

Further Assessment of the Iron Law of Financial Regulation: A Postscript to Regulating in the Dark

Law Working Paper N° 273/2014

November 2014

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ECGI Working Paper Series in Law

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Abstract

In an earlier companion essay, *Regulating in the Dark*, I contended that there is a systemic pattern in major U.S. financial regulation: (i) enactment is invariably crisis driven, adopted at a time when there is a paucity of information regarding what has transpired, (ii) resulting in off-the-rack solutions often poorly fashioned to the problem at hand, (iii) with inevitable flaws given the dynamic uncertainty of financial markets, (iv) but arduous to revise or repeal because of the stickiness of the status quo in the U.S. political framework of checks and balances. This pattern constitutes an “Iron Law” of U.S. financial regulation. The ensuing oneway regulatory ratchet generated by repeated financial crises has produced not only costly policy mistakes accompanied by unintended consequences but also a regulatory state whose cumulative regulatory impact produces over time an increasingly ineffective regulatory apparatus.

This Postscript analyzes the experience with regulators’ implementation of Dodd-Frank since the publication of the earlier essay. After a discussion of broad issues related to the statute and its implementation, the analysis focuses on two provisions by which Dodd-Frank exemplifies the difficulties that are created by legislative strategies conventionally adopted in crisis-driven legislation, off-the-rack solutions along with open-ended delegation to regulatory agencies as legislators, who perceive a political necessity to act quickly, adopt ready-to-go proposals offered by the policy entrepreneurs to whom they afford access: the Volcker rule, which prohibits banks’ proprietary trading, and the creation of the Consumer Financial Protection Bureau. The analysis bolsters the original essay’s contention regarding the inherent flaws in major financial legislation and the corresponding benefit for improving decision-making that would be obtained from employing, as best practice, the legislative tools of sunseting and experimentation to financial regulation. The use of those techniques, properly implemented, advances means-ends rationality, by better coupling the two, and improves the quality of decision-making by providing a means for measuring and remedying regulatory errors.

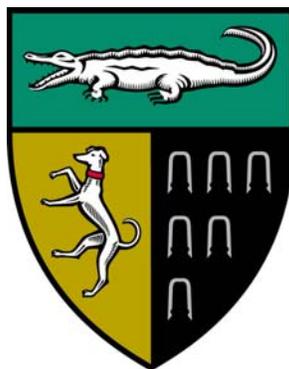
Keywords: Dodd-Frank, sunseting, financial regulation, experimentation

JEL Classifications: K22, K23, G18, G28, G38

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YALE LAW SCHOOL



John M. Olin Center for Studies in Law, Economics, and Public Policy
Research Paper No. 515

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* Yale Law School, NBER, and ECGI. Contact: roberta.romano@yale.edu. I would like to thank for helpful comments and references, Yakov Amihud, Ryan Bubb, Cary Coglianese, William Eskridge, Abbe Gluck, Gerard Hertig, Edward Iacobucci, Jerry Mashaw, Geoffrey Miller, Anne Joseph O’Connell, Nicholas Parrilo, Peter Schuck, Alan Schwartz, Paul Tucker and participants at the Yale-Humboldt Consumer Law Lecture Series at Humboldt-University Berlin and University of Toronto Faculty of Law & Centre for the Legal Profession Conference on Financial Design.

I. Introduction

In *Regulating in the Dark*,¹ I contended that there is an “Iron Law” of major U.S. financial regulation: (i) enactment is invariably crisis driven, adopted at a time when there is a paucity of information regarding what has transpired, (ii) resulting in off-the-rack solutions often poorly fashioned to the problem at hand, (iii) with inevitable flaws given the dynamic uncertainty of financial markets, (iv) but arduous to revise or repeal given the stickiness of the status quo in the U.S. political framework of checks and balances. The ensuing one-way regulatory ratchet generated by repeated financial crises has produced not only costly policy mistakes accompanied by unintended consequences but also a regulatory state whose cumulative regulatory impact produces over time an increasingly ineffective regulatory apparatus.

This Postscript analyzes the experience with regulators’ implementation of Dodd-Frank since the publication of that earlier essay. The analysis bolsters its contention regarding the inherent problems in crisis-driven financial legislation and the corresponding benefit for improving decision-making that would be obtained from employing, as best practice, the legislative tools of sunseting and experimentation to such legislation and its implementing regulation. While it would be foolhardy to claim that application of these tools would produce the optimal regulatory policy, it is plausible to conclude that their use would advance means-ends rationality by better coupling the two, substantially raising the quality of decision-making by providing a feedback loop measuring and remedying regulatory errors. The depressing travails of Dodd-Frank’s implementation, which make plain the statute’s shortcomings, will, it is to be

¹ Roberta Romano, *Regulating in the Dark*, in *REGULATORY BREAKDOWN: THE CRISIS OF CONFIDENCE IN U.S. REGULATION* (Cary Coglianese, ed. 2012) [hereinafter Romano, *Regulating*].

hoped, focus attention on how, going forward, we can achieve more effective financial regulation by including in crisis-driven legislation, the safeguards of sunseting and experimentation.

II. Dodd-Frank Act: A Regulatory Morass

Four years after enactment, all 280 of Dodd-Frank's specified rulemaking deadlines had elapsed with 45% having been missed, and of the Act's 398 rulemaking requirements, slightly more than half, 52% had been finalized, while nearly one-quarter (24%) had not yet even been proposed.² Of course, the vast number of required rules and complexity of issues would of their own accord impede implementation. But rulemaking has also moved at a glacial pace due to intensive lobbying by affected parties who, given the stakes in the legislative delegation to agencies of the task of reconfiguring financial markets and institutions, have understandably sought to shape regulatory outcomes to their advantage.

The regulatory morass occasioned by Dodd-Frank might on first impression suggest to some that sunseting is inapposite for the complexity of contemporary emergency legislation because its delegated rulemaking would not, in fact, be in place in time to be assessed when a sunset review would have to commence. I draw a contrary conclusion. In my judgment, the protracted rulemaking experience of Dodd-Frank only further strengthens the case for sunseting. First, the stakes for interested parties would be lowered, and hence lobbying might be less intense and prolonged, if regulation had to be reassessed and put to a legislative vote at a future date.³

² DAVISPOLK, DODD-FRANK PROGRESS REPORT 2 (July 18, 2014), *available at* <http://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/>

³ Experimentation could provide a further benefit of mitigating concerns expressed by commentators that rulemakers subject to a cost-benefit standard, such as the U.S. Securities and Exchange Commission ("SEC"), cannot meet the rigors of judicial review, following the invalidation of the proxy access rule discussed in Romano, *Regulating*, *supra* note 1 at 90. It has

The affected parties would be assured of a second chance to make their case, so to speak, at a time when far more information would be available to indicate whether proponents' claims or critics' concerns were well-founded, and they could be assured that at a specified point in time unintended adverse consequences could be attended to and reversed or mitigated by legislation adopting (or more likely, instructing implementation of) a better regulatory solution. A specified timetable, expert counsel, and streamlined voting procedures accompanying a legislative vote on whether to retain or modify the expiring legislation and implementing regulation should go a long way to ensuring such an outcome.⁴

Second, when a rule cannot be crafted within a reasonable time frame of a multi-year interval prior to a sunset review, a fair inference is that the statutory delegation was poorly devised or entirely misconceived, in the first instance. Rulemaking is not intended to be interminable. If a proposed rule has not been implemented by the time set for sunset, the sunset review could, of course, automatically be postponed to a specified date after implementation. But legislators could also reasonably draw a negative inference regarding a rule's appropriateness or efficacy from an agency's inability to implement it in timely fashion. A protracted implementation could plausibly suggest that a proposed rule has raised broad-based concern that it would create severe market dislocations and would fail a cost-benefit test, as

been advocated that SEC rules that are adopted on an experimental or sunset basis could be subjected to a lower level of judicial scrutiny because a more finely tuned cost-benefit analysis could be undertaken with the knowledge gleaned from the experiment when the rule comes up for the required renewal. *See, e.g.,* Zachary James Gubler, *Experimental Rules*, 55 B.C.L. REV. 129 (2014); Yoon-Ho Alex Lee, *An Options-Approach to Agency Rulemaking*, 65 ADM. L. REV. 881 (2013).

⁴ Romano, *Regulating*, *supra* note 1, at 99-100, 111 n. 17 (sketching procedures necessary to render sunset effective).

opposed to its being due to dilatory tactics by interest groups, because it is reasonable to suppose that regulators have a strong incentive to implement statutory directives expeditiously to avoid being called to task by Congress for failure to do so.

More fundamentally Dodd-Frank and the regulatory apparatus it imposes have generated controversy, disappointment and alarm, at nearly every turn. For instance, it fails to address key factors widely-acknowledged to have contributed to the financial crisis, such as, runs on shadow banks, whose liabilities were collateralized with securitized mortgages, and government-sponsored enterprises (“GSEs”) that guaranteed those securitized mortgages.⁵ Rather than address shadow banking and the GSEs explicitly, the focus of the statute directed at the subprime mortgage market’s contribution to the crisis is a requirement that mortgage securitizers retain five percent of the securities of non-qualified mortgages.⁶ This provision is informed by a mistaken premise, however, as securitizers did retain risk pre-crisis, holding substantial amounts of

⁵ For the critical importance of the shadow banking sector in sparking the global financial crisis, see GARY GORTON, *SLAPPED BY THE INVISIBLE HAND: THE PANIC OF 2007* (2010); and for that of the GSEs, see Viral V. Acharya et al., *The Government-Sponsored Enterprises*, in *REGULATING WALL ST.: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE* (Acharya et al., eds. 2011). As Christopher Foote et al. state, the GSEs

“were major players in the lending boom of the 2000s, even if much of [the] lending occurred outside of their traditional guarantee business [i.e., were privately originated]. Specifically, both Fannie Mae and Freddie Mac indirectly invested heavily in risky mortgages by buying AAA tranches of subprime and Alt-A mortgage-backed securities and holding these securities in their retained portfolios... in many of the boom years, ...account[ing] for half of the subprime AAA-rated securities.”

Christopher L. Foote et al., *Why Did So Many People Make So Many Ex Post Bad Decisions? The Causes of the Foreclosure Crisis* 35-36 (Fed. Reserve Bank of Boston Discussion Paper No. 12-2, 2012). Their large holding of such securities led to their failure and the government’s taking them over in 2008.

⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, 124 Stat. 1376, § 941(b) (2010) (codified at 15 U.S.C. § 78o-11).

mortgage-backed securities on their balance-sheets.⁷ As Ryan Bubb and Prasad Krishnamurthy note, banks' retention of securitized mortgage risk contributed to the financial crisis, jeopardizing banks' liquidity, and ultimately solvency.⁸ Consequently, this particular Dodd-Frank provision advances a perverse regulatory strategy for it would appear to aggravate, not diminish, systemic risk created by mortgage securitizations.⁹

⁷ See, e.g., Viral Acharya & Matthew Richardson, *Causes of the Financial Crisis*, 21 CRITICAL REV. 195, 200 (2009); Foote et al., *supra* note 5, at 19 (six of the top ten institutions with subprime losses “not only securitized subprime mortgages, but also actually owned companies that originated them”). For a critique of the efficacy of this provision, as well as Dodd-Frank's requirement that mortgage originators' judge an applicant as having the ability to pay for the loan, see Ryan Bubb & Prasad Krishnamurthy, *Regulating against Bubbles: How Mortgage Regulation Can Keep Main Street and Wall Street Safe*, 163 U. PA. L. REV. (forthcoming 2014) (manuscript at 22-23, 30-31, 42-43).

⁸ Bubb & Krishnamurthy, *supra* note 7 (manuscript at 40-42).

⁹ *Id.* at 30-32. The risk retention provision may prove to be a relatively minor constraint in the overall scheme of things, however. That is because financial regulators are adopting the Consumer Financial Protection Bureau's (“CFPB”) definition of a “qualified” mortgage, which does not include a down payment requirement, has a lax debt to income ratio requirement of 43 percent plus includes numerous exemptions from these and other requirements such as limits on interest rates and prohibition of balloon payments, for small and rural area banks (some of which are statutory), and for government agency-insured loans. Consumer Fin. Prot. Bur., 12 C.F.R. § 1026.43(e)(vi) (2013). Although the definition proposed in 2011 for a qualified mortgage under the risk retention provision by bank regulators, the SEC and Department of Housing and Urban Development (“HUD”) had far more substantial requirements, such as a 20 percent down payment and 75 percent debt-to-income ratio, that was not to be. Credit Risk Retention, 76 Fed. Reg. 24,090, 24,123-34 (proposed Apr. 29, 2011). The agencies were lobbied by legislators, the housing industry, consumer advocacy groups and community activists to adopt instead, as the risk-retention definition of a qualified mortgage, the CFPB's definition of a qualified mortgage, and they did exactly that in a re-proposed rule issued in 2013, Credit Risk Retention, 78 Fed. Reg. 57,927, 57,989 (proposed Sept. 20, 2013), and finalized in 2014, Credit Risk Retention, 79 Fed. Reg. ____ (Oct. 22, 2014), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20141022a.htm>. Further, HUD designated all of its mortgages as qualified, and stated that its standards conform to the CFPB's definition. Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages, 78 Fed. Reg. 75,215, 75,215-16 (Dec. 11, 2013). Consequently, the pool of mortgages falling into the non-qualified category for risk-retention purposes will be small, and many qualified mortgages will carry considerable default risk. As Peter Wallison and Edward

In addition, Dodd-Frank inadequately responds to the aftereffects of the crisis—taxpayer bailouts of “too big to fail” financial institutions. Although legislators enacting Dodd-Frank have emphatically insisted that the statute has ended “too big to fail” and taxpayer bailouts, having included a section addressed to the resolution of large financial institutions,¹⁰ many commentators maintain that the provision has not, in fact, resolved the “too-big-to-fail” syndrome and could well exacerbate it.¹¹ The basis for such a contention is that by identifying systemically important financial institutions (“SIFIs”) and subjecting them to a special regime that permits their being bailed out upon approval by designated government actors, it simply codifies too-big-to-fail, and thereby does not diminish the likelihood of such an occurrence, despite legislators’

Pinto put it, assessing the CFPB’s definition: “Neither Dodd-Frank nor the new QM [qualified mortgage] rule has changed anything significant. Political pressure to continue lending to borrowers with weak credit standards has trumped common sense underwriting standards.” Peter J. Wallison & Edward J. Pinto, *New Qualified Mortgage Rule Setting Us Up for Another Meltdown*, WASH. TIMES (Mar. 3, 2013), available at: <http://www.aei.org/article/economics/financial-services/housing-finance/new-qualified-mortgage-rule-setting-us-up-for-another-meltdown/>. Bubb and Krishnamurthy’s critique of the risk-retention rule could, however, suggest that a lax definition is for the better from the perspective of financial institution stability. Bubb & Krishnamurthy, *supra* note 7 (manuscript at 30-31). This is an issue that a sunset review and regulatory experimentation could arbitrate.

