

CHAPTER 9:

Reforming the Financial Regulators

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Bank regulation is often based on the idea that banks are special because bank failures might lead to widespread economic damage due to the role of banks in the U.S. payments system. Under this theory, strict regulation—and, if this regulation fails—government backstops, are warranted. Since the 2007–2009 financial crisis, this regulatory approach has bled from banks to other types of financial firms, such as broker-dealers, insurance companies, and asset managers. Historically, these non-bank financial firms have not been painted with the same regulatory brush as banks, but the crisis marks a clear shift from the “banks are special” doctrine to the “all financial institutions are special” doctrine.

Proponents of the shift worry that failures of these non-banks would lead to the same economy-wide problems they fear from bank failure. According to this perspective, dividing regulatory authority among different agencies that take different regulatory approaches weakens regulation, invites arbitrage, and prevents any single regulator from having a clear picture of the overall financial system. Though the U.S. financial regulatory structure needs reform, a single “super” regulator with a banking mindset and a ready safety net would not improve economic outcomes.

During its post-crisis negotiations, Congress considered creating a consolidated financial regulator.¹ The ultimate product of those discussions—the Dodd–Frank Wall Street Reform and Consumer Protection Act²—did not on its face include such a super regulator. Nevertheless, Dodd–Frank, as it

has taken shape during its first half-decade, is moving the financial system toward uniform regulation. If this trend continues, the system may well end up under the de facto control of a super regulator: the Board of Governors of the Federal Reserve.

The move toward more uniform financial regulation is occurring in a number of ways. First, Dodd–Frank increased the scope of the Federal Reserve’s authority to include new powers, such as an explicit systemic-risk mandate, and new supervised entities, such as savings-and-loan holding companies, securities holding companies, and systemically important financial institutions (SIFIs).³ For example, as of May 2016, the Federal Reserve had supervisory authority over approximately 25 percent (based on total assets) of the insurance industry.⁴

The Federal Reserve is also active in international regulatory efforts to identify and

establish regulatory standards for SIFIs.⁵ Domestic regulators face substantial pressure to follow the international consensus regarding the regulation of individual companies and industry sectors.⁶ Additionally, the Financial Stability Oversight Council (FSOC)—in which federal banking regulators play an outsized role—has authority to override the decisions of individual regulators, even independent regulatory agencies.⁷ Finally, the Federal Reserve has been actively advocating changes outside its normal regulatory sphere.⁸

This chapter argues that regulatory homogenization threatens to impair the effective functioning of the financial system. Regulatory reform is needed, but should be rooted in a recognition that financial market participants and their regulators respond to incentives in the same way that participants in other markets do. This chapter lays out several structural, procedural, and policy reforms that would produce more effective financial regulation by making financial market participants, including regulators, more accountable for their actions.

LAYING THE PROPER GROUNDWORK FOR FINANCIAL REGULATION

Before identifying regulatory solutions, policymakers need to consider regulatory justifications. Which problems are regulations supposed to solve? Policymakers can only design appropriate solutions after clearly answering this question. It is not enough simply to point to the potential for a financial crisis to justify a particular regulation. Likewise, a stated desire to maintain financial stability is not sufficient because nobody knows what the term means, let alone how to measure it.⁹ Rather, policymakers must understand the particular problems they are trying to solve before they can design effective solutions.

Common Justifications for Financial Regulation. Policymakers and regulatory advocates have identified several problems they believe financial regulation can and should address. These include threats to

macroeconomic stability, consumer harm, and potential drains on taxpayer resources. Proponents argue that government regulation is the most effective way to keep all of these problems in check.

Coloring the assessment of problems and solutions is a belief that the financial industry is different from other industries. The idea that financial firms require stringent regulations because they are different from nonfinancial companies used to be confined to the banking sector.¹⁰ As the relative share of bank financing has declined, however, policymakers have extended this aura of exceptionality to virtually all forms of non-bank financing.¹¹ Policymakers, in the name of global macroeconomic stability, also have increasingly embraced a homogenous, complex regulatory framework for the whole financial system. The approach ignores industry distinctions and national boundaries in favor of a uniform, bank-regulatory approach.

The financial system is central to the functioning of the rest of the economy, so policymakers' concern for financial stability is not surprising. Financial firms facilitate commerce among nonfinancial firms, so failures in the financial sector could impede business activity at nonfinancial companies. Main Street is interconnected with Wall Street, and problems in the financial sector can give rise to problems in the rest of the economy. Non-financial companies, consumers, and investors all may suffer if one or more large financial firms fail. However, the very same reasoning could be used to justify heavy regulation of nonfinancial firms, which are also deeply interconnected with one another. To see this, one need only imagine the failure of a large company, such as Walmart, and the grave consequences for its millions of customers, employees, and suppliers.

In addition to financial stability, policymakers cite consumer and investor protection as a justification for an increasingly intensive financial regulatory system. Traditionally, regulators have sought to protect consumers from fraud, but consumer protection has

expanded to include averting financial loss, constraining consumers' choices for their own good, or—even more expansively—maintaining confidence in the financial sector.¹² The consumer confidence justification complements the goal of ensuring macroeconomic stability.¹³ If consumers and investors lack confidence in the financial system, so the theory goes, the system will crumble and carry down the rest of the economy with it. Together, the macroeconomic stability and consumer protection justifications undergird calls for an expanded financial regulatory framework.

Another reason policymakers call for expanding bank-like regulation to non-banks is the need to protect the integrity of governmental financial guarantees. These guarantees are claimed to protect consumers and ensure financial stability. Both the federal and state governments provide taxpayer-backed guarantees. The main federal guarantee for the financial system is federally backed deposit insurance through the Federal Deposit Insurance Corporation (FDIC). The FDIC collects premiums from banks to establish the Deposit Insurance Fund (DIF), but the U.S. Treasury is obligated to cover any shortfall when the DIF is insufficient to cover depositors' losses. As the 2007–2009 financial crisis illustrated, the federal government also may create special programs to assist banks and other financial firms during times of stress.¹⁴ States maintain industry-funded, but ultimately taxpayer-backed, guaranty funds that provide financial protection to insurance policyholders in the event an insurance company becomes insolvent.¹⁵ Thus, governments justify imposing strict capital and other regulations on the grounds that doing so protects taxpayers.¹⁶

On the surface it makes sense to protect taxpayers in this manner. However, the evidence shows that extensive regulation has not actually worked as intended,¹⁷ and that implementing government-backed insurance schemes has likely done more harm than good. In particular, countries with more government involvement in a deposit insurance

system, and with higher levels of deposit insurance coverage, tend to have more bank failures and financial crises.¹⁸

One problem with this type of government-backed insurance is that it gives deposit holders and investors an incentive to stop carefully monitoring the risks firms are taking. This problem magnifies what is known as moral hazard, whereby government backing gives managers the incentive to take on more risk than they would without a taxpayer backstop.¹⁹ Therefore, while it seems laudable to protect taxpayers from potential losses through the DIF, an alternative to government-backed guarantees and government-imposed regulation could more readily accomplish that goal.

The moral hazard created by government guarantees can be in itself a justification for prudential regulation. Such regulation, however, is only justified when it reduces risk, whereas some regulations, like the Community Reinvestment Act, push banks to take more risks, not fewer. In many cases, the actual justification for financial regulation is not safety and soundness or the greater public interest, but the redistribution of income via the financial system. Financial regulation can also have fiscal goals, as illustrated by the favoring of sovereign debt in most regulatory schemes.

A MARKET-BASED APPROACH TO FINANCIAL REGULATION

The goals of maintaining macroeconomic stability, protecting consumers, and exercising good stewardship over taxpayer resources provide policymakers broad cover to micromanage the financial system. Almost any regulatory intervention can hide under the shadow of one of these broad and superficially appealing themes. More precise identification of the problems at issue leads to a narrower, more tailored, and more realistic regulatory framework and leaves room for private-market-based solutions.

Financial regulation should establish the framework within which financial institutions survive and thrive based on their

ability to serve consumers, investors, and Main Street companies. Financial regulators have historically punished fraud and encouraged sound disclosure, but did not micro-manage decision making. Such an approach runs counter to the current macroprudential trend in regulation, which places governmental regulators—with their purportedly greater understanding of the financial system—at the top of the decision-making chain.

Experience clearly shows that the government may not be the best regulator of financial markets. The financial crisis of 2007–2009 occurred despite—and perhaps partly because of—heavy regulation.²⁰ Government regulations can be gamed and sometimes create incentives for companies to take actions that make them less resilient. The competitive process that is a natural part of a free enterprise system is an alternative, and often more effective, way to regulate markets. Firms have to figure out how to provide products and services at prices that customers are willing and able to pay. If, for instance, bank customers value deposit insurance, firms will provide it at a price that reflects its cost. The firms that provide the insurance will monitor the insured banks. The government, by contrast, assumes that all depositors want deposit insurance, does not charge economically appropriate rates, and does not monitor banks as closely as a private insurer with money on the line would do.

Ultimately, if private firms cannot provide such insurance, consumers do not value it. To provide more market discipline and move toward such a system, Congress can lower the amount of FDIC deposit insurance coverage to (at least) the pre-Dodd-Frank limit of \$100,000 per account.²¹ Even lowering the value to the pre-1980 limit of \$40,000 per account would insure a level (based on 2014 data) nearly 10 times the average transaction-account balance of approximately \$4,000.²² The same market principles apply to the extensive set of government-imposed regulations that determine banks' capital position.

Under the current system, financial firms must conduct their business and adhere to various capital and liquidity ratios based on regulators' subjective risk assessments. These rules impose needlessly complex requirements, and there is no reason to expect regulators to make better risk assessments than the market participants who stand to increase or lose their investments.²³ Rather than forcing banks and other financial firms to adhere to arbitrary standards set by regulatory fiat, policymakers should introduce more market discipline into the system so that, ultimately, market participants can impose their own capital rules. While allowing market participants to determine the appropriate equity levels for funding still fails to *guarantee* a stable banking system and macroeconomy, evidence clearly shows that allowing regulators to set statutory capital requirements fails as well.²⁴

What is more, both theory and evidence suggest that the banking system will perform better when banks' capital suppliers face more market discipline.²⁵ A common empirical finding is that companies that use more debt generally have to pay higher costs in order to borrow. This constrains both their ability to borrow and to grow. The exception to this finding is financial institutions that are backed by government. That backing pushes out the private monitoring of financial leverage, resulting in greater instability. The guarantee business of Fannie Mae and Freddie Mac was leveraged at more than 200 to 1.²⁶ Such massive leverage would never occur in the absence of government guarantees.

Government simply cannot impose financial stability on the economy, and any such macro-stability objectives are best achieved through a competitive market process.²⁷ Unlike government regulation, this process provides incentives for firms to monitor themselves, their counterparties, their competitors, and market conditions to prepare for adverse events. Markets function best when this competitive process is allowed to work, and it requires that the government allow the weakest, poorest-run firms to fail. These are

the companies that do not serve their customers well, and preventing their failure works against macroeconomic stability because it prevents the migration of resources to people and companies who are better able to put them to good use.

