Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation

Saule T. Omarova
Cornell Law School, sto24@cornell.edu

Follow this and additional works at: http://scholarship.law.cornell.edu/facpub

Recommended Citation
http://scholarship.law.cornell.edu/facpub/1010

This Article is brought to you for free and open access by the Faculty Scholarship at Scholarship@Cornell Law: A Digital Repository. It has been accepted for inclusion in Cornell Law Faculty Publications by an authorized administrator of Scholarship@Cornell Law: A Digital Repository. For more information, please contact jmp8@cornell.edu.
Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation

Saule T. Omarova*

I. INTRODUCTION .............................................................................................................................................. 622
II. REGULATORY CHALLENGES IN THE FINANCIAL SERVICES SECTOR ......................................................... 625
   A. Financial Regulation Reform After the Crisis: Systemic Risk and Regulatory Capture .................................. 625
      1. Systemic Risk Regulation .......................................................................................................................... 625
      2. The Problem of Regulatory Capture ......................................................................................................... 629
   B. Reframing the Dilemma: Systemic Risk Regulation as a Political Choice .................................................. 632
III. TRIPARTISM AND GUARDIANSHIP IN ACADEMIC DEBATE ...................................................................... 634
   A. Tripartism as a Counterweight to Regulatory Capture .................................................................................. 635
   B. Grappling with Public Interest in the Debate on Financial Regulation Reform ........................................... 637
      1. Improving Governance of Financial Regulation ......................................................................................... 637
      2. Broadening Regulators’ Intellectual Perspective ......................................................................................... 639
IV. ELEMENTS OF TRIPARTISM IN PRACTICE: “QUASI-GUARDIANS” AT WORK .............................................. 642
   A. Public Interest Organizations ...................................................................................................................... 643
      1. Functions and Activities .......................................................................................................................... 643
      2. Potential Limitations .................................................................................................................................. 646
   B. Government Actors: Proxy Advocates and Agency Monitors ...................................................................... 648
      1. Proxy Advocates ......................................................................................................................................... 648
      2. Agency Monitors ....................................................................................................................................... 650
   C. Technical Expert Councils .......................................................................................................................... 654
   D. Congressional Advisory and Investigatory Commissions ............................................................................ 655
   E. Summary ...................................................................................................................................................... 658

* Assistant Professor, the University of North Carolina at Chapel Hill School of Law. The author would like to thank the organizers of and participants in the symposium, Crisis and the Challenges for Regulatory Design, at Kenan Institute for Ethics, Duke University (June 2–3, 2011), and the Wharton Summer Conference on International Financial Regulation at the Wharton School, University of Pennsylvania (July 21–22, 2011). Special thanks to Edward Balleisen, Lissa Broome, John Coyle, Adam Feibelman, Michael J. Gerhardt, Thomas Lee Hazen, Arthur Laby, William P. Marshall, Brett McDonnell, Richard E. Myers II, Sidney Shapiro, Daniel Schwarcz, and David Zaring, for their comments on earlier drafts, and to Adam Battenhorst and Meghan Spears for their research assistance. All errors are solely those of the author.
V. ENTER THE GUARDIANS: DESIGNING TRIPARTISM IN FINANCIAL SERVICES
REGULATION .......................................................... 658

A. Public Interest Council: A Proposal Outline ................................................... 659
1. Creation and Status ...................................................... 659
2. Membership: Composition, Selection, Removal ........................................... 661
3. Powers and Responsibilities ................................................ 663

B. Potential Challenges on the Path to Tripartism .............................................. 669
1. Defining “Public Interest” .................................................................................. 669
2. Effectiveness and Accountability ...................................................................... 671
3. Political Feasibility and Potential Alternatives .............................................. 672

VI. CONCLUSION ........................................................................ 674

Government is the people’s business, and every man, woman and child becomes a shareholder with the first penny of tax paid.1

In France in the 1980s, the socialists took over the banks. In the United States in the 2000s, the banks took over the government.2

I. INTRODUCTION

The world is still reeling from the aftershocks of the recent financial crisis. What started as a bursting U.S. real estate bubble in mid-2007 escalated into a full-blown systemic meltdown in global financial markets in 2008–09, followed by crippling recession and sovereign debt crisis in the world’s leading economies in 2010–11.3 The crisis demonstrated that, in today’s complex and interconnected world, the process of financial innovation is not a matter of concern solely to financial market professionals. Risks generated by private market actors in pursuit of financial gain have serious and wide-ranging public implications. The ultimate cost of financial crises is inevitably borne by the taxpayers and the broader society, especially its least affluent members. In this context, making the financial system safer is increasingly a matter of direct public concern, which implicates democratic politics as much as technocratic administration.

Theoretically, protecting the public from potentially devastating financial crises is the job of government agencies regulating and supervising the financial services sector. As the latest crisis demonstrated, financial regulators consistently failed to exercise truly public-minded and independent judgment with respect to potential systemic risks created by unfettered financial innovation and the industry's pursuit of private profit. In response to the crisis, Congress enacted the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank Act), the most sweeping financial regulation reform legislation since the Great Depression. Yet, this voluminous new law falls short of correcting a critical flaw in the existing regulatory process: pervasive regulatory capture and lack of consistent representation of the public interest in long-term financial stability. Today, much like in the pre-crisis years, most substantive decisions in the area of systemic risk regulation are made behind closed doors, by industry insiders and agency technocrats. Is it possible to ensure meaningful public participation in the process of regulating systemic risk associated with financial innovation? Or should we continue relying on bankers and bureaucrats as the only viable guardians of the common good? This is the fundamental dilemma that this Article seeks to address.

This Article challenges the underlying concept of financial sector regulation as a process involving only two principals: the financial services industry and the government agencies overseeing it. This Article offers a new vision of systemic risk regulation as a tripartite process. It argues that, in order to adequately protect the public interest in systemic stability, it is necessary to include a designated public interest representative as an equal third party in the regulatory process. In academic literature, tripartism is commonly understood as a mechanism empowering specific public interest groups to participate in regulatory decision-making. Despite the existence of various consumer advocacy groups, there are currently no well-established and influential organized public interest groups specifically targeting systemic risk issues in the financial sector that are capable of effectively fulfilling that function. Given the absence of "natural" candidates for this role, this Article advocates the statutory creation of a functional equivalent to such a public interest group: the Public Interest Council (Council).

The proposed Council would have a special status as an independent government instrumentality created by Congress and located outside of the legislative and executive branches. Its explicit charge would be to protect the interests of U.S. taxpayers in preserving financial stability and minimizing potential systemic risk in the financial markets. The Council would comprise individuals who are independent from both the industry and regulators, and who are competent in issues of financial regulation—primarily academic experts, but also certain public figures (not holding any official post) and representatives of consumer and other public interest groups. Although the Council would not have any legislative or executive powers, it would have broad statutory authority to collect any information it deems necessary from any government agency or private market participant and to conduct targeted investigations and reviews of specific issues and trends in financial markets. The Council's statutory powers would also include

5. See infra Part III.A.
6. As explained below, the proposed Council's special status is designed to be similar to that of certain congressional advisory and investigatory commissions. See infra Part V.A.
the right to request regulatory agencies to report on their activities or to take action in identified areas, to participate in regulatory rule-making, and to petition Congress to take action with respect to specific issues of public concern. In effect, the Council's main functions would be to impose structural checks on regulatory capture and to diffuse the industry's power to control the regulatory agenda by putting both financial regulators and financial institutions under constant and intense public scrutiny. In that sense, the proposed Council may be viewed as a permanent equivalent of a congressional advisory commission whose task is to shine the disinfecting sunlight on the workings of the financial services industry and its official overseers before the disaster strikes.

The creation of the Council as a new form of tripartism in financial sector regulation would embody a radically novel approach to systemic risk containment. Unavoidably, this proposal raises many difficult questions and is likely to invite numerous and well-justified criticisms, especially from the perspective of political feasibility and practical implementation. This Article does not claim to answer all of these questions. It outlines the broad contours of the new system and leaves many important details to be filled in later. In that respect, this is very much a thought experiment. The purpose of the Article is not to develop a comprehensive, adoption-ready legislative proposal. Rather, its goal is to frame the inquiry into how to design a more explicitly public-minded system of financial sector regulation. By envisioning a fundamentally new form of regulatory process, however incomplete or difficult to implement, this Article takes an important step in that direction.