¹⁰ E.g., Cezary, Podkul, *Is ‘Too Big to Fail’ Really Over? Rep. Barney Frank Says Yes But Others Disagree*, WASH. POST, July 15, 2011, http://www.washingtonpost.com/blogs/political-economy/post/is-too-big-to-fail-really-over-rep-barney-frank-says-yes-but-others-disagree/2011/07/15/gIQAPMoSGI_blog.html (“Rep. Barney Frank, one of the law’s chief architects ...insisted several times that “too big to fail was over” and “reprimanded” a bank regulator for suggesting that banks’ unique role in the economy justifies a public safety net that is “unlikely ever to be provided at zero public cost.”).

¹¹ E.g., Viral V. Acharya et al., *Resolution Authority*, in REGULATING WALL ST.: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE, *supra* note 5; DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 131-32, 144-55 (2011).

contrary insistence.¹² As Peter Wallison puts the net effect of these provisions, Dodd-Frank extends the Federal Deposit Insurance Corporation's policy of paying off unsecured bank depositors to all large financial institutions, including non-bank institutions that are classified as SIFIs.¹³

But at the same time as ignoring or inadequately addressing critical issues related to the financial crisis, the statute will be imposing considerable costs on non-financial companies, which could well be in a multiple of billions of dollars, due to time-consuming disclosure requirements whose regulatory objectives have no connection to the financial crisis, the ostensible focus of the legislation (disclosures regarding conflict minerals, payments to foreign governments for oil and gas development, and the ratio of CEO compensation to that of the median employee).¹⁴ Even the

¹² E.g., Simon Johnson, *Sadly, Too Big to Fail Is Not Over*, N.Y. TIMES, Aug. 1, 2013, http://economix.blogs.nytimes.com/2013/08/01/sadly-too-big-to-fail-is-not-over/?_php=true&_type=blogs&_r=0; Peter J. Wallison, *Dodd-Frank and Too Big to Fail Receive Too Little Attention*, REAL CLEAR MARKETS (Nov. 1, 2012), <http://www.aei.org/article/economics/financial-services/banking/dodd-frank-and-too-big-to-fail-receive-too-little-attention/> [hereinafter Wallison, *Dodd-Frank*].

¹³ Wallison, *Dodd-Frank*, *supra* note 12.

¹⁴ The SEC's conflict minerals rule was adopted by a three to two vote a year after its deadline because of opposition to the costs of the proposal, with industry estimates of compliance costs in a range of \$9-16 billion. See Eric Savitz, *SEC Approves Detailed Disclosure on "Conflict Minerals"*, FORBES (Aug. 22, 2012, 1:05 PM), <http://www.forbes.com/sites/ericsavitz/2012/08/22/sec-approves-detailed-disclosure-on-conflict-minerals>; Peter Schroeder, *SEC Approves Rules on "Conflict Minerals"*, THE HILL (Aug. 22, 2012, 3:12 PM), <http://thehill.com/blogs/on-the-money/1007-other/244719-sec-adopts-contentious-rules-on-conflict-minerals>. Even more controversial, the CEO compensation ratio disclosure rule has yet to be finalized, given the daunting complexity of computing such a figure for multinational firms at any reasonable cost, with one estimate of the aggregate cost of compliance, based on individual firms' estimates of their own compliance costs, placed at \$1 billion. See *Capital Markets and GSE Bills: Before the Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 113th Cong. 1-2 (2013) (statement of Tom Quaadman, Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce). Similarly, commentators

proponents of those provisions did not believe that the issues informing their proposals had a connection to the financial crisis: the legislative majority simply opportunistically took advantage of including provisions that were desired by key constituent interest groups and that had scant chance of independent enactment (as evidenced by the stalled progress of related bills and the subsequent controversy over those rules' implementation).¹⁵

suggested that the extractive resources company foreign government payments disclosure rule could cost issuers in the billions of dollars in countries where such disclosure was prohibited. David C. Buck et al., *D.C. District Court Vacates Dodd-Frank Disclosure Rule for Payments by Resource Extraction Issuers*, NAT'L L. REV. (July 9, 2013), <http://www.natlawreview.com/article/dc-district-court-vacates-dodd-frank-disclosure-rule-payments-resource-extraction-is>.

¹⁵ A conflicts mineral bill, which among other provisions required companies to certify their imported products were conflict mineral free, had languished in the House since its introduction in November 2009, as had a Senate bill requiring disclosure, among other measures, introduced in April 2009. Library of Cong., *Bill Summary & Status, 111th Cong. [2009-10] H.R. 4128, All Information*, THOMAS, [http://thomas.loc.gov/cgi-bin/bdquery/z?d111:h.r.04128](http://thomas.loc.gov/cgi-bin/bdquery/z?d111:h.r.04128;);; Library of Cong., *Bill Summary & Status, 111th Cong. [2009-10] S 891, All Information*, THOMAS, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SN00891>. Similarly, a bill requiring resource extraction issuers to disclose payments to foreign governments had not progressed beyond its introduction in September 2009. Library of Cong., *Bill Summary & Status, 111th Cong. [2009-10] S.1700, All Information*, THOMAS, <http://thomas.loc.gov/cgi-bin/bdquery/D?d111:s01700>. Senator Menendez, who is closely identified with organized labor and was the sponsor of the CEO pay ratio provision, had introduced a bill requiring the pay-ratio disclosure in February 2010, among other provisions concerning executive compensation, and was unable to obtain even a single cosponsor. Jerry Markon & Dina ElBoghdady, *Pay Rule Still Unwritten amid Corporate Push*, WASH. POST, Jul. 6, 2013, at A1; Library of Cong., *Bill Summary & Status, 11th Congress [2009-2010] S. 3049 All Information*, THOMAS, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:s03049> (follow "All Information" hyperlink). He also did not attempt to rationalize the provision's inclusion as remedying a cause of the financial crisis. In a letter dated January 19, 2011, urging the SEC to implement the pay-ratio-disclosure rule within the year, Senator Menendez stated that he "wrote this provision so that investors and the general public know whether public companies' pay practices are fair to their average employees, especially compared to their highly compensated CEOs." Letter from Robert Menendez, U.S. Senator, to Honorable Mary L. Schapiro, Chairwoman, U.S. Sec. and Exch. Comm'n. (Jan. 19, 2011). In a more recent press release of March 2013 "reiterating" the need for the SEC to enact a rule, he shifted the rationale by noting that "excessive compensation schemes provided part of the fuel for the financial crash" while

Including provisions unrelated to the financial crisis in Dodd-Frank was also used strategically to secure a sponsoring legislator's vote, which a lead drafting legislator deemed necessary for the bill's passage.¹⁶ The sorry aftermath of this political horse-trading is that the SEC has had to devote time and resources to address rules quite unrelated to both the financial crisis and the agency's core mission, a diversion further exacerbating the delayed implementation of rules with at least an ostensible nexus to the crisis, such as those relating to security-based swaps and asset-backed securitizations, along with the Volcker rule prohibiting financial institutions' proprietary trading. Those rules' statutory deadlines have long since been missed.¹⁷

The present appalling legislative and regulatory state of affairs should not be a surprise for, as this essay has emphasized, emergency financial legislation is inherently ill-suited for

focusing on, as the rationale for the disclosure, "income inequality ...over the last decade," with "soaring" CEO compared to "workers'... stagnant wages" and declining "middle class family income," a subject matter that, although surely of concern, is not conventionally thought to be connected to the global financial crisis of 2008-09. Press Release, Robert Menendez, Menendez Calls on SEC to Expedite Adoption of CEO-to-Median Pay Disclosure Rule (Mar. 12, 2013).

¹⁶ As Markon and ElBoghdady, report, the pay ratio provision was included in the bill to obtain Senator Menendez's vote. Markon & ElBoghdady, *supra* note 15. Senator Menendez was a member of the Senate committee drafting what became the Dodd-Frank legislation, and prior to the pay ratio provision's inclusion, he was quoted as expressing hesitation over supporting the bill, although the concerns he mentioned in the press report related to improving provisions concerned bailouts. Jessica Brady & Anna Palmer, *Senators, K Street Not Sold on Dodd's Reform Bill*, ROLL CALL (Mar. 16, 2010, 12:00 AM), http://www.rollcall.com/issues/55_104/-44214-1.html.

¹⁷ There are, of course, additional reasons for the SEC's delayed implementation of the Volcker rule besides its having to focus attention elsewhere: the need to coordinate the drafting of a rule across multiple agencies, and the complexity of the substantive issues, which is discussed *infra* in part III.A. The SEC's final rule implementing the Volcker rule (coordinated with banking regulators and the CFTC) was adopted on December 10, 2013 and published in the Federal Register on January 31, 2014. Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5536, 5539 & n. 13, 5806 (Jan. 31, 2014).

addressing crises, given information difficulties. The politics of financial crises requires acting before sufficient information can be developed on what might be the wisest course of action, and thereby provides an opportunity for well-positioned political actors opportunistically to advance an agenda that is tangential to the crisis at hand and may well be inapposite given the best available data.¹⁸ Sunsetting such legislation, which is informed by the judgment of a panel of legislatively-appointed experts, would mitigate this situation, as the panel’s evaluation and recommendations would direct legislators’ attention to the extant evidence of a policy’s impact.

But the making of Dodd-Frank is considerably more dismal than that of well-intentioned legislators, operating in a panic, making mistakes. In a parody of the textbook behavioral response to a financial crisis, an eyewitness account of the enactment of Dodd-Frank, in which every action and reaction of Congressman Barney Frank and his staff were tracked, relates that Congressman Frank objected to appointment of a commission to study the causes of the crisis – which was being advocated by members of Congress and commentators – as a “distraction” and was reconciled to its creation only upon ensuring the commission’s work would be completed *after* legislation responding to the crisis could be enacted.¹⁹

¹⁸ See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. R. 1521, 1591, 1594 (2005) [hereinafter Romano, *The Sarbanes-Oxley Act*] (Sarbanes-Oxley substantive corporate governance mandates, advocated by policy entrepreneurs, were adopted despite empirical literature tending to suggest that they would be ill-conceived, as they would not improve corporate performance or audit quality, the stated statutory objective).

¹⁹ ROBERT G. KAISER, ACT OF CONGRESS 98 (2013) (stating that “Frank persuaded [House Speaker] Pelosi” that any legislation creating a commission would “stipulate that the commission make its final report” twenty months later so that “it would have no impact on the legislative process, which Frank intended to complete long before then.”) The author, who had known the congressman for many years, was invited to be “historian” of the legislation and had open access to Congressman Frank and his staff, sharing “behind the scenes” action, throughout

We are further provided with insight into Congressman Frank’s understanding of how to respond to the financial crisis by this description of his perspective on the crisis: it was that “the causes of the Great Crash were already well understood, and that it was due to “irresponsible financiers and anti-regulation Republicans.”²⁰ Such a cartoonish contention could only be made by a poorly-informed and highly-partisan political actor with a sound bite understanding of the complexity of what was, after all, a global financial crisis. Indeed, Congressman Frank’s simple-minded view of the crisis followed straightforwardly from his world view: he was one of the representatives most to the extreme left on the U.S. political spectrum, as indicated by his dw-

the legislative process. *Id.* at x-xi.