The overall failure of government rules and regulation to create a sound system is partly due to an insurmountable knowledge problem.²⁸ In particular, no group of experts can know precisely how to prevent future events that are themselves uncertain. Market participants cannot accomplish this task either, but the competitive process forces those with the most to lose to use their judgment. At best, government rules that profess to guarantee financial market safety create a false sense of security. Worse, over time, these rules have a tendency to increase in volume and complexity, thus protecting incumbent firms from new competitors. This outcome hinders innovation, tends to raise prices, and prevents people from learning the best ways to employ resources.

Government can play a role in protecting consumers, investors, and policyholders, particularly in mitigating and punishing fraudulent behavior. However, competitive markets have the most important role to play here. The competitive market process can, for example, help to root out fraudulent actors through monitoring and short-selling. In fact, one recent study found that short sellers “are proficient at identifying financial misrepresentation before the general investing public,” and that, even net of their profits, short sellers “generate external benefits for uninformed investors.”²⁹ Furthermore, the competitive process is likely the best way to generate effective consumer and investor-tailored disclosures. Any reforms to the U.S. financial regulatory framework should recognize that effective regulation—regulation that rigorously and relentlessly ferrets out and punishes bad behavior—is more likely to come from markets than from government.

Misleading and fraudulent behavior for all products and services—including financial

products and services—are prohibited by both state and federal law. Furthermore, while government-mandated disclosures aimed at mitigating fraud and misrepresentation are one type of regulation, they are properly viewed as distinct from regulations that dictate, for instance, the type and amount of capital that financial firms may use. Even disclosure-based regulations can be used to indirectly shape market behavior rather than to ensure that consumers and investors have the information they need to make decisions.

Market-based regulatory solutions can be more tailored, more flexible, and more effective than government mandates. Thus, as problems arise in the markets, policymakers should look for market-based solutions. Such solutions may be easier to implement if, as discussed in the next section, reforms are made to the financial regulatory structure and its degree of accountability to the American people.

THE ELUSIVE OPTIMAL FINANCIAL REGULATORY STRUCTURE

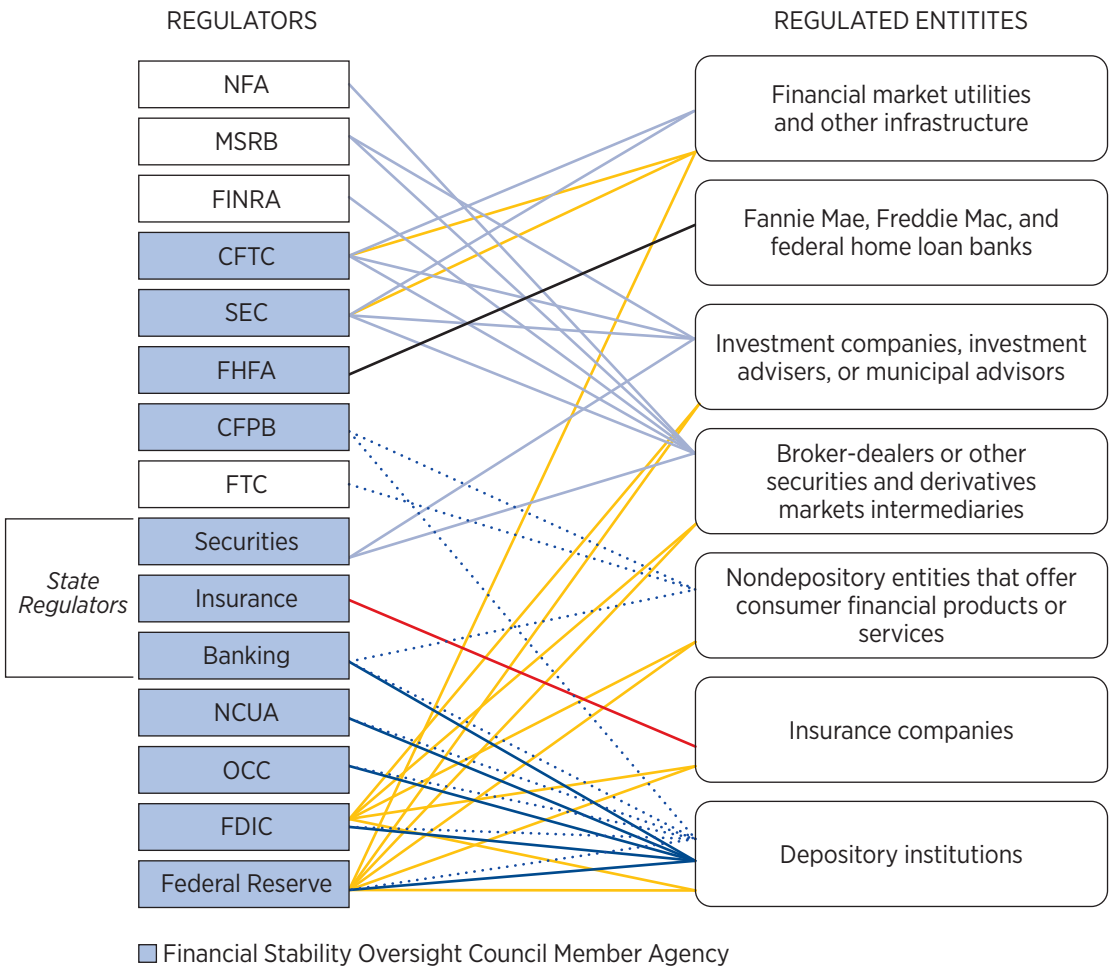
There is no perfect structure for the financial regulatory system, but design affects how well regulation is carried out, so regulatory re-designers should proceed with care. The quest for the holy grail of regulatory structure has resulted in periodic reconsideration of optimal regulatory structure in the United States and abroad, and some countries have consolidated many regulatory functions into a single financial regulator.³⁰ Others have embraced functional regulation. The fact that countries have modified their approaches over time reflects the universal difficulty of this exercise.³¹ We argue against a super-regulator, but recommend some areas in which consolidation could generate improved financial regulation. We do not undertake to prescribe the precise form the U.S. regulatory structure should take, but rather to suggest broad outlines.

AVOIDING A SUPER-REGULATOR

The blatant inefficiency and complexity of our regulatory system has prompted multiple

FIGURE 9-1

U.S. Financial Regulatory Structure, 2016



REGULATED ENTITIES

- Safety and soundness oversight
- Consumer financial protection oversight
- Securities and derivatives markets oversight
- Insurance oversight
- Housing finance oversight
- Consolidated supervision or systematic risk-related oversight

- CFPB Consumer Financial Protection Bureau
- CFTC Commodity Futures Trading Commission
- FDIC Federal Deposit Insurance Corporation
- FHFA Federal Housing Finance Agency
- FINRA Federal Industry Regulatory Authority
- FTC Federal Trade Commission
- MSRB Municipal Securities Rulemaking Board
- NCUA National Credit Union Administration
- NFA National Futures Association
- OCC Office of the Comptroller of the Currency
- SEC Securities and Exchange Commission

SOURCE: U.S. Government Accountability Office, “Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness,” February 2016, p. 12, Figure 2, <http://www.gao.gov/assets/680/675400.pdf> (accessed December 7, 2016).

efforts toward consolidation. For example, as the recent financial crisis was breaking out, the Department of Treasury issued a regulatory reform blueprint that posited an “optimal” regulatory structure as comprising three regulators—responsible respectively for “market stability regulation, safety and soundness regulation associated with government guarantees, and business conduct regulation.”³² This so-called objectives-based approach is attractive in its potential to eliminate regulatory arbitrage, but it also could aggravate the current tendency of bank regulation to seep into capital markets regulation. In other words, such a re-organization could further open the door for the banks-are-special doctrine to expand into the all-financial-institutions-are-special doctrine. After the financial crisis, Treasury issued another report, this time calling for a less-streamlined regulatory approach.³³ Under the latter approach, Treasury called for one national bank supervisor, a new consumer regulator, expanded powers for the Federal Reserve, and a new systemic risk council.³⁴ At the time, Congress also contemplated big changes, such as the merger of the SEC and Commodity Futures Trading Commission (CFTC),³⁵ and the creation of a super-regulator.³⁶

The attempts to consolidate regulators ran into political roadblocks and were dropped in favor of Dodd–Frank’s more politically palatable, but complex, regulatory structure. Nevertheless, Dodd–Frank implemented major changes—most notably the elimination of the Office of Thrift Supervision³⁷ and addition of the Consumer Financial Protection Bureau (CFPB), the FSOC, and the Office of Financial Research (OFR). Naturally, the fact that a large number of regulators remain continues to draw recommendations to consolidate. For example, the Government Accountability Office (GAO) recently issued a comprehensive look at financial regulation completed after the Dodd–Frank Act, and titled the report “Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness.”³⁸ The

report explored many ways in which the post-Dodd–Frank regulatory framework results in duplicative and inconsistent regulation. The dizzying array of financial regulators makes attractive the prospect of a super-regulator or—as the Treasury plans recommended—a much smaller set of financial regulators with expanded jurisdiction.

Regulatory diversity, even if not the most efficient approach, however, has certain advantages. First, it allows regulators to specialize in particular types of institutions.³⁹ Second, it allows regulatory experimentation and competition.⁴⁰ Third, it helps to highlight an error that one regulator is making. Regulators’ decisions can be measured in the context of other regulators’ approaches to similar issues. Fourth, if a regulator does make an error, only the subset of entities it regulates will be directly affected. Fifth, maintaining distinct capital markets and banking regulators provides speed bumps to banking regulators’ efforts to apply bank-like regulation more broadly.⁴¹

In short, one of the advantages of the current system is that regulators can be measured against one another, and their mistakes are bounded by the limits of their jurisdiction.⁴² Competition among regulators can also reduce the possibility that regulators choose the “quiet life” of not raising too many objections about the entities they regulate.⁴³ One of the reasons why the failings of supervision at the Office of Thrift Supervision (OTS) have been so well publicized is the parallel oversight by the FDIC. The material-loss reviews independently conducted by the Inspector General of the Treasury Department have also helped to expose regulatory failings.⁴⁴ Such reviews should be expanded to cover broader issues of regulatory performance.

One argument for consolidating regulators is to avoid “charter-shopping” or a “race to the bottom” among regulators.⁴⁵ This argument, however, assumes a degree of competition between financial regulators that is at odds with the existing regulatory system. Many of the institutions at the heart of the crisis, such as the government-sponsored enterprises

Fannie Mae and Freddie Mac, had no ability to choose their regulator. While banks and thrifts had some ability to shift their charters, such was only a choice between federal and state or between the Office of the Comptroller of the Currency (OCC) and the OTS.

