

ESSAY

“CAPTURE” IN FINANCIAL REGULATION: CAN WE CHANNEL IT TOWARD THE COMMON GOOD?

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Regulatory “capture” is central to regulatory theory and the economic analysis of regulation. It lies at the heart of public and social choice theory and it is a concept adopted by conservative and liberal theorists alike.¹ Capture theory has, since the 1960s, influenced the de-

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¹ See, e.g., MARVER H. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSION (Princeton Univ. Press 1955) (evaluating the role of independent regulatory commissions in government regulation); THEODORE J. LOWI, THE END OF LIBERALISM: IDEOLOGY, POLICY, AND THE CRISIS OF PUBLIC AUTHORITY (W.W. Norton & Co., Inc. 1969) (discussing clientelism resulting from delegation and accommodation of interest groups); MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (rep. ed. 1971) (discussing collective action problems in counteracting organized groups); Sam Peltzman, *Toward a More General Theory of Regulation*, J. L. & ECON. 211 (1976) (discussing social choice); George T. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971) (discussing public choice). See also Jean-Jacques Laffont & Jean Tirole, *The Politics of Government Decision-Making: A Theory of Regulatory Capture*, 106 QTRLY. J. ECON. 1089 (1991) (broadening capture theory toward a more dynamic perspective); Joel A.

velopment of two entirely opposing approaches to regulation: on the one hand, it provided impetus to the “deregulation movement” because markets were considered less susceptible to undue influence than regulatory agencies, and on the other, it led to attempts to pinpoint faithful implementation of legislative policy through the creation of *single executive* (and therefore directly accountable) agencies designed to implement social policies.²

The concept of capture has seductive moral power because it conveys a sense of illegitimate expropriation, performed by one powerful group over others, of the resources we might have thought were provided for a broader social benefit. Moreover, evidence of capture seems to leap out at us from the very statements by, professed motivations of, and political contributions from, well organized interest groups. The direction of specific policy outcomes often makes it easy to attribute the result to excessive influence of a group, or groups, whose views seemed most to support that result and who devoted the most resources to ensuring that outcome.

I. UNPACKING CAPTURE

A. *Surface Capture*

The concept of capture is not very reliable—whether as a descriptive or a normative tool—for understanding regulatory dysfunction. Though usually used quite simplistically in economic modeling, capture might take many forms and is likely to be a matter of degree. Consequently, differences of opinion abound as to whether capture has even occurred.

Capture is also notoriously difficult to define. As a working definition, this paper regards regulatory capture to be present *whenever a particular sector of the industry, subject to the regulatory regime, has acquired persistent influence disproportionate to the balance of interests envisaged when the regulatory system was established*. Yet this definition immediately begs questions, such as when influence is “persistent,” or what the “balance of interests envisaged” really is? For many reasons, good and bad, it is almost certain that some individuals or groups will have more influence than others, thus, another important question is which groups *should* have greater influence, and when does greater influence represent a distortion of the process.

Mintz, *Has Industry Captured the EPA?: Appraising Marver Bernstein’s Captive Agency Theory After Fifty Years*, 17 FORDHAM ENVTL. L. REV. 1 (2005) (assessing the validity of Bernstein’s capture theory as applied to the EPA); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974) (arguing for a more tentative endorsement of capture theory over public interest theory).

² See THOMAS K. McCRAW, PROPHETS OF REGULATION 303–04 (1984).

There is often another complicating and more fundamental factor at play: it might be that the regulatory regime appears “captured” because the legislature that created this regime was *itself* captured by “special interests” and, as a result, has produced a regime predestined to captured results favoring those interests.³ Figuring out where capture begins is itself both an empirical and a political question. Do we treat democratic legislative results as a given and therefore *prior* to regulatory capture analysis because the legislative process itself was democratic? If so, and if regulators are merely carrying out legislative will, then the rest of the capture inquiry would be little more than a waste of time.⁴

Scholars have shown regulatory capture, as an analytical concept, to be both indeterminate and sometimes not supported by the facts.⁵ It is indeterminate because a legislature may have adopted a particular policy *because it is the right one* and not because certain groups might have *bought or paid for* the policy (even though this might perhaps also have happened). Just because the result is supported by a powerful and organized group does not necessarily imply that it is wrong. This highlights the fundamental causal problem that capture theory does not satisfactorily address.⁶

The concept is also unsupported in significant situations where the legislature apparently adopted policies in the face of powerful opposition that would, under capture theory, have suggested a different result.⁷ One

³ See Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339, 341–43 (1988).

⁴ See *infra* note 16 (discussing the likely views of state banks in reaction to passage of the National Bank Act of 1863).

⁵ For critiques of regulatory capture see, for example, Daniel Carpenter, *Confidence Games: How Does Regulation Constitute Markets?*, in GOVERNMENT AND MARKETS: TOWARD A NEW THEORY OF REGULATION 164, 165, 170–73 (Edward J. Balleisen & David A. Moss eds., 2010); Steven Croley, *Interest Groups and Public Choice*, in RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC LAW 49, 56–58 (Daniel A. Farber & Anne Joseph O’Connell eds., 2010); Jessica Leight, *Public Choice: A Critical Reassessment*, in GOVERNMENT AND MARKETS 213, 230–38 (Edward J. Balleisen & David A. Moss eds., 2010). For a rich exploration of the dimensions and deficiencies of both public interest and capture theory, and an attempt to develop a more complex model for understanding the process of sound policy formation, see Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. 167 (*Special Issue* 1990). See also Susan Webb Yackee, *Reconsidering Agency Capture During Regulatory Policymaking*, in PREVENTING CAPTURE: SPECIAL INTEREST INFLUENCE IN REGULATION, AND HOW TO LIMIT IT 1–3 (Daniel Carpenter, Steven P. Croley & David A. Moss, eds., forthcoming 2011) (unpublished manuscript dated July 8, 2011) (manuscript at 5–10) (on file with author) (presenting a thorough analysis of the theoretical dimensions of the capture concept and ways of testing empirically the existence and degree of agency capture).

⁶ See DANIEL CARPENTER, REPUTATION AND POWER: ORGANIZATIONAL IMAGE AND PHARMACEUTICAL REGULATION AT THE FDA 35–43 (2010) [hereinafter CARPENTER, REPUTATION AND POWER] (discussing regulation, its theories, and externalities).

⁷ See, e.g., David A. Moss & Mary Oey, *The Paranoid Style in the Study of American Politics*, in GOVERNMENT AND MARKETS, *supra* note 5, at 256, 257 (describing three major

could easily argue that in such situations, other powerful interests have prevailed; but once one starts making this kind of concession, the concept becomes so diluted that it quickly loses analytical value.

Capture can also be unhelpful, even counterproductive, because it is hurled back and forth between competing interest groups, or “factions,”⁸ as an accusation—sometimes little more than an insult—rather than a constructive diagnosis.⁹ This leads to adversarial responses. Such controversy is not surprising given that regulatory capture is an idea borne out of the flat rhetorical rejection of any objective “public interest”: after all, if policy is simply the product of a zero sum game in which there are only winners and losers, then public policy can be no more than the spoils of victory, with losers left only to lament the capture of the prize by others. Under this view, capture is a concept embedded in an adversary model not only of *politics* but also of *policy* itself.

There are more problems. Capture is offered as an antidote to the supposed political naïveté of the “public interest” theory of policy formation.¹⁰ Yet the notion of an opposing, public interest theory is itself largely a straw man set up by capture theorists to advance their models.¹¹ There is no simplistic public interest school of public policy: as Daniel Carpenter has observed, “[t]he term is much more commonly used by capture and rent-seeking theorists” and “‘public interest’ is less a body of theory and more a descriptive label used by critics of an earlier era’s scholarship.”¹²

To make useful assessments on whether something like capture has occurred, we have to make much more precise distinctions about “regulation” and “regulators” than public choice economists are inclined to make.¹³ This is evident in the world of financial regulation, where there are many dimensions of “regulation.”

For example, what is the purpose of the legislation creating the regulatory framework? Sometimes the legislation under which the regulators act *expressly authorizes* favorable treatment of one group over

examples—voting rights, Medicare, and Superfund—in which “special interests appear to have given way to the general interest in the policymaking process”); see also David B. Spence & Frank Cross, *A Public Choice Case for the Administrative State*, 89 GEO. L.J. 97, 122–23 (discussing the ongoing influence battle that does not end with the passage of legislation, precisely because that legislation is itself often contrary to industry interests—which should not be the case if the capture theory of legislation was resilient).

⁸ See *infra* note 67.

⁹ PHILLIP J. COOPER, *THE WAR AGAINST REGULATION: FROM JIMMY CARTER TO GEORGE W. BUSH* 11 (2009).

¹⁰ See CARPENTER, *REPUTATION AND POWER*, *supra* note 6, at 38.

¹¹ See *id.* at 36–37.

¹² *Id.* at 37.