The Article is structured as follows. Part II defines the fundamental regulatory dilemma in the financial sector regulation after the crisis as the need to incorporate broader societal interests directly into the regulatory process. This argument serves as a normative justification for introducing the concept of tripartism in the financial sector regulation. Part III briefly examines the notions of tripartism and public interest representation in academic debate. Part IV analyzes the elements of tripartism and tripartite arrangements that currently exist in various regulatory contexts and discusses their potential applicability in systemic risk regulation in the financial sector. Part V outlines the principal framework for the design and operation of the proposed Council, including its key functions and powers, the process and criteria for the appointment and removal of its members, and methods of ensuring the Council's independence and

7. It is important to note that the Council's unique mission and status distinguish it from two new regulatory agencies created by the Dodd-Frank Act: the Financial Stability Oversight Council (FSOC) and the Bureau of Consumer Financial Protection (CFPB). The FSOC is an interagency body charged with identifying and monitoring systemic risk in the financial sector. See Dodd-Frank § 111 (to be codified at 12 U.S.C. § 5321) (establishing the FSOC). Its role is to provide a unifying regulatory perspective on systemic risk rather than to act as an independent third party at the table. CFPB focuses on protecting individual consumers of financial services from fraud and unfair treatment by financial market professionals. See id. tit. X (to be codified at scattered sections of 12 U.S.C.) (establishing the CFPB). While consumer protection is an important matter of public interest, it is substantively different from systemic risk regulation. Thus, CFPB's jurisdiction and regulatory competence limit its potential to perform the role of the proposed Council.

8. As Justice Brandeis once famously said about the critical role of publicity in financial regulation, "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman. . . . That potent force must, in the impending struggle, be utilized in many ways as a continuous remedial measure." LOUIS BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1933).
accountability. It also examines potential challenges to and criticisms of the proposed tripartite model of systemic risk regulation in financial markets.

II. REGULATORY CHALLENGES IN THE FINANCIAL SERVICES SECTOR

A. Financial Regulation Reform After the Crisis: Systemic Risk and Regulatory Capture

The recent global financial crisis exposed numerous faults in the pre-crisis paradigm of financial sector regulation. A search for the causes of the crisis is far from over, as scholars, policy-makers, and various specially-appointed commissions continue trying to discern general patterns and key break points in a complex maze of factors and events.\(^9\) Greed, recklessness, deception, arrogance, and ignorance—all of these human failings played an important role in the latest crisis.\(^10\) But there were also deeper structural problems that caused this systemic failure in the financial market.\(^11\)

1. Systemic Risk Regulation

In many ways, the recent crisis was the first truly systemic financial crisis.\(^12\) In the pre-crisis era, the complexity and interconnectedness of financial markets and institutions, driven by technological progress and innovation, far outpaced regulatory developments. To a great extent, the crisis was attributable to the regulatory agencies’ failure to prevent the excess accumulation of risk and leverage in the financial system.\(^13\) In part, this was a result of the sheer scope and speed of the changes in the market, which made it inherently difficult to detect and measure systemic risk.\(^14\) The availability of

---


10. *See, e.g., The Levin Report, supra note 9 (providing detailed case studies of various breaches of duties and other misconduct by private and public actors).


13. *See Fin. Crisis Inquiry Comm’n, supra note 9, at xvii–xx (concluding that the failure of regulatory oversight was one of the key causes of the crisis).

14. *There are many definitions of systemic risk. As Professor Adam Levitin noted, “The term systemic risk is not a term of art with a precise, generally accepted definition.” Adam Levitin, In Defense of Bailouts, 99 Geo. L.J. 435, 443 (2011). Thus, according to one definition, systemic risk is the risk “of widespread failures of financial institutions or freezing up of capital markets that can substantially reduce the supply of capital to the real economy.” Viral V. Acharya et al., Regulating Systemic Risk, in A Bird’s Eye View, The Financial Crisis of 2007–2009: Causes and Remedies 1 (2009). Another popular definition refers to systemic risk as the risk that (i) an economic shock such as market or institutional failure triggers (through a panic or otherwise) either (X) the failure of a chain of markets or institutions or (Y) a chain of significant
high-speed computing power coupled with the developments in theoretical finance allowed financial institutions to create new financial products whose value could only be established through the use of sophisticated proprietary-mathematical models. These products, frequently structured as over-the-counter derivative contracts, were widely used for the purposes of regulatory arbitrage, over-leveraging, and high-volume speculation. The markets for trading such products, and the financial institutions actively participating in these markets, grew in size and importance and became more complex, dynamic, and opaque. This ever-increasing complexity effectively put many financial products beyond the reach of transparency and governability. Despite the recent advances in technologies of compliance and risk management, neither the financial institutions nor their regulators were able to understand the dynamics of systemic-risk accumulation.

The spread of economic woes around the globe, triggered by the bursting of the subprime-mortgage bubble in the United States in 2007, clearly illustrates potentially devastating consequences of a glitch in a seemingly insulated segment of the financial market on the economic, social, and political stability and welfare of millions of people who have no direct connection to such a market. Government bailouts of troubled financial institutions, whose risky business activities were at the heart of the crisis, imposed unprecedented costs on taxpayers in the United States and other countries. The true costs of the crisis, however, go far beyond the amounts disbursed directly through official bailout programs. Widespread failures of small and mid-size businesses in the

losses to financial institutions, (ii) resulting in increases in the cost of capital or decreases in its availability, often evidenced by substantial financial-marketplace volatility.

16. Derivatives are financial instruments whose value is “derived” from the value of another asset, referred to as the underlying or reference asset. Over-the-counter derivatives are bilateral contracts that are not traded on exchanges. Henry T.C. Hu, Misunderstood Derivatives: The Causes of Informational Failure and the Promise of Regulatory Incrementalism, 102 YALE L.J. 1457, 1464-65 (1993).
17. See FIN. CRISIS INQUIRY COMM’N, supra note 9, at xxiv-xxv (concluding that derivatives significantly contributed to the crisis).
19. See id. at 216-36 (examining how complexity impairs markets actors’ ability to understand and measure risk in financial system).
21. There is a vast and rapidly growing literature on the sources and dynamics of systemic risk in the financial market. See supra note 14. For the purposes of the present discussion, it is assumed that systemic risk remains the key, widely acknowledged but poorly understood, feature of today’s global financial market.
22. See generally Margaret M. Blair, Financial Innovation, Leverage, Bubbles, and the Distribution of Income, 30 REV. OF BANKING & FIN. L. 225 (2010) (arguing that financial innovation created a high level of leverage in the financial system and exposed the broader economy and society to too much risk).
24. Cheryl D. Block, Measuring the True Cost of Government Bailout, 88 WASH. L. REV. 149, 159
post-crisis economic recession, historically high levels of long-term unemployment, public budget cuts, and loss of funding for numerous social programs are an integral part of the overall cost of the financial crisis to society. Thus, financial crises directly implicate virtually every area of public concern, including housing, education, health care, labor markets, and environmental protection. This increasingly visible public dimension of systemic risk in the financial market creates a fundamental tension within the existing system of financial regulation, traditionally not equipped to deal directly with such broad societal interests. While spectacular financial sector gains remained privatized, equally spectacular losses were effectively socialized.

Unfortunately, post-crisis regulatory reforms failed to provide a satisfactory solution to this deep-seated problem. The Dodd–Frank Act seeks to achieve its ambitious goal of containing systemic risk in the financial sector through a wide range of measures. The Act established a new regulatory agency, the Financial Stability Oversight Council (FSOC), specifically charged with the task of monitoring and regulating systemic risk throughout the entire U.S. financial sector. The FSOC’s activities are to be supported by the new Office of Financial Research (OFR) in the U.S. Treasury Department, which, among other things, will focus on detecting and analyzing potential systemic risk concerns in financial markets. The FSOC has the power to identify systemically important financial institutions (SIFIs) that would be subject to regulatory oversight by

---

25. It is particularly disturbing that the poorest members of society are bearing the brunt of the post-crisis recession. See, e.g., Ben S. Bernanke, Chairman, Fed. Reserve Bd., Community Development in Challenging Times, Address at the Federal Reserve Community Affairs Research Conference (Apr. 29, 2011), available at http://www.federalreserve.gov/newsevents/speech/bernanke20110429a.htm (stating that poor communities and individuals have been hit the hardest by the economic problems in the aftermath of the financial crisis).


27. In fact, the primary goal of the U.S. system of bank regulation and supervision is to ensure solvency of banking organizations and to protect the banking industry from failure. For an overview of the U.S. banking regulation, see RICHARD SCOTT CARNELL ET AL., THE LAW OF BANKING AND FINANCIAL INSTITUTIONS (4th ed. 2009); LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES (2011).

28. See, e.g., Taleb, supra note 2 (“We have managed to combine the worst of capitalism and socialism.”); Nouriel Roubini, Is Purchasing $700 billion of Toxic Assets the Best Way to Recapitalize the Financial System? No! It is Rather a Disgrace and Rip-Off Benefitting only the Shareholders and Unsecured Creditors of Banks, ECONOMONITOR (Sept. 28, 2008), http://www.economonitor.com/nouriel/2008/09/28/is-purchasing-700-billion-of-toxic-assets-the-best-way-to-recapitalize-the-financial-system-no-it-is-rather-a-disgrace-and-rip-off-benefitting-only-the-shareholders-and-unsecured-creditors-of-banks/ (“This is again a case of privatizing the gains and socializing the losses; a bailout and socialism for the rich, the well-connected and Wall Street.”).