Contrary to the charter-shopping argument is that, during the recent financial crisis, banks failed at roughly similar rates across the various bank regulators.⁴⁶ Despite its many well-documented failings, the OTS was not an outlier. Furthermore, as professors Henry Butler and Jonathan Macey have so aptly observed, competition among banking regulators is largely a myth.⁴⁷ In surveying the literature of state corporate governance and banking laws, one recent article found that such competition did not generally lead to a “race to the bottom” but rather a sorting into alternative regulatory systems.⁴⁸ While the extent of competition between bank regulators can certainly be debated, the fact remains that state bank regulators may not face the full costs of their decisions, given that banks they charter are ultimately backed by the federal government.⁴⁹

STREAMLINING REGULATION

Although full regulatory consolidation could harm financial markets, some streamlining is important. The existing regulatory structure embodies certain inefficiencies and redundancies. Regulators coordinate, but “this coordination requires considerable effort that, in a more efficient system, could be directed toward other activities.”⁵⁰ The following discussion offers some examples of areas in which regulatory consolidation could make financial regulation more effective at achieving its goals and less costly for regulated companies—and ultimately their consumers and investors.

Removing the Federal Reserve’s Regulatory and Supervisory Powers. As the United States central bank, the Federal Reserve’s primary roles are in the monetary policy arena. Specifically, the Federal Reserve Act directs the central bank to “maintain long

run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates.”⁵¹ The Federal Reserve has struggled to fulfill these macroeconomic responsibilities, and its supplementary regulatory and supervisory responsibilities—particularly as they have expanded since the financial crisis⁵²—are simply unnecessary for conducting monetary policy.

First, these responsibilities take the time of the Federal Reserve Board of Governors and staff. The Federal Reserve has been actively engaged in regulation and supervision in the post-crisis years. Second, the chairman of the Federal Reserve is typically chosen for her monetary policy expertise. Expecting the chair to also master a massive regulatory and supervisory portfolio is unreasonable. Dodd-Frank, in conjunction with increasing the responsibilities it placed on the Federal Reserve, established a new, Senate-confirmed position—Vice Chairman for Supervision.⁵³ This as-yet-unfilled position is to be filled by one of the Federal Reserve Governors, whose ability to focus on monetary policy would therefore be attenuated. Third, allowing the same entity to exercise regulatory and monetary functions gives rise to unnecessary and potentially dangerous conflicts of interest. A central bank that is also a regulator and supervisor could be tempted to use monetary policy to compensate for mistakes on the regulatory side, and financial stability concerns could sometimes lead to regulatory forbearance.

Fourth, as discussed earlier, the larger the Fed’s regulatory role, the greater the magnitude of the effects of its policy mistakes. These mistakes will reverberate across the full range of financial institutions, rather than be limited to banks and bank holding companies. Fifth, the Federal Reserve’s responsibilities overlap with those of other financial regulators.⁵⁴ The overlap results in inconsistencies and duplicative efforts by both regulators and regulated entities.⁵⁵ Efforts at inducing

coordination, including the Federal Financial Institutions Examination Council (FFIEC)⁵⁶ and the FSOC’s mandate to encourage cooperation among regulators, have not addressed this problem adequately. Removing the Federal Reserve’s regulatory and supervisory powers would allow it to focus on monetary policy. The Federal Reserve’s regulatory and supervisory responsibilities could be shifted to either the OCC or the FDIC.

Repurposing the FSOC and Eliminating the OFR. The missions of two of the new agencies created by Dodd–Frank—the Financial Stability Oversight Council and the Office of Financial Research—do not contribute to the efficacy and efficiency of the financial regulatory system. Dodd–Frank’s framers ambitiously envisioned that the FSOC and OFR would work together to identify systemic risks and prevent them from harming the economy. The FSOC, a more powerful version of the President’s Working Group (PWG) on Financial Markets,⁵⁷ was a natural result of concerns of poor regulatory coordination leading up to the crisis. The new entity, however, unlike its predecessor, was given regulatory functions. Its key functions include identifying systemically important financial institutions,⁵⁸ identifying systemically important financial market utilities and activities,⁵⁹ and making recommendations to other financial regulators.⁶⁰ Identifying individual firms that pose a systemic risk is a futile mission that serves mostly to strengthen bailout expectations.⁶¹ Furthermore, its power to make regulatory recommendations makes other regulators accountable to the FSOC rather than to the President, Congress, or the public.

A more useful mission would look more like that of the PWG—bringing regulators (albeit not exclusively agency heads) together to discuss issues that cut across their jurisdictions. The regulators could share concerns with one another, identify financial market trends, and play a valuable role in discussing ways in which regulators’ actions are complementary or conflicting. A more collegial mission would avoid some of the problems that

the FSOC has exhibited to date, such as imposing a bank-centric view, an undue deference to foreign regulators, and a tendency to perpetuate too-big-to-fail expectations.⁶²

The OFR, although rarely the subject of much public attention, has the potential to impose substantial pecuniary and privacy costs on the financial industry and the American public without clear benefits.⁶³ The OFR director has the authority to collect (including by subpoena) data from financial companies and has broad power to share that information with the industry.⁶⁴ Regulated financial firms cannot hide data from their primary regulators, so it was unnecessary to create a new government agency for such a narrow regulatory purpose. Creating a new agency, such as the OFR, with broad powers and very little accountability, was entirely unwarranted. While some have suggested refocusing the OFR so that it that could assess “the impact of regulation on economic growth as well as the impacts of the financial system and financial regulation on consumers and businesses,”⁶⁵ all existing financial regulators—in addition to the Congressional Budget Office and the Office of Management and Budget—can already conduct such assessments.

If the PWG was ineffective, thus necessitating a new agency created via legislation, Congress should formally ask the President to rescind the executive order that created the PWG. Then, Congress should eliminate the OFR, and also restructure the FSOC so that it is nothing more than a regulatory council for sharing information. In particular, Congress should reorient the FSOC so that its only responsibility is to provide a mechanism for financial regulators to formally share information.⁶⁶ Because these agencies are charged with broad powers to maintain financial stability, the FSOC and the OFR have the perverse effect of lessening market discipline, which runs directly counter to their stated purposes.⁶⁷

Consideration of an SEC–CFTC Merger. The SEC and CFTC regulate markets that have increasingly blurred into one another over the years. Yet the two agencies have

approached their regulatory responsibilities in different and sometimes conflicting ways, causing market participants to struggle to navigate the resulting regulatory morass.⁶⁸ There is a theoretical case for allowing the two regulators, which historically have taken very different regulatory approaches,⁶⁹ to exist side-by-side. If one regulator's approach is flawed, for instance, regulated entities may be able to migrate to the markets in the other regulator's purview. In practice, however, the bifurcated responsibility has resulted in tense regulatory battles and duplicative effort by regulators and market participants.

Periodic attempts to address the problem have helped calm some of the interagency fighting, but the agencies' closely related mandates promise continued discord.⁷⁰ For example, the Shad-Johnson Jurisdictional Accord of the early 1980s brought a measure of peace, but jurisdictional disputes continued. Dodd-Frank, which awkwardly split regulatory responsibility for the over-the-counter derivatives market between the two agencies, only compounded the problem with overlapping authorities.⁷¹ The CFTC, although built on the hedging of agricultural commodities, now is primarily a financial markets regulator. The markets it regulates are closely tied—through common participants and common purposes—with SEC-regulated markets. The U.S. is unusual in having separate regulators for these markets.

A merged SEC and CFTC might be better able to take a holistic view of the capital and risk-transfer markets. A single regulator could conserve resources in overseeing entities that are currently subject to oversight by both the SEC and CFTC. In addition, a unified regulator would eliminate discrepancies in the regulatory approaches that can frustrate good-faith attempts by firms to comply with the law. Cultural differences between the agencies could initially make such a merger messy,⁷² but serious consideration of a merger of the two entities is long overdue.⁷³ In order to facilitate such a merger, Congress could consider creating a joint committee,

composed of members from both the agriculture and banking committees, to oversee the new merged agency.

Transferring Department of Labor Investment Regulatory Authority to the SEC. Although not included in a typical list of financial regulators, the Department of Labor plays an increasingly important role in financial regulation. Specifically, under the Employee Retirement Income Security Act of 1974 (ERISA),⁷⁴ the Labor Department regulates private pension plans; the department also has some regulatory authority over individual retirement accounts (IRAs).⁷⁵ The Labor Department regulates interactions of financial professionals with these tax-advantaged plans and the retail investors that rely on them to save for their retirement.

The Labor Department's financial regulatory role has recently attracted particular attention in connection with a controversial rule-making related to financial professionals working with retail retirement investors.⁷⁶ The rule-making changes the way broker-dealers and other financial firms interact with clients, the way financial firms are compensated, the disclosures these firms must make, the records they must keep, and the liability they face.⁷⁷ It also may change the availability and cost of financial services.

The breadth of the rule and the novelty of the standards it applies mean that it will govern much of the retail financial services industry. Because of the importance of ERISA plans and IRAs, the changes made in this context will spill over into other contexts and likely overshadow any potential future rule-making by the SEC regarding a broker-dealer's standard of care. The Labor Department's rule-making occupies a space—retail investors' interactions with their financial professionals—that more naturally belongs to the SEC, and the Labor Department's rules may conflict with SEC rule-making. Given the SEC's greater experience in regulating broker-dealers and investment advisers, Congress should shift responsibility for regulating the relationship between pension

plan and IRA investors and their fiduciaries to the SEC.

Reconsidering the Nature of Self-Regulation. Self-regulatory organizations (SROs) are a key set of players in the U.S. financial regulatory landscape. These organizations include securities and futures exchanges, the Financial Industry Regulatory Authority (FINRA), the National Futures Association, and the Municipal Securities Rulemaking Board (MSRB).⁷⁸ These entities are rooted in the notion that market participants have an incentive to self-regulate to maintain the integrity of the markets and customer trust. If members of an industry collectively set and enforce strong standards, investors will have the necessary confidence to participate in markets. For example, a stock exchange regulates its listed companies to make those companies and hence its marketplace more attractive to investors.⁷⁹ FINRA (like its predecessor entity, the National Association of Securities Dealers) regulates brokerage firms and their employees to ensure that customers are comfortable trusting them with their money.

Over time, self-regulation has changed. These self-regulators have begun to look more governmental, and the industry's tether on the governance of these organizations has loosened.⁸⁰ In large part, this change is due to a tendency by regulators to formally delegate responsibilities to these private organizations. The change is also driven by a fear that, left to themselves, industry members will be too lenient. History shows, however, that self-regulation in its more traditional form can work well.

Financial firms rely heavily on reputation, so they have an incentive to maintain strong standards to ensure that customers feel comfortable dealing with them. That incentive would be particularly strong if there are competing SROs that market themselves on the quality of the standards they maintain. Competition among SROs obviates the need for the government to micromanage the approaches that SROs take. SROs can experiment with different approaches, and customers can

choose the SRO that establishes the level and nature of regulation they prefer.