¹³ See *id.* at 38.

another.¹⁴ The National Bank Act provides a good example; it was enacted specifically to promote the development of a national banking system for the sake of the public interest.¹⁵ As Justice Strong famously declared in a case favoring national banks over state banks, “National banks have been National favorites.”¹⁶ Sometimes it is perfectly appropriate, and even statutorily *required*, for the Office of the Comptroller of the Currency (OCC), which is charged with applying the Act, to promote the interests of national banks over other competing interests.¹⁷ Yet this does not mean that the Comptroller is therefore captured by the national banking industry and thereby not acting in the public interest.¹⁸

Furthermore, there are many kinds of regulators with many kinds of missions.¹⁹ In the financial world there are regulators who, like the OCC and state banking commissions, are primarily established to *create* and *promote* an industry.²⁰ There are others, like the Securities and Exchange Commission (SEC) and the newly created Consumer Financial Protection Bureau, whose mission is to regulate the *business conduct* of those industries.²¹ Others, like the Federal Deposit Insurance Company (FDIC) and even the chartering agencies such as the OCC, have the important “micro-prudential” mission of preventing institutional failure, to protect depositors, shareholders or even the general public.²² There are “macro-prudential” regulators, such as the Federal Reserve and the new Financial Stability Oversight Council, whose mission, among others, is financial stability.²³ And some, such as the FDIC, play the role of undertaker in ensuring “orderly liquidation” of financial companies that have

¹⁴ See William Isaac, *Bank Regulatory System Out of Balance*, AMERICAN BANKER, Feb. 6, 2006, available at <http://www.williamisaac.com/published-works/bank-regulatory-system-out-of-balance/> (“The OCC . . . [is] charged by statute with promoting the interests of national banks and federal thrifts.”) (last visited August 26, 2011).

¹⁵ See *History*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, <http://www.occ.treas.gov/about/history.html> (last visited Apr. 12, 2011) (discussing the history of the National Bank Act and the public interest reasons for its implementation).

¹⁶ *Tiffany v. Nat’l Bank of Miss.*, 85 U.S. 409, 413 (1873). The opponents of a national banking system, of which there were many, would no doubt have argued that Congress had been captured by special interests when it enacted the legislation in the first place.

¹⁷ See Isaac, *supra* note 14.

¹⁸ This does not mean that the legislature, in creating a pro-industry regulator such as the OCC, has been effective in ensuring promotion of the *public* (as opposed to *industry*) interest. On the contrary, it is later suggested that recent events show this to be a fundamental design flaw. See *infra* text accompanying notes 101–03.

¹⁹ See HEIDI M. SCHOONER & MICHAEL W. TAYLOR, *GLOBAL BANK REGULATION: PRINCIPLES AND POLICIES* 260–65 (2010).

²⁰ See *id.*

²¹ Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 § 1011 (2010) [hereinafter Dodd–Frank Act].

²² See SCHOONER & TAYLOR, *supra* note 19, at 56–59, 95–97.

²³ See *id.* at 268–71.

become insolvent.²⁴ These distinctions are important if we are to attain any degree of precision when talking about capture.

Except perhaps in some extreme situations, the surface concept of capture does not even plausibly describe the overall process of policy formation. This is not only because “influence is not quite the same thing as control,”²⁵ but also because the direct focus on capture theory inconsistently and wrongly presupposes simple linear influences on the emergence of policy. Yet many fluctuating and buffeting forces interact to determine results that are seldom the “logical” result of the inputs involved. Policy, as much as market prices, is the result of a *process* in which the result is an *emergence* from the process, not the linear sum of its parts.²⁶

Finally, there is a strange irony to the position of some capture theorists. Capture is a central tenet for adherents of the rational choice school of economics and public choice school of public policy, and is a basis for preferring market discipline to regulation in most circumstances.²⁷ Under this model, however, market forces, supposedly less susceptible to capture themselves, are likely to provide a more reliable means of generating efficient or “utility maximizing” results.²⁸ “Efficiency,” under the rational choice model, has in effect become a substitute for public interest. The irony is that market discipline theorists celebrate the efficient results of properly functioning markets by tirelessly reiterating Adam Smith’s overworked metaphor of the “invisible hand,”²⁹ yet the efficient

²⁴ See Dodd–Frank Act, H.R. 4173, tit. II. For a general discussion of financial agency types, see SCHOONER & TAYLOR, *supra* note 19, at 259–77.

²⁵ Richard S. Whitt, *Adaptive Policymaking: Evolving and Applying Emergent Solutions for U.S. Communications Policy*, 61 FED. COMM. L.J. 484, 534 (2009).

²⁶ “Emergence” is a complicated concept connoting a condition, state, or quality that evolves from the systemic interaction of diverse agents within a complex system and it is not the linear sum of those inputs. For example, the “wetness” of water is not the mere sum of H₂O molecules, nor is “mind” just the accumulation of brain tissue powered by electrical impulses between neural connections. See, e.g., JOHN H. MILLER & SCOTT E. PAGE, *COMPLEX ADAPTIVE SYSTEMS: AN INTRODUCTION TO COMPUTATIONAL MODELS OF SOCIAL LIFE* 44–53 (Princeton Univ. Press 2007); Julianne D. Halley & David A. Winkler, *Classification of Emergence and its Relation to Self-Organization*, COMPLEXITY, May/June 2008, at 10, <http://online.library.wiley.com/doi/10.1002/cplx.20216/pdf> (last visited Apr. 12, 2011).

²⁷ See, e.g., THE ENCYCLOPEDIA OF PUBLIC CHOICE vol. 1 at 267 (Charles Kershaw Rowley & Friedrich Schniieder eds., Kluwer Academic Publishers, 2004) (“[T]he public choice model stresses that issues of income distribution will tend to carry greater weight in the public policy process than concerns of economic efficiency. . . . Depending on the policy process in question, the beneficiaries of regulation may turn out to be almost any well-organized special-interest group. Owing to the fact that ‘the public’ is numerous, geographically dispersed, and, in general, unorganized politically, its influence on the policy process is necessarily weak. Public regulation of private industry therefore will rarely, if ever, serve the public’s interest.”).

²⁸ On the incoherence of the “utility maximization” claims of public choice theory, see for example, Leight, *supra* note 5, at 225–30.

²⁹ Gavin Kennedy, *Adam Smith and the Invisible Hand: From Metaphor to Myth*, 6 ECON. J. WATCH 239 (2009).

result is mysteriously generated by the collective energy of myriads of selfishly motivated market participants.³⁰ However, public and social choice theorists seem to implicitly deny the possibility that any analogous public interest may similarly emerge through the process of policy formation. By the same logic, properly designed regulation—a product of competing forces—would surely also lead to an efficient or utility maximizing result.

B. Structural Capture

So capture seems at first to be rather deficient as a tool for analyzing the performance of regulators. It turns out, however, to be very relevant in the context of contemporary financial regulation for two distinct reasons. First, the overt conduct of the industry and various high regulatory officials appears to demonstrate the kind of extreme situation in which one of the regulated interests—namely the very large financial institutions—have secured such dominant influence that it may be said that they have captured the regulators, the regulatory process, and the regulatory outcomes, to the disregard of many other important interests.³¹

Examples of recent strong industry bias on the part of key financial regulators seem to abound. There is ample evidence from various regulatory actions that the industry, particularly large financial organizations, have enjoyed surprising favor at the hands of the financial regulators. The Office of Thrift Supervision has been excoriated in a detailed Senatorial report for its pro-industry laxity.³² The OCC has used its interpretive powers to enable national banks to evade long-standing legislative restrictions on their activities, whether geographic or product restrictions.³³ The Federal Reserve, charged with maintaining prudential

³⁰ This is not an unreasonable claim, as countless highly efficient, diverse markets seem to demonstrate and complexity theory would support. See, e.g., W. Brian Arthur, *Complexity and the Economy*, 284 SCIENCE 107, 108 (Apr. 1999). See generally MELANIE MITCHELL, COMPLEXITY: A GUIDED TOUR 9–10 (Oxford Univ. Press 2009).

³¹ See, e.g., James Kwak, *Cultural Capture and the Financial Crisis*, in PREVENTING CAPTURE: SPECIAL INTEREST INFLUENCE IN REGULATION, AND HOW TO LIMIT IT 1–3 (Daniel Carpenter, Steven P. Croley, and David A. Moss, eds.) (forthcoming 2011) (unpublished manuscript) (on file with author).

³² STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, 112TH CONG., J. REP. ON WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE 161–242 (2011), available at http://hsgac.senate.gov/public/index.cfm?FuseAction=press.MajorityNews&ContentRecord_id=51bf2c79-5056-8059-76a0-6674916e133d.

³³ See, e.g., Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the “Business of Banking”*, 63 U. MIAMI L. REV. 1041 (2009) (discussing deregulation of activities); Elizabeth R. Schiltz, *Damning Watters: Channeling the Power of Federal Preemption of State Consumer Banking Laws*, 35 FLA. ST. U. L. REV. 893 (2008) (discussing geographic and product deregulation); Comment, *The New American Universal Bank*, 110 HARV. L. REV.

firewalls between corporate subsidiary structures, has deployed tortured interpretive techniques to permit their breach.³⁴ And the SEC notoriously adopted a “consolidated supervised entities” policy that in effect freed large financial companies from prior leverage restrictions and enabled them to reach the dangerous levels of leverage that have been identified as a major reason for the financial collapse in 2008.³⁵ Financial regulation might therefore have come to reflect just the kind of extreme situation in which capture accurately describes the result of our regulatory policy.