30. Id. § 111 (to be codified at 12 U.S.C. § 5321) (establishing the FSOC). The voting members of the FSOC, headed by the Secretary of the Treasury, include primarily the heads of the key financial regulatory agencies, such as the Board of Governors of the Federal Reserve System (Federal Reserve), the Securities Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), and the Office of the Comptroller of the Currency (OCC). Id.

31. Id. § 152 (to be codified at 12 U.S.C. § 5342) (establishing the OFR).
the Federal Reserve. In addition, the voluminous new legislation contains provisions dealing with derivatives trading and clearing, resolution of failing SIFIs, consumer protection, and many other issues related to financial stability and systemic risk prevention.

It is far from clear how successful the Dodd–Frank Act will be in taming systemic risk in practice. In essence, the Act takes a technocratic approach to systemic risk prevention, to be achieved through imposing enhanced prudential requirements on certain financial institutions, mandating greater data disclosure, and rationalizing market infrastructure. Ultimately, most of its solutions seek to shape entity-level incentives to reduce or better manage risks, mainly by expanding the scope and availability of information and by rendering certain risks more costly for individual firms to undertake or keep on their books. However, the act of balancing the costs of a risky asset or activity (including the cost of acquiring and processing relevant information) versus its potential returns at the individual entity level is fundamentally different from the same balancing act at the systemic level. What may be an acceptable level of risk for a firm, acting as a rational decision-maker, may nevertheless contribute to unacceptably high levels of systemic risk.

There are many explanations for this mismatch. The complexity of the markets and products significantly inhibits any individual firm’s ability to gauge accurately the broader systemic effects of its actions. Various behavioral biases further increase the chances of a presumably rational actor making seemingly “irrational” choices. Finally, as private profit-seeking enterprises, firms act in a self-regarding manner in assessing and taking risks. They do not internalize the spillover effects of such selfish risk-taking, which are particularly dangerous in the context of increasing interconnectivity in today’s financial markets. This interplay of conflicting incentives explains why market forces, without regulatory intervention, are not capable of solving the fundamental tension between private and public costs of risk-taking in the financial sector.

32. Id. § 113 (to be codified at 12 U.S.C. § 5323).
34. See id. tit. II (to be codified in scattered sections of 12 U.S.C.) (establishing the process for orderly liquidation of financial institutions).
35. See id. tit. X (to be codified in scattered sections of 12 U.S.C.) (establishing and describing regulatory powers and duties of the CFPB).
38. Scholars in behavioral finance offer sophisticated theoretical accounts of such biases, or heuristic devices, commonly used by market actors as short cuts for their decision making. See ADVANCES IN BEHAVIORAL FINANCE (Richard H. Thaler ed., 1993); BEHAVIORAL LAW & ECONOMICS (Cass R. Sunstein ed., 2000); RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008).
40. As some commentators have argued, this “tragedy of commons suggests that, absent intervention, financial market participants will progressively pursue their self-interest in the form of socially excessive risk-taking.” Id. at 1375.
The enacted reforms, despite their undeniable importance, fall short of a paradigmatic shift necessary to resolve that dilemma. As the crisis demonstrated, effective monitoring and control of systemic risk in today's complex and dynamic global financial market require an approach that is more assertive and comprehensive, as well as self-reflective.\(^1\) To put it simply, there seems to be too much undetected, unmeasured, and misunderstood risk in the financial system, which is not likely to be effectively internalized by private market actors. Yet, the Dodd–Frank Act conspicuously fails to frame the core issues in terms of imposing explicit front-end limits on the creation of excess risk in the financial system. Most of the Act's provisions continue to "rely on the old, pre-crisis, regulatory principles and assumptions."\(^2\) The new legislation does not disturb the existing public–private balance in financial regulation and does not articulate a principle for defining how much risk in the financial system is too much to bear for the society as a whole.\(^3\) Without addressing this fundamentally political issue, it will not be possible to solve the problem of containing systemic risk and ensuring long-term financial, economic, and social stability.\(^4\)

2. The Problem of Regulatory Capture

In large part, the latest crisis was also attributable to the regulators' failure to maintain their independence from the financial industry and to act in a truly public minded manner—the phenomena commonly associated with the concept of regulatory capture. Regulatory capture is one of the most widely accepted concepts in the studies of politics, regulation, and administrative law.\(^5\) The original theory focused on the capture of legislators by private interest groups, which used their economic resources to "buy"...
desired legal and regulatory outcomes from politicians.\textsuperscript{46} Later versions of this public choice theory and its intellectual offshoots offer a more nuanced view of regulatory capture, which comes in different forms and often defies simple definitions.\textsuperscript{47} Despite the complexities and ambiguities in its normative meaning, the concept of regulatory capture commonly denotes the misalignment of incentives of government actors who pursue narrow private interests that may conflict with the public interest they purport to serve.\textsuperscript{48}

In the financial services sector, regulatory capture is particularly pervasive and difficult to avoid. Certain characteristics of financial markets and institutions render regulatory and supervisory agencies overseeing them inherently susceptible to capture.\textsuperscript{49} The financial services industry is well-organized, contains a number of large institutional players, and has a great deal of economic and political power. By contrast, consumers of financial services, especially at the retail level, are a large, widely dispersed group with diffused interests.\textsuperscript{50} Financial regulators routinely consult with the industry on rule-making, and agency supervisors typically maintain close contact with the firms they examine.\textsuperscript{51} As a result, not only do the supervisors and regulators come to rely on the industry's superior technical expertise, especially with respect to the increasingly complex financial products and services, but they also build strong professional and personal relationships with the managers of the regulated institutions.\textsuperscript{52} The "revolving door" phenomenon makes these ties particularly strong, as the heavily regulated financial industry has a special interest in hiring former agency employees familiar with the inner workings of the regulatory process.\textsuperscript{53}

Financial regulators often come to view their institutional interests or mission as largely congruent with the interests of their regulated industry constituency. The

\begin{footnotes}

47. See, e.g., Lawrence G. Baxter, Capture in Financial Regulation: Can We Channel It Toward the Common Good?, 21 CORNELL J.L. & PUB. POL’Y 176 (2011) (arguing that capture is often used as a rhetorical device rather than a rigorous analytical tool).


50. Id. at 4.


52. As Hardy argues, “The complexity of financial systems, the need in many circumstances to maintain confidentiality, and the normally diffuse interests of the nonfinancial sector in financial sector regulation suggest that the institutions will exert a dominant influence.” Hardy, supra note 49, at 20.

\end{footnotes}
dynamics of regulatory arbitrage and competition in global financial markets partially explain this phenomenon.\textsuperscript{54} In a broader sense, however, it reflects a more subtle and insidious form of ideological or cultural capture.\textsuperscript{55} The famous “Greenspan doctrine,” exalting the virtues of unfettered financial innovation as the ultimate public good, is but one example of such ideological capture.\textsuperscript{56}

The financial industry’s agenda-setting power, or the power to frame the debate on regulation, is an important channel for maintaining its dominance and ability to shape regulatory outcomes.\textsuperscript{57} In the decades preceding the latest crisis, the debate on financial sector regulation was framed in terms of inevitability and desirability of innovation and complexity in financial markets, which had to be protected from all but absolutely necessary regulatory interference.\textsuperscript{58} The regulators themselves largely embraced the idea that they should avoid directly regulating financial products, leaving it to the operation of the free market, and “to get out of the way of industry innovation.”\textsuperscript{59} This ideological cooption of regulators who willingly ceded control of the regulatory debate to private industry interests effectively precluded them from identifying potential sources of systemic instability and devising effective solutions.\textsuperscript{60}

As this experience shows, ameliorating the sinister effects of regulatory capture in the financial sector is a critical element of successful systemic risk regulation. Unfortunately, the Dodd–Frank Act does not directly address the issue of regulatory capture and agencies’ failure to act in a publicly minded manner.\textsuperscript{61} It does little to disturb the familiar image of financial sector regulation as a process involving the same two key actors: the financial services industry and its regulators. In fact, Professor David Skeel argues that the new legislation embodies an explicitly corporatist approach to financial services regulation, under which the government forms a partnership with large financial

\textsuperscript{54} According to Hardy, “the regulatory agency in many countries has a more or less explicit mandate to promote the development of the national financial system and the promotion of its competitiveness against other financial centers. Such an agency is committed to formulating regulations that are advantageous to its banks.” Hardy, supra note 49, at 4–5.


\textsuperscript{56} See JOHNSON & KWAK, supra note 53, at 100–18 (describing the “ideology of finance”).

\textsuperscript{57} For a discussion of various forms and sources of power, including agenda-setting and normative power exercised by private financial institutions, see Ford, supra note 41, at 604–15 (describing the dynamics of power and influence in setting regulatory agenda). Professor Ford defines the agenda-setting power as “the power to decide what will be discussed.” Id. at 610.

\textsuperscript{58} Id. at 611–13.

\textsuperscript{59} Id. at 612.

\textsuperscript{60} As Professor Ford argues, “This [agenda] made it effectively impossible for regulators to act on concerns—indeed, to legitimately have concerns—about the extraordinary growth of the over-the-counter derivatives market. It also prohibited a more nuanced examination of varieties of innovation, incentives for innovation, and effects of innovation.” Id.