Allowing Federal Pre-Emption and State Reciprocity. The financial services marketplace is increasingly national, but much of the regulatory structure is still state based. A state-based approach can work for products and services that are offered locally. It can also work for national markets, as it does in the corporate chartering space, where companies choose their state of incorporation and that state's laws govern the company's relationships with its shareholders wherever they reside.⁸¹ In much of financial regulation, however, the model is more complicated—a company must satisfy the laws of every state in which it operates. The Internet conveniently matches customers with far-flung financial service providers, but also exposes companies to the legal risk arising from potential violations of every customer's state laws.⁸²

The process of learning which obligations apply in each state and coming into compliance is burdensome, particularly for would-be new entrants, and the burden of state-by-state compliance is especially evident in the marketplace-lending and securities sectors.⁸³ In some markets, a better model is federal pre-emption of state law or, alternatively, state “passporting,” which allows a company that complies with one state's laws to operate across the nation. Both of these approaches ensure that financial companies are regulated, but they also streamline the regulation and avoid duplicative and overlapping regulation.

Considering a State-Based Competitive Model for Insurance Regulation. The troubles of American International Group (AIG) during 2008 that prompted the government to rush to the aid of the company and its creditors renewed questions about the existing system of insurance regulation. Dodd-Frank, although widely characterized as not having substantially altered insurance regulation, added a new layer of federal regulation that is likely to expand over time.⁸⁴ The FSOC can designate—and has designated—insurance companies as systemically important

and thus subject to Federal Reserve regulation. The Federal Insurance Office can negotiate international agreements that override state law. Prior to Dodd–Frank, the existing state regulatory system subjected insurers to multiple state regulators. Thus, by adding a more active role for federal regulators, Dodd–Frank increased the regulatory hurdles to competition in the insurance industry.

In the past, there have been calls for a federal insurance charter to streamline regulations. An optional federal charter would, for instance, enable nationwide insurers to avoid the hassle of dealing with multiple state regulators.⁸⁵ However, a federal charter would increase the temptation of federal policymakers to wrap insurance companies into the federal safety net, thus increasing moral hazard problems in the industry.⁸⁶ In addition, insurance-regulation expertise largely resides at the state level. Building a new federal bureaucracy seems wasteful, although the process is already underway due to Dodd–Frank.

A state-based approach might be more effective and less costly than federal regulation. The state model has succeeded in the corporate-law area, whereby companies are chartered in and governed by the laws of a single state. Delaware courts have developed particular expertise in dealing with corporate law matters, and other states can experiment with different approaches.⁸⁷ Professors Henry Butler and Larry Ribstein have argued that a similar state-based competitive approach could work in the insurance context.⁸⁸ Under such a model, an insurer would only have to be licensed in one state to operate nationwide. States, competing for chartering revenues, would have an incentive to design effective regulatory systems and to refine them in response to changes in the industry.

Butler and Ribstein further propose supplementing the existing state-guaranty funds with solvency bonds the value of which would fluctuate in response to the market's assessment of the efficacy of a state's insurance regulation, and that would default upon failure of the fund.⁸⁹ These bonds also would play a role

in signaling market participants' beliefs that one of the state's large insurers was in trouble. Such a state-based system would build on states' regulatory expertise in insurance, while obviating the need for a new federal regulator and the likely associated expansion of future federal bailouts.

RETHINKING AGENCY STRUCTURE, FUNDING, AND ACCOUNTABILITY

In addition to thoughtful consolidation and reorganization of regulatory authority, policymakers should consider procedural changes to strengthen financial regulation. Who makes rules and the nature of the process by which they are made influence the effectiveness of those regulations. This section sets forth some principles of sound regulatory and procedural design.

Improving Accountability Through Structure and Funding. The way a financial-regulation agency is structured and funded affects its accountability and therefore the quality of its regulation. Typically, agencies are accountable to the President, who directs their actions, and Congress, which controls their funding. Many financial regulators do not fit this mold because historically they have been funded by assessments on the firms they regulate, and in some instances have been outside the traditional congressional appropriations process. The reliance on industry assessments for funding can also distort regulators' incentives, particularly when a small number of institutions constitute a large percentage of the assessment base.

At the time of its failure, assessments on Washington Mutual constituted just over 12 percent of the OTS budget.⁹⁰ At one extreme, the entire budget of the Office of Federal Housing Enterprise Oversight was derived from two companies: Fannie Mae and Freddie Mac. As the financial services industry continues to consolidate, these incentives will only become more perverse. Due to peculiarities of funding and structure, these agencies tend to be less politically accountable than many of their non-financial counterparts.

Greater accountability can be introduced by, for example, subjecting financial regulators to appropriations and implementing a commission governing structure.

Regulatory structure has drawn much attention recently on account of two new Dodd-Frank regulators' unusual design. The CFPB is a single-director agency with complete autonomy from its host agency and, more important, little accountability to Congress and the President.⁹¹ The FSOC comprises the heads of the federal financial regulators, an insurance expert, the head of the Federal Insurance Office, and some state regulators. The FSOC depends on the OFR for funding. The FSOC's structure poses a number of problems: (1) The presence of state officials raises potential constitutional concerns; (2) the exclusion of non-chair members of financial regulators gives undue power to the chairmen of those agencies; and (3) the ability of the FSOC to force independent regulators to act undermines the independence of those agencies.

The design and funding of other financial regulators also give rise to accountability concerns. The OCC, Federal Housing Finance Agency (FHFA), and OFR have some of the same markers of autonomy as the CFPB—a single director, funding autonomy, and, in the case of the OCC and OFR—no accountability to the Treasury Department of which they are part. The Federal Reserve is governed by a board, but enjoys a high degree of independence from accountability.

Because financial regulators are deeply involved in setting financial policy, rather than just implementing laws and supervising financial institutions, political accountability is important. As the mandates and scope of discretion of these agencies expands, the need for accountability also increases. Furthermore, agencies designed to be independent of outside influence are not the most effective regulators.⁹² The CFPB, OCC, and FHFA will better incorporate a broad range of policy views if they are governed by multimember boards with mandatory political balance. Such a structure will help to ensure

policy continuity over time, thus affording the industries they regulate and the public greater certainty about the future of the financial markets. The CFTC and SEC, both of which are governed by five-member politically balanced commissions, can serve as models in this regard.

Congress's greatest ability to guide and direct regulators comes through the appropriations process. Even though the SEC is funded through fees paid by the industry, Congress can determine how much the SEC can spend. The Congressional Research Service explains how "the annual appropriation processes and periodic reauthorization legislation provide Congress with opportunities to influence the size, scope, priorities, and activities of an agency."⁹³ We propose that all financial regulatory activity be funded via the appropriations process, which would reduce the perverse incentives that arise from having regulators' budgets so heavily dependent on a small number of entities. The appropriations process also provides an important avenue for additional congressional oversight that can complement the oversight process of the Senate Committee on Banking, Housing, and Urban Affairs and House Financial Services Committees.

Opponents of this view fear that Congress might cut regulatory budgets to curtail agencies' ability to supervise financial firms, but this argument is a broader critique of Congress's ability to make sound decisions. Furthermore, there is no reason to anticipate better decision making, relative to private market participants, from the unelected heads of federal regulators. Federal regulators should be conformed to the constitutional allocation of the appropriations power to Congress.⁹⁴ While Congress is subject to its own failings, this process improves accountability because Members of Congress can be removed at the ballot box, whereas financial regulators have historically faced little public accountability for their failures.

Increasing Congressional Accountability for Regulation. In Dodd-Frank,

Congress delegated to financial regulators the job of filling in many important aspects of the post-crisis regulatory framework. Within that broad authority, regulators have written rules that impose substantial costs on financial institutions and their customers. Because of how important these delegations are, congressional review of the completed rules is necessary to ensure that they achieve congressional objectives. The Congressional Review Act allows Congress to overturn major agency rules before they take effect.

Requiring Congress to sign off on major financial regulations would ensure that this review actually happens and is not merely perfunctory; congressional failure to approve a rule would preclude it from going into effect. Such an approach has been proposed in Congress.⁹⁵ A congressional review requirement for major rules would recognize the reality that many of the meaningful decisions about financial regulation are currently delegated to regulatory agencies. Allowing political review of these decisions would provide a political check on unelected officials. Requiring Congress to affirmatively assent to a rule *after* the contours and nuances of the rule are defined would allow Congress to take into account the new information generated in the rule-making process. Congress would also be reluctant to approve a rule the costs of which exceeded the benefits.

Mandating Economic Analysis. As a counterpart to enhanced congressional review, financial regulation would be improved by a requirement that regulators conduct more robust economic analysis. Regulatory scholar Jerry Ellig explains that “legislators [cannot] make a responsible decision to approve or disapprove a regulation if they do not know whether the regulation solves a real problem or whether there is a better alternative solution than the proposed regulation.”⁹⁶ These are questions that a proper economic analysis answers.

Financial regulators, many of which are structured as independent regulatory agencies, do not have a strong tradition of

economic analysis. They are not subject to the regulatory impact-analysis requirement applicable to executive branch agencies⁹⁷ and, with only a few exceptions, their organic statutes do not require economic analysis. Financial regulators, bolstered by academic arguments that financial regulation does not lend itself to economic analysis, have tended to downplay their limited statutory obligations to conduct cost-benefit analysis. As a consequence, financial regulators are regulating in the dark—deprived of the light that economic analysis would shed on the consequences of regulation and alternatives available to them.

Economic analysis is a useful rule-making tool. It allows regulators to assess the nature and magnitude of a problem, determine whether regulation is an appropriate response, and—if it is—assess alternative regulatory solutions. This tool is as helpful for financial regulators as it is for other regulators.⁹⁸ A congressional mandate to conduct economic analysis, backed by a judicial-review requirement, would help to ensure that regulators have access to the information they need to think through regulatory problems and design effective solutions.

Resisting Internationalization. The international character of the financial markets has naturally led to cross-border regulatory cooperation and coordination. The financial system generally benefits from these transnational efforts. In recent years, however, international cooperation has increasingly resulted in what are effectively mandates crafted at the international level for domestic application. Organizations like the Group of 20, the Financial Stability Board (FSB), the International Organization of Securities Commissions, and the International Association of Insurance Supervisors issue statements that reflect a common understanding of appropriate regulatory approaches. The implicit—and sometimes explicit—understanding among participants in some of these groups is that group decisions will be translated into domestic regulations.⁹⁹

Cooperation and conversation with foreign regulators is important, but commitments cannot be made internationally to take particular domestic regulatory actions.¹⁰⁰ Doing so cedes sovereignty over domestic financial regulation. It also violates Administrative Procedure Act (APA) requirements that regulations be the product of a public notice and comment rule-making process. To maintain the integrity of the domestic rule-making process, financial regulators should be precluded from making international pre-arrangements about what regulations should be and to which entities they should apply.

