frank).

59. The belief that government-sponsored banking is illegitimate is reflected in at least three major strands of development in American financial history: first, in the long running battle over whether to create a central bank and the ensuing creation of the First and Second Banks of the United States; second, in the repeated reversion by the states toward permitting "free banking," under which numerous private banks were permitted to operate largely without restraint and which system was vigorously defended in the face of the impending creation of a national banking system; and third, in the curious structure of the federal reserve system, which continues to provide a

always been critical for central banking and monetary policy purposes, both of which are core to the operation of modern government.[60] Ironically, what was perceived as a mark of sophistication in American banking—the dominance of "private" banks—has obscured the critical "public" functions banks perform.[61]

Even before the creation of "central" banks, either in America or Britain, bankers were critically important to government funding. Indeed, the Bank of England was created in part with the support of the goldsmiths of London to fend off robbing sovereigns, while also enabling the sovereign to bypass Parliament when raising finance.[62] The creation of both the First and Second Banks of the United States, and even the subsequent establishment of a national banking system, was accompanied by political controversy at the level of the highest branches of government.[63] Certainly the two Banks of the United States and even the seemingly "private" national banks were considered essential for the conduct of government. The U.S. Supreme Court and various state courts recognized the Banks of the United States to be instrumentalities of government.[64] National banks, chartered under the subsequent

---

major role for private banks in the operation of central banking functions. There is a vast literature on these events and the accompanying, vigorous political debates. *See generally, e.g.*, DAVIS RICH DEWEY, FINANCIAL HISTORY OF THE UNITED STATES (2d ed. 1903) (giving history prior to the creation of the federal reserve system); MILTON FRIEDMAN & ANNA JACOBSEN SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1857–1960 (1963) (outlining the development of the modern federal reserve system).

60. On the evolving central bank functions of the Banks of the United States and the national banking system, see, for example, RICHARD H. TIMBERLAKE, MONETARY POLICY IN THE UNITED STATES: AN INTELLECTUAL AND INSTITUTIONAL HISTORY 10–12 (1978) (explaining the functions of the First Bank of the United States); *id.* at 30–33 (explaining the functions of the Second Bank of the United States); *id.* at 160–164 (explaining the functions of national banks).

61. *See* Baxter, *supra* note 15, at 818–25 (describing the various "quasi-public" functions banks perform).

62. *See, e.g.*, 1 WALTER THORNBERRY, OLD AND NEW LONDON, ch. 40 (1878), *available at* http://www.british-history.ac.uk/report.aspx?compid=45058.

63. Of course this role has historically operated in tension with the other prerogatives of legislatures and sovereigns. In Britain both Whigs and Tories fiercely resisted the creation of the Bank of England in 1694. It was damned in the usual manner of the times as yet another dastardly idea from Holland. *Id.* So, too, was the resistance met by the idea of a Bank of the United States. The history of the veto of the Second Bank by President Andrew Jackson in 1832, in terms remarkably reminiscent of those uttered against the Old Lady of Threadneedle Street herself, is well known. The story is once again retold in his biography. *See* JON MEACHAM, AMERICAN LION: ANDREW JACKSON IN THE WHITE HOUSE 208 (2008).

64. *See, e.g.*, Osborn v. Bank of the United States, 22 U.S. 738, 860 (1824) (describing the Bank of the United States as "the great instrument by which the fiscal operations of the government are effected"); McCulloch v. Maryland, 17

National Currency Act of 1863[65] and the National Bank Act of 1864,[66] were similarly recognized to enjoy the privileges of government agencies.[67]

This quasi-governmental function and status has continued to the modern day, blurring the divide between public and private—between government and private industry—in ways that confuse any simple analysis of either "capture" or "public interest." It often appears as if "capture" *oscillates* between government and the banks in a mutually codependent relationship that is sometimes coercive, sometimes supportive.

A. Vehicles of Government Finance

The most visible role of banks as instrumentalities of government has been to provide the financial means for government to function. Governments have felt a compelling need for either central banks or "private" banks (and, in practice, both) in order to fund wars or other more peaceful enterprises. In the United States the national banking system itself was created for two reasons: to create a national system of legal tender and to provide a market and mechanisms for raising public finance.[68] As the federal government found itself unable to fund itself effectively, and when the drains on its coffers during the Civil War proved overwhelming, a compromise in the form of the National Bank Act of 1864 led to the creation of a federal chartering system for private "national" banks.[69] Thus from their inception, national banks had a public mission alongside their private banking functions. Whereas they were restricted from the outset in the degree to which they could invest in and underwrite private debt, national banks have always been permitted, and even

U.S. 316, 354, 396, 422 (1819) (referring to the Bank as a "convenient, a useful, and essential instrument in the prosecution of fiscal operations" and remarking that "[it] is as much an instrument of the government for fiscal purposes, as the courts are its instruments for judicial purposes").

65. 12 Stat. 665, *repealed by* National Bank Act of 1864, 13 Stat. 99 (1864) (codified as amended in scattered sections of 12 U.S.C.).

66. 13 Stat. 99 (codified as amended in scattered sections of 12 U.S.C.).

67. *See* National Bank v. Kentucky, 76 U.S. 353, 361 (1869) (calling national banks "the instrumentalities by which the government proposes to effect its lawful purposes in the States").

68. *See generally* BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR, ch. 22 (1957) [hereinafter HAMMOND, BANKS]; BRAY HAMMOND, SOVEREIGNTY AND AN EMPTY PURSE (1970) [hereinafter HAMMOND, SOVEREIGNTY].