²⁰ *Id.* at 98-99. Congressman Frank apparently agreed with Mark Zandi’s contention that “indiscriminate home loans by overaggressive mortgage brokers, sloppy securitization of mortgages by banks and investment houses, and woefully inadequate government regulation were the principal causes of the financial crisis.” *Id.* at 98. Although such factors surely contributed to the crisis, it would be wildly inaccurate to contend that they explain what occurred. A list of factors that commentators have identified as contributing to the financial crisis would further include government policies encouraging home ownership and in particular subprime mortgages; low interest rate policy by the Federal Reserve; foreign nations’, particularly China’s, massive demand for dollars (driving down U.S. interest rates and making credit too easily available, thereby skewing investment decision-making); poorly designed incentive packages and risk management practices at financial institutions; a bubble in housing prices (e.g., distorted beliefs rather than distorted incentives); overreliance on credit rating agencies due to both private institutions’ guidelines and government regulation calling for their use; and international financial regulation. See FIN. CRISIS INQUIRY COMM’N, 112TH CONG., FIN. CRISIS INQUIRY REP. DISSENTING STATEMENT 444-45 (2011), available at http://www.law.yale.edu/documents/pdf/cbl/Financial_Crisis_Wallison.pdf; JOHN B. TAYLOR, GETTING OFF TRACK: HOW GOVERNMENT ACTIONS AND INTERVENTIONS CAUSED, PROLONGED, AND WORSENERED THE FINANCIAL CRISIS (2009); Alan Greenspan, *The Crisis* (2010); FIN. CRISIS INQUIRY COMM’N, 112TH CONG., FIN. CRISIS INQUIRY REP. xviii, xix (2011), available at <http://cybercemetery.unt.edu/archive/fcic/20110310173538/http://www.fcic.gov/report>; Foote et al., *supra* note 5; Frank Partnoy, *Historical Perspectives on the Financial Crisis: Ivar Kreuger, the Credit-Rating Agencies and Two Theories about the Function, and Dysfunction, of Markets*, 26 YALE J. REG. 431, 438-42 (2009); Jeffrey Friedman, *Capitalism and the Crisis: Bankers, Bonuses, Ideology and Ignorance*, in WHAT CAUSED THE FINANCIAL CRISIS? (J. Friedman ed. 2011).

nominate score, a widely-used ideology measure developed from roll call votes by political scientists Keith Poole and Howard Rosenthal.²¹ In the 111th Congress enacting Dodd-Frank, only 36 of 435 representatives had ideology scores to the left of Congressman Frank, and similarly, in the 110th Congress, the session prior to Dodd-Frank's enactment, only 35 representatives' scores were to his left.²²

The failure of Dodd-Frank to address key contributing factors to the crisis related to government policies, such as the GSEs, was to be expected when an individual who had strong ideological priors, and hardly an empirically-oriented problem-solver, "alone would decide what was in, and what was out" in the shaping of the legislation in the House.²³ In keeping with this synoptic characterization of Congressman Frank's perspective, he did not make an earnest effort to forge a coalition across the aisle, as that was not in his nature and he did not have to given large Democratic majorities in both chambers and a president from his party. Dodd-Frank was consequently enacted on a virtual party-line vote, in contrast to the typical crisis-driven legislation, which garners broad bipartisan support.²⁴

²¹ For a discussion of the construction of the dw-nominate scores, see KEITH T. POOLE & HOWARD ROSENTHAL, *IDEOLOGY & CONGRESS* 26-30 (2007)

²² See *HOUSE_110 Rank Ordering*, VOTEVIEW.COM, http://voteview.com/HOUSE_SORT110.HTM; and *HOUSE_111 Rank Ordering*, VOTEVIEW.COM, http://voteview.com/HOUSE_SORT111.HTM.

²³ KAISER, *supra* note 19, at 153. It was also convenient to blame the financial crisis on the private sector and political opponents for that deflected blame away from Congressman Frank's own contribution to the crisis as he was an ardent supporter of the failed housing and easy credit policies.

²⁴ No Republicans voted for the bill in the House, although several Democrats also voted against the bill, and only three Republicans voted to agree to the conference report, the vote resolving differences across the chambers, and thus enacting the legislation. *Final Vote Results for Roll Call 413*, HOUSE.GOV (June 30, 2010, 6:54 PM),

There is an additional factor besides policy preferences of the agenda setters that informs the absence of any provision concerning the GSEs. As detailed in numerous sources, the GSEs were munificent contributors to election campaigns, as well as glad-handers to constituents, such as, community organizers and activists, who in response lobbied legislators on the GSEs' behalf.²⁵ An extensive analysis of the GSE fiasco concludes that “[Congressman] Frank was a perpetual protector of Fannie [Mae] and those in his orbit were rewarded by the company,”²⁶ as it provided employment for Frank's friends and made sizeable contributions to his mother's nonprofit

<http://clerk.house.gov/evs/2010/roll413.xml>; *Final Vote Results for Roll Call 968*, HOUSE.GOV (Dec. 11, 2009, 2:28 PM), <http://clerk.house.gov/evs/2009/roll968.xml>. In the Senate, similarly, all but one Democrat and only four (three) Republicans voted for the Senate's version of the bill (conference report). *U.S. Senate Roll Call Votes 111th Congress-2nd Session*, SENATE.GOV (July 15, 2010, 2:29 PM), http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=2&vote=00208; *U.S. Senate Roll Call Votes 111th Congress-2nd Session*, SENATE.GOV (May 20, 2010, 8:25 PM), http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=2&vote=00162. Sarbanes-Oxley, by contrast, was enacted with overwhelming bipartisan support, unanimously approved in the Senate and with only three House Republican members voting against it. See Roberta Romano, *Does the Sarbanes-Oxley Act Have a Future?*, 26 YALE J. ON REG. 229, 238 (2009) [hereinafter Romano, *Does the Sarbanes-Oxley Act*].

²⁵ GRETCHEN MORGENSON & JOSHUA ROSNER, RECKLESS ENDANGERMENT: HOW OUTSIZED AMBITION, GREED, AND CORRUPTION LED TO ECONOMIC ARMAGEDDON 68-69 (2011) (noting that Fannie Mae was “highly creative when it came to ‘encouraging’ its higher-level executives to donate to political campaigns”). Morengenson and Rosner detail Fannie Mae's public relations campaign earmarking \$1 trillion in spending on affordable housing between 1994-2000 which would “commit so much money to low-income housing...that no one would dare to criticize its other activities,” and placing “partnership offices” in towns and cities throughout the country which “cemented the company's relationships with members of Congress.” *Id.* at 59-61.

²⁶ *Id.* at 69. Congressman Frank's cozy relationship with the GSEs and consequent opposition to reining them in pre-crisis has been extensively documented. *Id.* at 7, 68-69, 246-47, 256-59.

organization.²⁷ Frank was, of course, not alone in his staunch support of the GSEs in the years leading up to the crisis, as the GSEs' largesse was ubiquitous.²⁸ This venal political environment helps in explaining Dodd-Frank's peculiar silence on the GSEs and government housing policy.²⁹

While the political largesse of the GSEs has ceased with their placement under government conservatorship, there has still been no legislative response to the considerable risk to the fisc and the economy at large that they and government housing policies pose. Numerous bills since Dodd-Frank's enactment have, however, been introduced regarding the GSEs, with a

²⁷ *Id.* at 68-71. Senator Chris Dodd, one of the GSEs "most strident defenders," was also one of several legislators who received favored treatment for home mortgages from Countrywide Financial, the subprime mortgage originator closely associated with the GSEs, as they had common legislative interests; it was an equally vigorous campaign contributor and lobbyist. *Id.* at 186-87, 304. Although Senator Dodd's voting record indicates he was to the left of the center of his party, he was not an outlier, as was Congressman Frank, among his chamber compatriots: in the 111th Congress that enacted Dodd-Frank, there were more than twenty Democrats with a dw-nominate score to the left of his score and over thirty Democrats with a score to his right, while in the Senate of the 110th Congress, which was nearly evenly divided by party, there were twenty-one Democrats with scores to his left. *See Senate_110 Rank Ordering*, VOTEVIEW.COM, http://voteview.com/SENATE_SORT110.HTM; *Senate_111 Rank Ordering*, VOTEVIEW.COM, http://voteview.com/SENATE_SORT111.HTM. As these are chamber-derived scores, one must be cautious in interpreting these data as indicating that Frank was considerably more to the left of the political spectrum than Dodd, because we cannot say whether the center of the Senate and House Democrats would be identically placed on a left-right political scale. Poole and Rosenthal have estimated a "joint space" model for the dw-nominate scores, using the votes of representatives who moved on to the Senate. POOLE & ROSENTHAL, *supra* note 21, at 26-30. Although this model fits House members better than it does the Senate, in the joint space ranking, Frank's being considerably far more to the left than Dodd is again borne out: there are only 36 members whose dw-nominate score is to the left of Frank's, while there are 169 with scores to the left of Dodd's, among all members of the 111th Congress. *HOUSE_111 Rank Ordering*, *supra* note 22. For the legislator dw-nominate score estimates from the joint space model and an explanation of the methodology, see Royce Carroll et al., "Common Space" DW-NOMINATE Scores With Bootstrapped Standard Error (Joint House and Senate Scaling), VOTEVIEW.COM (Feb. 6, 2013), <http://voteview.com/dwnomjoint.asp>.

²⁸ *E.g.*, MORGENSON & ROSNER, *supra* note 25, at 59-71.

²⁹ *See, e.g., id.* at 304-305.

bipartisan bill that would replace the GSEs with a new federal agency that would guarantee all mortgages having been voted out of a Senate committee by a close vote.³⁰ Some commentators have contended that the bill is a solution far worse than the problem it ostensibly seeks to solve.³¹ Such criticism underscores how difficult implementing a policy to control the risk of loss generated by the GSEs and existing housing policies will be politically. But that is not why the GSEs were not addressed in Dodd-Frank; they were omitted because agenda-setting legislators had been ardent supporters of the agencies, did not consider them a problem, and would not have wanted to see policies they advocated undone.³²

The protracted implementation of Dodd-Frank has led some commentators to assert that the regulatory process has been captured by banking interests.³³ That is a possibility. It would, of

³⁰ The bill was introduced by Senators Tim Johnson (Democrat) and Mike Crapo (Republican), and voted out of committee by a thirteen to nine vote, with several members of both parties voting against it. Trey Garrison, *Johnson-Crapo Reform Bill Voted to Senate Floor*, HOUSINGWIRE (May 15, 2014), <http://www.housingwire.com/articles/30016-johnson-crapo-reform-bill-voted-to-senate-floor>.

³¹ See Phil Gramm & Peter Wallison, *Worse Than Fannie and Freddie*, WALL ST. J., Apr. 17, 2014, at A15; Garrison, *supra* note 30 (citing reservations regarding the bill by former Treasury Secretary Timothy Geithner and House Financial Services Committee Chairman Jeb Hensarling).

³² See text and accompanying notes 20, 26-27, *supra*.

³³ See Arthur E. Wilmarth, Jr., *Turning A Blind Eye: Why Washington Keeps Giving in to Wall Street*, U. CIN. L. REV. 1283, 1302, 1304-05 (2013). For capture-thesis critiques of Dodd-Frank and its implementation, see NOLAN MCCARTY ET AL., POLITICAL BUBBLES: FINANCIAL CRISES AND THE FAILURE OF AMERICAN DEMOCRACY 76-77, 79-80, 81, 83, 85-86, 89 (2013) (discussing statute and regulatory implementation in general); John C. Coffee, *The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019 (2012) (discussing regulatory implementation of executive compensation provisions). For capture-thesis explanations of the origins of the financial crisis and regulatory actions taken during it, see JAMES R. BARTH, GERALD CAPRIO, JR., & ROSS LEVINE, GUARDIANS OF FINANCE: MAKING REGULATORS WORK FOR US 4-7, 85-91 (2012) (suggesting regulators' lax, deregulatory policies were the principal contributors to the

course, be inconceivable for the financial industry not to engage in intensive lobbying over proposed rules, given the immense financial stakes.³⁴ But there is an alternative, equally plausible, explanation for the present state of affairs. The sheer complexity and numerosity of required rulemakings under Dodd-Frank, which at times requires coordination across multiple agencies, would contribute to slowing down any specific rule's enactment quite apart from the additional hurdle of interest group lobbying.

Moreover, lobbying has been deliberately built into the rulemaking process, and serves a critical function related to information and accountability, albeit the process can, no doubt, morph into regulatory capture. Namely, the notice and comment rulemaking procedure under which Dodd-Frank's required rules' enactment will proceed, as established by the Administrative Procedure Act ("APA"),³⁵ intentionally encourages such a dialogue: agencies are expected to be responsive to issues raised by interested parties in rulemaking deliberations and informed by their input, as the bureaucracy is thought not to be well situated to be adequately conversant with

financial crisis, and can be explained either by regulatory capture by large banks or regulators' subscribing to simplistic free-market ideologies, and placing greater emphasis on ideology than capture explanation); Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1951, 2041-49 (2014) (contending that because they were captured by banks, regulators both mistakenly deregulated financial institutions and failed to regulate consumer financial products, causing the crisis, and by engaging in forbearance, had to bail out banks at greater cost during the crisis). The intellectual pitfall for the pre-crisis capture explanation is that it mechanically assumes that all deregulation (or all deregulation not opposed by industry) is a function of capture and ill-advised. Theoretically, this is an open-ended question and short of an empirical inquiry, it is not possible to ascertain whether the narrative is accurate.

³⁴ Although it would not reach the level of a fiduciary breach, it would be irresponsible for management of financial firms to not seek to defend their institutions against regulation which they believed to be both counterproductive and injurious to their firms' financial position.

³⁵ 5 U.S.C. § 553 (2012).

business practices and consequently not attuned to the imposition of unanticipated compliance costs.³⁶ In addition, the APA was modified by the Negotiated Rulemaking Act, in which Congress further authorized direct bargaining between agencies and interested parties to develop proposed rules.³⁷ While business groups are the most frequent public participants in pre- and post- proposal rulemaking, scholars studying the administrative process find that the data are “not sufficient” to establish capture, nor whether business groups’ greater interest in rulemaking evidences “their defensive posture, or simply greater sophistication.”³⁸

Given the ambiguity in the impact of public participation in the rulemaking process, it is most important to note that were regulators implementing Dodd-Frank captured by the industry, then adopting this essay’s recommendation of sunseting crisis-driven regulation would be even more desirable than earlier advocated. The highly public legislative reassessment, replete with hearings and independent expert analyses, accompanying the process of sunset review, would draw attention to captured agencies, and so reassert, not undermine, democratic accountability and decision-making. Moreover, the public review of agency decisions subject to sunseting

³⁶ See CORNELIUS M. KERWIN & SCOTT R. FURLONG, *RULEMAKING: HOW GOVERNMENT AGENCIES WRITE LAW AND MAKE POLICY* 168-169 (4th ed. 2011) (recognizing that the purpose of public participation in rulemaking is to provide agencies with information and legitimacy). Consistent with informational needs, agencies frequently initiate contact with interest groups to obtain guidance on potential rules. *Id.* at 200. Although the APA does not state what an agency must do with public comments (except to require a statement of basis and purpose for adoption of a rule, 5 U.S.C. § 553(c)(2012)), agencies typically discuss the comments in the preamble to rules, and ignore significant comments at peril of the rule’s reversal by a reviewing court. KERWIN & FURLONG, *supra*, at 67.