Requiring Transparent and Tested Rule-Making. Rule-making through international cooperation is not the only way that financial regulators evade the APA. The APA requires agencies, before imposing new regulatory obligations, to publish a proposal, seek public comment on that proposal, and to consider the feedback in developing its final rule-making.¹⁰¹ Dodd-Frank placed heavy rule-writing requirements on financial regulators.¹⁰²

Faced with so many statutory mandates, financial regulators have been particularly tempted to cut corners by supplementing their regulatory activity with less-formal means than the standard notice-and-comment rule-making.¹⁰³ These methods include regulating through staff letters, enforcement actions, guidance documents, examination findings, and even speeches.¹⁰⁴ Although not technically binding, regulators can force change in the industry without engaging in a transparent discussion with the public about the costs and benefits of the change, as well as potential superior alternatives.

Regulators should use transparent rule-making methods that are consistent with the APA to regulate financial markets. Notice-and-comment rule-making is time-consuming and expensive, but it generates benefits for the agency, regulated entities, and the public that is supposed to benefit from regulation. Government agencies have limited information, and putting a proposal out for public

comment generates additional information. The public may, for instance, raise awareness of costs, benefits, alternatives, or interactions with other rules that the regulator had not considered.¹⁰⁵ Commenters can also challenge the assumptions underlying the rule and fill in data gaps in the proposal. The notice-and-comment process is particularly important when Congress makes broad delegations to agencies, thus leaving the regulators—which are not as accountable to the public as Congress—with leeway to craft rules in a way that may particularly affect certain groups of consumers or firms. To raise the quality of regulation, financial regulators should be held to the standard set forth in the APA.

Dis-Embedding Bank Examiners. Financial-industry supervisors often work in the offices of the companies they oversee and report daily to those firms.¹⁰⁶ While this practice enables supervisors to get to know the people, practices, and culture of the companies they supervise, embedded supervision also breeds capture. Moreover, it is an outgrowth of the flawed notion that banks (and, increasingly, other financial institutions) are different from other companies and need government micromanagement. This intensive, long-term engagement with regulated entities suggests to the entities' managers, shareholders, and customers that firm decision making is blessed by the regulators. It thus shifts responsibility from the private sector to the government sector. A better approach would not rely on permanent on-site supervision, but on targeted inspections.

Facilitating Innovation. Financial regulators, as other regulators, have an incentive not to approve innovation. By approving innovation, they expose themselves to future criticism if the innovation is later associated with customer harm. Thus, a rational regulator might delay or deny requests to make the legal accommodations necessary for new financial products and services. Naturally, the financial industry's ability to serve the rest of the economy suffers from regulatory roadblocks to innovation. These natural anti-innovation

tendencies have drawn public attention, and some regulators have looked at ways to counteract the problem.

The United Kingdom's Financial Conduct Authority (FCA), for example, set up a "regulatory sandbox," which the FCA defines as "a 'safe space' in which businesses can test innovative products, services, business models and delivery mechanisms in a live environment without immediately incurring all the normal regulatory consequences of engaging in the activity in question."¹⁰⁷ Similarly, the CFPB established Project Catalyst, which offers joint CFPB–financial-company pilot programs¹⁰⁸ and staff "no action" letters to provide a temporary promise not to recommend an enforcement action "for a new product or service that offers the potential for significant consumer-friendly innovation."¹⁰⁹ The OCC, acknowledging a "low risk tolerance for innovative products and services,"¹¹⁰ has also indicated a new openness to financial technology.¹¹¹ Among other things, it is considering offering a special charter for FinTech companies.¹¹²

Although the regulatory desire to lower barriers to innovation is commendable, the approaches that regulators are using raise concerns. The regulators, by asking financial companies to prove that their innovations will benefit consumers¹¹³ or that their innovations are "responsible,"¹¹⁴ are placing themselves in the role of the market. Regulators need not make these assessments; if they allow companies to innovate, consumers will decide which innovations they like. When a regulator tries to usurp this market function to screen out bad products, it inhibits innovation.

Financial regulators, therefore, should look for ways to make it easier for financial firms to develop new products regardless of whether the regulator thinks the effort will be successful. Making a concerted effort to modify existing rules so they accommodate new technologies and taking care to avoid cementing a particular technology into new rules are two ways regulators can foster innovation without attempting to direct it. An individual or office within a regulator that is

charged with shepherding products through the difficult-to-navigate approval process could also help, but financial regulators' overall approach toward innovation must change. CFTC Commissioner Christopher Giancarlo put it succinctly when he called for a "do no harm" approach that "open[s] wider our agency doors and regulatory minds to benefit from FinTech innovation."¹¹⁵

Thriving innovation can reshape the financial industry so dramatically that the notion of banks being special falls by the wayside. When that happens, the door to regulatory innovation will also be open wide.

REMOVING FAILED REGULATORS

Financial regulators are subject to failure, just as market participants are. Private-sector failure is met with market discipline, but because of the muted accountability mechanisms in government, regulatory failure is rarely punished. After the financial crisis, regulators who had not performed well were rewarded with new jurisdiction and powers. An effective financial regulatory system holds regulatory bodies and the people that lead and staff them responsible for their failures and rewards them for their successes.

Appropriate incentives for regulators will encourage them to perform their jobs carefully and diligently. Regulators should not be punished when regulated entities or regulated products and services fail—failure is a natural occurrence in properly functioning market systems. Regulators should be held responsible for decisions that induce, abet, or cover up failure.

CONCLUSION

This chapter takes a broad view of the financial regulatory framework. Far from being the product of a careful architect, the regulatory system has been built in pieces. The result is much like a house, each successive owner of which has fitted it with an awkward addition in the style of the time. The resulting house is an eyesore that does not accommodate the needs of its current occupants.

We have attempted here to suggest some areas that could benefit from reorganization—consolidating related powers in one regulator, removing authorities from agencies ill-equipped to perform them, and revamping processes to ensure appropriate accountability for and public input in rule-making.

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ENDNOTES

1. Restoring American Financial Stability Act of 2009, discussion draft, http://thf_media.s3.amazonaws.com/2016/DoddSenateBankingMarkup.pdf (accessed November 22, 2016). The discussion draft included statutory language to create a single financial regulator called the Financial Institutions Regulatory Administration (FIRA).
2. Public Law 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 5, 7, 12, 15, 22, 26, 28, 31, and 42 U.S. Code).
3. For a discussion of this expansion, see Hester Peirce and Robert Greene, “The Federal Reserve’s Expanding Regulatory Authority Initiated by Dodd–Frank,” Mercatus Center at George Mason University, November 13, 2013, <http://mercatus.org/publication/federal-reserves-expanding-regulatory-authority-initiated-dodd-frank> (accessed October 8, 2016).
4. Daniel K. Tarullo, speech at the National Association of Insurance Commissioners’ International Insurance Forum, Washington, DC, May 20, 2016, <https://www.federalreserve.gov/newsevents/speech/tarullo20160520a.htm> (accessed October 8, 2016).
5. See, for example, Financial Stability Board, “About the FSB,” <http://www.fsb.org/about/> (accessed October 8, 2016). (“The FSB promotes international financial stability; it does so by coordinating national financial authorities and international standard-setting bodies as they work toward developing strong regulatory, supervisory and other financial sector policies. It fosters a level playing field by encouraging coherent implementation of these policies across sectors and jurisdictions.”) The Federal Reserve, along with the Federal Insurance Office at the Treasury and state insurance regulators, represents the United States in the International Association of Insurance Supervisors, which is working on identifying and establishing regulatory approaches for globally systemically important insurers. International Association of Insurance Supervisors, “Financial Stability and Macroprudential Policy & Surveillance,” <http://www.iaisweb.org/page/supervisory-material/financial-stability-and-macroprudential-policy-and-surveillance> (accessed October 8, 2016).
6. For a discussion of these issues, see Peter J. Wallison, “The Regulators’ War on Shadow Banking,” AEI Research, January 2015, <https://www.aei.org/wp-content/uploads/2015/01/Regulators-war-on-shadow-banking.pdf> (accessed October 8, 2016).
7. 12 U.S. Code § 5330 (Dodd–Frank § 120) sets forth a procedure for the FSOC to “provide for more stringent regulation of a financial activity by issuing recommendations to the primary financial regulatory agencies to apply new or heightened standards.”
8. See, for example, Daniel K. Tarullo, speech at the Brookings Institution, Washington, DC, November 17, 2015, <https://www.federalreserve.gov/newsevents/speech/tarullo20151117a.htm> (accessed October 8, 2016). Federal Reserve Governor Tarullo calls for “market regulation,” which he illustrates by citing the Federal Reserve’s plans to “establish minimum haircuts for securities financing transactions (SFTs) on a market-wide basis, rather than just for specific classes of market participants.” See also Stanley Fischer, Vice Chairman, Board of Governors of the Federal Reserve System, speech at the Debt and Financial Stability—Regulatory Challenges Conference at the Bundesbank and the German Ministry of Finance, Frankfurt, Germany, March 27, 2015, <https://www.federalreserve.gov/newsevents/speech/fischer20150327a.htm> (accessed October 8, 2016). Fischer calls for additional reforms in the non-bank financial sector.
9. This term is so conveniently nebulous that it is easily used to justify a range of regulatory interventions. See, for example, the January 28, 2016, letter from Mark A. Treichel, Executive Director of the National Credit Union Administration, to Christine Houle of the U.S. Government Accountability Office. Treichel explains that multiple measures of financial stability are appropriate because: “There is still wide disagreement within the financial community as well as across regulators about what constitutes financial stability and how it should be measured.” Treichel’s letter is appended to the end of the following report: U.S. Government Accountability Office, “Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness,” GAO-16-175, February 2016, pp. 121 and 122, <http://www.gao.gov/assets/680/675400.pdf> (accessed November 22, 2016). Given the uncertainty about how to identify and measure financial stability, it is difficult to design regulations that can achieve it.
10. Vern McKinley, “After the Crisis: Revisiting the ‘Banks Are Special’ and ‘Safety Net’ Doctrines,” Mercatus Center at George Mason University, 2015, <http://mercatus.org/sites/default/files/McKinley-Are-Banks-Special.pdf> (accessed July 18, 2016).
11. Daniel K. Tarullo, “Exploring Shadow Banking: Can the Nation Avoid the Next Crisis?” opening remarks at Center for American Progress and Americans for Financial Reform Conference, Washington, DC, July 12, 2016, <https://www.federalreserve.gov/newsevents/speech/tarullo20160712a.pdf> (accessed July 18, 2016). Federal Reserve Governor Tarullo argues that: “Thus, in deciding where—from a prudential viewpoint—to concentrate analysis and policy initiatives within the broad universe of activities that can be described by the term shadow banking, it seems to me that the presence of runnable funding is the key, though perhaps not the only, consideration.”
12. See, for example, U.S. Securities and Exchange Commission, “Equity Market Structure Advisory Committee: Subcommittees,” <https://www.sec.gov/spotlight/equity-market-structure/equity-market-structure-advisory-committee-subcommittees.htm> (accessed August 24, 2016). The purpose of the Customer Issues Subcommittee is to “consider initiatives to protect investor interests and promote investor confidence.” Commissioner Michael Piwowar countered that it is better to provide investors the information they need to make wise decisions rather than trying to boost their confidence. Michael S. Piwowar, speech at the

Equity Market Structure Advisory Committee Meeting, August 2, 2016, https://www.sec.gov/news/statement/piwowar-remarks-emsmac-meeting-080216.html#_ftnref1 (accessed October 8, 2016).