69. *See* HAMMOND, BANKS, *supra* note 68. The statute initially giving effect to this system was the National Currency Act of 1863, which created the OCC within the Treasury Department. This legislation was substantially amended in 1864 by what came to be known as the National Bank Act, subsequently codified at 12 U.S.C. §§ 1 *et seq.*

strongly encouraged, to invest in the debt of the U.S. government, states, and their political subdivisions.[70]

And this role has continued to escalate to the present day. Now the investment and dealing in government debt is a major component of modern banking business; national banks and their affiliates within complex holding company structures deal in trillions of dollars of government debt.[71] It is a role that has only escalated as modern government deficit spending itself has burgeoned. In 1991 total outstanding U.S. public debt stood at under $4 trillion.[72] This balance took nearly fifteen years to double.[73] In 2012, six years later, it has almost doubled again, and outstanding debt is already nearly $16 trillion.[74]

70. The most important piece of financial regulation before Dodd-Frank, namely the Glass-Steagall Act of 1933, had established a separation of investment and traditional or "commercial" banking by prohibiting banks from investing and trading in securities on their own account. *See* The Banking Act of 1933 §§ 16, 20, 21, 32, 12 U.S.C. §§ 24, 78, 377, 378 (2006). Section 16 allowed for a most important exception: U.S. Government obligations, obligations issued by government agencies, college and university dormitory bonds, and the general obligations of states and political subdivisions. During the 1990s, sovereign bonds were again given special treatment in that those issued by OECD member countries have received zero-risk weightings—hence requiring no capital charge—in assessing required minimums for bank risk adjusted capital. Though clearly specious in light of numerous threats of sovereign default, this policy certainly encourages banks to invest and deal in sovereign debt. Most recently, the Volcker Rule specifically exempts U.S. government debt from the prohibition against proprietary trading. *See infra* note 89; *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act § 619(d)(1)(A), 12 U.S.C. § 1851(d)(1)(A) (Supp. IV 2010) (adding § 13(d)(1)(A) to the Bank Holding Company Act of 1956, 12 U.S.C. § 1841 (2006)).

71. *See* Baxter, *supra* note 15, at 818–21 (citing more detailed statistics); *see also* RICHARD BOVE, WHY DO BANKS NEED MORE CAPITAL? 16 (2012), *available at* http://www.chicagofed.org/digital_assets/others/events/2012/bsc/bove_051012.pdf (citing the need for banks to act as primary dealers and maintain liquidity in the Treasury markets as the major reason for protection of the big banks).

72. *Historical Debt Outstanding-Annual 1950-1999*, TREASURYDIRECT (Aug. 18, 2008), http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_histo4.htm.

73. *Historical Debt Outstanding-Annual 2000-2010*, TREASURYDIRECT (Oct. 1, 2010), http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_histo5.htm.

74. *See* DEP'T OF TREASURY, MONTHLY STATEMENT OF THE PUBLIC DEBT OF THE UNITED STATES 1 (2012), *available at* http://www.treasurydirect.gov/govt/reports/pd/mspd/2012/opds062012.pdf (reflecting an outstanding balance of $15.85 trillion as of June 30, 2012).

B. Conveyor Belts of Monetary Policy[75]

Closely related to their roles as market makers and investors in government debt, banks—particularly national banks (which comprise the overwhelming portion of the banking industry by assets)—are instruments for applying monetary policy. They are, as has famously been put, the "transmission belts" [76] by which the Fed enlarges or contracts the money supply and stimulates or dampens the economy, whether through setting overnight interbank lending rates or buying securities from and selling them to banks.

It is of course true that other participants in the financial services industry are also engaged in these roles, but here banks are indeed "special." In any event the other participants are tightly interwoven with the banks, either as corporate affiliates or counterparties. Like the tentacles of an octopus, banks form a quasi-governmental web in the ocean of public finance.

C. Bailout Agents of the Government

Two lesser-known "quasi-governmental" functions of banks are just as important as those previously described. The first is that they act as blotters on behalf of the government when other banks fail. The second is that they are vehicles for the emergency restoration of liquidity in the aftermath of a significant bank failure or a widespread financial crash.

The first role is particularly true for very big banks: they are most needed when other very large financial institutions fail and are beyond the capacity of the government itself to resolve directly. In such situations the government uses devices such as "purchase and assumption" ("P&A") transactions so that the net public outlay is reduced as far as possible and disruptions to the economy are kept to a minimum.[77]

The role of banks as bailout agents for the government is particularly evident in the case of big banks. One will recall the absorption by JPMorgan Chase & Co. of Bear Sterns and Washington Mutual, the catastrophic acquisitions by Bank of

---

75. This imagery was used by E. Gerald Corrigan, then President of the Federal Reserve Bank of Minneapolis, to illustrate an important quasi-governmental role played by banks, and one of such roles that differentiated banks from other firms. *See* E. Gerald Corrigan, *Are Banks Special?,* FED. RESERVE BANK MINN. (1982), http://www.minneapolisfed.org/pubs/ar/ar1982a.cfm.

76. *Id.*

77. A P&A transaction is one in which another bank acquires the assets (branches, etc.) of the failing bank and assumes some or all of its liabilities (mostly to depositors). This saves the FDIC from having to make a net cash outlay to depositors. On P&A transactions, see FDIC, RESOLUTIONS HANDBOOK, ch. 3 (2003), *available at* http://www.fdic.gov/bank/historical/reshandbook/ch3pas.pdf.