Secondly, when one turns from the shallow concept of visible capture, which has been the focus of the earlier discussion, to the “deep capture”³⁶ that might be embedded within the financial regulatory system, the evidence seems to accumulate even more rapidly. This suggests that our financial and economic public policy process has been systematically captured by large-scale financial interests. The leading exponents of the theory of deep capture have described their use of the term as follows:

By “deep capture,” . . . we . . . refer to the disproportionate and self-serving influence that the relatively powerful tend to exert over all the *exterior* and *interior* situational features that materially influence the maintenance and extension of that power—including those features that purport to be, and that we experience as, independent, volitional, and benign. Because the situation generally tends to be invisible (or nearly so) to us, deep capture tends to be as well.³⁷

To understand capture from this perspective we must reach beyond surface connections that suggest causality and the attribution of outcomes to obvious inputs; instead, we have to consider the implicit assumptions, shapes, and channels of information that ultimately, notwithstanding professed views and objectives, drive perceptions and

1310 (1997) (discussing OCC development of its “operating subsidiary rule” to enable national banks to get into the business of insurance and securities underwriting).

³⁴ See, e.g., Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C. L. REV. 101 (2011).

³⁵ See, e.g., Ben Protess, “Flawed” SEC Program Failed to Rein in Investment Banks, PROPUBLICA Oct. 1, 2008, <http://www.propublica.org/article/flawed-sec-program-failed-to-rein-in-investment-banks-101>.

³⁶ For a discussion of “deep capture,” see Jon Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. PA. L. REV. 129, 202–84 (2003).

³⁷ *Id.* at 218. See also Simon Johnson, *The Quiet Coup*, THE ATLANTIC, May 2009, at 48–50 (developing a case that our financial regulators and policy have become victim to a pervasive cultural capture that promotes the interests of large financial institutions to the detriment of financial stability).

decisions.³⁸ There could be various dimensions of this type of capture, including “cultural”³⁹ and “social”⁴⁰ capture. Here, the entire language of the policy debate is shaped by an elite group that has gained dominance in promoting and controlling policy outcomes; further, the language of regulation is shaped by the common backgrounds, education, experience, and intermingling of the more powerful players in the policy formation process.⁴¹

Perhaps equally insidious are the subtle conflicts of interest created by academics that are dependent on industry sponsored research, or deriving income from industry associations such as directorships. A recent study on the activities of academic economists suggests that the conflicts are sufficiently real as to require a code of ethics, including fuller disclosures when economists take public positions on policy issues.⁴² This industry-academic relationship might significantly distort our understanding of the true relationship between industry and the regulators.

James Kwak, in an illuminating analysis, has characterized the kind of deep capture evident in financial services regulation as “cultural capture.”⁴³ He notes that the potential recruits to the financial agencies are less likely to be committed ideologically to *constraining* the industries they will regulate than are recruits to agencies specifically established for

³⁸ See Hanson & Yosifon, *supra* note 36, at 177–79 (discussing how and why our surface assumptions do not reliably reflect the basis for decisions and action and, therefore, can lead to inaccurate attribution of cause and effect).

³⁹ See, e.g., Kwak, *supra* note 31; SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 89–90 (Pantheon Books 2010); Johnson, *supra* note 37, at 50 (describing the “cultural capital” amassed by the financial industry, creating a network that ensures massive influence among colleagues, former colleagues, and other socially and vocationally connected individuals who collectively control the levers of government decision-making in matters relating to the financial system); see *infra* text accompanying notes 43–47.

⁴⁰ See Steven M. Davidoff, *The Government’s Elite and Regulatory Capture*, N.Y. TIMES DEALBOOK (Jun. 11, 2010, 2:00 PM), <http://dealbook.nytimes.com/2010/06/11/the-government-elite-and-regulatory-capture/>.

⁴¹ See JOHNSON & KWAK, *supra* note 39, at 92–104.

⁴² See Gerald Epstein & Jessica Carrick-Hangenbarth, *Financial Economists, Financial Interests And Dark Corners of the Meltdown: It’s Time to Set Ethical Standards for the Economics Profession* 25–28 (Univ. of Mass. Amherst, Political Econ. Research Inst., Working Paper No. 239, 2010) (reviewing the writings and media appearances of nineteen economists between 2005 and 2009); see also, Seth Lohove & Oliver Staley, *Schools Find Ayn Rand can’t be Shrugged as Donors Build Courses*, BLOOMBERG, May 5, 2011, <http://www.bloomberg.com/news/2011-05-05/schools-find-ayn-rand-can-t-be-shrugged-as-donors-build-courses.html> (describing the growing number of wealthy donors who are attaching ideological academic conditions to their donations); Catherine Rampell, *Buying Influence at Universities*, N.Y. TIMES ECONOMIX BLOG (May 12, 2011, 3:00 PM), <http://economix.blogs.nytimes.com/2011/05/12/buying-influence-at-universities/>; Nancy Folbre, *Economics for sale*, N.Y. TIMES ECONOMIX BLOG, (May 16, 2011, 6:00 AM), <http://economix.blogs.nytimes.com/2011/05/16/economics-for-sale/?hp>.

⁴³ See Kwak, *supra* note 31.

the purpose of protecting the environment, for example.⁴⁴ Hence, there is likely to be a general disposition in favor of the industry from the outset. Kwak also demonstrates how cultural capture works through three mechanisms. First, regulators *identify* with the more powerful and “are more likely to adopt positions advanced by people whom they perceive as being in their in-group.”⁴⁵ Second, financial regulators have a tendency to value *status*: “[r]egulators are more likely to adopt positions advanced by people whom they perceive to be of higher status in social, economic, intellectual, or other terms.”⁴⁶ Third, ongoing *relationships* are important, as “[r]egulators are more likely to adopt positions by people who are in their social networks.”⁴⁷

These overall dynamics nurture a kind of “consanguinity” among the captains of industry—the heads of political and regulatory departments, from which lesser committees, officials, and corporate officers continuously take their lead,⁴⁸ as well as many academics. This may generate a collective cognitive bias, known as “intellectual hazard,” in which different views are not even perceived, let alone recognized and properly analyzed.⁴⁹

Given the “situational” context of financial regulation and the deep structures that shape and influence regulatory outcomes, it seems that the financial regulatory system is suffering from deep capture. The power of the financial industry—particularly that of the big banking conglomerates—looms large in the shaping of general public policy and specific regulatory action. This is evident from the phone logs of current and

⁴⁴ *Id.* at 16–17. In this regard one may distinguish the new Consumer Financial Protection Bureau, *supra* note 21, because, unlike the other financial agencies (with a possible exception of the FDIC) it was set up to protect *consumers*, not the industry itself. This is perhaps one of the reasons there has been such fierce opposition to the new agency on the part of the industry. *See also*, Kwak, *supra* note 31, at 17.

⁴⁵ Kwak, *supra* note 31, at 12. Kwak builds on the identity economics work of George Akerlof, Rachel Kranton and others. *See infra* note 117.

⁴⁶ Kwak, *supra* note 31, at 12.

⁴⁷ *Id.*

⁴⁸ Consider, for example, the recent criticism of the International Monetary Fund (IMF) for its “group think” and being “overly influenced” and “in awe of” the reputation and expertise in larger nations. *See* Sandrine Rastello, *IMF Economists ‘In Awe’ of Rich Nations Missed Coming Crisis, Audit Finds*, BLOOMBERG, Feb. 9, 2011, <http://www.bloomberg.com/news/2011-02-09/imf-economists-in-awe-of-rich-nations-missed-coming-crisis-audit-finds.html>; Indep. Evaluation Office [IEO] of the Int’l Monetary Fund, *IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004-07* (Jan. 10, 2011), available at <http://www.ieso-imf.org/ieo/pages/IEOPreview.aspx?img==i6nZpr3iSIU%3d&mappingid=DRx2VaDG7EY%3d> (discussing the IMF’s surveillance during the years leading up to the global financial and economic crisis).

⁴⁹ *See* Geoffrey Miller & Gerald Rosenfeld, *Intellectual Hazard: How Conceptual Biases in Complex Organizations Contributed to the Crisis*, 33 HARV. J.L. & PUB. POL’Y 807, 816 (2010).

former Treasury Secretaries,⁵⁰ the very visible revolving doors between the SEC⁵¹ and other financial regulators and industry,⁵² the origin and composition of the Federal Reserve Banks,⁵³ statements by the new

⁵⁰ See, e.g., WILLIAM M. ISAAC, *SENSELESS PANIC: HOW WASHINGTON FAILED AMERICA* ch. 13 (2010) (describing the almost exclusive engagement by Treasury Secretary Paulson with the large financial institutions, including an average of ten calls per day with Goldman Sachs, and the then-President of the New York Federal Reserve Bank, Timothy Geithner, to the virtual exclusion of other participants in the political process who represented major stakes in the financial collapse). Compare Jackie Calmes, *At Treasury, Geithner Struggles to Escape a Past He Never Had*, N.Y. TIMES, Aug. 19, 2010, at B1, <http://www.nytimes.com/2010/08/20/business/20tax.html> (describing how Treasury Secretary Geithner is perceived to be a Wall Street Insider), with Jo Becker & Gretchen Morgenson, *Member and Overseer of Finance Club: Geithner Forged Close Ties to Wall St.*, N.Y. TIMES, Apr. 26, 2009, at A1, <http://www.nytimes.com/2009/04/27/business/27geithner.html?pagewanted=all> (describing Treasury Secretary Geithner’s very close relationship with Wall Street).