³⁷ 5 U.S.C. §§ 561-570 (2012).

³⁸ KERWIN & FURLONG, *supra* note 36, at 194-95. Moreover, case studies of rulemaking find that business groups’ positions are not monolithic, *id.* at 195, paralleling the lack of unity among such groups regarding legislation, see Romano, *Regulating*, *supra* note 1, at 97.

should incentivize an agency to resist industry capture from the outset, as it would be aware that its actions would necessarily be evaluated thereafter and possibly overturned.

III. Dodd-Frank and the Legacy of Crisis-Driven Legislative Responses

Crisis-driven legislation often adopts off-the-rack solutions along with open-ended delegation to regulatory agencies as legislators, who perceive a political necessity to act quickly, adopt ready-to-go proposals offered by the policy entrepreneurs to whom they afford access.³⁹

Dodd-Frank exemplifies the difficulties that are created by these conventional crisis-driven legislative strategies, in the Volcker rule, which prohibits banks' proprietary trading, and creation of the Consumer Financial Protection Bureau ("CFPB").

A. Problematic Delegation: The Volcker Rule

The statutory provision known as the Volcker rule illustrates both that delegation in crisis-driven legislation can be particularly problematic and that, in turn, inapt congressional directives can contribute to protracted rulemaking. The provision restricts banking entities from engaging in specific risky activities, including proprietary trading and investment in hedge funds and private equity funds, which have often been among banks' more profitable lines of business.⁴⁰ It has arguably been the most contentious and protracted implementation of Dodd-Frank's regulatory directives, no doubt exacerbated by the broad discretionary delegation; as one commentator has put it, there are "broad gaps and ambiguities on key definitional issues," the

³⁹ *See id.* at 88-91.

⁴⁰ 12 U.S.C. § 1851(a)(1) (2012). Non-bank institutions designated as SIFIs are not subject to the ban, but are subject to heightened capital requirements and other restrictions regarding such activities. § 1851(a)(2). For the proposed rule's expected adverse impact on banks' bottom line, see Kimberly D. Krawiec, *Don't "Screw Joe the Plummer": The Sausage-Making of Financial Reform*, 55 ARIZ. L. REV. 53, 61 (2013).

resolution of which much rides on, not the least, banks' business models.⁴¹ Accordingly, the lengthy gestation period has been asserted to provide the opportunity for industry capture (that is, for industry delaying tactics and resistance to wear down, or otherwise convince, regulators to adopt definitions favorable to banks).⁴²

A comprehensive study by Kimberly Krawiec of pre-proposal stage agency contacts and comments regarding the Volcker rule found that the vast majority of contacts were by industry and, while the vast majority of comments were by members of the public, those comments were uninformative, non-substantive form letters (a campaign organized by public interest groups), whereas the much smaller set provided by the industry were carefully drafted, addressing technical issues related to the rule.⁴³ Certainly, such findings are intuitive: given the highly technical nature of the rule, the general public could not be expected to provide informative

⁴¹ *Id.* at 67. Among the ambiguities and gaps that need interpretation are the definition of “trading account” and the scope of statutory exemptions to the ban on proprietary trading and the ban on fund investments. *Id.* at 65-66.

⁴² *See id.* at 69-70.

⁴³ *Id.* at 58-59. This is also not a unique situation. Studies of rulemaking by the Environmental Protection Agency (“EPA”) similarly find that pre-proposal stage contacts are overwhelmingly dominated by industry (although some of those contacts are initiated by the agency as information requests). Wendy Wagner et al., *Rulemaking in the Shade: An Empirical Study of the EPA’s Air Toxic Emission Standards*, 63 ADMIN. L. REV. 99,125-26, 143 (2011). EPA rulemaking studies further report that a majority of comments submitted during the rulemaking process are by industry and that the number of comments from industry is positively correlated with a rule’s projected cost (crudely measured as above or below \$100 million), while the number of comments from the public increases with newspaper coverage (issue salience) and is unaffected by a rule’s projected cost. *Id.* at 139-40. Krawiec suggests that the latter finding may explain the higher proportion of public comments in her data (i.e., that the Volcker rule is a high salience provision). Krawiec, *supra* note 40, at 83.

comments, whereas industry representatives would have the expertise to do so.⁴⁴ While the study at times intimates that the data are consistent with a capture story, Krawiec does not conclude that the data evince capture. Rather, she notes that there were important, informed “countervailing” voices weighing in during the pre-proposal period – Senators who sponsored the rule and Paul Volcker himself – and that the political science literature suggests that the input of such individuals can provide an effective counterbalance to that of industry in agency decision-making.⁴⁵ And she leaves the question open for, as she recognizes, it is difficult to glean much in the way of a bottom line on industry capture without examining the constellation of comments and contacts in the later rulemaking stages, nor, more importantly, how, if at all, pre-proposal concerns raised by industry affected the proposed rule, which will be subjects of her future research.⁴⁶

More important, an assertion that the prolonged implementation of the rule, or a finding that issues raised in the pre-proposal stage influenced the proposed rule, demonstrates industry

⁴⁴ Krawiec finds one datum surprising: no sector of the financial industry, such as institutional investors, who might have been “expected to fight any weakening” of the rule’s “protections that supposedly accrue to their benefit,” participated in the pre-proposal stage. *Id.* at 84. An explanation of their non-participation that I believe is plausible is that the provision did not benefit investors or, as she puts it, albeit as an open question, that the rule’s benefits to investors were “overstated.” *Id.*

⁴⁵ *Id.* at 82-84. The study of EPA rulemaking also does not conclude that the numerical dominance (or as the authors put it, “imbalance”) of industry contacts and comments during the rulemaking process “has a meaningful impact” on the rules, but after considering arguments why it might not have such an effect, concludes that the evidence “does not rule out” that possibility. Wagner et al., *supra* note 43, at 147. Reviewing the several case studies of pre-proposal comments, which all find business groups did not obtain their desired objective, Kerwin and Furlong conclude that given the small number of such studies, “no easy generalization” about the overall influence of business can be drawn. KERWIN & FURLONG, *supra* note 36, at 212.

⁴⁶ Krawiec, *supra* note 40, at 83.

capture, would sweep aside what is, in fact, deep and genuine intellectual disagreement on both the efficacy and workability of the Volcker rule.⁴⁷ For example, distinguishing between illegal proprietary trading and legal market making, can, to put it mildly, be a formidable task.⁴⁸ Yet such a distinction is in the statutory formulation. Indeed, the Volcker rule's substantive requirement poses such severe implementation challenges that the United Kingdom deliberately adopted instead a retail ring-fencing approach to constrain banks' risk-taking, which requires separating into different entities an institution's retail banking and related services from its wholesale and investment banking businesses, thereby, in theory, isolating retail banking services, and hence taxpayers, from losses on trading activities and other wholesale banking risks.⁴⁹ With sunset, legislators' attention, with the assistance of an expert review panel, would be directed to reassessing the proprietary trading prohibition and a comparative assessment by experts could be undertaken concerning which approach, prohibition or ring-fencing, was more effective, as well as whether such rules make much sense in the first place. Such an inquiry would raise the quality of decision-making.

⁴⁷ Charles A. Piasio, *It's Complicated: Why the Volcker Rule Is Unworkable*, 43 SETON HALL L. REV. 737, 738-40 (2013). It also would ignore the built-in source of delay, as noted earlier, from the need for the rule to be coordinated across multiple regulators. For a discussion of the difficulties of policy implementation when there are multiple decision points, with the Volcker rule as an example, see PETER H. SCHUCK, *WHY GOVERNMENT FAILS SO OFTEN AND HOW IT CAN DO BETTER* 236-38 (2014).

⁴⁸ Krawiec, *supra* note 40, at 65-68; Piasio *supra* note 47, at 761.

⁴⁹ TIMOTHY EDMONDS, THE INDEP. COMM'N ON BANKING, *THE VICKERS REPORT* 3, 7 (2013) (explaining the Independent Commission on Banking's ring-fencing recommendation and rejection of Volcker rule); Jeremy G. Hill & Edite Ligere, *Debevoise & Plimpton LLP Client Update, Financial Services (Banking Reform) Bill – Expect the Unexpected* (Feb. 7, 2013), <http://www.debevoise.com/clientupdate20130207a/> (indicating that the U.K. government will implement the recommendations of the Independent Commission on Banking and bill has been introduced that does so).

Compounding the challenge of implementing the Volcker rule beyond its sheer intractability, is the fact that it is one of many Dodd-Frank “solutions” to conjectural problems, for as former Treasury Secretary Timothy Geithner succinctly put it, “Proprietary trading by banks played no meaningful role in the crisis.”⁵⁰ Although legislation plainly should seek to anticipate future financial crises and not solely address past ones, directing the focus of regulatory efforts on resolving known and pressing regulatory issues over speculative ones is self-evidently a more rational and prudent regulatory agenda, given scarcity in agency time and resources.

Notwithstanding a protracted drafting effort, there were still large unintended adverse consequences that became immediately apparent upon the Volcker rule’s promulgation. Within a month, an interim rule was further adopted to provide an exception to the final rule’s treatment of specified derivative instruments (collateralized debt obligations backed by trust-preferred securities) to mitigate an adverse impact on small and medium-sized banks, the principal holders of such assets. Without the exception, the banks would have had to take large losses writing down the securities, placing them at risk of violating capital requirements.⁵¹ The Rube Goldberg-like Volcker rule, which is over nine-hundred pages, will, no doubt, produce further surprises, in

⁵⁰ TIMOTHY F. GEITHNER, *STRESS TEST REFLECTIONS ON FINANCIAL CRISES* 414 (2014). For similar views in the academic literature, see, e.g., Piasio, *supra* note 47, at 738-40; Charles Whitehead, *The Volcker Rule and Evolving Financial Markets*, 1 HARV. BUS. L. REV. 39, 41-42 (2011).

⁵¹ Matthew Goldstein, *Regulators Ease Volcker Rule Provision on Smaller Banks, Dealbook*, N.Y. TIMES, Jan. 15, 2014, at B2; Rob Blackwell, *Volcker Rule Fix Will Aid Large and Small*, AM. BANKER (Jan. 14, 2014, 5:38 PM), http://www.americanbanker.com/issues/179_10/volcker-rule-fix-will-aid-large-and-small-banks-1064926-1.html;

addition to imposing substantial compliance costs.⁵² This is yet another consideration for why sunseting would be of value in this context. The Office of the Comptroller of the Currency estimates the Volcker rule could cost the banking entities that it supervises upwards of \$4 billion, a figure challenged by an SEC commissioner as, in all likelihood, far too low.⁵³ As he put it, “Based upon the fact that this is not a serious analysis, I have no way to evaluate whether they are even in the right ballpark.”⁵⁴ Sunseting would provide an opportunity for Congress to obtain a handle on the true scope of the cost and accordingly, revise the rule or direct regulators to do so, in order to produce a more cost-effective implementation or to adopt an entirely different approach to the problem.

One might contend that sunseting is unnecessary for a salient rule such as the Volcker rule because it would attract congressional attention for consideration under the Congressional

⁵² Steve Culp, *Final Volcker Rule Leaves Banks Facing Compliance Hurdles*, FORBES (Dec. 17, 2013, 3:23 PM), <http://www.forbes.com/sites/steveculp/2013/12/17/final-volcker-rule-leaves-banks-facing-compliance-hurdles/> (summarizing lengthy set of activities companies must undertake to “bring themselves into compliance with the Volcker rule”). Adding to the cost, at least in the immediate future, is the considerable uncertainty over how to comply with the rule, as the rule raises a host of interpretative questions without a transparent process for how to obtain clarity from enforcement agencies, including the issue whether when one agency provides an interpretation, other agencies will concur. *Id.*; see also Margaret E. Tahyar, *Volcker Rule: Observations on Interagency FAQs, OCC Interim Examination Guidelines*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (June 20, 2014, 9:02 AM), <http://blogs.law.harvard.edu/corpgov/2014/06/20/volcker-rule-observations-on-interagency-faqs-occ-interim-examination-guidelines/>

⁵³ Jesse Hamilton, *Volcker Rule Will Cost Banks Up to \$4.3 Billion, OCC Says*, BLOOMBERG (Mar. 21, 2014, available at: <http://www.bloomberg.com/news/2014-03-20/volcker-rule-will-cost-banks-up-to-4-3-billion-occ-says.html>). SEC Commissioner Michael Piwowar’s critical judgment of the estimate was derived from his view of the agency’s analysis as “not rigorous.”

⁵⁴ *Id.*

Review Act (“CRA”), under which, before a rule can take effect, it must be submitted to each chamber of Congress, for review under an expedited legislative process that permits enactment of a joint disapproval resolution, which, when signed by the President (or a veto is overridden), repeals the rule.⁵⁵ However, as evidenced by the experience under the CRA—since enactment in 1996, only one rule has been disapproved and only two other disapproval resolutions have ever been passed by one chamber⁵⁶—the CRA is not an effective substitute for sunseting.

⁵⁵ 5 U.S.C. §§ 801-802 (2012). The joint resolution must be adopted within sixty days of the submission, subject to extension if Congress is not in session at the time. *Id.* § 802. The statute requires consideration in the Senate under fast-track procedures, preventing a resolution from being held up in committee or filibustered, *Id.* § 802(c) & (d). While there are no special procedural requirements for the House, a chamber receiving a disapproval resolution from the other chamber cannot bottle it up in committee. *Id.* § 802(f)(1).