America Corp. of Countrywide and Merrill Lynch, and the snatching by Wells Fargo and Co. of our venerable Wachovia from the jaws of Citicorp at a frantic time when it was not always clear who was the savior and who was being saved.[78]

In the process of these dramatic government-triaged acquisitions, the big banks of course grew much bigger. Indeed, even at a time when public objections to the size of our largest banks had become central to the debate on financial regulatory policy, the Financial Stability Oversight Council ("FSOC"),[79] which had been charged by Congress to conduct a study on whether the national deposit and debt caps imposed on bank mergers were adequate, concluded that banks should be *exempted* from these caps when acquiring other distressed banks.[80] This provides both a key to the persistence of the "too-big-to-fail" phenomenon and an indication of the national criticality, for good or ill, of the nation's system of big banks.[81]

The second role is much more subtle, and it is by no means confined to large banks. When a bank fails, and particularly when a series of banks fail, the economy served by that bank is placed under immediate distress. Depositors do not have access to their savings, and employers cannot meet their payrolls. Local and national

---

78. Among the many books describing these convoluted events, see generally ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES (2009); DAVID WESSEL, IN FED WE TRUST: BEN BERNANKE'S WAR ON THE GREAT PANIC (2009).

79. The FSOC was created by section 111 of the Dodd-Frank Act. Dodd-Frank Wall Street Reform and Consumer Protection Act § 111, 12 U.S.C. § 5321 (Supp. IV 2010).

80. FIN. STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS REGARDING CONCENTRATION LIMITS ON LARGE FINANCIAL COMPANIES 16 (2011).

81. In general, the banking industry is not very concentrated in the United States. A recent analysis indicates that for the banking industry as a whole, the four largest organizations (JPMorgan Chase, Bank of America, Citicorp and Wells Fargo) hold a total market share of about 35%. IBISWORLD, BANK ON IT: AFTER A ROLLER COASTER RIDE, GOVERNMENT AID WILL REVIVE INDUSTRY REVENUE 25 (2012). Partly as a result of their critical public service as bailout agents, however, these banks have increased their concentration by almost 50% since 2008 (23% to 34.2%). *See id.* at 21. The industry is highly concentrated in certain areas. For example, the five largest banking organizations in the United States own over 53% (in 1913 it was 6%) of all the banking assets, which represent 57% of nominal GDP (2.6% in 1913), provide over 60% of all mortgages, issue 62% of all credit cards, and control 95% of all corporate lending. Heather Draper, *Hoenig Targets Fed, Wall Street, Big Banks in Denver Talk,* DENVER BUS. J. (July 12, 2011), http://www.bizjournals.com/denver/news/2011/07/12/hoenig-targets-fed-wall-street-big.html?page=all; *see also* David J. Lynch, *Banks Seen Dangerous Defying Obama's Too-Big-To-Fail Move*, BLOOMBERG (Apr. 16, 2012), http://www.bloomberg.com/news/2012-04-16/obama-bid-to-end-too-big-to-fail-undercut-as-banks-grow.html (reporting on the rapid recent growth of the large banks as a proportion of economic activity).

economies instantly bear the impact of the failure because depositors and employees are not able to pay their bills or continue spending, and suppliers are, in turn, impacted.

In order to minimize these impacts, other banks must step in, not only to act as bailout agents in the manner described above but also to *restore liquidity* to local and national markets.[82] While this function has been well noted in the aftermath of the Crisis, as attempts have been made to "get banks lending again," it is often assumed that such a role is confined to large banks. Indeed, it is seldom remembered that the same role was considered important for the creation of the federal deposit insurance system in 1933.[83] And to this day the role of community banks as maintainers of liquidity remains important.[84]

In light of these economically critical functions, it is obvious that banks of all kinds play a quasi-governmental role that is qualitatively different from that of other financial institutions[85] and industries.[86]

IV. VEHICLES FOR PROMOTING AND SUSTAINING THE PUBLIC INTEREST

The situation just described would seem at first blush to be starkly antidemocratic. The lobbying power of big banks, their powerful access to senior regulators, and their ongoing, codependent

82. *See generally* Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 24 FED. RES. BANK MINN. Q. REV. 14 (2000) (modeling the way in which deposit insurance offers a more efficient mechanism for stabilizing local liquidity than exchange markets, which lead to runs on the banks).

83. *See* 77 CONG. REC. 3840 (1933) (setting forth Representative Steagall's explanation that the billions of dollars banks would have loaned but for the fact that they feared another bank run and therefore found it impossible to extend credit).

84. *See, e.g.*, Ben S. Bernanke, Chairman, Fed. Reserve, Community Banking, Speech at the Independent Community Bankers of America National Convention and Techworld, Nashville, Tenn. (Mar. 14, 2012), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20120314a.htm (explaining the important role of community banks in their local economies).

85. Note that this does not mean that banks are not tightly connected with other financial institutions, which, indeed, underlines the dilemma of modern, desegregated/post-Glass-Steagall banking.

86. *See* Corrigan, *supra* note 75 (continuing, rightly in the author's view, to hold the view that, enormous changes notwithstanding, banks are "special" players in the economy); *see also* E. Gerald Corrigan, *Are Banks Special? A Revisitation,* FED. RES. BANK MINN. (Mar. 1, 2000), http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3527. *See generally* Biagio Bossone, *What Makes Banks Special? A Study of Banking, Finance, and Economic Development* (World Bank, Working Paper No. 2408, 1999) (supporting Corrigan's position by arguing that the banking industry is "special" and still distinct from its complementary nonbank financial partners).

relationship with government all suggest the potential for, and probability of, capture in the extreme. And this is not even to take into consideration the enormous power of the government-sponsored enterprises directly charged with implementing government housing and education policy.