⁵¹ See PROJECT ON GOVERNMENT OVERSIGHT, *REVOLVING REGULATORS: SEC FACES ETHIC CHALLENGES WITH REVOLVING DOOR* (May 13, 2011), <http://www.pogo.org/pogo-files/reports/financial-oversight/revolving-regulators/fo-fra-20110513.html#Executive%20Summary> (report), <http://www.pogo.org/tools-and-data/sec-revolving-door-database/> (database) [hereinafter POGO REPORT]; David S. Hilzenrath, *SEC Staff’s ‘Revolving Door’ Prompts Concerns About Agency’s Independence*, WASH. POST, May 13, 2011, http://www.washingtonpost.com/business/economy/sec-staffs-revolving-door-prompts-concerns-about-agencys-independence/2011/05/12/AF9F0FIG_story.html (discussing the POGO report and the danger of docility on the part of the SEC as a result of employee departures for businesses subject to SEC regulation).

⁵² See, e.g., Paula Reid, *Goldman Sachs’ Revolving Door*, CBS NEWS INVESTIGATES (Apr. 7, 2010, 6:26 PM), http://www.cbsnews.com/8301-31727_162-20001981-10391695.html (“A CBS News analysis of the revolving door between Goldman and government reveals at least four dozen former employees, lobbyists or advisors at the highest reaches of power both in Washington and around the world.”); Gabriel Sherman, *Revolver*, N.Y. MAG. (Apr. 10, 2011), <http://nymag.com/news/business/wallstreet/peter-orszag-2011-4/>; Matthew Leising & Shannon D. Harrington, *Goldman Sachs Hires New York Fed’s Lubke, Pointman on Derivatives Reform*, BLOOMBERG (Dec. 15, 2010), <http://www.bloomberg.com/news/print/2010-12-15/goldman-sachs-hires-new-york-fed-s-lubke-pointman-on-derivatives-reform.html>; Jason Linkins, *Peter Orszag’s Move from the White House to Citigroup Should Definitely Trouble You*, THE HUFFINGTON POST (Dec. 16, 2010, 5:46 PM), http://www.huffingtonpost.com/2010/12/16/peter-orszag-white-house-citigroup-troubling_n_797648.html?view=screen; Tom McGinty, *SEC ‘Revolving Door’ Under Review*, WALL ST. J., June 16, 2010, at C1, http://professional.wsj.com/article/SB10001424052748703280004575309061471494980.html?mod=wsjproe_hps_TopMiddleNews; Tom McGinty, *Staffer One Day, Opponent the Next*, WALL ST. J., Apr. 5, 2010, at C1, <http://professional.wsj.com/article/SB10001424052702303450704575160043010579272.html> (describing numerous instances of, and growing concerns about, the movement from regulatory agencies and key government positions to positions within the industries that are directly regulated and affected by those governmental roles). The financial industry is among the top five for hiring congressional and agency staffers. See *Revolving Door: Top Industries*, OPEN SECRETS, <http://www.opensecrets.org/revolving/top.php?display=1> (last visited Apr. 12, 2011).

⁵³ From their inception, the Federal Reserve Banks have been owned by and operated under the strong influence of the member banks. There are interesting parallels in the current environment to that which existed during the original creation of the Federal Reserve System following the Panic of 1907: at that time, progressive reforms were met by a backlash from the industry, leading to a much less radical set of reforms than outrage generated by the Panic would have created. See ROBERT F. BRUNER & SEAN D. CARR, *THE PANIC OF 1907: LESSONS LEARNED FROM THE MARKET’S PERFECT STORM* 141–50 (2007) (discussing the aftermath of

Chairman of the House Financial Services Committee,⁵⁴ the opposition by the Treasury Department and other senior members of the Obama Administration to the imposition of concentration limits on an unstable and publicly subsidized industry,⁵⁵ and the inexplicable disregard of powerful, contrarian economic studies by the Treasury Department that favors allowing continued growth by gargantuan, high-risk financial conglomerates.⁵⁶ Political spending by the nation's largest banks alone dwarfs the lobbying efforts of most other sectors.⁵⁷ However, the spending influence does not end there: deep capture seems to be nourished by collateral institutional interests.⁵⁸ For example, the "deregulatory" position of the financial industry has been heavily supported with allied lobbying by groups such as the U.S. Chamber of Commerce.⁵⁹

the Panic, which led to the eventual enactment of the Federal Reserve Act of 1913). The Congress that enacted the Dodd–Frank Act appeared set, particularly in the Senate, to strip away many of the powers of the Federal Reserve System. Although the ultimate result was to eliminate the role of member banks in electing the individual reserve bank presidents. *See* Dodd–Frank Act, H.R. 4173, § 1107. However, the Federal Reserve System has in fact come out much stronger than ever before, and its membership will likely continue to promote very strong industry influence over its actions. *But see* Marc Labonte, *The Dodd–Frank Wall Street Reform and Consumer Protection Act: Systematic Risk and the Federal Reserve*, CONGRESSIONAL RESEARCH SERVICE (Aug. 27, 2010), available at <http://www.llsdc.org/attachments/files/240/CRS-R41384.pdf> ("Although the act could be portrayed as an expansion of the Fed's powers, the legislation also strips the Fed of certain powers . . .").

⁵⁴ *See infra* text accompanying note 63.

⁵⁵ *See, e.g.*, Ryan Grim & Shahien Nasiripour, *Senate Votes for Wall Street; Megabanks to Remain Behemoths*, THE HUFFINGTON POST, (June 17, 2010, 4:36 PM), http://www.huffingtonpost.com/2010/05/06/senate-votes-for-wall-str_n_567063.html (describing opposition by the Obama Administration to an amendment that would have required megabanks to be broken down in size).

⁵⁶ *See, e.g.*, Simon Johnson, *The Financial Stability Oversight Council Defers to Big Banks*, BASELINE SCENARIO (Jan. 20, 2011, 8:56 AM), http://baselinescenario.com/2011/01/20/the-financial-stability-oversight-council-defers-to-big-banks/?utm_source=feedburner&utm_medium=email&utm_campaign=feed%3A+BaselineScenario+%28The+Baseline+Scenario%29 [hereinafter Johnson, *Financial Stability*]; Simon Johnson, *Tunnel Vision, or Worse, From Banking Regulators*, N.Y. TIMES ECONOMIX BLOG (Jan. 20, 2010, 5:00 AM), <http://economix.blogs.nytimes.com/2011/01/20/tunnel-vision-or-worse-from-banking-regulators/> [hereinafter Johnson, *Tunnel Vision*]; Shahien Nasiripour, *Trillion-Dollar Banks Could Get Bigger Under Financial Overhaul Law*, THE HUFFINGTON POST (Jan. 19, 2011, 7:28 AM), http://www.huffingtonpost.com/2011/01/18/trilliondollar-banks-could-get-bigger_n_810747.html (alleging that the Treasury Department has neglected important economic studies and manipulated powerful contrary data in favor of the position of large financial institutions).

⁵⁷ *See, e.g.*, AMERICANS FOR FINANCIAL REFORM, *Wall Street Influence, by the Numbers* (May 14, 2010), <http://ourfinancialsecurity.org/2010/05/wall-street-influence-by-the-numbers/>; *see also* Americans for Financial Reform, *Post Passage Lobbying Statistics* (Aug. 2, 2010, 11:19 AM), <http://ourfinancialsecurity.org/2010/08/post-passage-lobbying-statistics/> (describing the extent of lobbying by various segments of the financial services industry and the related news reports).

⁵⁸ *See* Hanson & Yosifon, *supra* note 36, at 219–33 (discussing the development of extensive institutional, political, and cultural support for corporate interests).

⁵⁹ *See, e.g.*, Eric Lipton, Mike McIntyre & Don Van Natta, Jr., *Large Donations Aid U.S. Chamber in Election Drive*, N.Y. TIMES, Oct. 22, 2010, at A1, http://www.nytimes.com/2010/10/22/us/politics/22chamber.html?_r=2&pagewanted=all (describing the extensive mutual fi-

Furthermore, the particular processes involved in financial regulation suggest that the opportunity for capture might be greater than ever in financial services, particularly in relation to large-scale financial institutions, which have very deep engagements with the regulators. Banks are not only subject to rules that govern their structure, operations, and activities in advance but they are also subject to *ongoing monitoring* in a manner that involves broad regulatory discretion.⁶⁰ One need not be totally cynical⁶¹ to recognize that the highly discretionary and continuous nature of bank regulation is dependent on and nurtures an environment in which the regulators and the regulated are engaged in such close, daily relationships as to nurture intense mutual empathy—perhaps even a kind of “transference”⁶²—between the two sides. This codependence might seem inevitably to lead to a mutual identification of interests and a manifestation of deep, if not surface, capture. Worse, it might even lead to the kind of lop-sided relationship baldly asserted by incoming House Financial Services Committee Chairman Spencer Bachus in remarks to the Alabama newspaper Birmingham News: “the regulators are there to serve the banks.”⁶³ In other words, bank supervision provides even more opportunity for the kind of influence that leads to capture than traditional regulation itself.⁶⁴

Yet this codependence is a fact of political life. In the face of such reality, instead of trying to eliminate the existence of ideology and attempts to influence, it would be more effective to create, strengthen, and

nancing support between the Chamber of Commerce, and major financiers and financial institutions, and the anti-financial regulatory stance of the Chamber).

⁶⁰ Cf. Christoph Knill & Andrea Lenschow, *Modes of Regulation in the Governance of the European Union: Towards a Comprehensive Evaluation*, in THE POLITICS OF REGULATION: INSTITUTIONS AND REGULATORY REFORMS FOR AN AGE OF GOVERNANCE 218, 231 (Jacint Jordana & David Levi-Faur eds., 2004) (“Generally, capture is more likely in cases of highly detailed regulation. In such constellations, regulators require a large amount of information in order to carry out their task. As the regulated industry itself is the best source of such information, this gives the industry a degree of leverage over regulatory arrangements which, in the extreme case, might lead to capture.”).

