FOREWORD

THE ADMINISTRATIVE LAW OF FINANCIAL REGULATION

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To paraphrase Rob Jackson,[1] this symposium issue brings together scholars of administrative law, financial regulation, and securities law to provide a rare—and largely unprecedented—opportunity to consider how lessons drawn from each area should inform financial regulation. Several themes emerge.

Perhaps the dominant theme is the significant divergence between financial regulation and other forms of regulation. Outside of the financial sector, accountability is the defining attribute of administrative law.[2] This is exemplified by its notice-and-comment rulemaking, which seeks public input. In contrast, financial regulation is sometimes defined by the very independence of the regulators.[3] The U.S. Federal Reserve (the Fed), for example, has budgetary autonomy from Congress. And its Federal Open Market Committee (FOMC), which "may be the country's most important agency" because it controls the U.S. money supply,[4] exercises "remarkable" discretion.[5]

This regulatory independence has justifications. Among other things, it "serves to improve the credibility of the Fed's price stability mandate by insulating its decisionmaking from politics and, in particular, from the political pressure in favor of easy money during election cycles."[6] To some extent also, the regulatory independence may result from the fact that "[f]inancial

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1. Robert J. Jackson, Jr., *Cost-Benefit Analysis and the Courts*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 55.

2. Michael S. Barr, Comment, *Accountability and Independence in Financial Regulation: Checks and Balances, Public Engagement, and Other Innovations*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 119; Gillian E. Metzger, *Through the Looking Glass to a Share Reflection: The Evolving Relationship Between Administrative Law and Financial Regulation*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 130.

3. Barr, *supra* note 2, at 121; Metzger, *supra* note 2, at 130–31, 134–37.

4. David Zaring, *Law and Custom on the Federal Open Market Committee*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 157–58.

5. *Id*.

6. Barr, *supra* note 2, at 119.

regulation concerns activity that has very low exit costs."[7]

For example, "administrative law developed in the context of activities that either had no exit option or very high exit costs," such as railroads that depended on tracks and rights of way.[8] Similarly, environmental regulation "target[s] facilities that have high fixed costs and little ability to relocate in the short run, such as coal-burning power plants."[9] Because the externalities associated with these businesses are "chronic and cumulative," regulators have the luxury of engaging in a "very elaborate, inclusive, deliberate, multistaged, heavily lawyered decision making process."[10] Financial regulation, in contrast, is different because a financial business "has very low or no exit costs."[11] Financial regulation thus "requires rapid decisionmaking [and] secrecy," making it unrealistic to solicit "comments by interest groups, responses to comments, or lawyerly deliberation."[12]

Whatever the reason for the regulatory independence, the financial crisis has motivated Congress to try to reduce that independence.[13] The Dodd–Frank Wall Street Reform and Consumer Protection (Dodd–Frank) Act, for example, limits the Fed's power to bail out individual financial institutions.[14] Perversely, however, that increases the risk that a systemically important financial firm will fail, transmitting failure to other financial institutions through their interinstitutional correlation.[15] This confirms the importance of the warning that "[u]sing traditional mechanisms to make the Fed more politically accountable could substantially impede the Fed's capacity to achieve the aims assigned to it."[16]

Some of the symposium-issue contributors argue that the perception of financial regulatory independence is merely superficial. Although hard law does not always require financial regulators to be accountable to the public, those regulators are nonetheless subject to "soft constraints."[17] There are at least two categories of constraints: principled norms, and the Fed chair's reputational concerns.[18] Soft constraints "have the capacity to meaningfully constrain agency

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7. Thomas W. Merrill, *A Comment on Metzger and Zaring: The Quicksilver Problem*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 189–90.

8. *Id*. at 190.

9. *Id*.

10. *Id*.

11. *Id*. at 191.

12. *Id*. at 192.

13. *Cf.* Barr, *supra* note 2, at 128 (arguing that the financial crisis "sparked innovations in substantive financial regulation and administrative law designed to balance independence and accountability").

14. Dodd–Frank Act § 1101(a)(6) (amending § 13(3) of the Federal Reserve Act).

15. Iman Anabtawi & Steven L. Schwarcz, *Regulating Systemic Risk: An Analytical Framework*, 86 NOTRE DAME L. REV. 1349, 1412 n. 238 (2011).

16. Kathryn Judge, *The Federal Reserve: A Study in Soft Constraints*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 66.

17. Judge, *supra* note 16.

18. *Id*.

action and to facilitate oversight and discourse."[19] Thus, an "internally developed tradition" based on norms makes the FOMC effectively accountable to the public, notwithstanding that it has no "externally imposed [legal] constraints."[20]

Perhaps of particular interest to scholars reading this symposium issue, the "quality and efficacy of [these] soft constraints depends on the effort that academics [among others] expend in the processes through which soft constraints are formed and enforced."[21] Among other things, this means that academics are essential to the process of establishing the principled norms that serve as soft constraints.[22] (At least we're essential to something!)