It is therefore not surprising that the accusation of "capture" has been one of the most common charges leveled at banks, politicians representing their interests, and senior officials, particularly since the Crisis.[87] Yet there are some mitigating elements, including increased publicity requirements, a raised public consciousness, and, perhaps least understood, the virtue of America's "hodgepodge" financial regulatory system. Furthermore, it is important to consider the reality that a good deal of the interaction between banks and the government is highly technical in nature and necessarily so. This is not to excuse the lopsided nature of political influence that banks often enjoy, but one must address the different levels of interaction in order to start assessing whether and when the overall public interest is being smothered because regulators appear to be held captive by the industry.

A. *Expert v. Democratic Voices*

When two very complicated elements of the Dodd-Frank reform legislation were being translated into enforceable regulations, namely the Volcker Rule[88] and the new system for exchange-traded derivatives,[89] the level of ex parte access enjoyed by the banks seemed astonishing. Numerous form comments were filed by ordinary members of the public in the case of the Volcker Rule far outnumbering the formal comments filed by the financial institutions that were most likely to be affected. But the substance of the industry comments was far more detailed. Logs of meetings between representatives of the financial industry and regulators appear to tell a similar story.[90] In a similar vein, many of the senior officials involved in implementing the reforms have been drawn directly from the very industry that was the object of reform. Many of these officials have since returned to the same industry.[91]

87. *See* Baxter, *supra* note 4, at 181–82.

88. Dodd-Frank Wall Street Reform and Consumer Protection Act § 619, 12 U.S.C. § 1851 (Supp. IV 2010) (explaining the details of the Volcker Rule, which is the name given to section 619 of the Dodd-Frank Act, and adding a new section 13 to the Bank Holding Company Act of 1956 that prohibits proprietary trading by banks and their affiliates).

89. The Dodd-Frank Act added extensive provisions governing the regulation of the derivatives business, a highly technical area of financial services activity. *See* Dodd-Frank Act §§ 711–774.

90. *See, e.g.*, KRAWIEC, *supra* note 57, at 29–35.

91. *See supra* text accompanying note 54.

Yet it seems unrealistic to expect a more "balanced" picture. Regulating proprietary trading (Volcker Rule) and derivatives, or bank capital structures,[92] is an exceptionally technical matter. While some public interest and consumer organizations might possess sufficient expertise, the ability of the lay public to offer meaningful input is likely to be very limited. Even financial journalists often struggle to understand the issues and mechanisms involved.

Complicating matters still further, financial regulation involves the application of contested policies to these highly technical fundamentals. While ex post empirical economic studies might sometimes validate the effectiveness of certain policies, trying to determine ex ante which policies should be applied, even when complex technical issues are well understood, is inherently a matter of ideology, narrative, and trope. The long-running battles between Keynesians and Hayekians provide, of course, vivid examples.[93] To this extent, financial regulation, perhaps less than other regulatory strategies addressing the natural environment,[94] inevitably renders policy formulation a *political* process that, in turn, not only requires

---

92. For example, the Collins Amendment to section 171 of the Dodd-Frank Act extends minimum capital requirements to holding company structures. The international Basel III standards add yet another complex dimension to such requirements. *See supra* text accompanying note 47.

93. *See generally* NICHOLAS WAPSHOTT, KEYNES—HAYEK: THE CLASH THAT DEFINED MODERN ECONOMICS (2011) (tracing the profound consequences for, and differences in approach to, the role of government, including regulation, in the economy, and the way in which Keynesian and Hayekian macroeconomics defines many clashes over regulatory policy).

94. Environmental regulation might provide an example of more scientifically verifiable policy results. When it comes to complex human system failures, such as financial collapses, one only has to review the great classics on the origins and causes of bank failures in the Great Depression to recognize that in financial regulation we cannot agree even when presented with a specific event, such as the Crash of 1929, to study. *See generally* GEORGE J. BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING: THE GLASS-STEAGALL ACT REVISITED AND RECONSIDERED (1990); BEN S. BERNANKE, ESSAYS ON THE GREAT DEPRESSION (2000); MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1867-1960, ch. 7 (1963); JOHN KENNETH GALBRAITH, THE GREAT CRASH 1929 (reissue 1997). Similar disagreement is to be found in the Financial Crisis Inquiry Commission set up to examine the causes of the 2008 Crisis. *See* NAT'L COMM'N ON THE CAUSES OF THE FIN. AND ECON. CRISIS IN THE U.S., THE FINANCIAL CRISIS INQUIRY REPORT 3, 411, 441 (2011) [hereinafter FINANCIAL CRISIS INQUIRY REPORT] (containing a majority report and two dissenting reports). In complex systems involving multiple human agents, any efforts to rely on linear, reductionist causal connections is bound to be incomplete and misleading. *See generally* George F. R. Ellis, *On the Nature of Causation in Complex Systems*, 63 TRANS. ROYAL SOC. SOUTH AFR. 69 (2008), *available at* http://www.mth.uct.ac.za/%7Eellis/Top-down%20Ellis.pdf (exploring the multiple forms of causation operating in real world systems).

effective policy participation to be highly expert but also becomes indeterminate in ways that encourage mutual suspicion between contesting participants. It is this suspicion that can make capture rhetoric so pernicious because capture offers a spuriously "scientific" veneer to the analysis.