⁶¹ For an example of this cynicism, see Steve Randy Waldman, *Discretion and Financial Regulation*, INTERFLUIDITY (Nov. 16, 2009, 4:40 AM), <http://www.interfluidity.com/v2/215.html> (“An enduring truth about financial regulation is this: [g]iven the discretion to do so, financial regulators will always do the wrong thing.”). Waldman’s lugubrious view is based on the political and resource pressures that drive the institutional dynamics of regulator-industry interaction. See *id.*

⁶² This is a metaphorical reference to the Freudian notion that in psychoanalysis a patient redirects feelings for an important person to the analyst.

⁶³ Mary Orndorff, *Spencer Bachus Finally Gets His Chairmanship*, BIRMINGHAM NEWS (Dec. 9, 2010, 11:32 AM), http://blog.al.com/sweethome/2010/12/spencer_bachus_finally_gets_hi.html (“In Washington, the view is that the banks are to be regulated, and my view is that Washington and the regulators are there to serve the banks.”). The article goes on to state that “[Chairman Bachus] later clarified his comment to say that regulators should set the parameters in which banks operate but not micromanage them.” *Id.*

⁶⁴ See *id.*

enhance countervailing checks and balances. We must do something to try to counteract the massive dominance of the financial industry in our public life.

II. CREATIVE TURBULENCE AND BALANCING STRUCTURES

One technique for promoting effective and rejuvenating policy in the complex financial world is to promote and maintain a constant, creative, and constructive turbulence through transparency, debate, and deliberation. We do not always do this very well: we tend to be least successful when our theories of government are themselves captured by simplistic doctrines purporting to explain policy results that appear to favor one interest group over another as capture,⁶⁵ or using dichotomous juxtapositions that treat regulatory failure and market failure as mutually exclusive.⁶⁶ Yet our inveterate frailty and frequent failure to achieve good results does not mean we should abandon the Madisonian ambition⁶⁷ of striving to structure a framework conducive to the common good and channeling the process of policy formulation toward better social results.

We gain a better understanding of the problems of financial regulation by treating attempts at capture as an expected, and in the right context sometimes even healthy,⁶⁸ tactic of policy participants that are channeled through institutions and practices designed to balance their impact. In this respect, it can be helpful to adopt a complexity view of the process of policy formation and the techniques for promoting the best policy over time.⁶⁹ From a complexity perspective, policy formation is a continuous process, not a static end result.⁷⁰

⁶⁵ See Hanson & Yosifon, *supra* note 36, at 177–79 (discussing how we “[g]et[] ourselves [w]rong” by overestimating the extent to which a person’s behavior is caused by internal, dispositional factors and underestimating the influence of the situation).

⁶⁶ See Joseph Heath, *An Adversarial Ethic for Business or When Sun-Tzu Met the Stakeholder*, 72 J. BUS. ETHICS 359, 371 (2007) (describing the business tendency to create market failures and oppose regulations that aim to correct those market failures).

⁶⁷ THE FEDERALIST NO. 10 (James Madison) (discussing the challenge for a republican government in addressing the problem of “factions,” groups of citizens united by a common passion or interest that is adverse to the interests or rights of the community).

⁶⁸ SUSAN E. WOODWARD, REGULATORY CAPTURE AT THE U.S. SECURITIES AND EXCHANGE COMMISSION 18 (1998), available at http://www.sandhillecon.com/pdf/Regulatory_Capture.pdf (last visited Sept. 7, 2011).

⁶⁹ See Lawrence G. Baxter, *Adaptive Regulation in the Amoral Bazaar*, 128 S.A. L. J. 253, 257–64 (2011) (defining complexity theory).

⁷⁰ See, e.g., Whitt, *supra* note 25, at 499 (describing policy formation as an evolving process without a permanent outcome); Richard S. Whitt & Stephen J. Schultze, *The New “Emergence Economics” of Innovation and Growth, and What it Means for Communications Policy*, 7 J. ON TELECOMM. & HIGH TECH. LAW 217, 304–06 (2009) (describing the need for adaptive regulation in the rapidly evolving field of telecommunications). A similar approach applies to the world of financial services—for the author’s attempt to apply complexity theory to general regulatory technique, see Baxter, *Adaptive Regulation*, *supra* note 69 (outlining an

One of the most perplexing challenges of regulatory policy formation is reconciling the important disposition toward other regulatory, or “public”⁷¹ action with the necessity of informed policy. One can hardly demand that regulators be free of industrial influence.⁷² It would be rash, for example, to insist that only totally impartial outsiders design and set the rules for such complicated infrastructures as derivatives exchanges, uninformed by the heavy input of industry participants. The derivatives industry itself should have deep influence on this process. At the same time, how do we prevent the regulators from being overwhelmed by high-paid lobbyists and liaison organizations whose purpose is to aggressively persuade the regulators that their organization’s point of view is the only correct one? How do we encourage independent thinking on the part of regulators? We cannot rely on the cacophony of competing, often one-sided, heavily funded, and partisan comments alone.

Some solutions might actually be more traditional than narrow capture models of economic analysis, using stylized frameworks,⁷³ would suggest. Like any complex process, stability depends on the interaction of a diverse range of forces, many of which we have instinctively nurtured for decades, even centuries.⁷⁴ Unfortunately, resilient solutions to each problem tend toward obsolescence as competing agents learn how to game the structures and processes.⁷⁵ Therefore, constant adaptation is

approach to adaptive regulation and citing numerous fuller discussions). For a good general introduction to complexity theory and the law, see J.B. Ruhl, *Law’s Complexity: A Primer*, 24 GA. ST. U. L. REV. 885 (2008).

⁷¹ For a much more sophisticated analysis of the distinction between public and private action, and between general and special interests, see Levine & Forrence, *supra* note 5, at 174–82.

⁷² See, e.g., WOODWARD, *supra* note 68, at 1–2 (discussing how the complexity of the securities industry makes it more effective to have a regulator that is already familiar with these complexities).

⁷³ On the narrowness of stylized economic analytical models, see for example, David Colander, *Complexity and the History of Economic Thought* 3 (Middlebury Coll., Dept. of Econ., Working Paper No. 08-04, March 2008), available at <http://sandcat.middlebury.edu/econ/repec/mdl/ancoec/0804.pdf> (“All economists know the economy is complex—very complex. That is one of the reasons why society needs economists—to try to make that complexity somewhat simpler and more understandable. In that endeavor conventional economics has seen itself as a conventional science; it takes complexity and simplifies it by finding a formal structural analytic model—an equation, or set of equations—that fits the data. The model is then tested by comparing the predictions of the model with the empirical data, using formal statistical techniques. These models are generally linear and static, since they are only ones with unique, deterministic solutions. To test the models classical statistical tests are generally used.”).

⁷⁴ See, e.g., *infra* notes 81–94 and accompanying text.

⁷⁵ See Baxter, *Adaptive Regulation*, *supra* note 69, at 12–16 (“For every ‘command’ there is likely to be a corresponding reaction that creates yet a new situation to which the ‘commander’ must react. One-way direction becomes ineffective.”).

needed to sustain a process that seeks to promote the greatest social welfare.⁷⁶

Combining various dimensions of reform is probably a prerequisite to achieving an adaptive policy, although the combination would be difficult to achieve in a partisan environment. There is no simple formula. A real solution would have to be complex, multidimensional, and would require a more serious attitude toward regulation than we have culturally been willing to display.⁷⁷ The Dodd–Frank Act⁷⁸ addressed a few dimensions, but the regulatory reform agenda has still been left with gaping omissions.⁷⁹

A. *Important Methods for Reform*

On the one hand, we should accept the obvious: all agents, including industry, consumers, and taxpayers will have influence. On the other hand, we should try to avoid disproportionate or undue influence by any one sector over the others, while recognizing that all agents will try to impose that influence.⁸⁰ Essentially, we should seek to establish and preserve a system that is resilient over time. We should seek a system that ebbs and flows, but does not swing so far in one direction that it ends up excluding or disregarding other legitimate interests. In addition, we should seek a system that leads to an end result of real capture. Perhaps, in an age of “corporatocracy,” it is already too late for us to succeed. However, assuming reform is still worth trying, the following dimensions seem most relevant.

⁷⁶ See Whitt, *supra* note 25, at 495–99 (advocating adaptive policymaking).

⁷⁷ For a discussion of the failure to display this serious attitude towards regulation, see Lawrence Baxter, *Capture*, THE PARETO COMMONS, May 26, 2010, <http://www.theparetocommons.com/2010/05/capture/> (“We have to figure out ways to modernize regulation from the ground up. This will involve better understanding of the regulatory function through teaching at our higher institutions of learning. It will involve the courage to restructure agencies when changed economic conditions so demand (a courage that has failed Congress in the current financial reforms). It will involve developing incentives (not always financial) for the ‘best and brightest’ and highly skilled young people to go into agencies to help develop the fire-power required for effective regulation of powerful industries—and earn those industries’ respect. Modernization would also develop better firewalls between regulators and the regulated. And we need to figure out how to extend a proper social respect for the profession of regulation. Such respect has existed in America from time to time—for the SEC for example, and until recently for the Fed, which were once considered to be elite agencies where graduates clamored to find positions.”).

⁷⁸ Dodd–Frank Act, H.R. 4173, § 1011.