\textsuperscript{61} See, e.g., Heidi Mandanis Schooner, Private Enforcement of Systemic Risk Regulation, 43 CREIGHTON L. REV. 993, 994 (2010) (“The Dodd–Frank Act does not sufficiently address the problem of agency discretion generally, or the problem of an agency’s discretion to forebear, in particular.”).
institutions that get powerful protections of the "too big to fail" status in exchange for regulatory tightening in certain areas.\(^6\) Other commentators go even further, decrying the continuing dominance of the regulatory sphere by the "financial oligarchy" and further entrenchment of "crony capitalism" in the aftermath of the crisis.\(^6\)

**B. Reframing the Dilemma: Systemic Risk Regulation as a Political Choice**

This Article argues that a truly paradigm-shifting regulatory reform ultimately has to move beyond technocratic solutions and confront a fundamental political problem: how to incorporate broader societal interests directly into the process of financial services regulation, and how to counteract the powerful tendency toward regulatory capture in the financial sector. In the aftermath of the crisis, academics and policymakers have been actively debating reform measures aimed at reducing and controlling systemic risk in the financial sector. Many reform proposals, formulated before and after the passage of the Dodd–Frank Act, advocate a wide array of specific measures, such as enhanced disclosure of financial and transactional data,\(^6\) more finely-tuned regulation of non-bank financial actors operating in the so-called shadow banking system,\(^6\) strengthened corporate governance and changes in executive compensation at financial firms,\(^6\) heightened capital requirements,\(^6\) more stringent regulation of credit rating agencies,\(^6\) and breaking up financial institutions that are "too big to fail."\(^6\)

The crisis also reinvigorated scholarly debate on potential methods of reducing the distortion of financial regulators' incentives as a result of undue influence of private interests.\(^7\) Most of the proposed solutions focus on regulatory agencies and offer ways to

---


63. See, e.g., JOHNSON & KWAK, supra note 53, at 120 (arguing that the U.S. financial elite constitutes an oligarchy that used its economic power to gain political power). Interestingly, Ken Griffin, the founder of the $15 billion hedge fund Citadel Investment Group, was recently quoted as saying that the Dodd–Frank Act is "going to deeply entrench crony capitalism into the very fabric of our financial system." Andrew Ross Sorkin, *Dodd-Frank Dissenters Sound Off*, N.Y. TIMES DEALBOOK, May 9, 2011, http://dealbook.nytimes.com/2011/05/09/dodd-frank-dissenters-sound-off/.


68. See, e.g., John P. Hunt, *Credit Rating Agencies and the 'Worldwide Credit Crisis': The Limits of Reputation, the Insufficiency of Reform, and the Proposal for Improvement*, 2009 COLUM. BUS. L. REV. 109, 111 (2009) (noting that enhanced regulation would be "superior to the existing regime").

69. See, e.g., Jonathan R. Macey & James P. Holdcroft, Jr., *Failure is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L.J. 1368, 1394 (2011) (urging the government to "break up the largest financial institutions before they become too big to fail").

70. Of course, political scientists, economists, and administrative law scholars, among others, have been
insulate their decision-making from direct political interference by Congress or the presidential administration, to increase transparency of regulatory decision-making and agency accountability, and to strengthen the agencies’ internal subject-matter expertise by increasing compensation of agency employees and creating an elite professional culture among them. Better paid and better educated corps of elite financial regulators, the argument goes, will be less dependent on industry expertise, less tempted by private sector employment, and more free to act in a publicly minded manner. Other proposals envision broader structural changes in the financial services industry, such as breaking up large financial conglomerates, which would curb the power of private institutions to exert disproportionate influence on government decision-makers and control regulatory process.

All of these proposals contain valuable insights into important issues in financial services regulation. Nevertheless, they tend to offer only partial solutions to the pervasive problem of minimizing systemic risk in the financial sector and making financial services regulation less “captive” and more public interest-oriented. Most of the proposals tend to focus on specific, clearly delineated measures, which gives them credibility as policy recommendations, even though some of the proposed measures may be politically controversial. On the other hand, that same discrete and narrowly targeted character explains the inherent limitations of these proposals. Much like the currently enacted reforms aimed at containment of systemic risk, these largely technical solutions are likely to achieve the desired goal only if they are part of a comprehensive and coherent overhaul of the existing regime. Any such comprehensive reform strategy, among other things, would have to address directly the underlying issue that most reform proposals, at best, address only implicitly: how to ensure that financial regulators effectively balance technocratic concerns and the broader considerations of the common good in their decision-making.

At their core, both the problem of preventing regulatory capture and the larger

actively debating how to counter regulatory capture in general for decades before the latest financial crisis, and most theoretical development in this area took place outside the specific context of financial services regulation. See supra note 46. For a recent example of this, see Rachel E. Barkow, Insulating Agencies: Avoiding Capture Through Institutional Design, 89 TEX. L. REV. 15 (2010).

71. See, e.g., Barkow, supra note 70, at 15 (discussing mechanisms for insulating agencies from political pressure); Lisa Schultz Bressman & Robert B. Thompson, The Future of Agency Independence, 63 VAND. L. REV. 599, 600 (2010) (noting that political interference “undermine[s] the traditional binary division[s]”).

72. Thus, one of the most heated debates in the wake of the financial crisis focused on the secretive nature of the Federal Reserve’s decision-making process and the need to mandate periodic audits of the Federal Reserve’s activities.

73. See, e.g., Baxter, supra note 47, at 195 (bemoaning the difficulties the public sector encounters in competing with the private sector for equivalently skilled employees).

74. As Steven Croley argues, agency employees generally have a genuine desire to serve the common good and to protect the interests of the public. See Steven P. Croley, Public Interested Regulation, 28 FLA. ST. U. L. REV. 7, 29 (2000) (“[T]hose whose career paths take them to public service seem likely to be those most committed to serving the public.”).

75. See, e.g., JOHNSON & KWAK, supra note 53, at 205–22 (arguing that the right solution is not to allow financial institutions to become and stay too big to fail).

76. This short list is by no means exhaustive of the vast array of scholarly writings and regulatory reform proposals aimed at containing systemic risk in the financial sector. A full discussion of this literature is beyond the scope of this Article.
problem of minimizing systemic risk may be a matter of revisiting the basic tenets of our regulatory philosophy and, even broader, a fundamentally political choice. An effective reform effort should seek to reinsert the concept of public interest into the structure and process of financial sector regulation. Given the unacceptably high societal costs of systemic financial crises and the increasing informational and power asymmetries between the financial industry and the general public, the core issue in the reform should be how to remedy such asymmetries. In effect, Congress has to do what it resolutely failed to do in the Dodd-Frank Act: articulate the principle for balancing the public interest in preserving financial stability and limiting systemic risk against the private interests of financial market participants in pursuing economic gain.

A decision to impose principled limits on the currently unrestricted business activities of private market participants, in the name of an inevitably vague notion of public interest, requires a great deal of political will and courage. Yet, it may be a necessary step toward a truly publicly minded shift in the regulatory paradigm, which the current reforms failed to deliver. As one commentator put it, “financial market stability, like environmental security and personal safety, is a public good that cannot be left to market participants and their pale reflections in regulatory agencies. Since everyone is a stakeholder, the debate must be open to all.” This Article argues that one way to revitalize the public-interest dimension of financial regulation, by opening the debate to all stakeholders and restraining the agenda-setting power of the financial industry, is to introduce the principle of tripartism in financial regulation.

III. TRIPARTISM AND GUARDIANSHIP IN ACADEMIC DEBATE

This Article uses the term “tripartism” to refer to a system designed to include public interest representatives as direct participants in the regulatory process, along with the regulatory agencies and the regulated industry. The idea of empowering an independent third party to guard against the pitfalls of regulatory capture and other forms of regulatory failure is not new in the academic debate. This Part briefly discusses some of these scholarly approaches that offer valuable potential insights into designing an effective tripartite system in financial sector regulation.

77. See Roberta S. Karmel, The Controversy Over Systemic Risk Regulation, 35 BROOK. J. INT’L L. 823, 841 (2010) (“In the final analysis, the problem of dealing with systemic risk is a political problem.”).
79. Defining “public interest” in the area of financial services regulation is a difficult intellectual enterprise. In general, the concept of public interest tends to be elusive and highly context-specific. See infra notes 288–93 and accompanying text (discussing the concept of public interest). Developing a theoretical definition of public interest in the context of financial sector regulation is beyond the scope of this Article. Thus, for the purposes of the following discussion, the term “public interest” is used to refer to the general public’s interest in preserving financial and economic stability, minimizing the likelihood of major financial crises occurring, and containing the potential and actual costs of such crises.
The concept of tripartism as an element of regulatory design is commonly associated with the model developed by Ian Ayres and John Braithwaite. Ayres and Braithwaite view tripartism as an integral part of responsive regulation. They argue that "empowering public interest groups," or PIGs, provides a solution to the problems of regulatory capture, while allowing the government to retain the benefits of flexible and responsive regulation built on cooperation between the regulators and the regulated industries. In their model, they describe three ways tripartism can foster the participation of PIGs in the regulatory process:

First, it grants the PIG and its members access to all the information that is available to the regulator. Second, it gives the PIG a seat at the negotiating table with the firm and the agency when deals are done. Third, the policy grants the PIG the same standing to sue or prosecute under the regulatory statute as the regulator. Tripartism means both unlocking to PIGs the smoke-filled rooms where the real business of regulation is transacted and allowing the PIG to operate as a private attorney general.