So it is in the world of complex financial regulation that our democratic norms supporting public participation and our desire to be sure that "technocrats" who really understand the industry they are trying to regulate come into direct conflict. This does not mean that public representation cannot be made independent of the industry, which will naturally be looking out for its interests and not those of a wider public, but it does mean that a substantial amount of technical input will be necessary. This input is most likely to derive from deep knowledge of the industry, and therefore to emanate in practice from the industry itself. Indeed, in the case of rapidly evolving modern financial markets it is hard to imagine where else, other than very well-funded public interest groups, academia, retired regulators, and members of the industry, such input might come from.

B. Traditional Balancing Mechanisms

To the extent that deep reliance on the industry is indispensible to meaningful financial regulation, it would seem that industry influence, though critical to realistic regulation, should be *balanced* by other well-informed forces in order to prevent the influence from becoming excessive to the point that it leads to regulatory outcomes that ignore or prejudice competing public considerations. These balancing forces take a variety of forms, each designed to provide an offsetting mechanism. Some are very traditional, some are internal to the regulatory process, and others are external checks and balances. Some are still emerging. Some rely on regulatory capability and expertise, others on objectivity, and others invoke processes of participation in order to bring a variety of views to bear in the deliberative process by which policy is decided. All have received considerable attention in administrative law and will only be summarized here.

1. Adequate Regulatory Capacity

An emerging literature has drawn attention to the difficulties in the United States, where regulators lack the status sometimes enjoyed by their foreign counterparts and where regulator salaries do not compete with those of their expert counterparts in the financial markets.[95] In addition, regulators are subject to the

95. *See, e.g.*, Baxter, *supra* note 4, at 194–96 (discussing the importance of elevating the status and rewards of regulators).

sometimes-whimsical budgetary and legislative mandates of Congress. It is difficult for them to match the power and resources of a well-funded array of industrial players, and it is difficult for regulators to hold on to their best performers when these individuals are faced with the temptations of private sector salaries while having to meet high living expenses. When regulators are given jurisdiction, it is simply not enough to provide them with legal authority to act; they must also be *able* to discharge this legal authority.[96]

2. Meaningful Transparency

In financial services, regulators tend to have a penchant for secrecy. Yet this opacity makes meaningful policy input difficult unless one has inside access—a factor that often provides the basis for accusations of capture.[97] The Fed is particularly notorious for avoiding publicity concerning its accusations and has had to be forced, by Congress[98] and through Freedom of Information Act lawsuits,[99] to divulge key information relating to its actions during the Crisis. Yet it is a truism that transparency is a prerequisite not only for the proper functioning of markets[100] but also for the proper

96. *See, e.g.*, JAMES R. BARTH ET AL., GUARDIANS OF FINANCE: MAKING REGULATORS WORK FOR US 206–13 (2012) (discussing various elements of regulatory capacity and vulnerability that must be addressed in order to ensure effective implementation of regulation).

97. During the Crisis, the then-Secretary of the Treasury, Henry Paulson, and the then-President of the New York Fed, Timothy Geithner, spoke repeatedly to only a few of the industry titans. *See, e.g.*, John Carney, *Look Who Really Controls Tim Geithner*, BUS. INSIDER (Oct 8, 2009), http://articles.businessinsider.com/2009-10-08/wall_street/29961329_1_investment-banks-financial-firms-treasury-secretary-timothy-geithner (reprinting an AP report, no longer available, revealing Geithner's phone logs during the Crisis); Andrew Ross Sorkin, *Paulson's Call Logs*, ANDREW ROSS SORKIN BLOG (Oct. 17, 2009), http://www.andrewrosssorkin.com/?p=88 (reproducing Paulson's call logs during the September 2008 meltdown).

98. *See Monthly Report on Credit and Liquidity Programs and the Balance Sheet*, BOARD GOVERNORS FED. RES. SYS., http://www.federalreserve.gov/monetarypolicy/clbs-appendix-c-201204.htm (last updated May 3, 2012) (describing the legislation and its application to fed disclosures). *See generally* Nancy Watzman, *Federal Reserve Forced to Report Which Banks Benefit from Loan Programs*, SUNLIGHT FOUND. REP. GROUP (Oct. 18, 2011), http://reporting.sunlightfoundation.com/2011/Federal_Reserve_forced_to_say/ (describing the legislative and judicial actions necessary to force Fed disclosure).

99. *See* Bob Ivry, *Revealing Fed's Secrets Fails to Produce Harm that Banks Cited*, BLOOMBERG (Apr 2, 2011), http://www.bloomberg.com/news/2011-04-02/revealing-fed-s-secrets-fails-to-produce-harm-that-banks-cited.html (describing the FOIA lawsuits brought by Bloomberg and Fox News to force the Fed to release information).