⁵⁶ MORTON ROSENBERG, CONG. RESEARCH SERV., RL 30116, CONGRESSIONAL REVIEW OF AGENCY RULEMAKING: AN UPDATE AND ASSESSMENT OF THE CONGRESSIONAL REVIEW ACT AFTER A DECADE 6 (2008) (stating that as of March 31, 2008, Congress had received reports on 731 major rules and 47,540 non-major rules under the statute, 47 joint resolutions concerning 35 rules were introduced, and only one rule was disapproved, while two other rules were disapproved by the Senate alone). Moreover, the circumstances of the one disapproved rule, the Occupational Safety and Health Association’s (“OSHA”) 2001 ergonomics standard, are considered to be “unique” and unlikely to be repeated. First, it was an extremely controversial proposal due to its projected imposition of extremely high costs on business. Second, Congress delayed adoption of any ergonomics standard for over a decade by appropriations riders. Third, the political situation changed completely within the statutory sixty-day period for review, as the rule was adopted when the Clinton presidency was a lame duck, after the intervening election had given Republicans control of the presidency and both congressional chambers. *Id.* at 6, 14-15. Whether the rule could have been repealed without the CRA is unclear (the Republican control of the Senate was not filibuster-proof, although the disapproval resolution was supported by some Democrats), but as one commentator put it,

“Because of the unique circumstances surrounding ergonomics, we cannot generalize from the impact on the CRA on ergonomics to conclude that the CRA has a significant impact on the regulatory process...Even *with* [the conditions of a Republican presidency and Congress and many lame duck regulations], Congress did not attempt to overturn any of the many other major regulations issued by the Clinton administration in its waning months.”

Stuart Shapiro, *The Role of Procedural Controls in OSHA’s Ergonomics Rulemaking*, 67 PUB. ADMIN. REV. 688, 696 (2007) (emphasis in original).

The problems with the CRA are considerable. First, the CRA permits only an up or down vote on a rule in its entirety, while at the same time prohibiting an agency from reissuing a “substantially similar” rule if a rule has been disapproved.⁵⁷ This structure deters legislators from voting for a disapproval resolution, due to genuine concern that it would create an administrative vacuum,⁵⁸ which could especially be a problem with a long and complicated rule, such as the Volcker rule, where parts of the rule may well be desirable to retain. Sunset review, by contrast, permits legislative tailoring: besides the yes or no approach of the CRA, a rule can be revised, retained or repealed only in part. The ability to tailor regulation would facilitate a more deliberative review process than the CRA, by eliminating the contention that a rule must be left intact to prevent a regulatory void. Yet as noted in the original essay, although commentators skeptical of the value of sunseting have missed it, sunseting can be structured so as not to create a similar regulatory vacuum: the proposed action timetable to discharge a review panel’s recommendation from committees with jurisdiction and use of budget reconciliation procedures for consideration by the Senate eliminates regulatory repeal due to deliberate congressional inaction or obstruction by a legislative minority.⁵⁹ Second, there is no mechanism in the CRA by

⁵⁷ ROSENBERG, *supra* note 56, at 22-23, 34-35.

⁵⁸ For instance, opponents of the resolution disapproving the ergonomics standard contended that it would not be possible for OSHA to write another rule were the resolution to pass. Shapiro, *supra* note 56, at 696

⁵⁹ See Romano, *Regulating*, *supra* note 1, at 99, 111. For critiques of sunseting as facilitating repeal due to the legislative process see, Coffee, *supra* note 33, at 1023-24; Brett McDonnell, *Dampening Financial Regulatory Cycles*, 65 FLA. L. REV. 1597, 1676 (2013). A total repeal due to Congress following the recommendation of an independent review panel should, by contrast, not be a matter of concern, as it is improbable that the process would be “captured,” the concern of Coffee and McDonnell regarding a failure by Congress to renew a statute, Coffee, *supra* note 33, at 1023-24; McDonnell, *supra*, at 1636, due to the public nature of the process and the composition of the panel. Indeed, the independent panel’s sunset review

which Congress can readily obtain additional information to assess a rule, as would be provided by a sunset review's panel of independent experts, which, again, should render decision-making of higher quality under sunseting.⁶⁰

Finally, noncompliance with the requirements of the CRA is rampant, with agencies having failed to submit to Congress for review well over 1000 rules from 1998-2008, 101 substantive final rules in 2008 alone.⁶¹ Without notice of a rule, Congress cannot review it, yet neither the CRA, nor Congress through subsequent action, devised a mechanism by which unsubmitted rules can be identified or compliance enforced.⁶² Agency noncompliance, and hence absence of congressional review, would not occur under a sunseting regime, given the starkly different default: a rule stays in existence if Congress does not act under the CRA, whereas it expires if Congress fails to act under sunseting. In short, sunseting provides a forcing mechanism for action, that the CRA lacks, and combined with similar fast-track legislative

would function more effectively than the expert studies that McDonnell favors, *id.* at 1636-37, because its recommendations would have real bite. *See* Romano, *Regulating*, *supra* note 1, at 100.

⁶⁰ For example, the statute requires an agency to provide a cost-benefit analysis with the submission of the rule and the Comptroller General (“CG”) to assess the agency’s compliance with that requirement, but the CG interprets the requirement narrowly: it simply reports whether the required cost-benefit analysis is present and does not substantively evaluate the agency’s analysis. ROSENBERG, *supra* note 56, at 3.

⁶¹ Sean D. Croston, *Congress and the Courts Close Their Eyes: The Continuing Abdication of the Duty to Review Agencies’ Noncompliance with the Congressional Review Act*, 62 ADMIN. L. REV. 907, 908 (2010) (citing figures from a 2009 report by the Congressional Research Service). As Croston notes, that estimate is likely to be an understatement because an earlier congressional report suggested that “thousands” of rules had not been submitted for review. *Id.*

⁶² For possible reasons why Congress has not acted to remedy the compliance failures, see *id.* at 909-911.

procedures, the possibility of a minority preventing action will be vastly reduced. Although in theory, the CRA is an admirable concept through which Congress could exercise substantive control over poorly devised regulation, in practice, it has failed spectacularly, as commentators have noted, interpreting its disuse as evidence of total ineffectiveness.⁶³

B. Off-the-Rack Solutions: Reshuffling Bureaucratic Boxes and the CFPB

An illustration of the problematic nature of “off-the-rack solutions” fashioned in crisis-driven legislation is Dodd-Frank’s creation of the CFPB, which consolidated into one agency functions that had been allocated across seven federal agencies pre-crisis.⁶⁴ Reshuffling bureaucratic boxes is a tried and true legislative response to crises. This is because it is a high visibility “solution”—it demonstrates that legislators are “doing something” in a way that is relatively easy for a poorly informed public to observe—and it combines two favored legislative responses to crises—an “off-the-rack” response conjoined with a delegation strategy, for the agency will bear responsibility for policy failures rather than legislators.⁶⁵

⁶³ ROSENBERG, *supra* note 56, at 14-15; Croston, *supra* note 61, at 908.

⁶⁴ Leonard J. Kennedy et al., *The Consumer Financial Protection Bureau: Financial Regulation for the Twenty-First Century*, 97 CORNELL L. REV. 1141, 1145 (2012).

⁶⁵ Romano, *Regulating*, *supra* note 1, at 88-90. A number of financial regulatory agencies have been created in response to financial crises: the Federal Deposit Insurance Corporation in the Banking Act of 1933, which responded to the bank failures in the 1930s and the Great Depression; the Securities and Exchange Commission in the Securities Exchange Act of 1934, which responded to the stock market crash of 1929 and the Great Depression; the Public Company Accountant Oversight Board in the Sarbanes-Oxley Act, which responded to the 2001-02 accounting scandals involving Enron and other companies; and not only the CFPB but also the Financial Stability Oversight Council in Dodd-Frank. The approach has also been used in response to nonfinancial crises, the most recent and notable example being creation of the Homeland Security Department in the USA Patriot Act of 2002. And it would seem to be a stock response to crises beyond U.S. borders as well: the European Union created three new EU-level supervisory agencies in the wake of the crisis. See Memorandum from Brussels European Comm’n Financial Supervision Package - Frequently Asked Questions, 10/434, at 1-3 (Sept. 22,

As often occurs with “off-the-rack” legislative responses to financial crises, Dodd-Frank’s administrative reorganization mismatches problem and solution because the U.S. regulatory architecture, and in particular, absence of a designated consumer-product regulator, did not contribute to the financial crisis. For instance, housing bubbles produced severe financial crises in Iceland, Ireland and Spain, despite the absence of subprime mortgage securitizations in those nations.⁶⁶ In addition, there were meltdowns of financial institutions operating under distinctly different regulatory architectures (e.g., under both the multi-regulator, decentralized U.S. regime and the United Kingdom’s centralized one).⁶⁷ Given the simultaneous regulatory failures and crises in nations with disparate financial products, markets and regulatory structures, it is improbable that any bureaucratic reorganization would address the causes of the recent financial crisis, let alone prevent a future one.⁶⁸

2010), available at: http://europa.eu/rapid/press-release_MEMO-10-434_en.htm. For a cogent critique of bureaucratic reorganization as a crisis response, see RICHARD POSNER, *THE CRISIS OF CAPITALIST DEMOCRACY* 171-175 (2010).

⁶⁶ CARMEN M. REINHART & KENNETH S. ROGOFF, *THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY* 244 (2009). For an analysis debunking the contention that the resets on exploding adjustable-rate mortgages caused a wave of foreclosures ushering in the financial crisis, see Foote et al., *supra* note 5, at 35-36.

⁶⁷ While the regulatory structures differed substantially across nations, international bank capital requirements were harmonized under the Basel Accords, and elsewhere I have contended that international harmonization contributed, in some measure, to the global financial crisis, by incentivizing banks to follow similar business strategies. See Roberta Romano, *For Diversity in the International Regulation of Financial Institutions: Rethinking the Basel Architecture*, 31 *YALE J. ON REG.* 1, 13-20 (2014). But the Basel Accords did not harmonize how regulators should respond to bank failures, and different regulatory architecture did not produce quicker or cleaner resolutions to the global financial crisis.

⁶⁸ In addition, most of the new agency’s jurisdiction is over products and institutions that had no connection to the crisis. See, e.g., Todd Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 *GEO. WASH. L.REV.* 856, 861-62 (2013). As Zywicki notes “[T]here is absolutely no evidence that failures in consumer protection actually

More particularly, it is quite implausible that the recent financial crisis would have been averted had there been an independent federal agency regulating consumer financial products: in discussing in his memoir the Administration’s decision to reorganize the government bureaucracy in the area of consumer protection, former Treasury Secretary Geithner does not mention the financial crisis once as a rationale or cause for the proposal. Rather, he refers to the President’s passion for “defending ordinary families from financial abuse,” dating back to outrage at his credit card rates when he was a community organizer, and presidential aides’ political considerations, which included pleasing activists in the political base who were dissatisfied with Administration policies, and promoting an issue that would resonate with the general public, thereby building support for the rest of the bill.⁶⁹

As is also quite typical for many components of crisis-driven legislation, the idea of a single federal agency with regulatory authority specifically over consumer financial products was not a new proposal carefully tailored to address an identified problem related to the financial crisis. Rather, it had been floated as a proposal by a policy entrepreneur prior to the onset of the crisis. Then law professor Elizabeth Warren had advocated such an entity in a short 2007 article, by analogy to the federal agency protecting consumers from harm by physical products.⁷⁰ The

contributed in a major way to the crisis—indeed, many of the financial service providers swept under the CFPB’s umbrella, such as payday lenders and providers of cash remittances, had nothing at all to do with the financial crisis.”

⁶⁹GEITHNER, *supra* note 50, at 403-04. The CFPB’s lax definition of a qualified mortgage, *see supra* note 9, and the fact that none of the subprime products sold to consumers were newly invented in the years before the financial crisis, Foote et al., *supra* note 5, further support the text’s counterfactual contention that had the CFPB predated the crisis, the financial meltdown still would have occurred.

⁷⁰ Elizabeth Warren, *Unsafe at Any Rate: If It’s Good Enough for Microwaves, It’s Good Enough for Mortgages: Why We Need a Consumer Financial Product Safety Commission*,

Bush Administration had similarly proposed such an entity in a March 2008 plan to consolidate the multiple regulators of financial institutions, which had been crafted prior to the onset of the financial crisis as a strategy to improve capital market competitiveness (but then repositioned as a solution to the financial crisis in the waning days of the Bush presidency).⁷¹

Warren shortly thereafter co-authored a more extensive law review article with Oren Bar-Gill which sought to provide a theoretical justification for her original proposal, fleshing out why consumers of financial products could need regulatory protection using concepts from behavioral economics.⁷² Underscoring the fact that the genesis of the idea for the agency was independent of the financial crisis, the bulk of the 100 page-long article's analysis focuses on consumer credit cards, which had no role in the financial crisis, with only a page or so discussing mortgages. But the Bar-Gill and Warren article was identified by the Obama Administration as the source of its inclusion of such an agency in its legislative reform proposal to address the financial crisis.⁷³

The law review article did not, however, provide any institutional detail concerning the agency's structure, except to state that it should be either an independent agency or a division

DEMOCRACY, Summer 2007, at 8.

⁷¹ DEP'T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 170-71 (March 2008), *available at* <http://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf>.

⁷² Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 69, 98-100 (2008).