⁷⁹ See, e.g., Kim Krawiec, *Dodd–Frank: “I’ll Have the Meatless Entrée, Please”*, THE PARETO COMMONS, July 20, 2011, <http://www.theparetocommons.com/2010/07/Dodd-Frank-“I’ll-have-the-meatless-entree-please”/> (discussing how the Dodd–Frank Act failed to satisfactorily address issues relating to the financial crisis).

⁸⁰ See *infra* notes 87–99 and accompanying text.

B. *Tripartism*

Robert Dahl, in his theory of economic democracy, advocated extending the principles of participatory democracy into the realm of economic activity as a means of maintaining a balance within corporate capitalism between liberty and equality.⁸¹ The notion is relevant for current purposes because one of the factors that creates a climate ripe for capture is the exclusion of important stakeholders, such as consumers, taxpayers, smaller financial institutions, and other diffuse interests from the policymaking process.⁸² These large institutions have the financial and political power to secure preferential access to the policymaking process.⁸³ Large corporations can, and in the case of the financial industry do, distort the democratic process through their lobbying power, disproportionate access to high-level government decision-makers, and the government’s recruitment directly from corporations’ executive layers.⁸⁴ Charles Lindblom described this phenomenon as “the privileged position of business.”⁸⁵

In an attempt to restore balance to the process, scholars have advocated empowering or strengthening the weaker interest groups within the “iron triangle” of policy making,⁸⁶ so that they can act as a counterweight to these powerful forces, thereby reducing the likelihood of capture.⁸⁷ Ian Ayres and John Braithwaite propose a model of “tripartism,” defining this model as a “regulatory policy that fosters the participation of [public interest groups] in the regulatory process.”⁸⁸ Under the tripartism model, those groups would have full access to all the information available to the regulator, a “seat at the negotiating table . . . when deals are done,” and “the same standing to sue or prosecute under the regulatory statute as the regulator.”⁸⁹

⁸¹ ROBERT A. DAHL, A PREFACE TO ECONOMIC DEMOCRACY 91–110 (1985).

⁸² *See id.*

⁸³ *See* CHARLES E. LINDBLOM, POLITICS AND MARKETS: THE WORLD’S POLITICAL-ECONOMIC SYSTEMS 170–88 (1977).

⁸⁴ *See id.*

⁸⁵ *Id.* at 170.

⁸⁶ The term “iron triangle” is used to refer to the political interaction between “three key participants in a clearly delineated area of policy-making: the Federal bureaucracy, the key committees and members of Congress, and the private interest.” GORDON ADAMS, THE IRON TRIANGLE: THE POLITICS OF DEFENSE CONTRACTING 24 (Nancy Sokoloff ed., 1981).

⁸⁷ IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE ch. 3 (1992) [hereinafter AYRES & BRAITHWAITE, RESPONSIVE REGULATION]; Ian Ayres & John Braithwaite, *Tripartism: Regulatory Capture and Empowerment*, 16 LAW & SOC. INQUIRY 435, 439 (1991) [hereinafter Ayres & Braithwaite, *Tripartism*] (proposing the empowerment of private interest groups to prevent capture).

⁸⁸ AYRES & BRAITHWAITE, RESPONSIVE REGULATION, *supra* note 87, at ch. 3; Ayres & Braithwaite, *Tripartism*, *supra* note 87, at 441.

⁸⁹ *Id.* For imaginative examples of how tripartism might be applied in financial services regulation, see for example, Robert F. Weber, *New Governance, Financial Regulation, and*

In providing for a continued role on the part of state attorneys general in the enforcement of consumer protection laws against financial institutions, Dodd–Frank has made a step toward something analogous to tripartism.⁹⁰ However, this preservation of state enforcement power is still dependent on state action, and it is confined to consumer protection issues.⁹¹ There are also organized interest groups for various and diverse financial interests,⁹² but they are fragmented and far outgunned by the spending power of the large financial organizations.⁹³ Without greater funding for such groups and a revival of the “private attorney general,” a private citizen or lawyer acting on behalf of the public interest,⁹⁴ it is unlikely that individuals or smaller organizations will be able to effectively understand and act upon fuller access to information, let alone influence unsympathetic regulators or successfully counterbalance the large-scale industry influence in ensuing legal battles.

C. *Limiting the Influence of the Industry Players*

One obvious way to contain the degree of influence of financial institutions is to limit their size and power.⁹⁵ The large financial institutions are in effect an oligarchy possessed of unprecedented power.⁹⁶

Numerous commentators, and even very senior regulators, have proposed limitations on the size and complexity of financial institutions, or even that they be broken into smaller components.⁹⁷ Yet, all of these

Challenges to Legitimacy: The Example of the Internal Models Approach to Capital Adequacy Regulation, 62 ADMIN. L. REV. 783, 842–45 (2010) (discussing extending and enhancing stakeholder engagement in setting bank capital standards); Robert F. Weber, *Combating the Teleological Drift of Life Insurance Solvency Regulation: The Case for a Meta-Risk Management Approach to Principles-Based Reserving* 8 BERKELEY. BUS. L.J., 35, 109–15 (2011) (discussing a similar extension of stakeholder involvement in setting insurance solvency reserves).

⁹⁰ See CONSUMER FEDERATION OF AMERICA, THE DODD–FRANK CT: HOW STATES AND THE CONSUMER FINANCIAL PROTECTION BUREAU WILL WORK TOGETHER TO PROTECT CONSUMERS, available at http://www.consumerfed.org/pdfs/Fact%20Sheet%20CFPB%20and%20the%20States%20Nov%202010%20_3_.pdf (highlighting the power of states’ attorneys general to bring actions against national banks and federal savings associations in order to enforce consumer protection provisions in the Act, notwithstanding the creation of a new federal enforcement agency); see also Dodd–Frank Act, H.R. 4173, § 1011 (establishing a new federal enforcement agency—Consumer Financial Protection Bureau).

⁹¹ See Dodd–Frank Act, H.R. 4173, § 1011.

⁹² For an example of one of the many interest groups in the financial industry, see THE CENTER FOR RESPONSIBLE LENDING, <http://www.responsiblelending.org/> (last visited Apr. 12, 2011).

⁹³ See *supra* note 57 and accompanying text.

⁹⁴ See, e.g., William Rubinstein, *On What a “Private Attorney General” Is—And Why it Matters*, 57 VAND. L. REV. 2129 (2004) (describing the forms, history, and development of the concept of private attorney general).

⁹⁵ See, e.g., *infra* note 97 and accompanying text.

⁹⁶ See JOHNSON & KWAK, *supra* note 39, at ch. 7.

⁹⁷ For a convenient review of the large number of experts who have advocated breaking up the banks, see, for example, *Virtually All Independent Financial Experts Say That the Size*

proposals have been to no avail because of fierce industry and administration opposition.⁹⁸ Dodd–Frank did expand the concentration cap on financial institutions,⁹⁹ but so far the Financial Stability Oversight Council and the Treasury Department show little inclination to give meaning to this limit.¹⁰⁰

D. Properly Structured and Resourced Agencies

Given that Dodd–Frank¹⁰¹ failed to implement broad-scale regulatory consolidation, it seems inevitable that the US financial system will continue to be governed by a complicated array of regulators. Indeed, what little consolidation there was appears to have headed in precisely the *wrong* direction. As discussed earlier, the OTS and OCC, which were consolidated by Dodd–Frank under the OCC,¹⁰² have tended to be industry cheerleaders, not regulators.¹⁰³ This is not surprising given their conflicting missions as both chartering and regulating agencies. The observation by columnist Joe Nocera that the OCC “is a coddler, a protector, an outright enabler of the institutions it oversees,”¹⁰⁴ while perhaps hyperbolic, has some historical support. A case could be made for *sepa-*

of Big Banks is Hurting the Economy, WASHINGTON’S BLOG (Jan. 11, 2011, 7:57 PM), <http://www.washingtonsblog.com/2011/01/virtually-all-of-leading-financial.html>. This view is shared by the governor of the Bank of England and across the political spectrum. See Johnson, *Financial Stability*, *supra* note 45; see also Lawrence Baxter, *Financial Macrophilia and Shrinking the Banks*, THE PARETO COMMONS (Sept. 24, 2010), <http://www.theparetocommons.com/2010/09/financial-macrophilia-and-shrinking-the-banks/> (providing a further link to an important Bank of England study that indicates that the large financial institutions may be detrimental to economic growth); Arnold Kling, *Break Up the Banks*, NATIONAL REVIEW (Mar. 31, 2010, 4:00 AM), <http://www.nationalreview.com/articles/229442/break-banks/arnold-kling> (expressing a conservative viewpoint and arguing that “[b]ig banks are bad for free markets”); Jonathan R. Macey & James P. Holdcroft, Jr., *Failure is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L. J. 1368 (2011) (proposing a radical reduction in the permitted size of financial institutions).

⁹⁸ During the past two years the Chairman of the Board of Governors, Treasury Secretary, and chief executive officers of very large financial institutions have made dozens of speeches vehemently opposing the notion of limiting the size of financial companies. For discussion of many of these statements, see *supra* note 97.

⁹⁹ Dodd–Frank Act, H.R. 4173, § 622 (imposing a cap on consolidated, risk-weighted liabilities of a financial institution comprising “10 percent of the aggregate consolidated liabilities of all financial companies”). The liability cap, initially imposed in the Riegle–Neal Act of 1994, was formerly limited to ten percent of insured deposits. Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328; 108 Stat. 2338 (codified as amended at 12 U.S.C. § 1811 (2006)).