This symposium issue also observes that, notwithstanding the divergence, there are many overlaps between financial and nonfinancial regulation, including areas of increasing convergence. The most observed overlap is cost-benefit analysis (CBA), which increasingly is being used to assess the merits of financial regulation.[23]

The symposium-issue contributors generally believe that CBA can be usefully applied to financial regulation, but they caution that regulators should be aware of its limitations. One contributor argues, for example, that, although in "the long term, [CBA] has the potential to improve [financial] regulatory outcomes substantially," much more work is required to determine how and when to apply CBA to financial regulation before CBA "will be capable only of edifying, rather than generating, regulatory judgments."[24] Until that time, CBA should be treated as a "helpful but limited exercise[] in structured reasoning, not as [a] method[] to produce optimal regulatory changes."[25] Another contributor cautions that "whatever position one takes about the appropriate role of CBA in financial regulation, all should agree that the courts should play virtually no role in conducting or reviewing that analysis."[26] Yet another contributor warns that CBA may be, to some extent, incompatible with a financial regulator's independence.[27]

Another dominant theme of the symposium issue is complexity. This should not be a surprise; one of us has observed, for example, that complexity is the greatest financial-market regulatory challenge of the future.[28] Complexity helps

19. *Id*. at 95.

20. Zaring, *supra* note 4, at 158.

21. Judge, *supra* note 16, at 96.

22. *Cf. id*. at 96 (observing that "principled norms can constrain only to the extent that there is an established principled norm").

23. Metzger, *supra* note 2, at 155 (observing that "[c]ross-pollination is evident in the context of" cost-benefit analysis).

24. John C. Coates IV, *Towards Better Cost-Benefit Analysis: An Essay on Regulatory Management*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 23.

25. *Id*.

26. Jackson, *supra* note 1, at 55.

27. Ryan Bubb, *The OIRA Model for Institutionalizing CBA of Financial Regulation*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 47.

28. Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH. U. L. REV. 211,

to explain why "Congress . . . tends to delegate to financial [regulatory] agencies significant, core questions regarding financial institution supervision, such as capital rules."[29] Complexity also explains why financial regulatory decisions may be inappropriate for judicial review: "Many financial regulatory decisions involve probabilistic judgments about risk, such as whether a bank's failure might lead to financial panics, which are not readily subject to judicial second-guessing."[30]

Because financial regulation "is a complex undertaking, . . . unintended consequences lurk behind ever well-meaning regulatory effort."[31] That highlights the danger of the "inevitability of politics" interfering with financial regulation, which one symposium contributor believes to be the "important lesson [that] administrative law holds for financial regulation."[32] This foreword has already observed an example of such a danger, resulting from Congress's attempt to try to reduce financial regulatory independence.[33]

To address complexity, one symposium contributor argues for incremental financial regulation.[34] Such an approach can help financial regulators better assess "the likely consequences of the regulations."[35] Evidence of the consequences of an incremental administrative rule thus can "inform[] the agency how to next proceed, including tweaking of its past initiatives."[36] This type of an approach, for example, has

> worked well for the SEC [Securities and Exchange Commission] when a securities statute or regulation announces a regulatory principle. Enforcement and experience gained under such a principle can inform the development of safe harbors. Thus, adoption and refinement of safe harbors are iterative, as is the more informal SEC noaction letter process. It would also be useful throughout the process to demonstrate how experience gained has enabled the agency, consistent with its presumed expertise, to adapt its rules so as to reduce their burdens on the regulated while increasing their expected benefits.[37]

Complexity can also help to explain why financial regulatory agencies sometimes "seem structured to invite [regulatory capture], with a number of agencies being given authority over narrow industry slices."[38] This better enables specialization, which is one approach by which lower paid financial

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212–13 (2009); Steven L. Schwarcz, *Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown*, 93 MINN. L. REV. 373, 405 (2008).

29. Barr, *supra* note 2, at 120.

30. *Id*. *Cf. supra* note 22 and accompanying text (observing that courts should play virtually no role in conducting or reviewing cost-benefit analysis of financial regulation).

31. James D. Cox, *Iterative Regulation of Securities Markets After* Business Roundtable*: A Principles-Based Approach*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 44.

32. Metzger, *supra* note 2, at 155.

33. *See supra* notes 13–15 and accompanying text (arguing that Congress's legislating limits on the Fed's power to bail out individual financial institutions perversely increases systemic risk).

34. Cox, *supra* note 31, at 25.

35. *Id*. at 45.

36. *Id*.

37. *Id*.

38. Metzger, *supra* note 2, at 130.

regulators can keep up with their much higher paid industry counterparts.[39] Complexity also helps to explain the fact that "[m]uch financial regulation displays a collaborative approach, with greater reliance on information sharing and partnership between regulators and those they regulate."[40] Absent these and other types of measures intended to reduce the information asymmetry between the members of the financial industry and their regulators, regulators may be unable to "fully understand, and thus to effectively monitor and regulate, financial innovations that might create systemic externalities."[41]

This brief foreword attempts merely to begin to introduce the reader to the richness of the symposium issue. The issue, however, speaks for itself. The issue's contributors are the leaders in their fields, and no summary could ever do justice to their actual writings.

39. Steven L. Schwarcz, *Intrinsic Imbalance: The Impact of Income Disparity on Financial Regulation*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 114–15 (also demonstrating at least a two-to-one income disparity between financial industry employees and their regulatory counterparts).

40. Metzger, *supra* note 2, at 130.

41. Schwarcz, *supra* note 39, at 97.