In this tripartite system, the PIGs act as the appointed guardians of the public interest. However, recognizing that PIGs can also be captured by the industry actors, Ayres and Braithwaite propose to make the guardianship contestable. Thus, multiple PIGs would compete among themselves for the right to sit at the negotiating table and to fight for the public interest that legislation intended to protect.

Several critical assumptions underlie Ayres and Braithwaite's argument. Most importantly, their model of tripartism is based on an assumption that there is always an appropriate PIG in each area of business regulation, which is in turn defined by a discrete statutory scheme. As they explain, "We assume that it is possible to identify PIGs whose mission is the same as that embodied in a regulatory statute: environmental groups for environmental statutes, animal welfare groups for animal welfare statutes, civil liberties groups for privacy statutes, women’s groups for affirmative action legislation, and so on."

81. Id. at 54. Ayres and Braithwaite recognize that regulatory models that foster such cooperation between private actors and their regulators are inherently likely "to encourage the evolution of capture and corruption." Id.
82. Id. at 57–58.
83. Id. at 57.
84. Ayres & Braithwaite, supra note 80, at 58. This concept of contestability is one of the key elements distinguishing Ayres and Braithwaite's theory of tripartism from models of corporatism, under which the government essentially chooses specific groups to act as permanent third-party representatives of pre-selected public interests in the rule-making and enforcement process. See, e.g., Mark Seidenfeld & Janna Satz Nugent, The Friendship of the People: Citizen Participation in Environmental Enforcement, 73 GEO. WASH. L. REV. 269, 310–11 (2005) (describing the advantages of a corporatist model, which grants selected interest groups a permanent seat at the table, over the concept of contestable guardianship).
85. Ayres & Braithwaite, supra note 80, at 59. Ayres and Braithwaite assume the existence of relevant PIGs because they "think it unlikely that statutes that threaten the interests of business would ever have been enacted in the absence of an interest group pushing for them." Id.
86. Id. at 74.
Ayres and Braithwaite further argue that the empowerment of PIGs through tripartite arrangements would create incentives for formation of new PIGs, although they admit that there may be certain regulatory areas in which this key assumption would not hold true.\textsuperscript{87} Accordingly, there is also a strong emphasis on the enforcement of the relevant statute by the PIGs whose interests are aligned with those of a rational (i.e., not captured) regulator.\textsuperscript{88}

Ayres and Braithwaite explicitly state that their model of tripartism is designed as a solution to the general problem of regulatory capture and corruption.\textsuperscript{89} In a broader sense, their theory is a prominent part of academic literature focusing on making regulation more flexible and effective by “empowering stakeholders” in the regulatory process.\textsuperscript{90} This vast and diverse body of scholarship is theoretically and empirically rich and offers many insights to inform the quest for reinserting public interest into financial regulation.\textsuperscript{91} However, the core assumptions underlying Ayres and Braithwaite’s concept of tripartism as an element of a more dialogic, responsive regulation potentially limit its applicability in the context of financial sector regulation.\textsuperscript{92} For instance, the high degree of transactional and regulatory opacity, extreme informational and power asymmetries, and the dynamics of market cycles explain why this pure form of PIG participation “may not even have been a realistic possibility” in the financial regulation field.\textsuperscript{93} Moreover, the very existence of PIGs that pursue goals explicitly relating to systemic risk prevention in the financial services sector remains a highly questionable assumption.\textsuperscript{94}

Yet, Ayres and Braithwaite’s tripartism contains an important normative dimension, which they characterize as an “application of a republican theoretical tradition to regulation.”\textsuperscript{95} Civic republicanism’s proponents generally advocate the ideal of a more

\textsuperscript{87} The specific example they cite is corporate tax enforcement, where there is no natural impetus for the emergence of a PIG willing to play the enforcement game with the Internal Revenue Service (IRS). Id. at 59. However, they argue that this case may be unusually difficult “because tax laws are peculiar in the way they are brought into existence by the state to serve the needs of the state rather than in response to clamoring from external interests.” Id.

\textsuperscript{88} AYRES & BRAITHWAITE, supra note 80, at 74. Although Ayres and Braithwaite acknowledge that the “front-end participation” by the PIGs in regulatory decision-making is more empowering than “back-end” right to challenge results of corrupt decision-making in court, they view the ability to sue as the prerequisite for the PIGs to be taken seriously at the front-end negotiating table. Id. at 77-78.

\textsuperscript{89} Id. at 54.


\textsuperscript{91} Although it is difficult to make generalizations about this broad scholarly area, it is worth noting that much of this literature tends to focus on empowering and securing cooperative engagement of the regulated private actors rather than the general public. From that perspective, its direct relevance to our present inquiry may be limited.

\textsuperscript{92} See infra notes 147–55 and accompanying text.

\textsuperscript{93} Ford, supra note 41, at 613. According to Professor Ford, “the experience of the financial crisis suggests that injecting a meaningfully independent perspective into regulation, by way of tripartism, may be more challenging in practice than sometimes realized.” Id. at 614.

\textsuperscript{94} See infra notes 150–55 and accompanying text.

\textsuperscript{95} AYRES & BRAITHWAITE, supra note 80, at 81.
deliberative democracy and extol the virtues of enlightened public involvement in political process. Incorporating this spirit of “civic engagement” into the regulatory process may prove a timely idea in the aftermath of a major global financial crisis.

B. Grappling with Public Interest in the Debate on Financial Regulation Reform

The ongoing scholarly debate on financial regulation reform centers largely around the issues of systemic risk prevention. To date, legal academics have not engaged directly with the concept of tripartism. Nevertheless, certain trends within that debate move in the same direction and call for a greater, and more direct and effective, reinsertion of public interest in the structure and process of financial sector regulation.

1. Improving Governance of Financial Regulation

One of the most controversial proposals on that topic comes from Brown University Professor of Economics Ross Levine. In a series of recent articles, Levine argues that one of the main causes of the global financial crisis of 2007–09 was the systemic failure in the governance of financial regulation, which, in turn, produced faulty “policies that encouraged financial markets to take excessive risk and divert society’s savings toward socially unproductive ends.” According to Levine, financial regulators remained aware of potential problems accumulating in the financial markets and possessed sufficiently robust legal powers to fix such problems, but chose not to do so, in large part due to regulatory capture. He criticizes current reform proposals for failing to address the fundamental cause of this regulatory failure: the near complete exclusion of the public from the regulatory process. As Levine puts it,

There is no mechanism through which the public and its elected representatives, possess to obtain an informed, expert, and independent assessment of financial regulation. Therefore, the public cannot induce regulatory institutions to act on their behalf. It does not get any more basic than this: How can the public and its elected representatives induce regulatory

---


98. See, e.g., Kelly, supra note 26 (arguing that greater participation of civil society groups in financial regulation remains necessary to enhance legitimacy of regulatory institutions in global financial markets); Caroline M. Bradley, Transparency Is The New Opacity: Constructing Financial Regulation After The Crisis, 1 AM. U. BUS. L. REV. 7 (2011) (arguing that the existing transparency mechanisms in global financial markets, in practice, increase their opacity and contribute to the effective exclusion of the world’s citizens from meaningful participation in the financial regulation process).


100. Id. at 1.

101. Id. at 19.

102. Id. at 2.
authorities to behave in the best interests of the public when the regulatory authorities have a monopoly on both the information and expertise necessary for assessing their own performance?  

Levine argues that, as a result of inherent information asymmetries and lack of technical expertise, the general public is not capable of meaningful participation in financial policymaking. Only the regulatory agencies “not effectively designed to act in the public’s long-run interests” possess the information and expertise necessary to evaluate financial regulation’s effectiveness. To remedy this systemic governance problem, Levine proposes to create a new kind of regulatory agency, the Financial Regulatory Commission, which he labels the “Sentinel,” to provide a continuing informed and independent assessment of substantive financial regulation from the viewpoint of the public interest. The Sentinel is envisioned as a politically independent agency funded from the Federal Reserve’s budget and staffed with economists, lawyers, accountants, and financial industry professionals. It would possess only the power to acquire information from other agencies necessary for evaluating financial regulation. Its sole responsibility would be to deliver an annual report to the legislative and executive branches of government assessing “the current and long-run impact of financial regulatory and supervisory rules and practices on the public.” By doing so, the Sentinel would promote transparency and informed debate on financial regulation, both of which remain critical to effective systemic crisis prevention.