13. George Benston, "Consumer Protection as Justification for Regulating Financial-Services Firms and Products," *Journal of Financial Services Research*, Vol. 17 (2000), pp. 277–301. Also see George Benston, "Is Government Regulation of Banks Necessary?" *Journal of Financial Services Research*, Vol. 18 (2000), pp. 185–202, and George Kaufman, "Bank Failures, Systemic Risk, and Bank Regulation," *Cato Journal*, Vol. 16 (Spring/Summer 1996), pp. 17–45, <http://object.cato.org/sites/cato.org/files/serials/files/cato-journal/1996/5/cj16n1-2.pdf> (accessed July 18, 2016).
14. For an overview of TARP programs, see Office of the Special Inspector General for the Troubled Asset Relief Program, Quarterly Report to Congress, July 27, 2016, pp. 107–246, https://www.sigtar.gov/Quarterly%20Reports/July_27_2016_Report_To_Congress.pdf (accessed October 8, 2016). For an overview of other crisis-era programs, see Board of Governors of the Federal Reserve System, "Credit and Liquidity Programs and the Balance Sheet," https://www.federalreserve.gov/monetarypolicy/bst_lendingother.htm (accessed November 22, 2016).
15. For a discussion of state guaranty funds, see Peter G. Gallanis, "Policyholder Protection in the Wake of the Financial Crisis," in John H. Biggs and Matthew P. Richardson, eds., *Modernizing Insurance Regulation* (New York: Wiley, 2014), pp. 207–240.
16. In many cases, safety and soundness regulations imposed on U.S. banks are justified by citing systemic-risk concerns (financial and macroeconomic stability) as well as the necessity of protecting the FDIC insurance fund. Mark Flannery, "Supervising Bank Safety and Soundness: Some Open Issues," Federal Reserve Bank of San Francisco, Conference on Safe and Sound Banking: Past, Present, and Future, August 17–18, 2006, <http://www.frbsf.org/economic-research/files/flannery.pdf> (accessed December 18, 2015).
17. In the 1980s, regulators implemented the Basel capital rules, and banks are now dealing with the third iteration of these rules, known as Basel III. See Norbert J. Michel and John L. Ligon, "Basel III Capital Standards Do Not Reduce the Too-Big-to-Fail Problem," Heritage Foundation *Backgrounders* No. 2905, April 23, 2014, <http://www.heritage.org/research/reports/2014/04/basel-iii-capital-standards-do-not-reduce-the-too-big-to-fail-problem?ac=1> (accessed July 18, 2016).
18. For an overview, see Thomas Hogan and Kristine Johnson, "Alternatives to FDIC Deposit Insurance," *Independent Review*, forthcoming, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2568767 (accessed December 18, 2015). According to the World Bank, 87 countries have explicit deposit insurance, as opposed to a system where people simply expect the government to cover deposit losses in the event of bank failures. Of these 87 countries, 21 countries had (as of 2003) some form of private co-insurance requirement as part of their deposit insurance system. See Asli Demirguc-Kunt, Baybars Karacaovali, and Luc Laeven, "Deposit Insurance Around the World: A Comprehensive Database," The World Bank, April 2005, http://siteresources.worldbank.org/INTRES/Resources/469232-1107449512766/DepositInsuranceDatabasePaper_DKL.pdf (accessed December 12, 2015).
19. The same arguments apply to the state insurance guaranty funds. See Elijah Brewer, Thomas Mondschean, and Philip Strahan, "The Role of Monitoring in Reducing the Moral Hazard Problem Associated with Government Guarantees: Evidence from the Life Insurance Industry," *The Journal of Risk and Insurance*, Vol. 64, No. 2 (1997), pp. 301–322, http://www.jstor.org/stable/pdf/253732.pdf?_=1468861525292 (accessed July 18, 2016).
20. See, for example, RegData, "Did Deregulation Cause the Financial Crisis? Examining a Common Justification for Dodd-Frank," Mercatus Center at George Mason University, <http://regdata.org/did-deregulation-cause-the-financial-crisis-examining-a-common-justification-for-dodd-frank/> (accessed November 22, 2016).
21. The Federal Deposit Insurance Reform Act of 2005 (Title II, Subtitle B, of the Deficit Reduction Act of 2005, Public Law 109–171, February 8, 2006) raised the coverage limit to \$250,000 for retirement accounts, and Dodd-Frank (Title III, Subtitle C, Section 335) permanently extended this coverage limit to all insured deposits. See 12 U.S. Code §1821 (a)(1)(E).
22. Transaction accounts include checking, savings, money market, and call accounts. See Federal Reserve Board of Governors, "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, Vol. 100, No. 4 (September 2014), p. 16, <http://www.federalreserve.gov/pubs/bulletin/2014/pdf/scf14.pdf> (accessed March 15, 2016). Also see Christine M. Bradley, "A Historical Perspective on Deposit Insurance Coverage," *FDIC Banking Review*, December 2000, https://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2_1.pdf (accessed March 15, 2016).
23. The Basel rules came under criticism in the wake of the Greek debt crisis because they allowed banks to hold no capital—via zero-risk weights—against sovereign government debt. In January 2015, the Basel Committee initiated a review of its existing treatment of sovereign debt. See Huw Jones, "Global Bank Watchdog to Review Rule on Zero-Risk Weighting for Sovereign Debt," Reuters, January 23, 2015, <http://www.reuters.com/article/2015/01/23/basel-sovereign-regulations-idUSL6N0V2Z20150123#2MI4gx2T3BydgvQ.97> (accessed March 15, 2016).
24. In an ideal world—free of government interventions that encourage and subsidize excessive risk-taking—there would be no capital-adequacy issue and no need for any capital adequacy regulation. Obviously, the ideal world is not the current one, and many policymakers support trading off higher capital requirements in return for less regulation. See chapter 3, Kevin Dowd, "A Simple Proposal to Recapitalize the U.S. Banking System."

25. One author argues: "Although bank supervision under the National Banking System exercised a light hand and panics were frequent, depositor losses were minimal." Eugene N. White, "To Establish a More Effective Supervision of Banking": How the Birth of the Fed Altered Bank Supervision," NBER *Working Paper* No. 16825, February 2011, <http://www.nber.org/papers/w16825> (accessed March 15, 2016). Also see Jonathan Macey and Geoffrey Miller, "Double Liability of Bank Shareholders: History and Implications," *Wake Forest Law Review*, Vol. 27 (1992), pp. 31–62.
26. Fannie and Freddie were allowed to borrow more than \$200 for each dollar of capital used to guarantee mortgage-backed securities. Combined, Fannie and Freddie owned or guaranteed \$5.3 trillion of mortgage-related assets at the end of 2007 against just \$70.7 billion of capital, a ratio of 75:1. See *The Financial Crisis Inquiry Report* (Washington, DC: U.S. Government Printing Office, 2011), p. 65, <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf> (accessed November 22, 2016).
27. Furthermore, stability itself should not be a goal, as it ensures very few risks are ever taken.
28. Friedrich A. Hayek, "The Use of Knowledge in Society," *The American Economic Review*, Vol. 35, No. 4 (September 1945), pp. 519–530, <http://home.uchicago.edu/~vlima/courses/econ200/spring01/hayek.pdf> (accessed October 8, 2016).
29. J.M. Karpoff and X. Lou, "Short Sellers and Financial Misconduct," *The Journal of Finance*, Vol. 65 (2010), pp. 1879–1913.
30. For example, Japan's Financial Services Authority "is responsible for ensuring stability of Japan's financial system, protection of depositors, insurance policyholders and securities investors, and smooth finance through such measures as planning and policymaking concerning the financial system, inspection and supervision of private sector financial institutions, and surveillance of securities transactions." Japanese Financial Services Agency, "Financial Services Agency," February 2016, p. 3, <http://www.fsa.go.jp/en/about/pamphlet.pdf> (accessed October 8, 2016).
31. The United Kingdom provides a good example of changing structures. Going into the financial crisis of 2007 to 2009, the U.K.'s Financial Services Authority and Bank of England regulated the financial system. As in the U.S., the financial crisis prompted regulatory restructuring. Regulation is now divided among: (1) the Financial Conduct Authority, which regulates business conduct, markets, and firms not subject to the Prudential Regulation Authority; (2) the Prudential Regulation Authority, a subsidiary of the Bank of England that regulates the safety and soundness of deposit-taking institutions and certain systemically important companies; (3) the Bank of England, which regulates clearinghouses and payment and settlement systems; and (4) the Bank of England's Financial Policy Committee, which is the U.K.'s macroprudential regulator. For a diagram and general discussion of the new regulatory structure, see the Financial Services Authority, "Journey to the FCA," October 2012, pp. 11 and 12, <https://www.fca.org.uk/publication/corporate/fsa-journey-to-the-fca.pdf> (accessed October 8, 2016).
32. Department of the Treasury, "Blueprint for a Modernized Financial Regulatory Structure," March 2008, p. 14, <https://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf> (accessed October 8, 2016). Multiple Administrations have initiated similar reform efforts through the Treasury Department. For instance, a 1991 Treasury report recommended shrinking the number of federal banking regulators from four to two, and also focusing the FDIC's mission solely on administering deposit insurance and bank resolutions. See U.S. Treasury, "Modernizing the Financial System: Recommendations for Safer, More Competitive Banks," February 1991, pp. 68–70, http://thf_media.s3.amazonaws.com/2016/ModernizingFinancialSystem.pdf (accessed November 22, 2016).
33. Department of the Treasury, "Financial Regulatory Reform: A New Foundation," June 17, 2009, https://www.treasury.gov/initiatives/wsr/Documents/FinalReport_web.pdf (accessed October 8, 2016).
34. *Ibid.*, p. 3.
35. House Financial Services Chairman Barney Frank (D-MA) proposed legislation to merge the SEC and CFTC. See Sarah N. Lynch, "Retiring US Lawmaker Barney Frank Seeks SEC-CFTC Merger," Reuters, November 29, 2012, <http://www.reuters.com/article/sec-cftc-merger-idUSL1E8MTGFA20121129> (accessed November 24, 2016).
36. Senate Banking Committee Chairman Christopher Dodd (D-CT) proposed the creation of a "Financial Institutions Regulatory Administration," an independent agency that would have taken over the regulatory and supervisory functions of the OCC, OTS, FDIC, and the Board of Governors of the Federal Reserve System. See Restoring American Financial Stability Act of 2009, discussion draft.
37. More accurately, the OTS was not so much eliminated as it was simply made a department of the OCC. For instance, no OTS employees were fired, nor was the thrift charter eliminated.
38. U.S. Government Accountability Office, "Financial Regulation."
39. Lawrence A. Cunningham and David Zaring, "The Three or Four Approaches to Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response," *George Washington University Law Review*, Vol. 78 (2009), pp. 1–56, http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1551&context=faculty_publications (accessed October 8, 2016).
40. *Ibid.*, p. 50.