¹⁰⁰ See Johnson, *Tunnel Vision*, *supra* note 56, at 3 (commenting on the neglect by the Treasury Department of the economic evidence in support of breaking up the banks); Nasiripour, *supra* note 56 (noting that the concentration limits themselves do not apply to all banks).

¹⁰¹ See Dodd–Frank Act, H.R. 4173.

¹⁰² *Id.* tit. III, §§ 311–327.

¹⁰³ See *supra* text accompanying notes 14–18.

¹⁰⁴ Joe Nocera, Op-Ed, *Letting the Banks Off the Hook*, N.Y. TIMES, Apr. 18, 2011, <http://www.nytimes.com/2011/04/19/opinion/19nocera.html>.

rating the regulatory from the chartering functions, not *consolidating* them further.

The existence of the Financial Stability Oversight Committee and the Federal Reserve as means for addressing the systemic and other risks that large financial institutions pose is a promising advance.¹⁰⁵ The Federal Reserve Banks have also been partly reformed.¹⁰⁶ Nevertheless, concerns linger about the industry's degree of influence over, and blatantly privileged access to, senior regulators.¹⁰⁷ Given these concerns, it is hardly surprising that many support the elimination of the Federal Reserve system, which is perceived as a secretive, pro-industry agency.¹⁰⁸ Recent efforts to promote greater transparency in the Federal Reserve's operations, such as audits and delayed disclosures regarding the provision of financial assistance to ailing institutions,¹⁰⁹ help promote an accountability that might reduce the danger of undue influence, inappropriate allocations of public support, or decisions that are just plain wrong.

In the meantime, the problem of regulatory capture is exacerbated by poor regulatory design. Reform of the financial regulatory structure remains far from complete.¹¹⁰

E. *Better Institutional Roles for Regulators*

We do not take regulation very seriously in the United States, nor do we treat regulators very well.¹¹¹ Professors of regulation are hard to find in the US. Nor do we accord regulators much status. Unlike the UK, we do not give them knighthoods. They do not get paid much in the

¹⁰⁵ See Dodd–Frank Act, H.R. 4173, tit. I.

¹⁰⁶ *Id.* § 1107 (eliminating the voting power of member-bank representatives on the board—Class A directors—from the elections of individual Federal Reserve bank presidents).

¹⁰⁷ See *supra* note 50.

¹⁰⁸ See, e.g., RON PAUL, *END THE FED*, ch. 10 (2009) (arguing for the elimination of the Federal Reserve). Ron Paul is a current presidential candidate and now heads the Domestic Monetary Policy Subcommittee of the House Financial Services Committee. *Paul Appointed Chairman of Domestic Monetary Policy Subcommittee*, Dec. 9, 2010, http://paul.house.gov/index.php?catid=32:2010-press-releases&id=1806:paul-appointed-chairman-of-domestic-monetary-policy-subcommittee&option=com_content&view=article (last visited Apr.12, 2011).

¹⁰⁹ See Dodd–Frank Act, H.R. 4173, § 1102 (providing for audits of extensions of credit facilities by the Federal Reserve).

¹¹⁰ For extensive thoughts on better regulatory design to avoid industry capture, see, for example, Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Regulatory Design*, 89 TEX. L. REV. 15(2010). See also DAVID E. LEWIS, *PRESIDENTS AND THE POLITICS OF AGENCY DESIGN: POLITICAL INSULATION IN THE UNITED STATES GOVERNMENT BUREAUCRACY, 1946–1997* (Stan. Univ. Press 2003) (describing efforts to use agency design to avoid political capture).

¹¹¹ See *supra* note 82 and accompanying text (discussing the lack of serious attitude towards regulation in the United States).

UK, but at least they are considered important.¹¹² Instead, we pull them up in front of Congress and beat up on them, so they go and get highly paid jobs in the private sector.¹¹³

Yet, we need regulators who really understand the businesses that they are regulating, and have the moral authority to persuade and, where necessary, to coerce, those which they regulate. In order to attract regulators from the private sector we will have to pay them relatively high salaries,¹¹⁴ even though we already pay them more than most federal employees (at least those employed at senior levels in the financial agencies).¹¹⁵ Yet it is doubtful that public sector salaries could ever compete with those in the private financial sector, at least for equivalent skills.

There might, however, be other ways to address the aspirations of publicly minded experts. For one thing, elite, highly skilled personnel are not always the highest paid.¹¹⁶ In addition, Professors Akerlof and Kranton have demonstrated that people are incentivized by many values other than mere monetary compensation.¹¹⁷ For example, Professor Carpenter has demonstrated how reputation and prestige have enhanced the quality of the Food and Drug Administration.¹¹⁸ Similarly, the SEC

¹¹² See Natalie Holt, *Regulator's Salaries Leap by 22% Over Five Years*, MONEY MARKETING (Mar. 10, 2011, 9:45 AM), <http://www.moneymarketing.co.uk/regulation/regulators-salaries-leap-by-22-over-five-years/1027508.article>. In 2010, the lowest level UK regulators made £34,702 per year and supervisors made £48,263 per year. See Kern Alexander, *UK Corporate Governance and Banking Regulation: The Regulator's Role as Stakeholder*, 33 STETSON L. REV. 991, 993 (2004) (describing the role of UK regulators in British corporate governance).

¹¹³ See R.A. *You Get What You Pay For*, THE ECONOMIST (Sept. 19, 2010, 3:08 PM), <http://www.economist.com/blogs/freeexchange/2010/09/regulation> (discussing how many regulators go into the private sector for higher compensation).

¹¹⁴ See *id.*

¹¹⁵ Senior executive service (SES) officers are exempt from the federal pay grades. See *Federal Pay*, PARTNERSHIP FOR PUBLIC SERVICE, <http://www.makingthedifference.org/federal-benefits/federalpay.shtml> (last visited Sept. 7, 2011). The banking agencies tend to have higher pay-for-performance scales than the average federal agency. See, e.g., *Careers at the OCC, Salaries*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, <http://www.occ.treas.gov/about/careers/salaries.html> (last visited Aug. 26, 2011); *Careers at the Federal Reserve, Salaries*, FEDERAL RESERVE BOARD, <http://www.federalreserve.gov/careers/salary.htm> (last visited Aug. 26, 2011).

¹¹⁶ See, e.g., Baxter, *Capture*, *supra* note 77 (discussing how the U.S. Navy Judge Advocate General's (JAG) Corps and Navy Strike Fighter Tactics Instructor (NSFTI) programs employ highly-skilled employees, but pay them significantly less than in the private sector).

¹¹⁷ GEORGE A. AKERLOF & RACHEL E. KRANTON, *IDENTITY ECONOMICS: HOW OUR IDENTITIES SHAPE OUR WORK, WAGES, AND WELL-BEING* 48–51 (Princeton Univ. Press 2010). Many factors other than salary also influence performance in private firms. Companies often excel competitively because they are driven by superior employee culture, even when the salaries are not competitive with other companies. See *id.*

¹¹⁸ See CARPENTER, *REPUTATION AND POWER*, *supra* note 6.

could reduce its susceptibility to industry capture through leadership and prestige.¹¹⁹

F. *Transference, Appearances, and Disclosures*

Louis Brandeis' famous statement that "sunlight is said to be the best of disinfectants"¹²⁰ remains as valid today as it ever was. We have made great strides, albeit not always in a straight line, toward rendering the regulatory process more transparent.¹²¹ Bank supervision requires detailed inspection, observation and examination on the part of regulatory officials. Yet, even under the glare of modern publicity, this intense interaction between financial regulators and the industry carries with it a constant danger of "transference":¹²² regulators begin to think like the regulated and in the process, lose their critical detachment.¹²³ Indeed, transference is the reason that dictatorial regimes rotate their prison guards—lest these guards begin to develop too great a sympathy for their prisoners. The French have a saying that captures the problem: "to understand all is to forgive all."

Currently, regulators spend years at the same large institutions, often working in offices on the very same floors as the offices of those whom they regulate.¹²⁴ One illustration of this closeness can be seen by observing the Treasury Secretary whom continually seems to talk to the

¹¹⁹ See, e.g., Lawrence Baxter, *Capture III: Authority and Prestige*, THE PARETO COMMONS (June 17, 2010), <http://www.theparetocommons.com/2010/06/capture-iii-authority-and-prestige/>. At the same time, it would be important to measure this prestige against *public service*, and not by reference to the large compensation to be earned in the financial industry itself; otherwise the danger of "cultural capture" would quickly displace any benefits to be gained from such prestige. See *supra* text and accompanying notes 44–48.

¹²⁰ Louis Brandeis, *What Publicity Can Do*, HARPER'S WEEKLY, Dec. 20, 1913, available at <http://www.louisville.edu/library/collections/brandeis/node/196>.

¹²¹ See, e.g., Dodd–Frank Act, H.R. 4173.

¹²² See *supra* note 62.

¹²³ See Philip D. Broughton, *New Rules of Engagement for Banks and Regulators* (Jan. 5, 2011), <http://philipdelvesbroughton.com/2011/01/05/new-rules-of-engagement-for-banks-and-regulators/> ("Critics argue, however, that too close a relationship can lead to a blurring of the lines between regulator and regulated.").