Levine’s diagnosis of financial regulation’s core weakness as the systematic, institutionally embedded failure of regulatory agencies to act in the public interest, strikes at the heart of the problem this Article identifies. He recognizes the fundamentally political nature of the necessary reforms and articulates the need to “push the policy debate toward focusing on the general welfare of the public and away from the narrow interests of the powerful and wealthy.” Levine’s proposed solution, however, falls short of a truly tripartite approach. He dismisses the possibility of public interest representatives’ direct inclusion in the regulatory process as the third party at the table. Instead, under his proposal, the mission of guarding the public interest against captured or corrupt regulatory agencies would become entrusted to yet another agency.

103.  Id.  
105.  Id. at 3.  As Levine describes it, the Sentinel’s mission would be “to act as the public’s sentry over financial policies and to help compel financial regulators to act in the public interest, regardless of their private interests.”  
106.  Id. at 23.  Levine proposes the President appoint the Sentinel’s senior members, with the Senate’s advice and consent, for staggered terms, and set their salaries at market-based levels, in order to ensure the new agency’s independence and prestige.  
107.  Levine, supra note 99, at 22.  Levine emphasizes that the Sentinel would not influence the central bank’s and other regulators’ powers and responsibilities; its sole mission being to shine the disinfecting light on the secretive world of financial regulation.  
108.  Id.  
109.  Id. at 25.  Levine does not claim that the creation of the Sentinel would, in fact, lead to complete elimination of systemic risk, but believes that it would improve the process of financial policymaking, thus reducing the danger of repeating regulatory failures of recent decades.  
2. Broadening Regulators’ Intellectual Perspective

Regulatory agency design remains at the center of the academic debate on how to make financial sector regulation more adaptive, effective, and also more publicly minded.111 Despite recognizing that financial regulators consistently failed to fulfill their duty as the guardians of public interest in the pre-crisis era, scholars of financial regulation continue to focus their attention on potential reforms of the existing regulatory apparatus as the only realistic answer to the problem of capture and systemic risk prevention.112 An important theme in this debate is the need to enhance regulators’ intellectual and analytical capacity to detect potentially risky trends in today’s increasingly complex financial markets. Although conceptually different from the traditional notion of regulatory capture, this phenomenon is of central importance to the broader discussion of systemic risk.

In a recent article, Professors Geoffrey Miller and Gerald Rosenberg argue that systemic risk regulation must aim at minimizing what they call intellectual hazard in financial markets.113 They define intellectual hazard as “the tendency of behavioral biases to interfere with accurate thought and analysis within complex organizations, thus interfering with the acquisition, analysis, communication, and implementation of information both within an organization and between an organization and external parties.”114 The authors group these biases into three broad categories: complexity biases that reflect actors’ limited ability to analyze and interpret a complex situation,115 incentive biases that lead actors “to see the world in accordance with their self-interest,”116 and asymmetry biases that make actors within complex organizations favor certain pre-formed or preferred conclusions and attitudes.117 The combined effect of these behavioral biases is to create pervasive, pro-cyclical underestimation and mispricing of risk in the increasingly complex financial system—a problem that “can

111. One of the rare attempts to move away from the discussion on institutional structures is Professor Heidi Mandanis Schooner’s recent proposal to expand private right of action in the area of systemic risk regulation, which would empower broader interest groups to monitor regulatory agencies and financial institutions. Schooner, supra note 61.
112. See, e.g., McDonnell & Schwarcz, supra note 48, at 1644–64 (discussing different categories of so-called “regulatory contrarians” within regulatory agencies and their potential for acting as guardians of public interest in financial sector regulation).
114. Id. at 810.
115. Id. at 813–15. Examples of typical complexity biases include confirmation bias (an actor’s preference to analyze available information in a way that confirms his or her previous expectations), representativeness bias (an actor’s tendency to assume that a sample from past experience is an accurate predictor of the future events), oversimplification bias (the use of oversimplified “rule of thumb” heuristics), and authoritarian bias (an actor’s tendency to overvalue information from authoritative sources, based on prestige or scope of formal powers possessed by the source of information). Id.
116. Id. at 815. Examples of incentive biases include cognitive dissonance bias (an actor’s tendency to avoid the discomfort of seeing things in a way inconsistent with the actor’s self-interest) and loss aversion bias (an actor’s desire to avoid recognition of a loss for which the actor bears responsibility). Miller & Rosenfeld, supra note 113, at 815–17.
117. Id. at 817–18. Examples of asymmetry biases include status quo bias (an actor’s tendency to overvalue the status quo even where the available data strongly suggests taking a different course of action) and optimism bias (a tendency to ignore information that implies negative conclusions). Id.
metastasize into a serious threat to the stability of the system as a whole" in times of unusual market distress.\textsuperscript{118}

Miller and Rosenberg argue that one of the reform measures potentially effective in combating intellectual hazard in financial markets is the creation of a new systemic risk oversight body explicitly charged with preserving financial stability.\textsuperscript{119} However, writing before the enactment of the Dodd–Frank Act, they expressed skepticism with respect to the notion of placing systemic risk oversight responsibilities exclusively in the hands of the existing financial regulators:

Experience suggests that the problem of intellectual hazard will not be effectively addressed if the personnel in the agency charged with identifying systemic threats to financial stability are simply recycled regulators and central bankers. They will not bring new ideas to the table; on the contrary, they will come as advocates for their agency's positions and as defenders of their agency's turf and power. These people will suffer from the forms of intellectual hazard we have already observed in regulators: asymmetry bias embodied in fixed positions on policy questions, self-serving bias in the form of turf protection and blame avoidance, and authoritarian bias in the form of deference to the agencies that delegate personnel to these new monitoring bodies.

A preferable solution would be to establish financial stability boards not dominated by existing regulators. A truly independent board, composed largely of people from outside the government, selected according to some principle of merit rather than political connections, and adequately funded and protected against retaliation for expressing unpopular views, would offer a potentially more efficacious approach to the problem of impartially and objectively identifying systemic threats to the financial system and proposing possible remedies or solutions.\textsuperscript{120}

Although Miller and Rosenberg do not directly address the issue of tripartism, their argument is consistent with the idea of creating an independent source of authority, located largely outside the existing regulatory hierarchy and serving as an external check on the process of regulatory decision-making, in order to assure a more objective assessment of potential systemic threats to financial stability.\textsuperscript{121} Professors McDonnell and Schwarcz propose a slightly different approach to the same problem of overcoming regulators' intellectual entrenchment, inertia, or capture.\textsuperscript{122} In particular, they suggest

\begin{itemize}
  \item \textsuperscript{118} Id. at 820.
  \item \textsuperscript{119} Id. at 837.
  \item \textsuperscript{120} Miller & Rosenberg, supra note 113, at 838–39.
  \item \textsuperscript{121} In 2009, the Investors' Working Group (IWG), an independent nonpartisan commission established by the Council of Institutional Investors and the Consumer Federation of America, advanced a similar proposal. Investors' Working Group, COUNCIL OF INST. INVESTORS (Jan. 25, 2009), http://www.cii.org/iwglinfo. The IWG's reform proposal envisioned the creation of a similarly independent systemic risk regulator whose members would be appointed by the President and whose primary mission would include collecting, aggregating, and evaluating information on financial products, markets, and institutions in order to identify threats to systemic stability. Id. This new systemic risk oversight body would report its findings to Congress and recommend specific actions to be undertaken by financial regulators, which would have to either comply with such recommendations or explain their refusal to do so. Id.
  \item \textsuperscript{122} McDonnell & Schwarcz, supra note 48.
\end{itemize}
"charging an entity that is affiliated with, but independent of, a financial regulator with the task of monitoring that regulator and the regulated marketplace and publicly suggesting new initiatives or potential structural or personnel changes."

The key role of such "regulatory contrarians" is to help regulators overcome the various cognitive and incentive biases and "to counteract agency inaction or ossification in the face of changing market risks." McDonnell and Schwarcz define a regulatory contrarian as an actor possessing three key features: (1) it "must be at least partially affiliated with a particular regulatory body but simultaneously enjoy meaningful independence from that agency;" (2) it "must possess pervasive influence over its affiliated agency by virtue of its position, access to media and officials, or speaking engagements and reports;" and (3) it "must be tasked with studying and identifying deficiencies and potential improvements in the regulatory process, regulatory policy, and/or the regulated market." The existing examples of regulatory contrarians include various ombudsman offices, designated consumer representatives, inspectors general of individual regulatory agencies, and certain research entities.

Importantly, McDonnell and Schwarcz argue that affiliation with, and privileged access to, regulatory agencies, and the resulting ability to work through informal channels to achieve better practical results, makes these insider entities particularly effective in promoting regulatory adaptation to the changing market conditions. At the same time, they admit that, at least in the realm of financial services regulation, such contrarians' role and potential to counteract agency inaction has been limited to relatively narrow domains, such as representing consumer interests or investigating specific instances of misconduct or waste at the relevant agencies. Nevertheless, McDonnell and Schwarcz are cautiously optimistic about the emphasis in the Dodd-Frank Act on the creation of new "research contrarians," such as the OFR or the new Federal Insurance Office, which they see as a step in the direction of institutionalizing the greater diversity of views in systemic risk regulation.