41. Former SEC Commissioner Daniel Gallagher has frequently discussed the importance of preventing bank regulators from taking over capital markets regulation. See, for example, Daniel M. Gallagher, “Bank Regulators at the Gates: The Misguided Quest for Prudential Regulation of Asset Managers,” speech at the 2015 Virginia Law and Business Review Symposium, April 10, 2015, <https://www.sec.gov/news/speech/041015-spch-cdmg.html> (accessed November 22, 2016).
42. Spillover effects from bad decisions by one regulator can affect regulated entities outside that regulator’s jurisdiction.
43. Allan Berger and Timothy Hannan, “The Efficiency Cost of Market Power in the Banking Industry: A Test of the ‘Quiet Life’ and Related Hypotheses,” *Review of Economics and Statistics*, Vol. 80 (1998), pp. 454–465.
44. For example, see Office of the Inspector General, Department of the Treasury, “Material Loss Review of IndyMac Bank, FSB,” OIG-09-032, <https://www.treasury.gov/about/organizational-structure/ig/Documents/oig09032.pdf> (accessed November 22, 2016).
45. Jessica Silver-Greenberg, “Small Banks Shift Charters to Avoid US as Regulator,” *The New York Times*, April 2, 2012, <http://www.nytimes.com/2012/04/03/business/small-banks-shift-charters-to-avoid-us-as-regulator.html> (accessed November 22, 2016), and Sumit Agarwal et al., “Inconsistent Regulators: Evidence from Banking,” *The Quarterly Journal of Economics*, Vol. 129, No. 2 (2014), pp. 889–938.
46. U.S. Government Accountability Office, “Causes and Consequences of Recent Bank Failures,” *Report to Congressional Committees*, GAO-13-71, 2013, <http://www.gao.gov/assets/660/651154.pdf> (accessed November 22, 2016).
47. Henry Butler and Jonathan Macey, “The Myth of Competition in the Dual Banking System,” *Cornell Law Review*, Vol. 73 (1988).
48. Bruce G. Carruthers and Naomi R. Lamoreaux, “Regulatory Races: The Effects of Jurisdictional Competition on Regulatory Standards,” *Journal of Economic Literature*, Vol. 54, No. 1 (2016), pp. 52–97.
49. State-chartered banks that are members of the Federal Reserve System are subject to oversight by both the Federal Reserve Board and by state regulators, whereas non-Fed-member state-chartered banks that are insured by the FDIC are regulated by the FDIC and state regulators.
50. U.S. Government Accountability Office, “Financial Regulation,” p. 64.
51. Federal Reserve Act § 2A [12 U.S. Code 225a].
52. Peirce and Greene, “The Federal Reserve’s Expanding Regulatory Authority Initiated by Dodd–Frank.” Also see Patrick McLaughlin, Chad Reese, and Oliver Sherouse, “Dodd–Frank and the Federal Reserve’s Regulations,” Mercatus Center at George Mason University, February 4, 2016, <http://mercatus.org/publication/dodd-frank-and-federal-reserve-s-regulations> (accessed October 8, 2016).
53. Dodd–Frank § 1108(a). To date, the President has not nominated anyone for this position, the holder of which is responsible for “develop[ing] policy recommendations for the Board regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the Board, and shall oversee the supervision and regulation of such firms.” *Ibid.*
54. See, for example, U.S. Government Accountability Office, “Financial Regulation,” p. 28, which explains that “[a]ll forms of consolidated supervision by the Federal Reserve create overlap with authority of the primary regulators of the holding company’s regulated subsidiaries.”
55. See, for example, U.S. Government Accountability Office, “Financial Regulation,” p. 36, which noted that “the Federal Reserve’s data requests can be very similar to the OCC’s requests and that often the two requests will ask for the same data but in different formats.” See also Office of the Inspector General to the Board of Governors of the Federal Reserve System, “2015 List of Major Management Challenges for the Board,” *Memorandum*, September 30, 2015, <https://oig.federalreserve.gov/reports/board-management-challenges-sep2015.pdf> (accessed October 8, 2016). Among the items in the list was “maintaining effective relationships with other regulators.” The Inspector General noted: “While the Board has taken steps to improve interagency collaboration and cooperation...continued coordination with other federal supervisory agencies, such as the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, is crucial to implementing the financial stability regulatory and supervisory framework.” *Ibid.*, p. 6.
56. The FFIEC is “a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the” Board of Governors, FDIC, National Credit Union Administration, OCC, and CFPB.
57. The PWG was formed after the October 1987 crash. See Ronald W. Reagan, “Working Group on Financial Markets,” Executive Order 12631, March 18, 1988, <http://www.archives.gov/federal-register/codification/executive-order/12631.html> (accessed October 8, 2016).
58. Dodd–Frank § 113.
59. Dodd–Frank § 804.
60. Dodd–Frank §§ 115 and 120.

61. Peter Wallison, "Title I and the Financial Stability Oversight Council," in Norbert J. Michel, ed., *The Case Against Dodd–Frank: How the "Consumer Protection" Law Endangers Americans* (Washington, DC: The Heritage Foundation, 2016), <http://thf-reports.s3.amazonaws.com/2016/The%20Case%20Against%20Dodd-Frank.pdf>, and Norbert J. Michel, "The Financial Stability Oversight Council: Helping to Enshrine 'Too Big to Fail,'" Heritage Foundation *Backgrounders* No. 2900, April 1, 2014, <http://www.heritage.org/research/reports/2014/04/the-financial-stability-oversight-council-helping-to-enshrine-too-big-to-fail>.
62. Norbert Michel, "Dodd–Frank's Financial Monster Council: The FSOC," *Forbes*, July 7, 2014, <http://www.forbes.com/sites/norbertmichel/2014/07/07/dodd-franks-financial-monster-council-the-fsoc/#357f5afa4ffb> (accessed October 8, 2016).
63. Hester Peirce, "Dodd–Frank's Office of Financial Research Is an Affront to Privacy," Real Clear Markets, April 19, 2012, http://www.realclearmarkets.com/articles/2012/04/19/dodd-franks_office_of_financial_research_is_an_affront_to_privacy_99624.html (accessed October 11, 2016).
64. 12 U.S. Code § 5343(f) and § 5344(b)(6).
65. Bipartisan Policy Center, "Did Policymakers Get Post-Crisis Financial Regulation Right?" September 2016, p. 17, <http://cdn.bipartisanpolicy.org/wp-content/uploads/2016/09/BPC-FRRI-Post-Crisis-Financial-Regulation.pdf> (accessed October 11, 2016).
66. The Financial CHOICE Act takes a similar approach. See Norbert J. Michel, "Money and Banking Provisions in the Financial CHOICE Act: A Major Step in the Right Direction," Heritage Foundation *Backgrounders* No. 3152, August 31, 2016, <http://www.heritage.org/research/reports/2016/08/money-and-banking-provisions-in-the-financial-choice-act-a-major-step-in-the-right-direction?ac=1>.
67. Dodd–Frank § 112(1)(B).
68. See, for instance, U.S. Government Accountability Office, "Financial Regulation," p. 41, which observes: "Over time, separate regulation of the securities and futures markets has created confusion about which agency has jurisdiction and has raised concerns about duplicative or inconsistent regulation of entities that engage in similar activities."
69. Historically, the CFTC applied a principles-based approach to regulation, whereas the SEC's approach was more rule-based. The two agencies' approach is now very similar, particularly since Congress passed the 2010 Dodd–Frank Act.
70. For a discussion of cooperative efforts over the years, see U.S. Government Accountability Office, "Financial Regulation," pp. 43 and 44.
71. See, for instance, Annette L. Nazareth and Gabriel D. Rosenberg, "The New Regulation of Swaps: A Lost Opportunity," *Comparative Economic Studies*, Vol. 55, No. 3 (September 2013), pp. 535–548.
72. Jerry W. Markham, "Merging the SEC and CFTC—A Clash of Cultures," *University of Cincinnati Law Review*, Vol. 78, No. 2 (2009), p. 537. Markham's concerns about a cultural barrier to the merger may not be as relevant now that the CFTC has moved toward the SEC's rules-based approach and away from the CFTC's more traditional principles-based approach.
73. Jerry Markham lays an important foundation for such consideration. See Markham, "Merging the SEC and CFTC."
74. Public Law 93–406.
75. Department of Labor, Reorganization Plan No. 4 of 1978, http://www.dol.gov/ebsa/regs/exec_order_no4.html (accessed October 11, 2016).
76. Department of Labor, "Definition of the Term 'Fiduciary': Conflict of Interest Rule—Retirement Investment Advice," *Federal Register*, Vol. 81 (April 8, 2016), p. 20945, and Department of Labor, "Best Interest Contract Exemption," *Federal Register*, Vol. 81 (April 8, 2016), p. 21002. The rule-making is complicated, but the Labor Department describes it as follows: "Going forward, those that provide investment advice to plans, plan sponsors, fiduciaries, plan participants, beneficiaries and IRAs and IRA owners must either avoid payments that create conflicts of interest or comply with the protective terms of an exemption issued by the Department. Under new exemptions adopted with the rule, firms will be obligated to acknowledge their status and the status of their individual advisers as 'fiduciaries.'" Department of Labor, "Fact Sheet: Department of Labor Finalizes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle Class Families Billions of Dollars Every Year," <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/dol-final-rule-to-address-conflicts-of-interest> (accessed October 11, 2016).
77. For a helpful analysis of the rule, see Shearman & Sterling LLP, "The U.S. Department of Labor's Final 'Fiduciary' Rule Incorporates Concessions to Financial Service Industry but Still Poses Key Challenges," April 14, 2016, <http://www.shearman.com/en/newsinsights/publications/2016/04/fiduciary-rule-but-still-poses-key-challenges> (accessed October 11, 2016). The memorandum concluded that "the rule will still have a profound and, if it survives any ensuing court challenges, lasting effect on the retail retirement market and the business of many financial institutions." *Ibid.*, p. 17.
78. The Public Company Accounting Oversight Board (PCAOB), formed pursuant to the Sarbanes–Oxley Act of 2002, is an odd entity that combines self-regulatory and governmental features. Donna M. Nagy, "Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status," *Notre Dame Law Review*, Vol. 80 (2005), pp. 975–1071. The Supreme Court adjusted its accountability mechanism to correct a constitutional violation, but its unusual structure continues to raise questions of accountability and effectiveness. *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477 (2010).