⁷³ DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 55-62 (2009) [hereafter TREASURY DEP'T WHITE PAPER], *available at* http://treasury.gov/initiatives/Documents/FinalReport_web.pdf; Kennedy et al., *supra* note 64, at 1146 n. 14 (stating that idea for Administration's proposed agency derived from Bar-Gill and Warren's recommendation).

within an existing agency, such as the Federal Reserve or Federal Trade Commission, while the Obama Administration proposal advocated creating an independent executive branch agency with a director and board of which one member would be the head of a prudential regulator.⁷⁴

Adapting the Administration proposal, the statute established an entity with a unique autonomous structure for a U.S. administrative agency. The CFPB is organized similarly to a cabinet department in the executive branch with a solitary director (in contrast to independent agencies that are typically structured as bipartisan commissions), but it is entirely independent of the executive, as it was placed within the Federal Reserve System (“Fed”),⁷⁵ and in contrast to cabinet department secretaries, who serve at the President’s whim, the director has statutory removal protection (i.e., serves a fixed term and can be removed only “for cause”).⁷⁶

Even more unique, the CFPB is also financially independent of Congress as it is not subject to the appropriations process: the director sets his own budget, which is funded by the Fed (capped at twelve percent of the Fed’s total operating expense).⁷⁷ Moreover, Federal Reserve

⁷⁴ Bar-Gill & Warren, *supra* note 72, at 98; TREASURY DEP’T WHITE PAPER, *supra* note 73, at 58.

⁷⁵ 12 U.S.C. §§ 5491(a)-(b)(1), 5492(c)(2) (2012). As Todd Zywicki describes the evolution of the agency’s structure, in the House bill, the agency was to be “a multimember commission funded in part by congressional appropriations,” but that was criticized, particularly by Republicans, who objected to the expense of creating a new agency, and the response, appearing in the Senate bill, was to “turn the agency into a bureau of the Fed.” Zywicki, *supra* note 68, at 860-61.

⁷⁶ 12 U.S.C. §5491(c)(3). Statutory removal protection is conventionally considered a hallmark of an independent agency. *See Note, Independence, Congressional Weakness, and the Importance of Appointment: The Impact of Combining Budgetary Autonomy with Removal Protection*, 125 HARV. L. REV. 1822, 1822 & n. 2 (2012).

⁷⁷ 12 U.S.C. §§ 5497(a),(c)(2012). Other regulatory agencies that are independently funded and not subject to the appropriations and budget processes—which tend to be prudential regulators of financial institutions such as the FDIC, as well as the Fed—have multimember

Board governors may neither intervene in the CFPB’s affairs, review or delay implementation of its rules, nor consolidate the bureau, its functions or responsibilities with any other office or division of the Fed.⁷⁸ This regulatory setup has a bizarre whiff of a Kafkaesque bureaucracy, as the agency is formally insulated from democratic accountability.⁷⁹

The CFPB’s unique independent structure is combined with wide-ranging authority that is inherently in conflict with prudential regulation aimed at reducing bank failure, underscoring the reality that creation of the agency was an off-the-rack solution quite unrelated to the financial

structures. *See* Kirti Datla & Richard L. Revesz, *Deconstructing Independent Agencies (and Executive Agencies)*, 98 CORNELL L. REV. 769, 793 (2013) (table 3, listing agencies with multimember structures); U.S. GENERAL ACCOUNTING OFFICE, GAO-02-864, SEC OPERATIONS: IMPLICATIONS OF ALTERNATIVE FUNDING STRUCTURES 11-12 (2002) (listing agencies with truly independent funding). In addition, in contrast to the broad grant of authority to the CFPB, those other agencies have narrower, and more technical purposes –prudential regulation and the setting of monetary policy–mitigating the accountability concerns raised by an agency’s independence from the appropriations process. *See* Note, *supra* note 76, at 1823-24.

⁷⁸§ 5492(b)(2).

⁷⁹ Although the director must file semi-annual reports with Congress, there is little action Congress can take to alter policies with which it disagrees, unless the agency requires additional funds beyond the amount that it obtains from the Fed and fines that it imposes on regulated entities, and must request a supplemental congressional appropriation, as permitted under the statute. Zywicki, *supra* note 68, at 888-89. There is an inflation index adjustment for the CFPB expenses, and if the amount is inadequate, the director can request a further appropriation from Congress, § 5497(a)(2)(B), and as yet, the CFPB has not sought supplemental funds: it requested less from the Fed to fund its operations than the transfer cap for fiscal year 2014 and projected it would do so as well for fiscal year 2015, whose respective budget caps are \$608.4 million and an estimated \$618.7 million. CONSUMER FIN. PROT. BUR., THE CFPB STRATEGIC PLAN, BUDGET, AND PERFORMANCE PLAN AND REPORT 20 (2014), *available at*: <http://www.consumerfinance.gov/strategic-plan-budget-and-performance-plan-and-report/> Moreover, as discussed *infra* at text and accompanying notes 84-109, the director has been able to circumvent Congress’s effort to impose accountability in the specification of criteria to be used in rulemaking, which the courts could enforce, by regulating without engaging in rulemaking. For an extensive criticism of the agency’s structure, as rendering the CFPB “one of the most powerful and publicly unaccountable agencies in American history,” see Zywicki, *supra* note 68, at 875-899.

crisis. For instance, the statutory mission is to “ensur[e] that all consumers have access to markets for consumer financial products and services” that are “fair, transparent and competitive.”⁸⁰ Such an objective suffers from the twin faults of over- and under- inclusiveness with regard to improving the financial regulatory architecture. It is under-inclusive by failing to target the market and product igniting the global financial crisis, the shadow banking sector, an institutional, not retail, market, and securitized mortgages, which were neither a consumer credit, nor even a retail, product. Yet it is over-inclusive as the CFPB is given authority to regulate all forms of consumer credit and not simply subprime mortgages, which were the only retail product implicated in the crisis (as the increase in subprime defaults was a trigger of the shadow banking run).⁸¹

More importantly, the CFPB’s overlapping supervisory authority with banks’ prudential regulators is in intrinsic conflict given their distinctly different missions: safety and soundness of banks and the financial system versus consumer protection. Indeed, the CFPB’s supervisory process “flip[s] the safety and soundness regulatory paradigm on its head” by directing the most intensive scrutiny to banks’ most profitable financial products and services.⁸² Recognizing that the differing regulatory objectives of this dual supervisory system would lead to inevitable conflict, the statute permits banks to request that agencies coordinate if there is a supervisory

⁸⁰ 12 U.S.C. § 5511(a) (2012).

⁸¹ For the contention that whatever the contribution of subprime mortgages to the financial crisis it was entirely unconnected to consumer protection issues and implicated solely prudential—safety and soundness--regulatory concerns, because consumers were rationally responding to incentives provided by lenders who were making unwise loans, and not consumers’ misunderstanding of the loan terms, see Zywicki, *supra* note 68, at 910-11.

⁸² Eric J. Mogilnicki & Melissa S. Malpass, *The First Year of the Consumer Financial Protection Bureau: An Overview*, 68 BUS. LAW. 557 (2013).

conflict and, if they fail to coordinate, to appeal to an ad hoc panel of three regulators, which includes one regulator from each of the agencies that failed to coordinate.⁸³ But this setup is not a satisfactory resolution of the supervisory tension as such an appeals process would be both costly to undertake and uncertain in outcome, given the panel composition (as it will likely only shift venue without resolving the turf battle the agencies could not negotiate in the first place), factors that discourage its use.

The most troubling aspect of the CFPB's insulation from congressional oversight, however, is that it has facilitated policymaking that evades democratic accountability and that, on occasion, has been of questionable lawfulness. Namely, the CFPB has used notice and comment rulemaking only when it was statutorily required to adopt a rule.⁸⁴ On virtually all other occasions, as far as I can determine, it has instead engaged in rulemaking by subterfuge, through

⁸³12 U.S.C. §5515(e)(3)-(4)(B) (2012).

⁸⁴ Besides substantively mandated rules, *e.g.*, 12 U.S.C. § 5532(b)(f) (2012) (mandating that the CFPB propose for public comment rules and model disclosures that integrate mortgage loan disclosures under the Truth in Lending Act and the Real Estate Settlement Procedures Act), the agency has also engaged in rule-making on a few other occasions when it could not otherwise exercise authority over specific institutions or products and a rule was necessary to establish its jurisdiction (that is, when it had to follow a rulemaking procedure as prescribed by the statute), *e.g.*, Consumer Fin. Prot. Bur., Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service, 79 Fed. Reg. 60762 (Oct. 8, 2014), *available at* <https://www.federalregister.gov/articles/2014/10/08/2014-23115/defining-larger-participants-of-the-automobile-financing-market-and-defining-certain-automobile> (expanding regulatory jurisdiction to define as a “covered market”, “a market for automobile financing,” automobile leases as “covered products” and nonbank automobile lenders as “covered persons”). Because this market and the institutions offering these financial products and services would not be subject to the agency’s authority in the absence of its adopting a rule defining them to be covered, 12 U.S.C. § 5514 (2012), it could not regulate their activity by issuing a guidance document or bringing an enforcement action, its typical mode of operation as discussed in the text, and had no choice but to follow the prescribed rule-making process.

the use of guidance (statements of “expectations”) and enforcement actions. These strategies enable the agency to evade not only engaging in the informed and transparent decision-making process that Congress sought in enacting the APA, but also complying with the specific criteria Congress enumerated in Dodd-Frank regarding factors it wished to inform the CFPB’s rulemaking, including a cost-benefit standard, as Congress did not similarly specify criteria for CFPB orders, guidance or enforcement actions.⁸⁵

The use of guidance and enforcement actions, rather than rulemaking, to effect regulatory policy further sidesteps an important safeguard of congressional delegation which is maintained by judicial review. Political scientists have emphasized that a key mechanism by which Congress controls administrative agencies is its specification of administrative procedures.⁸⁶ Because it cannot predict what regulatory issues will arise and therefore what substantive mandates to enact or require agencies to implement, Congress designs procedures that “assign relative degrees of importance” to constituents, to participate in, monitor, and appeal the outcome of, administrative decisions.⁸⁷ In creating the CFPB, Congress added specific procedural content going beyond APA general rulemaking procedures, specifying that the agency must consider the costs and benefits not only to consumers but also to the providers and offerors of financial products and services, in its rulemaking.⁸⁸ Without judicial enforcement of those procedures, interested parties (i.e., constituents) cannot constrain agency outcomes to those Congress desired and political

⁸⁵ 12 U.S.C. §§ 5512(a)-(b) (2012).

⁸⁶ Mathew D. McCubbins et al. *Administrative Procedures as Instruments of Political Control*, 3 J. L. ECON. & ORG. 243, 244-45 (1987).

⁸⁷ *Id.* at 244-46.

⁸⁸ § 5512(b)(2).

control over agencies is crippled.⁸⁹ Using guidance to effectuate policymaking eviscerates the balance struck by Congress to maintain control over the agency because courts rarely characterize guidance as agency action subject to judicial review.⁹⁰

What I have described critically regarding the CFPB's regulatory strategy could be considered totally prosaic as agencies regularly engage in the same regulatory strategies – statements of guidance and enforcement actions – to avoid the arduous strictures of notice and comment rulemaking,⁹¹ and administrative law scholars have long debated the degree to which this should be a matter of concern.⁹² But there is a crucial difference between generic agencies and the CFPB that should render the CFPB's use of such tactics far more unsettling. An agency subject to an annual appropriations process, in contrast to the CFPB, cannot maneuver as freely and aggressively use such strategies because congressional committees have leverage to enforce accountability through imposition of budgetary restrictions and non-statutory directives and

⁸⁹ McCubbins et al., *supra* note 86, at 263.

⁹⁰ It is difficult to obtain judicial review of guidance decisions, as courts typically do not consider them to be final agency action, as required for standing by the APA, or otherwise ripe for review. Nina A. Mendelson, *Regulatory Beneficiaries and Informal Agency Policymaking*, 92 CORNELL L. REV. 397, 411 (2007). If an agency's guidance is viewed as having "binding" effect, then a court may deem it a "legislative rule" and uphold a challenge against the agency for not following the notice and comment process. Nicholas Bagley & Helen Levy, *Essential Health Benefits and the Affordable Care Act: Law and Process*, 39 J. HEALTH POL. POL'Y & L. 441, 454 (2014). This area of law is, to put it mildly, quite murky; as one article puts it, "the line separating policy statements from legislative rules is not crisp," and courts generally do not second-guess agencies' choice of regulatory tool. *Id.*; see Lisa Schultz Bressman, *Beyond Accountability: Arbitrariness and Legitimacy in the Administrative State*, 78 N.Y.U. L. REV. 461, 534 (2003).

⁹¹ Mendelson, *supra* note 90, at 397-99.

⁹² For a general discussion of the competing considerations, see, Bressman, *supra* note 90, at 541-44; and for a discussion of the considerations focused on guidance documents, see Mendelson, *supra* note 90, at 406-13.

instructions regarding specific expenditures accompanying budget legislation.⁹³ The incentive effect of the CFPB's unique organizational structure upon its choice of policy tools could, as I think it should, be revisited were financial regulation subject to sunseting.⁹⁴

Two examples will suffice to illustrate the CFPB's problematic employment of regulatory strategies that enable it to obtain the outcome it desires regarding regulated entities' behavior, without the use of rulemaking. First, the agency staff believed that credit card add-ons, such as payment for lost wallet protection, had little or no value and should not be sold.⁹⁵ This is, of

⁹³ For a discussion of appropriations committee oversight techniques, and their use to delay the SEC's implementation of the Sarbanes-Oxley Act's internal controls provision to small firms, see Romano, *Does the Sarbanes-Oxley Act*, *supra* note 24, at 284-86. For a parallel notion that the structural accountability of an agency affects its incentives to engage in robust informed decision-making, and is a matter of policy concern, see Catherine M. Sharkey, *State Farm 'with Teeth': Heightened Judicial Review in the Absence of Executive Oversight*, N.Y.U. L. REV. (forthcoming), available at http://lsr.nellco.org/nyu_plltwp/463 (contending that the factual determinations of independent agencies that are not subject to executive oversight should receive less judicial deference because they have insufficient incentives to engage in comprehensive cost-benefit analysis, compared to agencies which know their rules must be reviewed by the Office of Information and Regulatory Affairs in the Office of Management and Budget).