Whether or not this optimism is warranted remains to be seen, as these new regulatory contrarians begin their work. More generally, however, McDonnell and Schwarcz may be overstating the practical ability of any entity formally affiliated with a regulatory agency to act in a truly independent manner and to provide a meaningful counterweight to agency inaction, especially on politically salient issues. What they see as regulatory contrarians' key strength—their embeddedness in the administrative apparatus—is also their greatest potential weakness.

This Article seeks to take the debate on financial regulation reform a step further by

123. Id. at 1632.
124. Id. at 1645.
125. Id. at 1644. The contrarian's independence must be assured through arrangements relating to its "budget, staffing, appointment and removal process, or even institutional culture." Id. at 1644-45.
126. McDonnell & Schwarcz, supra note 48, at 1645. McDonnell and Schwarcz stress that a regulatory contrarian "must have limited, if any, regulatory authority." Id.
127. Id.
128. For a more detailed discussion of the role and activities of these types of government actors, see infra Part IV.B.
130. Id. at 1667–73.
overcoming what appears to be a pervasive conceptual preoccupation with the structure and functioning of administrative agencies in charge of financial sector oversight. Building on scholarly insights discussed above, it attempts to shift the focus away from the regulatory agencies and to explore potential methods of ensuring some form of direct public representation in the process of systemic risk regulation. The argument presented here is based on a conviction that true guardians of public interest must be independent from both bankers and bureaucrats. While it is true that, with respect to systemic risk regulation, well-meaning ignorance may be just as problematic as intentional malfeasance, expanding regulators' access to—and improving their ability to process—the relevant information is only part of the solution. It is equally important to create, and continuously enhance, incentives for regulatory agencies and private industry actors to act in a manner consistent with the long-term public interests of preserving financial and economic stability and curbing excessive risk-taking in the financial sector.

Introducing some form of tripartism in systemic risk regulation is one potential method of achieving both of these goals. The presence of an effective third-party “guardian” at the decision-making table potentially creates a built-in source of countervailing perspective on substantive policy issues and imposes structural checks on regulatory capture. Of course, the challenge is to find real-life examples of a successful tripartite regulatory scheme which would demonstrate the benefits of tripartism in action. While there may not be a readily available model of classic tripartism in practice, which could be easily replicated in financial sector regulation, it is instructive to look at the examples of institutions that perform at least some of the functions of such a public interest guardian and, by doing so, introduce elements of tripartism into the regulatory process.

IV. ELEMENTS OF TRIPARTISM IN PRACTICE: “QUASI-GUARDIANS” AT WORK

Tripartism is an inherently broad concept, and it may operate differently in different regulatory fields. The wide diversity of institutional forms and normative elements of tripartite regimes across various contexts makes it difficult to draw generalized conclusions. In certain cases, tripartite arrangements may exist only on a limited scale or as part of a broader regime that does not necessarily fit a tripartite model. Nevertheless, examining how some of these arrangements operate in practice helps to inform our search for tripartism in financial sector regulation.

As a general matter, it is possible to identify several broadly drawn categories of institutional actors that, in different ways and to varying degrees, act as representatives or advocates of the public interest in the regulatory process. Although their official mandates may not explicitly contemplate acting as a third party representing diffuse societal interests vis-à-vis regulatory agencies and regulated industries, these institutions often perform that function in practice. This Part discusses four main types of such institutions: (1) public interest groups, including various non-governmental organizations, grassroots activist movements, consumer protection organizations, and so on; (2) designated public interest representatives within regulatory agencies or separately

---

131. See Ayres & Braithwaite, supra note 80, at 58 (stating that “the appropriate model of tripartism will be an historically and institutionally contingent matter”).
instituted government bodies whose task is to monitor the efficiency or ensure accountability of regulators; (3) scientific or technical expert councils that help regulators take action in the public interest; and (4) special advisory commissions, typically established by Congress to investigate the causes of major crises and to identify the sources of regulatory failure to protect the public from their re-occurrence.

A. Public Interest Organizations

At first glance, this category of public interest representatives appears almost self-explanatory. However, the sheer multitude of public interest organizations that operate in a wide variety of policy areas and pursue many different agendas makes it difficult to present an accurate assessment of the activities and impact of the group as a whole. The following discussion sketches out some of the broadly common characteristics of these diverse organizations.

1. Functions and Activities

These organizations are the purest form of public interest representatives because they typically emerge organically, driven by the efforts of similar-minded citizens concerned with particular issues they view as a matter of public importance. This bottom-up nature of public interest organizations is the source of their key strength: a mantle of democratic legitimacy and a claim to representation of broad swaths of the interested citizenry. They vary in size of their membership, the degree of public visibility, and the nature and scope of their activities, in large part depending on the substantive subject-matter on which they focus. Their activities may be loosely grouped into the following inter-related and often overlapping categories.

Advocacy. Public interest groups can, and often do, actively lobby legislatures and policymakers on the issues of concern to them. By publicizing and investigating specific instances of wrongdoing on the part of private actors and government entities, these groups frequently frame the salient issues of public policy and define the terms of the political debate in the relevant area. Their efforts sometimes trigger legislative and regulatory responses as well as the changes in the private industry standards of conduct. Public interest groups often participate in regulatory rule-making by submitting comments on proposed agency rules, as required by the Administrative Procedure Act, or by directly advocating their positions on specific issues on regulators' rule-making agenda. Thus, under the system of negotiated rule-making, representatives of public interest groups whose members would be affected by a proposed

132. For an informative discussion and a typology of public interest groups, including pure membership groups, mass membership groups, and subsidized member groups, see Mark Seidenfeld, Empowering Stakeholders: Limits on Collaboration as the Basis for Flexible Regulation, 41 WM. & MARY L. REV. 411, 428-34 (2000).


agency rule negotiate with the agency to reach a consensus on the rule before it is proposed.\footnote{135}

Advisory activities. Public interest groups, or their individual members, may also participate in various advisory committees established by regulatory agencies. For example, the Federal Reserve has the Consumer Advisory Council (CAC), whose mission is to advise the Federal Reserve “on the exercise of its responsibilities under the Consumer Credit Protection Act and on other matters in the area of consumer financial services.”\footnote{136} Meeting three times a year, the CAC focuses on issues directly related to consumer finance.\footnote{137} However, the practical impact of its recommendations on the Federal Reserve’s decision-making is far from clear.\footnote{138} Generally, the ability of these advisory bodies to shape the regulatory agencies’ policies and to effectively counteract the private industry’s influence depends greatly on the relevant agency’s resolve to take their advice seriously.

Private standard-setting. As part of their advocacy and advisory activities, some public interest groups can also engage in developing substantive or procedural standards that private industry actors feel compelled to adopt. If successful, this standard-setting is a potentially important method of promoting public interest. Thus, certain private certification schemes by various environmentalist and labor groups have contributed to voluntary improvement of private companies’ performance.\footnote{139}

Enforcement of existing legal rules. Civic activists and public interest groups often bring lawsuits against private firms and regulators, seeking to compel them to comply with specific laws and regulations. This “private attorney general” function is an important aspect of these groups’ activities and a potentially powerful tool in their arsenal.\footnote{140} However, in order to bring an action in court, private citizens and public interest groups must establish legal standing to sue.\footnote{141} It is particularly difficult to

\footnote{135. The United States and Congress officially endorsed negotiated rule-making, which supplements the notice-and-comment procedure for the adoption of administrative rules, in the Negotiated Rule-Making Act, 5 U.S.C. §§ 561–70, originally enacted in 1990 and permanently reauthorized in 1996. However, the practical success of negotiated rule-making has been rather limited, and many public interest groups were less effectively represented in this process than the regulated industry actors. See, e.g., Jody Freeman, Collaborative Governance in the Administrative State, 45 UCLA L. Rev. 1, 78 (1997) (suggesting that, in Environmental Protection Agency actions, environmental groups were systematically underrepresented). For an analysis of negotiated rule-making, see Cary Coglianese, Assessing Consensus: The Promise and Performance of Negotiated Rulemaking, 46 DUKE L.J. 1255 (1997); Philip J. Harter, Assessing the Assessors: The Actual Performance of Negotiated Rulemaking, 9 N.Y.U. ENVT. L.J. 32 (2000).


137. Id. The typical issues discussed at the meetings of the CAC include credit card regulation, mortgage financing and foreclosures, the implementation of the Community Reinvestment Act, and similar issues. Id.

138. The recent crisis clearly demonstrated the Federal Reserve’s poor record on consumer protection issues, which casts doubt on the CAC’s practical influence. See FIN. CRISIS INQUIRY COMM’N, supra note 9, at 93–96 (arguing that the Federal Reserve failed to protect consumers from predatory lending and other abuses). The Council is going to cease its activities once the newly established CFPB commences its operations.

139. See Bartley, supra note 133, at 434–37 (describing the certification structures for environmental and labor standards in the apparel and forest products industries).