79. Edward Stringham, “The Past and Future of Exchanges as Regulators,” in Hester Peirce and Benjamin Klutsey, eds. *Reframing Financial Regulation: Enhancing Stability and Protecting Consumers* (Arlington, VA: Mercatus Center at George Mason University, 2016) <https://www.mercatus.org/publications/reframing-financial-regulation> (accessed December 14, 2016).
80. For a discussion of the transformation of self-regulation of broker-dealers, see William A. Birdthistle and M. Todd Henderson, “Becoming a Fifth Branch,” *Cornell Law Review*, Vol. 99 (2013), and Hester Peirce, “Financial Industry Regulatory Authority: Not Self-Regulation After All,” Mercatus Center at George Mason University *Working Paper*, January 6, 2015, <http://mercatus.org/sites/default/files/Peirce-FINRA.pdf> (accessed October 11, 2016).
81. Roberta Romano, “The States as Laboratory: Legal Innovation and State Competition for Corporate Charters,” *Yale Journal on Regulation*, Vol. 23, No. 2 (2006), pp. 209–247, and J. W. Verret, “Uber-ized Corporate Law: Toward a 21st Century Corporate Governance for Crowdfunding and App-Based Investor Communications,” *Journal of Corporation Law*, Vol. 41, No. 4 (2016), pp. 927–969.
82. This issue as it applies to FinTech companies is considered in cross-reference to chapter 22, Brian Knight, “FinTech and Federalism.”
83. *Ibid.*
84. For a discussion of these issues, see Hester Peirce, “Title V and the Creeping Federalization of Insurance Regulation,” in Michel, ed., *The Case Against Dodd-Frank*.
85. See, for example, Scott Harrington, “Federal Chartering of Insurance Companies: Options and Alternatives for Transforming Insurance Regulation,” Networks Financial Institute *Policy Brief* No. 2006-PB-02, February 2006, and Peter J. Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies* (Washington, DC: AEI Press, 2000).
86. See, for instance, Bert Ely, “The Fate of the State Guaranty Funds After the Advent of Federal Insurance Chartering,” in Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*, p. 137. Ely observes that government backing inevitably follows regulation.
87. See, for instance, Roberta Romano, *The Genius of American Corporate Law* (Washington, DC: AEI Press, 1993). Romano explains: “Competition for incorporation revenues makes U.S. states sensitive to investor concerns: such competition is the genius of American corporate law.” *Ibid.*, p. 149.
88. Henry N. Butler and Larry E. Ribstein, “A Single-License Approach to Regulating Insurance,” Northwestern Law Faculty *Working Paper* No. 154, 2008, <http://scholarlycommons.law.northwestern.edu/facultyworkingpapers/154/> (accessed November 22, 2016).
89. Henry N. Butler and Larry E. Ribstein, “The Single-License Solution,” *Regulation* (Winter 2008–2009), p. 40, <https://object.cato.org/sites/cato.org/files/serials/files/regulation/2008/11/v31n4-6.pdf> (accessed November 22, 2016).
90. Office of Thrift Supervision, “Washington Mutual Bank,” *Fact Sheet*, September 25, 2008, <https://occ.gov/static/news-issuances/ots/press-releases/ots-pr-2008-46b.pdf> (accessed November 22, 2016).
91. For a discussion of the structural oddity of the CFPB, see Todd Zywicki, “The Consumer Financial Protection Bureau: Savior or Menace,” *The George Washington Law Review*, Vol. 81, No. 3 (April 2013), pp. 856–928.
92. Mark Calabria, “Capture and Ignorance in Financial Regulation,” ProMarket, September 28, 2016, <https://promarket.org/capture-ignorance-financial-regulation/#comments> (accessed October 11, 2016). Calabria points out that mechanisms, such as a board structure, independent reviews, and the notice-and-comment process for regulations, can help to prevent regulatory capture and thus produce better regulation.
93. Henry B. Hogue, Mark Labonte, and Baird Webel, “Independence of Federal Financial Regulators,” Congressional Research Service *Report for Congress*, February 24, 2014, p. 25.
94. U.S. Constitution, Article 1, Section 9, Clause 7.
95. See, for instance, S. 226, Regulations from the Executive in Need of Scrutiny Act of 2015, January 21, 2015.
96. Jerry Ellig, “Comprehensive Regulatory Impact Analysis: The Cornerstone of Regulatory Reform,” testimony before the Senate Committee on Homeland Security and Governmental Affairs, February 25, 2015, <https://www.mercatus.org/publication/comprehensive-regulatory-impact-analysis-cornerstone-regulatory-reform> (accessed October 11, 2016).
97. For an overview of the use of economic analysis by federal financial regulators, see Hester Peirce, “Economic Analysis by Federal Financial Regulators,” *George Mason Journal of Law, Economics, and Policy*, Vol. 9 (2013), p. 576.
98. For an analysis of the feasibility of economic analysis in financial regulation, see Jerry Ellig and Vera Soliman, “Is Regulatory Impact Analysis of Financial Regulations Possible?” in Peirce and Klutsey, eds., *Reframing Financial Regulation*.
99. See, for instance, Financial Stability Board, “What We Do,” <http://www.fsb.org/what-we-do/> (accessed October 12, 2016), which explains that the FSB “operates by moral suasion and peer pressure, to set internationally agreed policies and minimum standards that its members commit to implement at national level.” For a discussion of how this issue in the insurance context,

- see Therese M. Vaughan and Mark A. Calabria, "International Developments in the Insurance Sector: The Road to Financial Instability?" *Cato Working Paper*, No. 30/CMFA No. 5, May 27, 2015, <http://object.cato.org/sites/cato.org/files/pubs/pdf/working-paper-30.pdf> (accessed October 12, 2016).
100. See, for instance, Peter J. Wallison and Daniel M. Gallagher, "How Foreigners Became America's Financial Regulators," *The Wall Street Journal*, March 19, 2015, <http://www.wsj.com/articles/peter-wallison-and-daniel-gallagher-how-foreigners-became-americas-financial-regulators-1426806547> (accessed October 12, 2016), and Peter J. Wallison, "Transparency on FSO Designations and its Relations with the FSB," testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, March 25, 2015, <https://www.aei.org/wp-content/uploads/2015/05/Senate-Banking-Testimony-3-25-15-FSB-FSO-2.pdf> (accessed October 12, 2016).
 101. 5 U.S. Code § 553. As an alternative, the APA offers regulators an even more formal process, which is rarely used.
 102. The law firm Davis Polk counts 390 rule-making requirements in Dodd-Frank. Davis Polk, "Dodd-Frank Progress Report," July 19, 2016, p. 2, <https://www.davispolk.com/sites/default/files/2016-dodd-frank-six-year-anniversary-report.pdf> (accessed October 12, 2016). See also Patrick McLaughlin and Oliver Sherouse, "The Dodd-Frank Wall Street Reform and Consumer Protection Act May Be the Biggest Law Ever," Mercatus Center at George Mason University, July 20, 2015, <https://www.mercatus.org/publication/dodd-frank-wall-street-reform-and-consumer-protection-act-may-be-biggest-law-ever> (accessed October 12, 2016).
 103. See, for instance, Hester Peirce, "Regulating Through the Back Door at the Commodity Futures Trading Commission," *Harvard Journal of Law and Public Policy*, Federalist Edition (2014), pp. 321-393, http://www.harvard-jlpp.com/wp-content/uploads/2010/01/Peirce_7.pdf (accessed October 12, 2016). The article documents methods, including staff no-action letters and undertakings in enforcement actions, used by the CFTC to regulate without going through notice-and-comment rule-making.
 104. There is a large body of literature on the use of so-called nonlegislative rule-making. See, for example, Robert A. Anthony, "Interpretive Rules, Policy Statements, Guidances, Manuals, and the Like—Should Federal Agencies Use Them to Bind the Public?" *Duke Law Journal*, Vol. 41 (1992), pp. 1311-1384; Michael Asimow, "Nonlegislative Rulemaking and Regulatory Reform," *Duke Law Journal*, Vol. 1985 (1985), pp. 381-426; and William Funk, "A Primer on Nonlegislative Rules," *Administrative Law Review*, Vol. 53 (2001), pp. 1321-1352.
 105. These benefits have been the subject of much academic discussion. See, for instance, Stephen M. Johnson, "Good Guidance, Good Grief!" *Missouri Law Review*, Vol. 72 (2007), p. 703; and Cary Coglianese, Heather Kilmartin, and Evan Mendelson, "Transparency and Public Participation in the Rulemaking Process: A Nonpartisan Presidential Transition Task Force Report," July 2008.
 106. See, for instance, Aaron Lucchetti, "The Regulator Down the Hall: Fed and Comptroller of the Currency Bolster the Ranks of Staffers 'Embedded' at Nation's Biggest Banks," *The Wall Street Journal*, June 20, 2011.
 107. Financial Conduct Authority, "Regulatory Sandbox," <https://www.fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox> (last updated September 12, 2016). See also Christopher Woolard, speech at the Innovate Finance Global Summit, April 11, 2016, <https://www.fca.org.uk/news/speeches/innovate-finance-global-summit> (accessed October 12, 2016).
 108. Consumer Financial Protection Bureau, "Project Catalyst," <http://www.consumerfinance.gov/about-us/project-catalyst/> (accessed October 12, 2016). Director Cordray recently described such a partnership with American Express "to structure a pilot program focused on promoting savings." Richard Cordray, speech at Corporation for Enterprise Development Assets Learning Conference, September 29, 2016, <http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-corporation-enterprise-development-assets-learning-conference/> (accessed October 12, 2016).
 109. News release, "CFPB Finalizes Policy to Facilitate Consumer-Friendly Innovation," Consumer Financial Protection Bureau, February 18, 2016, <http://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-policy-to-facilitate-consumer-friendly-innovation/> (accessed October 12, 2016).
 110. Office of the Comptroller of the Currency, "Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective," March 2016, p. 6, <https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf> (accessed October 12, 2016).
 111. See, for example, Thomas J. Curry, Comptroller of the Currency, speech at the Federal Home Loan Bank of Chicago, August 7, 2015, p. 7, <https://occ.gov/news-issuances/speeches/2015/pub-speech-2015-111.pdf> (accessed October 12, 2016). Curry committed the OCC to having "a robust process in place to understand and evaluate new approaches to permit and encourage responsible innovation that has benefits for consumers and businesses, while ensuring appropriate risk management and compliance with laws and regulations."
 112. Thomas J. Curry, Comptroller of the Currency, speech at the Marketplace Lending Summit 2016, September 13, 2016, <https://www.occ.gov/news-issuances/speeches/2016/pub-speech-2016-111.pdf> (accessed October 12, 2016).
 113. The CFPB's Project Catalyst is limited to products that offer "the promise for significant consumer benefit." Consumer Financial Protection Bureau, "CFPB Finalizes Policy to Facilitate Consumer-Friendly Innovation."
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114. Office of the Comptroller of the Currency, “Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective,” p. 5. The OCC pledges to “support responsible innovation,” which it defines as “The use of new or improved financial products, services, and processes to meet the evolving needs of consumers, businesses, and communities in a manner that is consistent with sound risk management and is aligned with the bank’s overall business strategy.”
115. J. Christopher Giancarlo, Commissioner, Commodity Futures Trading Commission, speech at the American Enterprise Institute, September 21, 2016, <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-17> (accessed October 12, 2016).