¹²⁴ See JOHN KEEL, REP. NO. 09-049, AN AUDIT REPORT ON THE DEP'T OF SAVINGS & MORTGAGE LENDING (2009), available at <http://www.sao.state.tx.us/Reports/report.cfm/report/09-049> ("The [Texas] Department [of Savings and Mortgage Lending] does not consistently rotate the examiners or the examiners in charge when it performs examinations of the institutions it regulates. Fifteen (75 percent) of 20 institutions were examined by the same examiners for at least three consecutive years."); see also Gillian G.H. Garcia, *Failing Prompt Corrective Action*, 11 J. BANK REG. 171, 189 n.40 (2010) (citing a report by the Treasury Department Office of the Inspector General noting the failure to rotate regulators of a failed bank). Practice might vary at the FDIC, where the chairman has emphasized the importance of rotating examiners. See, e.g., Dan Langdon, *From the Examiner's Desk . . . The FDIC's Relationship Manager Program: A Win/Win Situation*, FEDERAL DEPOSIT INSURANCE CORP., http://www.fdic.gov/regulations/examinations/supervisory/insights/siwin05/examiners_desk.html (last updated Dec. 6, 2005) ("Most banks are examined on a rotating basis by the FDIC. . .").

same CEOs and did so, as President of the New York Federal Reserve Bank, long before ascending to his current post.¹²⁵ We have to consider ways to insert rotation in the deployment of supervisors and to promote broader consulting by senior officials.¹²⁶ It seems, for example, that certain prominent financial institutions are over-represented at the highest levels of the executive.¹²⁷

G. *The Revolving Door*

As both our need for expert regulators and the skill of regulators increase, the doors between regulators and the industry will spin faster.¹²⁸ If we are to engage in technical regulation at all, this is not only unavoidable, but sometimes even desirable. But revolving doors are also dangerous: many current examples vividly highlight the unseemly appearance, if not reality, of an incestuous relationship between regulators and industry that must surely risk fostering an improper influence of industry over the regulators.¹²⁹

Formal ethical rules barring direct engagement on matters where regulators have already been on the industry side can help to reduce this improper influence. Such rules, however, are inevitably limited in their effect: as such rules become more absolute, the career paths for incoming or outgoing regulators would become less valuable because part of the value former regulators bring to private industry is that their privileged access to, and networks within, the agencies they leave. Here too appearances are extremely important. Prudence suggests that former regulators should simply avoid involvement with a matter that their new employer is dealing with, if that regulator was involved in developing or applying the policy or decision in question. Yet it is doubtful that many employers, public or private, could honestly claim that they rigorously uphold this firewall. There are various ways in which the detrimental effects of the revolving door could be reduced, ranging from outright exclusion of the employee from subsequent agency access to requiring post-employment statements to be made publicly available.¹³⁰

¹²⁵ See *supra* note 50 (referencing descriptions of continual and intense interactions between the Treasury Secretary and powerful industry executives).

¹²⁶ See Eleanor Bloxham, *The SEC Still Needs to Escape Regulatory Capture. Here's How*, CNN MONEY, Jul. 30, 2010, http://money.cnn.com/2010/07/30/markets/SEC_regulatory_capture.fortune/index.htm (stating that regulators fail when they make decisions based only upon the input of those whom they regulate).

¹²⁷ See *supra* notes 51–52 and accompanying text.

¹²⁸ See *id.*

¹²⁹ See *supra* notes 51–52 and accompanying text.

¹³⁰ For possible reforms, see, for example, POGO REPORT and *supra* note 51, at 28–31 (identifying a series of proposed reforms as the problem of revolving door relates to the SEC and other financial regulatory agencies).

Perhaps even more important than ethical rules is an ethical culture in which former regulators, or regulators recently hired from the industry, would regard their involvement on such a matter as simply wrong.¹³¹ Yet this ethical culture is not one that we have actively promoted or celebrated for some time.¹³²

H. *Independent Reviews*

The venerable notion of checks and balances has not lost its value.¹³³ Congressional hearings, when not abused, help promote accountability for the implementation of regulations.¹³⁴ Inspectors General perform a valuable (and lately much needed) role in unearthing mistakes and inappropriate conduct by agencies and their decision makers.¹³⁵ Judicial review operates as a powerful check on errant rules and orders.¹³⁶ However, the focus by such external reviewers, applying such ex-post reviews, is largely on the possibility of unlawfulness, rather than on whether the regulatory actions taken are the most *optimal*.¹³⁷ Scholars have also made interesting proposals for greater ex ante review by the Office of Information and Regulatory Affairs (OIRA) within the Administration.¹³⁸ On the other hand, this proposal has also been rejected because it might actually *increase* the danger of capture given the fact that OIRA tends to be concerned with matters most important to the Presi-

¹³¹ See, e.g., Kevin T. Jackson, *The Scandal Beneath the Financial Crisis: Getting a View From a Moral-Cultural Mental Model*, 33 HARV. J.L. & PUB. POL'Y 735 (2010) (exploring our collective cultural moral lapse as a major contributor to the financial crisis); Baxter, *Adaptive Regulation*, *supra* note 69, at 271 ("Markets cannot long survive without moral precepts."); see also Arnold Kling, *The Financial Crisis: Moral Failure or Cognitive Failure*, 33 HARV. J.L. & PUB. POL'Y 507 (2010) discussing the degree to which moral failings, as opposed to cognitive deficiencies, were a causative factor in the financial crisis).

¹³² See Kling, *supra* note 131 at 517 ("[I]t has lately been unfashionable to focus on market morality and ethics . . ."); *id.* at 520 ("Recent events have seen a sad shortage of ethical behavior . . .").

¹³³ See, e.g., *infra* notes 138–41.

¹³⁴ See, e.g., *Symposium: The Most Disparaged Branch: The Role of Congress in the Twenty-First Century: Panel VI: Toward a More Responsible Congress?: Can Enhanced Oversight Repair "the Broken Branch"?*, 89 B.U. L. REV. 756 (2009) (reviewing the value of congressional oversight of administrative agencies, including through committee hearings).

¹³⁵ See, e.g., *About the OIG*, U.S. DEP'T. OF THE TREASURY, <http://www.treasury.gov/about/organizational-structure/ig/Pages/about.aspx> (last visited Apr. 12, 2011) (describing the role of the Office of the Inspector General in overseeing agency actions).

¹³⁶ See Baxter, *Adaptive Regulation*, *supra* note 69, at 3 (noting how "the courts, through the process of judicial review" can check whether government agency actions have been "authorized by properly delegated discretion").

¹³⁷ See *id.* at 4 (noting the complexities and difficulties of making government action more legitimate and stating that this has caused agencies to instead deregulate in order to avoid the problem).

¹³⁸ See, e.g., Kwak, *supra* note 33, at 30–31; Nicholas Bagley & Richard Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260 (2006).

dent, and these in turn tend to be the concerns of the most powerful in the industry.¹³⁹

Perhaps what is needed is ex-ante review by an *independent*, even non-governmental institution. Here we might draw lessons from the MITRE Corporation—a federally funded research and development center, spun off from the MIT Lincoln Laboratory in 1958, that performs research on national defense issues.¹⁴⁰ MITRE describes itself as a “not-for-profit corporation, chartered to work solely in the public interest.”¹⁴¹ MITRE operates federally funded research and development centers sponsored by the Department of Defense, the Federal Aviation Administration, the Internal Revenue Service and Department of Veterans Affairs (jointly), and the Department of Homeland Security.¹⁴² Over the years, the organization’s scope of activities has steadily been expanded to provide objective research, testing, and advice on wider scientifically-oriented issues, including: organizational issues for the Department of Veterans Affairs, Financial Crimes Enforcement Network, and the SEC.¹⁴³

MITRE, or a similar organization, could be used to assess the optimality of regulations governing the financial industry. The use of MITRE or a similar organization could be funded out of the assessments levied on financial organizations via the Federal Reserve and federal deposit insurance systems, which provide the lynchpins of stability for the financial industry.¹⁴⁴ No doubt we would hear an outcry against this idea, with industry protesting their lack of access, regulators disliking their loss of complete control, and politicians complaining about added costs. However, if we really wanted the right decisions, this institutional review structure might actually help to professionalize financial regulation.

The connection between regulators and industry is the area that seems to need the most urgent attention. There are, of course, many other interconnected issues that would have to be explored in order to reset financial regulation so that it is directed toward the promotion of

¹³⁹ Barkow, *supra* note 110, at 35.

¹⁴⁰ *Corporate Profile*, MITRE CORP., <http://www.mitre.org/about/index.html> (last visited Apr. 13, 2011).

¹⁴¹ *Working in the Public Interest*, MITRE CORP., <http://www.mitre.org/about/ffrdcs.html> (last visited Apr. 13, 2011)

¹⁴² *See id.*

¹⁴³ *See Center for Enterprise Modernization (CEM)*, MITRE CORP., <http://www.mitre.org/about/ffrdcs/cem.html> (last visited Apr. 13, 2011).

¹⁴⁴ Bank supervision and deposit insurance is funded from fees charged to the financial institutions under supervision.

the common good.¹⁴⁵ Nevertheless, even the reforms already discussed would require a major resolve of our collective will in order to transcend the deeply embedded political, cultural, and institutional power of the financial industry itself. Until we make such a resolution, however, pointing out and lamenting regulatory capture adds little to the overall debate, and it only makes us angry, cynical, or despondent.

¹⁴⁵ Kwak, for example, suggests the use of negotiated rulemaking, which would require competing interest groups to join the regulators in deciding final rules, thereby perhaps equalizing the power of interest groups. Kwak, *supra* note 31, at 30.