⁹⁴ Congress could, of course, revisit the CFPB's structure without sunseting. Indeed, Republicans have introduced several bills, see Andrew J. Buczek & Haydn J. Richards, Jr., *House Financial Services Subcommittee Holds Legislative Hearing on CFPB Proposals*, CONSUMER FIN. SERVS. L. BLOG (May 27, 2014), <http://www.cfs-lawblog.com/House-Subcommittee-Hearing-CFPB-Proposals>, one of which passed the House on a nearly party line vote, to restructure the agency. *Final Vote Results for Roll Call 85: Consumer Financial Protection Safety and Soundness Improvement Act of 2013*, HOUSE.GOV (Feb. 27, 2014, 6:39 PM), <http://clerk.house.gov/evs/2014/roll085.xml> (showing that all Republicans and ten Democrats voted for the Bill). But no bill restructuring the CFPB, including the house-passed one, has moved in the Senate, and President Obama would surely veto any such legislation. As a practical matter, the many veto points in the legislative process render reorganization of the CFPB questionable in the absence of either another crisis leading to calls for a bureaucratic rearrangement, or an election sweep in which the Republican party, whose members uniformly opposed the agency's creation, took control of both chambers and the presidency.

⁹⁵ Although the agency's objections to the products were stated in terms of the use of "deceptive" or "high-pressure" marketing tactics, Consumer Fin. Prot. Bur., *What Are Credit Card "Add-on Products"* (Mar. 1, 2013), <http://www.consumerfinance.gov/askcfpb/1541/what->

course, possible, but a contested assertion.⁹⁶ Rather than adopt a rule prohibiting or restricting their sale, it brought three enforcement actions against credit-card providers for improper marketing and published a list of “expectations” – what it would look for in evaluating the product.⁹⁷ In response to those agency actions, the three largest banks, followed by other institutions (none of whom were the subject of the enforcement actions), “voluntarily” cancelled the products.⁹⁸ It is inconceivable that the CFPB’s heavy-handed use of its powers is the approach that Congress had in mind when it directed the agency to consider the “potential benefits and costs to consumers and covered persons [financial institutions], including the potential reduction of access by consumers to consumer financial products or services resulting

are-credit-card-add-products.html, the detailed procedures it identified for banks’ marketing of such products to not be considered deceptive were so burdensome that it is plain that the agency’s goal was to eliminate the products entirely, an objective that was achieved. *See infra* text and accompanying note 98.

⁹⁶ As Alan Schwartz has noted, a problem with substantive rules restricting consumer contracts (as opposed to disclosure regulation) is that both rational and irrational consumers may prefer the same contracts, such as a credit card add-on, but as the regulator can observe only contracting choices, not preferences, it cannot distinguish irrational from rational consumers by simply observing market choices. As a consequence, restricting the consumer’s ability to contract (e.g., purchasing the add-on), may decrease, not increase welfare, as it might be rationally chosen and not, as the regulator assumes, chosen by mistake (i.e., due to cognitive bias or consumer irrationality). Alan Schwartz, *Regulating for Rationality*, STAN. L. REV. (forthcoming 2014) (manuscript at 15-19).

⁹⁷ CONSUMER FIN. PROT. BUR., *MARKETING OF CREDIT CARD ADD-ON PRODUCTS* (2012), *available at*: http://www.consumerfinance.gov/f/201207_cfpb_bulletin_marketing_of_credit_card_addon_products.pdf

⁹⁸ *See* Karen Weise, *The Consumer Finance Watchdog Is Having an Impact*, BLOOMBERG BUSINESSWEEK. (Jan. 10, 2013), <http://www.businessweek.com/printer/articles/90258-the-consumer-finance-watchdog-is-having-an-impact>. The three banks subject to the enforcement actions – one of which was for failure to supervise a third-party vendor and not for any failures in its own marketing – were required to pay in aggregate \$101.5 million and \$435 million in refunds to customers. *Id.*

from such rule,”⁹⁹ as it conveyed a preference that the agency engage in cost-benefit analysis and not restrict the financial products available to consumers.

Second, the CFPB staff believes that data indicate that automobile dealers charge higher interest rates to women and minorities than to white men (although it did not make public the supporting data, which was derived from proxies – not actual sales data – to estimate discriminatory dealer practices, because the ethnicity of car buyers is not recorded.).¹⁰⁰ But Dodd-Frank expressly prohibited the agency from regulating automobile dealers.¹⁰¹ The agency therefore adopted the tactic of providing warning or “guidance” in a bulletin issued to banks, which are subject to its authority, that it would enforce anti-discrimination laws against banks that purchased auto loans from auto dealers, claiming that a disparate impact is sufficient to find a violation (as the agency did not have any evidence of discriminatory intent by the dealers).¹⁰²

⁹⁹ 12 U.S.C. § 5512(b)(2)(A)(i) (2012).

¹⁰⁰ Kim B. Perez, *The CFPB “Indirectly” Regulates Lending Through Auto-Dealers*, 18 N.C. BANK. INST. 399, 418 (2014) (showing that the CFPB guidance bulletin relied on mathematical proxies for race and ethnicity, using Social Security Administration and Census Bureau data to estimate the probability someone is of a racial or ethnic minority based on their surname and geographic location, and then used the proxies to determine where consumers might experience discrimination based on interest rates that proxy-determined minorities received); *Your Car Dealer Must Be a Racist*, WALL ST. J., Nov. 15, 2013, at A14.

¹⁰¹ 12 U.S.C. § 5519 (2012). The statute contains exceptions to the exclusion of auto dealers from the CFPB’s regulatory authority, but none of the exceptions apply to auto loans that the dealer provides through a bank or that are securitized, the subject of the guidance.

¹⁰² CONSUMER FIN. PROT. BUR., *INDIRECT AUTO LENDING AND COMPLIANCE WITH THE EQUAL OPPORTUNITY ACT* (2013) [hereinafter CONSUMER FIN. PROT. BUR., *INDIRECT AUTO.*]; *CFPB to Hold Auto Lenders Accountable for Illegal Discriminatory Markup*, Consumer Fin. Prot. Bur. (Mar. 21, 2013), <http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/>. No doubt, the CFPB’s disparate impact approach looks to a decades-old series of settlements of Department of Justice prosecutions under the fair lending laws that were based on a disparate impact standard. *See Zywicki, supra*

The guidance further suggested that banks could avoid an enforcement action if they imposed controls on, and monitored, dealer markups and then took “prompt corrective action” against miscreant dealers, or, better yet, if they charged flat fees to eliminate dealer discretion as to the interest rate, which was the industry practice regarding dealer compensation (lenders shared profits with dealers as a function of the loan’s interest rate).¹⁰³ Banks rationally responded to the guidance, which was provided in the shadow of an implicit supervisory threat of adverse regulatory action if they did not comply, by telling dealers that if they did not comply, they would impose flat fees (which was the CFPB’s desired objective).¹⁰⁴

The discrimination standard that the CFPB applied in the bulletin, a disparate impact rather than disparate treatment (i.e., intent) standard, in all likelihood, as confirmed by the government’s litigation strategy, would not stand up to judicial review. The Supreme Court’s jurisprudence has evolved to require an intent standard, and as a consequence, in recent years, whenever the Court has granted certiorari on a disparate impact challenge, the federal government has settled to avoid a possible adverse decision that rejected the disparate impact rationale.¹⁰⁵ Also problematic is the CFPB’s interpretation in the bulletin of who is a “creditor” under the fair lending law. Although the agency contended that it was not reinterpreting or making new

note 68, at 923. The disparate impact standard is a controversial theory which the Department has assiduously avoided subjecting to Supreme Court review. *See infra* note 105 and accompanying text.

¹⁰³ CONSUMER FIN. PROT. BUR., INDIRECT AUTO, *supra* note 102, at 4-5.

¹⁰⁴ *Your Car Dealer Must Be a Racist*, *supra* note 100; Perez, *supra* note 100 The agency brought enforcement actions against four banks under the Bulletin. *Id.* at 399 & n. 5.

¹⁰⁵ *Id.* at 424. As Perez notes, the statutes under which the Supreme Court has upheld a disparate impact are those that contain the word “affect,” language not contained in the lending statute. *Id.* at 423.

“law,” which conveniently eliminated the need for following rulemaking procedures, the interpretation would seem to a fair-minded observer, in fact, to be quite novel, as neither auto dealers’ markups nor indirect lenders had previously been understood to fall within the statutory definition.¹⁰⁶

By engaging in backdoor rulemaking through use of guidance (its supervisory authority over banks), the CFPB sought to restrict auto dealers’ negotiations with customers with regard to financing terms, and to impose a significant change in their business model, as the vast majority of auto sales are financed.¹⁰⁷ This was done, despite express restriction of jurisdiction over the subject matter, while employing a highly problematic, possibly lawless, interpretation of the statute and without publicly disseminating the data upon which its decision was based. Had the CFPB engaged in rulemaking, it would have had to explain itself and publicly release the data to justify the rule (if only to seek to avoid a defeat were it to be challenged in court).¹⁰⁸

¹⁰⁶ *Id.* at 413-14. The CFPB’s claim regarding the lack of novelty was provided in response to a query from members of Congress concerning why it had acted on the subject by issuing a guidance rather than a rule. *Id.* at 412-13.

¹⁰⁷ As the Wall Street Journal explained, flat fees cap dealers’ profits on loans and thereby limit their flexibility to lower an interest rate on one sale to compete with an offer from another dealer and to raise an interest rate on another sale to boost profits. *Your Car Dealer Must Be a Racist*, *supra* note 100.

¹⁰⁸ Perez, *supra* note 100, at 415. It seems probable that the cost-benefit criteria would not have been easily satisfied as the dealer compensation policy promoted by the guidance may well increase lending costs. As Perez notes, if dealer discretion on rates is maintained, then banks must engage in substantial monitoring, imposing considerable costs, which will increase the rate of interest banks require, and if instead discretion is replaced with flat fees, then dealers will lose the flexibility of trading interest rates off against purchase price, with the upshot that they will be less likely to offer lower purchase prices. *Id.* at 426-27. Were a bank to challenge an enforcement action brought against it for not complying with the guidance, then the agency would have to justify the rule just as it would have had to do for a challenged rulemaking. But as is typical for financial institutions subject to regulatory enforcement actions, it does not appear that any entity has chosen to litigate, rather than settle.

It is possible that the CFPB's determinations that credit card add-ons and auto dealer interest rate markups are questionable products and practices that should be prohibited are correct, although I am skeptical of such a conclusion.¹⁰⁹ But these are large and substantive policy matters that are most properly calibrated through rulemaking, with public participation, as contemplated by Congress, in which the agency has to develop a record and publicly justify its decisions, that is, provide evidence that credit card add-ons have no or little value and that auto dealers are discriminating.

Most important, these two examples are instances where both sunseting and experimentation would have been of considerable benefit. Namely, sunseting would reduce the possibility that the CFPB could persistently evade the more demanding notice and comment procedures. For if the agency were a sunset agency, then when Congress had to revisit its authorization, it could impose specific rulemaking requirements, or restrict the scope of the CFPB's authority, and, further, reevaluate whether the structure of the agency made much sense in the first place.¹¹⁰ The agency would also have an incentive to behave responsibly, knowing

¹⁰⁹ *See id.* at 425-26 (discussing benefits to consumers from dealer participation in lending, including data indicating that interest rates on indirect loans even with a dealer markup, were one percent lower than rates on direct bank loans).

¹¹⁰ McCarty et al. assert that Congress is the problem in resolving financial crises, contending that it does not enact effective reform regulation because of interest group lobbying and polarized politics. MCCARTY ET AL., *supra* note 33, at 57-61, 72-75. While this essay similarly contends that Congress's emergency financial legislation is deeply problematic, the explanation of its failure articulated here is altogether different from McCarty et al.'s. Their analysis assumes that the cause of the financial crisis was a "Republican" ideology of free markets and deregulation, and consequently, that legislative and regulatory initiatives of congressional Democrats are presumptively superior to the status quo, with the proviso that they should not provide regulatory discretion because industry will capture implementation. *Id.* at 38-42, 123-26. As students of the recent financial crisis are well aware, there is, in fact, plenty of blame to go around regarding the crisis across the political spectrum and across all institutions,

that its decisions would be publicly scrutinized by legislators during reauthorization, a context in which there could be serious consequences to the agency for questionable conduct, in contrast to their present posture. Moreover, restrictions on credit card add-ons and imposing flat fees on auto dealers are the type of regulation for which well-crafted experiments could prove to be fruitful: a subset of banks could be randomly selected to adopt such policies, and another subset could be randomly selected to take a different approach, such as improved disclosure, and the findings then used to inform policymaking.¹¹¹

It would be a mistake to conclude that implementation difficulties and problematic regulation are occasional occurrences that can be ameliorated over time, by regulators dutifully ironing out flaws, and thereby negate a need for sunseting. Experience teaches otherwise: the status quo is sticky, whether it be legislatively or administratively formulated. Regulations are rarely revisited and it takes an inordinately long time, sometimes decades, despite a policy consensus regarding the inappropriateness of a particular regulatory solution, for legislators to address the issue.¹¹²

In fact, congressional mandates to agencies to reevaluate existing regulations on a regular basis would appear to be totally ignored with impunity. A study of the statutory requirement that

public and private. *See, e.g., supra* notes 20, 28. Moreover, given the global scope of the crisis, with banks imploding in countries with diverse political leadership and regulatory institutions, what occurred cannot, in a simple-minded fashion, be ascribed solely to the “ideology” of a particular domestic political party. For a list of common fundamentals across diverse nations characterizing the financial crisis, such as real estate bubbles, current account deficits and large capital inflows (factors experienced in Iceland, Ireland, New Zealand and Spain, as well as the United States), see REINHART & ROGOFF, *supra* note 66, at 244.