100. Pillar 3 of Basel II, which will operate alongside Basel III, is the "Market Discipline" element of the international framework for financial

formulation and application of public policy in regulations—as much in financial regulation as anywhere else.[101]

3. Meaningful Access by Stakeholders

The notice and comment model of administrative law is designed to facilitate access by all interested parties to the policy formulation process. As has already been noted, however, access alone is not necessarily meaningful; the subject matter of financial regulation tends to be intensely specialized and beyond the abilities of ordinary members of the public. Therefore *meaningful* access requires proponents of expert views, and this in turn introduces an additional requirement for comment on technical financial matters.[102]

4. External Checks

These checks on the actions of regulators and policy outcomes are traditional and include Congress, congressional committees,[103] the Administration (including the Office of Information and Regulatory Affairs ("OIRA")), the courts, inspectors general,[104] and

---

regulation and its focus is on transparency as a means of promoting market discipline. *See Query for Pillar 3 Documents*, BANK OF INT'L SETTLEMENTS, http://www.bis.org/search/?q=Pillar+3&adv=1 (documents relating to Pillar 3); *supra* note 47.

101. *See generally* Craig Holman & William Luneberg, *Lobbying and Transparency: A Comparative Analysis of Regulatory Reform*, 1 INT. GRPS. & ADV. 75 (2012), *available at* http://www.palgrave-journals.com/iga/journal/v1/n1/pdf/iga20124a.pdf (discussing the criticality of *transparency* rather than mere *access*, and making recommendations for enhancing transparency in the policy making process).

102. For further review of the devices for making access more meaningful for non-industry participants, see *infra* text accompanying notes 110–133.

103. Including such entities as the Government Accountability Office, which produces numerous reports on financial regulation and its effectiveness, and the U.S. Senate Permanent Subcommittee on Investigations, which recently produced a meticulously researched, three-volume report, PERMANENT SUBCOMM. ON INVESTIGATIONS, WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (2011), *available at* http://www.hsgac.senate.gov/subcommittees/investigations/media/senate-investigations-subcommittee-releases-levin-coburn-report-on-the-financial-crisis.

104. The inspectors general of various financial regulatory agencies have produced important reports concerning regulatory failure. *See, e.g.,* U.S. SEC OFFICE OF INSPECTOR GEN., REPORT OF INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME (PUBLIC VERSION) (2009), *available at* http://www.sec.gov/news/studies/2009/oig-509.pdf; *Welcome to SIGTARP,* SIGTARP, http://www.sigtarp.gov/Pages/home.aspx (last visited Sept. 5, 2012).

specially created oversight committees such as the Congressional Oversight Panel[105] and the Financial Crisis Inquiry Commission.[106]

Rather than cover ground much more fully explored elsewhere, this Article will conclude with a consideration of some recent ideas and developments that are intended to create or develop institutions designed to enhance and promote non-industry-sponsored considerations of the public interest.

C. *Institutional Enhancement of Public Interest Representation*

While it is true that technocratic regulation is not necessarily captured regulation, and that divergent, multiple regulators help generate the "democracy of ideas" so critical to balanced public policy, it is also true that all of these interests are likely to be biased in general toward the industry in one way or another. In other words, the constant focus on the welfare of the industry, and the perpetual interaction with the industry at various levels, is likely to produce a distorted view of the overall interests of the public. Taxpayers, for example, and laid off employees have borne the biggest brunt of industry mistakes, yet those interests seldom figure in any strong way when financial regulators make decisions. The views of taxpayers and the general public are too dispersed to receive adequate representation in agency decisions. They are a stakeholder who is not at the table even when their interests are likely to be genuinely affected.

The proposal of a public interest representative in such decisions would no doubt provoke angry rejection by the financial industry itself as yet another illegitimate intrusion by government into the realm of free enterprise. In fact banking, and most of financial services, is not "free enterprise." On the contrary, it is a heavily subsidized industry that carries out major quasi-governmental functions and is fully dependent on government business and support for its current scale of operations. In the author's view this fact has been too often ignored or insufficiently understood. Without taking this reality into account, the public will always be short changed and the "public interest" that emerges from the interaction of the regulators as earlier described will not likely

105. This panel was created to oversee the deployment of the TARP funds committed by Congress to help remedy the economic collapse of the 2008 Crisis (documents now archived at http://cybercemetery.unt.edu/archive/cop/20110401223205/http:/www.cop.senate.gov/).

106. This bipartisan commission conducted hearings and researched the causes of the Crisis. *See generally* FINANCIAL CRISIS INQUIRY REPORT, *supra* note 94. The Commission's proceedings, documents, testimony, and report are now archived at http://fcic.law.stanford.edu/.

be sufficiently balanced to avoid the charge of "capture" by the public at large.[107]

This would suggest the balance should be restored by additional, more formal representation of the public interest. There are various ways such "tripartism"[108] might be enhanced.

1. Formal Public Interest Representation

One way to intensify policy input from the "general public"—in other words, views not specifically represented by a discreet stakeholder—might be the introduction of formal mechanisms for promoting representation of "public interests" through institutions and procedural requirements. At least three examples have been suggested. One would be a mandated requirement for an independent third-party opinion or brief in the administrative process. Elsewhere I have raised the example of the MITRE Corporation, which provides entirely independent, self-funding, and expert consulting on government decisions affecting the public interest yet besieged by strong commercial interests.[109]

The second method of promoting an independent view of the public interest comes from public utility regulation[110] and is illustrated by the recent decision of the Federal Energy Regulatory Commission ("FERC") involving the proposed acquisition by Duke Energy of Progress Energy.[111] The proposed merger had not yet satisfied the concerns of the Commission about its possible anticompetitive effects.[112] The process for upholding public interest

---

107. *See* Baxter, *supra* note 15, at 825–31 (identifying the various forms of public subsidy enjoyed by banks).

108. "Tripartism" has been defined as "regulatory policy that fosters the participation of [public interest groups] in the regulatory process" in order to promote fuller participatory democracy at the level of implementation of policy. Ian Ayres & John Braithwaite, *Tripartism: Regulatory Capture and Empowerment*, 16 LAW & SOC. INQUIRY 435, 441, 475 (1991); *see also* IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE, ch. 3 (1992); Baxter, *supra* note 4, at 191–92.

109. Baxter, *supra* note 4, at 199.

110. A potential model for applying tripartism in financial services regulation can perhaps also be found in insurance regulation, where some states have developed proxy advocates for advocating the public interest in regulatory proceedings. *See* Daniel Schwarcz, *Preventing Capture Through Consumer Empowerment Programs: Some Evidence from Insurance Regulation*, *in* PREVENTING CAPTURE: SPECIAL INTEREST INFLUENCE IN REGULATION, AND HOW TO LIMIT IT (forthcoming 2012).

111. *See* Duke Energy Corporation and Progress Energy Inc., 137 FERC ¶ 61,210 (2011), *available at* http://www.ferc.gov/EventCalendar/Files/20111214190732-EC11-60-001.pdf (order rejecting compliance filing).

112. *Id.* at para. 90 (applying the statutory "public interest" standard to reject the plans to mitigate adverse effects on competition of two energy companies that are seeking approval to merge). Public utility regulation has a long (and controversial) history of applying public interest standards, but these

considerations is, as the *Duke Energy* decision illustrates, well supported by the standing of numerous collectivities, such as local authorities, who are properly organized to represent the general interests of their taxpayers.[113]

A broad proposal along similar lines has been made by Ross Levine, who advocates for—in terms of financial services regulation—the creation of an agency or "Sentinel."[114] This agency would have power to demand information, have expertise to evaluate this information and the financial policies being adopted by the agencies, and have the responsibility to report its views to Congress and the executive branch.[115] With purview over the whole financial system, the Sentinel would bring a broader perspective to bear than might otherwise be held by the specific agency whose action is under review. Being independently funded and situated, the Sentinel would also be in a position to offer impartial views as between the various financial agencies.

Another such broad proposal, made by Saule Omarova, is a "Public Interest Council" ("PIC").[116] The PIC would consist of an expert independent government agency appointed by Congress and located outside the executive branch, charged with participating in the regulatory process as the designated representative of "the public interest in preserving financial stability and minimizing systemic risk."[117] Like the Sentinel, the PIC would possess neither legislative nor executive powers; it would, however, have broad authority to collect information from both government agencies and private market participants, conduct investigations, publicize its findings, and advise Congress and regulators to take action "with respect to specific issues of public concern."[118]

The difficulty with each of these ideas is that they are predicated on a substantive "public interest" that can be identified in some detached way by experts. Yet it is unlikely that any of the agents in the process would acknowledge or even perceive that their positions were not in fact the best ones for the public interest, and it is has become naïve to expect otherwise. As one critic of the

---

are usually reinforced by statute and assisted through well organized public and private representations (as was the case in the *Duke Energy* case).

113. *See also* Schwarcz, *supra* note 110, at 2.

114. This idea was first proposed by Ross Levine and is now incorporated into a book he has coauthored. *See* BARTH ET AL., *supra* note 96, at 215–24; Ross Levine, *The Governance of Financial Regulation: Reform Lessons from the Recent Crisis* 2 (BIS, Working Papers No. 329, 2012).

115. Levine*, supra* note 114.

116. Saule T. Omarova, *Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation*, 37 J. CORP. L. 621, 658–59 (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1924546.

117. *Id.*

118. *Id.* at 623–24.

Sentinel idea has put it, "[i]t is misleading to suggest that these [regulatory] judgments do not have a strong political dimension to them. They cannot be put on autopilot, or entrusted to a group of disinterested 'wise men.'"[119] Proposing the addition of new layers to the regulatory process is also a questionable strategy, politically and financially. The regulators tend to be underresourced as it is, and regulatory burden in financial services has become a rallying cry for the industry, sometimes with good reason. Proposing to allocate even more funds to yet more external public agencies would have little prospect of success in today's Congress.

2. Private Public Interest Representation

A third option of expert representation by independent yet well-resourced private groups is now emerging in the field of financial regulation. This is a cadre of privately funded and diverse expert organizations akin to the "shadow banking committee" that played a prominent role in critique of financial regulatory policy in the United States in the '80s and '90s. The original shadow banking committee is now known as the Shadow Financial Regulatory Committee, an independent committee sponsored by the American Enterprise Institute.[120] Additional examples are the Brookings Institution,[121] Center for Economic Policy Research,[122] PublicCitizen,[123] new deal 2.0,[124] Project on Government Oversight ("POGO"),[125] and Americans for Financial Reform.[126] Similar institutions are developing in the United Kingdom and elsewhere.[127] Important academic centers are also providing growing and deeply

119. Howard Davies, *Comments on Ross Levine's Paper "The Governance of Financial Regulation: Reform Lessons from the Recent Crisis"* 20 (Bank of Int'l Settlements, Working Paper No. 329, 2010).

120. The Shadow Financial Regulatory Committee is sponsored by the American Enterprise Institute. *Special Topic: Shadow Financial Regulatory Committee*, AM. ENTERPRISE INST., http://www.aei.org/topic/shadow-financial-regulatory-committee/ (last visited Sept. 5, 2012).