¹¹¹ For a brief discussion regarding the concern that firms in an experiment may act strategically, see Romano, *Regulating, supra* note 1, at 106.

¹¹² *See, e.g., id.* at 86, 96.

agencies periodically review existing rules for their impact on small business found that most of the time agencies did not even conduct the required review, and when they did, they rarely took any action beyond publishing a notice that the review had been conducted, or they revised regulations to increase, rather than reduce, as the statute intended, the burden on small firms.¹¹³ Moreover, even when regulators are repeatedly prodded by Congress to revisit a specific regulation that is thought to be flawed, regulators are congenitally conservative and tend to resist.¹¹⁴ And their technical staff, positioned in an organizational hierarchy in which there can be adverse professional consequences if they are not responsive to their superiors' preferences, cannot be relied upon to produce a balanced assessment concerning whether a rule should be revised or repealed, even if they have a sophisticated appreciation of a problem. It is simply in the nature of agency staff reports to perceive the task at hand as rationalizing agency policy. The report of an independent sunset review panel of experts would not suffer from that problem. The panel's experts, would not be beholden to a bureaucracy and would have professional reputations at stake, along with presumed diversity in perspectives, given the appointment process, that would minimize the possibility of a purely rationalizing report.

Agency use of experts when compelled by judicial review is no less likely to be problematic. An illustration demonstrating the difficulty of relying on internal experts' evaluation is its use by the SEC to support an effort to require mutual fund boards to have a supermajority of

¹¹³ See Michael R. See, *Willful Blindness: Federal Agencies' Failure to Comply with the Regulatory Flexibility Act's Periodic Review Requirement—And Current Proposals to Invigorate the Act*, 33 FORDHAM URB. L. J. 1199, 1200, 1215-19 (2006).

¹¹⁴ For an illustration of this tendency from Sarbanes-Oxley, see *infra* notes 120-24 and accompanying text.

independent directors. After the rule was rejected by the U.S. Court of Appeals for the D.C. Circuit for not having met a requisite cost-benefit standard,¹¹⁵ the Commission had its Office of Economic Analysis undertake a literature review to assist in the remanded rulemaking.¹¹⁶ Although the report is a careful evaluation of the literature, in a supplemental memo, the Chief Economist sought to explain it away, as it was inconsistent with the premise of the proposed rule.¹¹⁷ The memo explained that, despite the absence of evidence in the literature that more independent boards reduced fees or improved performance, a failure to find a relation does not mean there is no relation, given the limits of standard statistical methods.¹¹⁸ This observation is correct so far as it goes, but it also proves too much, as we must do the best that we can with the information that we possess when a judgment must be made. It is self-evident that the Chief Economist felt pressed to interpret the data in the report in the supplemental memo to assist the agency's effort to build a record that would support retaining the original rule and that could pass judicial scrutiny.

C. A Note on Sarbanes-Oxley's Lessons for Dodd-Frank

It could be asserted that the Sarbanes-Oxley Act is a good contrast to Dodd-Frank because its regulatory requirements were implemented in short order after enactment. Yet Sarbanes-Oxley provides a cautionary tale for relying on an agency to revisit a crisis-driven legislative directive, in the SEC's problematic implementation of section 404, the requirement that managers certify

¹¹⁵ Chamber of Commerce of U.S. v. Sec. Exch. Comm'n, 443 F.3d 890 (2006).

¹¹⁶ Memorandum from Chester Spatt, Chief Econ., to Inv. Co. File S7-03-4, at 1-2, 12-23 (Dec. 29, 2006).

¹¹⁷ Romano, *Does the Sarbanes-Oxley Act*, *supra* note 24, at 300

¹¹⁸ *Id.*

the effectiveness of their firm's internal controls, and that auditors attest to that certification.¹¹⁹ Complying with section 404 was quite costly for all companies, but disproportionately far more so for smaller firms, and the SEC initially postponed the provision's application to the smallest firms (market cap under \$75 million), but declined to adopt the recommendation of its own advisory committee to exempt those firms permanently.¹²⁰ Small firms had a better hearing in Congress, which threatened the SEC with budgetary restrictions were it to let the delayed application expire as planned, and in response, then-SEC Chairman Christopher Cox agreed to maintain the postponement and conduct a cost-benefit study of the statute and the budget restriction was accordingly eliminated from the appropriations bill in conference.¹²¹

The promised study of section 404's effects was undertaken by economists in the SEC's Office of Economic Analysis, and completed under Cox's successor, but when data indicated a negative impact on small firms, the SEC's accountants apparently found the findings objectionable, and presumably the Chairwoman did too, for the report attempts to provide a positive assessment, and only by combing through the 100-plus page study can one piece together

¹¹⁹ Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, § 404, 116 Stat. 745, 789 (codified at 15 U.S.C. § 7262).

¹²⁰ For a detailed narrative of the saga of the SEC's approach to section 404, see Romano, *Does the Sarbanes-Oxley Act*, *supra* note 24, at 239-44. The SEC's original estimate of per-firm annual compliance costs of \$91,000 was wildly inaccurate, by orders of magnitude, and despite declining from early per-firm compliance costs in excess of \$1 million, it is still well above that amount, OFFICE OF ECON. ANALYSIS, STUDY OF THE SARBANES-OXLEY ACT OF 2002 SECTION 404 INTERNAL CONTROL OVER FINANCIAL REPORTING REQUIREMENTS 5 (2009), *available at* http://www.sec.gov/news/studies/2009/sox-404_study.pdf [hereafter OEA, STUDY OF 404]; Romano, *Does the Sarbanes-Oxley Act*, *supra* note 24, at 240-41.

¹²¹ *Id.* at 284.

the negative findings.¹²² More to the point, when in Dodd-Frank, after eliminating the provision's applicability to the smallest firms, Congress instructed the SEC to conduct a study of the compliance burden of section 404 for small firms that Dodd-Frank did not exempt (market cap between \$75 - \$250 million),¹²³ this time the analytical work was given to the Office of the Chief Accountant, and not the economists, ensuring the study would – as it predictably did – advise against extending the exemption to more firms.¹²⁴

A recent article by John C. Coates IV and Suraj Srinivasan reviewing the empirical academic literature that has sought to assess the impact of Sarbanes-Oxley over the past decade, and concluding that “[o]n balance, research on the Act’s net social welfare remains

¹²² See generally, OEA, STUDY OF 404, *supra* note 120. It was rumored that the release of the SEC study was delayed so that the text be recrafted to place the statute in a positive light. Some evidence of the commission’s disapprobation of the original study is that the agency’s publication clearance review process would appear to have delayed the release of a scholarly paper derived from the study’s data: the paper was only recently published, years after the SEC study was completed. See generally Cindy R. Alexander et al., *Economic Effects of SOX Section 404 Compliance: A Corporate Insider Perspective*, 56 J. ACCT. & ECON. 267 (2013). The SEC accountants’ objections are not surprising, as the recommendation of the SEC’s advisory committee to exempt small firms was vigorously opposed by the two accountants on the committee, a position at one with the profession’s financial interest. E.g., Romano, *Does the Sarbanes-Oxley Act*, *supra* note 24, at 240-41 & n. 39 (indicating accountants on the advisory committee dissented from recommendation to exempt small firms and providing data that audit fees tripled as a percentage of revenue for small public companies before and after Sarbanes-Oxley).

¹²³ Dodd-Frank § 989G(b), 124 Stat. 1383, 1948 (2010) (codified at 15 U.S.C. § 7262).

¹²⁴ OFFICE OF THE CHIEF ACCOUNTANT OF, SEC. & EXC. COMM’N, STUDY AND RECOMMENDATIONS ON SECTION 404(B) OF THE SARBANES-OXLEY ACT OF 2002 FOR ISSUERS WITH PUBLIC FLOAT BETWEEN \$75 AND \$250 MILLION 112 (2011), *available at* www.sec.gov/news/studies/2011/404bfliat-study.pdf (recommending against extending exemption).

inconclusive,”¹²⁵ does not alter this essay’s evaluation of the need for sunseting that statute, along with other crisis-driven financial legislation. Although I believe that Coates and Srinivasan’s assessment of the literature is mistaken as it both overstates potential benefits and downplays or misses research with negative findings,¹²⁶ this essay is not the proper forum for providing a

¹²⁵ John C. Coates IV & Suraj Srinivasan, *SOX after Ten Years: A Multidisciplinary Review*, ACCT. HORIZONS (forthcoming) (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 758, 2014).

¹²⁶ For example, the authors omit from their review, articles indicating that Sarbanes-Oxley’s cost outweighs the benefits for foreign cross-listed firms— firm samples that tend to provide cleaner results than using samples of U.S. firms, because they can provide controls of comparable companies not affected by the statute. *E.g.*, Xi Li, *The Sarbanes-Oxley Act and Cross-Listed Foreign Private Issuers*, 58 J. ACCT & ECON. 21 (2014); Kate Litvak, *The Long-term Effect of the Sarbanes-Oxley Act on Cross-Listing Premia*, 14 EUR. FIN. MGMT. 875 (2008); Kate Litvak, *The Effect of the Sarbanes-Oxley Act on Non-U.S. Companies Cross-Listed in the U.S.*, 13 J. CORP. FIN. 195 (2007). In addition, despite the seemingly modest conclusion quoted above, the text of the literature review places the statute in a more positive light. This is conveyed through statements that seemingly broadly discredit prior critiques of Sarbanes-Oxley, related to its impact on corporate law, but that are then followed by qualifiers cabining the broad statements to reference only one provision, or only one out of many critics’ contentions, such that a non-specialist could easily miss the caveat and pick up only the broader statement. For example, the authors state that data on firms’ disclosures of material weaknesses under section 404, “suggests that for a significant number of public companies, SOX’s section 404 has functioned at least in part in a ‘comply or explain’ fashion, contrary to strong characterizations of that part of the law as ‘mandating’ corporate governance changes.” Coates IV & Srinivasan, *supra* note 125, at 14. But a consumer of the literature reviewing the pre-publication article, gleans from that statement the following mistaken conclusion: “Another concern was SOX would change financial regulation from disclosure to prescriptive command-and-control. But the authors conclude that it is a ‘comply or explain’ regime.” Peter van Doran, *Working Papers, Corporate Accounting, SOX after Ten Years: A Multidisciplinary Review*, in REGULATION 68 (Spring 2014). He missed the critical word “part” qualifying the sentence, which was referencing a *disclosure* provision that was not one of the many mandatory corporate governance provisions that are the source of that specific criticism of Sarbanes-Oxley, nor did Coates and Srinivasan identify any of those provisions as “comply or explain” and not mandatory ones. *See, e.g.*, Romano, *The Sarbanes-Oxley Act*, *supra* note 18, at 1529, 1533, 1538, 1540, 1594-95 (critiquing move to mandatory rules in Sarbanes-Oxley, that consisted of audit committee requirements, corporate loan prohibition, prohibition of auditor provision of non-audit services, and officer certification of financial statement accuracy).

critique of their literature review. For accepting Coates and Srinivasan's assessment and conclusion, for argument's sake, only serves to bolster this essay's advocacy of the importance of engaging in experimentation for financial regulation. Namely, the inability to conclude that Sarbanes-Oxley has produced a net benefit highlights how crisis-driven regulation could benefit from experimentation. If the SEC had structured implementation of the statute's provisions, such as the independent audit committee mandates or auditor attestation requirements, as randomized experiments, then we could have more accurately measured the net benefit or cost of the requirements.¹²⁷

Accepting their assessment and conclusion for argument's sake also underscores the need for sunseting. Sunseting would provide the agency with an incentive to get things right and operate with less of a closed bureaucratic mindset regarding experimentation when implementing emergency-driven legislation, as the agency would need to develop the highest quality information available. For if, in a sunset review occurring seven to ten years after implementation (the time range of Coates and Srinivasan's assessment), the net benefit were still inconclusive, then substantial revision of the delegating statute, reversing the agency's previous endeavors, would be a more probable outcome.

III. Conclusion

The post-enactment experience of the two most recent crisis-driven statutes concerning financial regulation, Dodd-Frank and Sarbanes-Oxley, underscores the importance of including in

¹²⁷ The article by Coates and Srinivasan adopts the position on regulatory experimentation I advanced in *Regulating in the Dark*, Romano, *Regulating*, *supra* note 1, at 104-06. *See* Coates IV & Srinivasan, *supra* note 125, at 57-58 (arguing that increased randomized trials would allow for a greater ability to assess causal effects of the Sarbanes-Oxley Act)..

such legislation, mechanisms – sunseting and regulatory experimentation – to ensure that there will be a serious, comprehensive reassessment after a fixed period, and that information regarding the impact of regulatory alternatives can be gathered in the interim to aid in the reassessment. The implementation of the statutes has been replete with instances of the sort of errors that inevitably arise from crisis-driven legislation, as it is enacted at a time when information necessary to devise suitable solutions is unavailable. That state of affairs permits agenda-setting legislators to adopt preferred policy entrepreneurs’ “off-the-rack” solutions, which are often not well-matched to the problems at hand, along with extensive, albeit poorly thought out, delegation, which result in costly market adjustments and adverse unintended consequences with questionable social benefits. Still, sunseting and regulatory experimentation are not panaceas. Legislators must conscientiously revisit the statute and its implementation, with the assistance of the analyses of independent experts, and regulatory experiments must be well-crafted to inform a reassessment. Nonetheless, sunseting and regulatory experimentation are the best tools we possess to mitigate the perils that arise when one is regulating in the dark.

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