121. BROOKINGS INST., http://www.brookings.edu/ (last visited Sept. 5, 2012).

122. CENTER FOR ECON. POL'Y RES., http://www.cepr.net/ (last visited Sept. 5, 2012).

123. PUB. CITIZEN, http://www.citizen.org (last visited Sept. 5, 2012).

124. *New Deal 2.0*, ROOSEVELT INST., http://www.rooseveltinstitute.org/new-deal-20 (last visited Sept. 2012).

125. POGO: PROJECT ON GOV'T OVERSIGHT, http://www.pogo.org/ (last visited Sept. 5, 2012).

126. AM. FOR FIN. REFORM, http://ourfinancialsecurity.org/ (last visited Sept. 5, 2012).

127. Such developments are described in a forthcoming chapter by Christine Farnish, chair of Consumer Focus in the United Kingdom. *See* INT'L CTR. FOR FIN. REG., REGULATORY CAPTURE: THE OPTIMAL RELATIONSHIP BETWEEN THE REGULATOR AND THE REGULATED (working title, forthcoming Sept. 2012).

informed input to the public policy process,[128] and financial regulators are beginning to take advantage of seemingly independent advisory boards.[129]

Perhaps the most prominent and potentially influential example of independent expert public interest representation is the new "Systemic Risk Council," recently formed by Sheila Bair, former chair of the FDIC, with support and sponsorship from the Chartered Financial Analyst ("CFA") Institute and the Pew Charitable Trusts.[130] The Council will comprise some of the leading and most senior former regulators,[131] at least two of whom took extraordinarily independent lines even while in government office.[132]

Bodies like these are independent of the industry itself and presumably reflect independent perspectives, accumulating financial expertise, and the potential for much needed expert input and balance on the complicated issues of financial regulation.

---

128. *See, e.g.*, *The Volatility Institute*, NYU STERN SCH. BUS., http://www.stern.nyu.edu/experience-stern/about/departments-centers-initiatives/centers-of-research/volatility-institute/index.htm (last visited Sept. 5, 2012); *see also INET@Oxford*, INST. FOR NEW ECON. THINKING, http://ineteconomics.org/initiatives/partnerships/oxford (last visited Sept. 5, 2012) (bringing together in a recently established institute various disciplines, including complexity science, to analyze issues such as systemic risk and financial crises).

129. *See, e.g.*, *FDIC Systemic Resolution Advisory Committee*, FED. DEPOSIT INS. CORP., http://www.fdic.gov/about/srac/index.html (last visited Sept. 5, 2012) (revealing a recently established committee, which has as its members some independent experts who have been highly critical of regulatory policy).

130. *See Former FDIC Chair to Lead Systemic Risk Council, Monitor Financial Regulation*, BUS. WIRE (June 6, 2012), http://www.businesswire.com/news/home/20120606005519/en/FDIC-Chair-Lead-Systemic-Risk-Council-Monitor [hereinafter *Former FDIC Chair*]; *Sheila Bair to Lead Private Financial Risk Council*, REUTERS (June 6, 2012), http://www.reuters.com/article/2012/06/06/financial-regulation-bair-idUSL1E8H66DN20120606; *Sheila Bair: From Regulator to Watchdog*, FRONTLINE (June 12, 2012), http://www.pbs.org/wgbh/pages/frontline/business-economy-financial-crisis/money-power-wall-street/sheila-bair-from-regulator-to-watchdog/.

131. The Council will be Paul Volcker, former chairman of the Fed, and several former financial agency chairs. For the full list, see *Former FDIC Chair*, *supra* note 130.

132. Sheila Bair herself exhibited fierce independence as chairman of the FDIC, and Brooksley Born, former chair of the CFTC, attempted herself to impose regulation on financial derivatives in the face of fierce industry and, ultimately, Congressional opposition. *See, e.g.*, Ryan Lizza, *The Contrarian: Sheila Bair and the White House Financial Debate*, NEW YORKER (July 6, 2009), http://www.newyorker.com/reporting/2009/07/06/090706fa_fact_lizza (providing a profile on Sheila Bair after her Profile in Courage award for her independent line on financial regulation); *Brooksley Born*, WIKIPEDIA, http://en.wikipedia.org/wiki/Brooksley_Born (last visited Sept. 5, 2012) (providing a profile on Brooksley Born, also a Profile in Courage award recipient).

CONCLUSION

Despite appearances, it is too facile to assert that financial agencies are simply "captured." To be sure, the great power of large financial institutions strongly suggests that their interests will receive considerable attention—perhaps even unduly special consideration—and that they are sometimes inappropriately favored. Yet, given the nature of the financial system and its operations, it is hard to envisage a more active interplay than the one between government and big banking. The implicit safeguard of the complex regulatory matrix, however, can operate as a brake on the inclinations of one particular agency to lean too far in the direction of a favored sector of the industry. At the same time, we are also seeing the growing organization and capability of powerful private groups that are providing expert voices to the policy formulation process. While it is difficult to sustain the argument for a single "public interest" representative, the growing number of organized, "public interest" oriented and independent participants offers the promise of an important counterbalance to the influence of industry.

It is possible that the complicating considerations reviewed in this Article—matrixed regulation and multiple layers of regulators, on the one hand, and a blurred division between government and private market functions on the other—are entirely unique to the financial industry. Yet it seems that some similarities in other regulated industries might also suggest that the charge of "capture" should often be taken with the proverbial pinch of salt, or at least with a healthy dose of detailed understanding of the complexities of the regulatory field under discussion. Such an approach might not win a Nobel Prize, but it will be grounded in greater reality.