140. Thus, Ayres and Braithwaite assign a critical role to that function of the PIGs in their model of tripartism. See supra note 88 and accompanying text.

141. The requirement of standing stems from the fact that Article III of the U.S. Constitution limits courts
overcome this hurdle in the context of lawsuits brought under the federal banking laws where courts have been reluctant to grant any implied right of private action. The much-discussed judicial deference to agency determinations under various standards of review further limits the practical efficacy of the public interest representatives’ attempts to enforce the rules in court.

Potential use of private litigation as an external check on financial firms and regulators is inherently limited by the substantive statutes establishing the bases for civil suits. Currently, the vast majority of private lawsuits against financial institutions are brought under various federal and state anti-fraud laws. A broad spectrum of potentially risky conduct by financial market participants does not necessarily implicate fraud within the meaning of the relevant law, and thus remains outside the private attorney generals’ reach.

Dissemination of information and public education. An important role of public interest groups is educating the citizenry on the relevant issues of broad public concern. By publicizing the instances of firms’ or regulators’ wrongdoing and explaining their effect on specific segments of the population or society as a whole, these organizations enable citizens to participate in policy debate more effectively. Modern information technology and the rise of social network media give public interest groups a particularly powerful tool to carry out public opinion campaigns and mobilize the public to act in defense of the common good.

\[\text{to resolving "cases and controversies." See Lujan v. Defenders of Wildlife, 504 U.S. 555, 560 (1992) (holding "the core component of standing is an essential and unchanging part of the case-or-controversy requirement of Article III"). Generally, the requirement of standing means that the plaintiff must establish the injury-in-fact, the connection between that injury and the conduct alleged, and a substantial likelihood that the relief sought would remedy the injury. See Ne. Fla. Contractors v. Jacksonville, 508 U.S. 656, 663–64 (1993) (holding the association had standing under an analysis of these three elements). For an example of courts' approach to the issue of standing in cases involving financial services, see Lee v. Bd. of Governors of the Fed. Reserve Sys., 118 F.3d 905 (2d Cir. 1997).\]

142. Schooner, supra note 61, at 1008–09 (discussing private enforcement mechanisms).

143. For example, under the Administrative Procedure Act, any member of the public can bring a lawsuit in federal court to "compel agency action unlawfully withheld or unreasonably delayed." Administrative Procedure Act § 2, 5 U.S.C. § 706(1) (2006). However, courts generally apply highly deferential standards of review to agencies’ decisions to delay action or not to act at all. See, e.g., Sierra Club v. Gorsuch, 715 F.2d 653, 658 (D.C. Cir. 1983) ("Absent a precise statutory timetable or other factors counseling expeditious action, an agency's control over the timetable of a rulemaking proceeding is entitled to considerable deference."); Minn. Milk Producers Ass’n v. Glickman, 153 F.3d 632, 642 (8th Cir. 1998), cert. denied, 526 U.S. 1130 (1999) ("[A] decision to do nothing is entitled to more deference than a decision to act."). As a result, this provision is of limited usefulness for citizens seeking to force financial regulators to act in the public interest.


145. Schooner, supra note 61, at 1011–17 (discussing alternative models of private enforcement to address systemic risk concerns not effectively addressed under the existing system).

2. Potential Limitations

Despite their importance, public interest groups (or PIGs, in Ayres and Braithwaite’s terminology) may not be the most effective candidates to act as the key representatives of the public interest in financial sector regulation, especially with respect to systemic risk. Generally, one of the key limitations of this form of representation is that individual PIGs are, in essence, private interest groups.\textsuperscript{147} Individual groups often organize around relatively narrow viewpoints and focus their efforts on specific issues. It is typically more difficult for a group to self-organize, from the bottom up, around a broad conceptual agenda that lacks concrete, often emotional, appeal. This is a particularly serious hurdle in the area of systemic risk regulation in the financial sector, where access to relevant information and technical expertise are often critical to one’s ability to formulate issues and to articulate a meaningful policy agenda. The complexity of the problem and the lack of consensus on the appropriate solutions, even among the experts, further exacerbate this difficulty.

The secretive, closed-door nature of the decision-making process involving financial regulators and industry actors makes it effectively impossible for a truly broad-based grassroots movement to emerge naturally as an advocate for a publicly minded systemic risk regulation. Even leaving aside the pernicious effects of regulatory capture in the financial services sector, discussed above, there are various cognitive and behavioral factors that may preclude financial regulators from accepting public interest groups as a legitimate third-party participant in systemic risk regulation:

Regulators operate within a relatively narrow, insulated, and expertise-based band of human experience, characterized by relationships with sophisticated repeat players. In spite of their public-regarding mandate, they may be cognitively predisposed against “outsiders” who either lack facility with the dominant jargon, or who take issue with assumptions that no one in the industry takes issue with. They are also more likely to share social, educational, or experiential ties with industry actors than with others. Even well-informed activist shareholders may not receive the same measure of automatic regulatory respect.\textsuperscript{148}

Of course, it is possible to envision emergence of a public interest group with the requisite expertise in financial markets and regulation.\textsuperscript{149} One potential model for such a

\begin{itemize}
\item \textsuperscript{147} In fact, that was the insight behind Ayres and Braithwaite’s concept of contestability of guardianship. See Ayres & Braithwaite, supra note 80, at 57 (suggesting the notion of “contestable guardianship”).
\item \textsuperscript{148} Ford, supra note 41, at 614–15.
\item \textsuperscript{149} One potentially interesting example of such a group is Better Markets, Inc., a non-profit organization formed in 2010 by a hedge fund manager, Michael Masters. This organization’s self-proclaimed goal is “to promote the public interest in the domestic and global capital and commodity markets,” especially through participation in the implementation of the Dodd–Frank Act. About Us, BETTER MARKETS, http://www.bettermarkets.com/about-us (last visited Mar. 25, 2012). The group’s ability to bring on board industry and government insiders may significantly enhance its ability to engage in the debate on complex substantive issues in financial regulation. At the same time, however, it may potentially undermine the group’s legitimacy as an unbiased advocate of the public interest. See, e.g., Courtney Comstock, Busted: Meet the Hedge Fund Manager Pushing the Government’s New Attack on Speculators, BUS. INSIDER (Apr. 22, 2011), http://articles.businessinsider.com/2011-04-22/wall_street/30088013_1_gas-prices-michael-masters-speculators
\end{itemize}
group is the Union of Concerned Scientists (UCS), a non-profit organization that grew out of an academic experiment at the Massachusetts Institute of Technology and that brings together scientists and policy advocates in an effort to promote environmental safety goals. However, it seems unlikely that a similar grassroots organization of academic experts in finance and financial regulation, concerned with safeguarding public interest in financial stability, would ever appear. Some of the reasons for this pessimistic view include the fact that the relevant academic community seems to lack the depth, in terms of the sheer number of active scholars in the area, and tends to be highly fragmented. Political economists, legal scholars, finance theorists, and social scientists often do not communicate effectively across the disciplinary lines. Moreover, even within the same discipline, the variety of competing methodologies and normative approaches frequently results in rigid intra-disciplinary divisions. There is a wide variety of views on the causes of, and the cure for, systemic instability. In the absence of incontrovertible “objective” evidence supporting or falsifying any particular academic view, it seems even less likely that a critical mass of academic experts will develop a common understanding of such a complex problem as systemic risk prevention, necessary to form a unified advocacy movement.

In the absence of an internally generated expertise, interest groups seeking to advocate for publicly minded systemic risk regulation would need to have sufficient resources to hire outside experts. This may be difficult, as public interest organizations often have limited resources and rely primarily on private donations from individuals and organizations supporting their mission. By contrast, the financial services industry’s vast resources would render public interest groups perennially outgunned.

The effectiveness of public interest organizations in the financial sector varies across different areas. To date, public interest groups have been active and relatively successful in performing most of their typical functions almost exclusively in the area of consumer protection. Although some of the larger, better-established organizations, such as Public Citizen or Americans for Financial Reform are more actively advocating for

---


151. Of course, this may be an overly pessimistic view of the situation, as some future events may, in fact, serve as a powerful catalyst for the formation of an equivalent of the UCS in the area of systemic risk regulation. One such external event is another major crisis that would alter popular perceptions and encourage greater numbers of public figures and academics to band together around some of the most important issues in financial sector regulation.


a broader spectrum of financial regulation reform in the wake of the global crisis, their ability to shape actual policy outcomes against the powerful industry lobbying machine and ideologically captured regulators is likely to remain limited.155

B. Government Actors: Proxy Advocates and Agency Monitors

The second group of institutional actors that often act as designated representatives of the broad societal interests operates within the administrative agency structure. Despite the differences in their formal mandates, legal status, and jurisdictional powers, all of these institutions constitute part of an official apparatus of the modern regulatory state. For the purposes of this discussion, these actors fall into one of two broad and loosely defined sub-groups: proxy advocates156 and agency monitors.157

1. Proxy Advocates

For purposes of this discussion, a proxy advocate can be defined as a government actor—a stand-alone agency, a division within an agency, an individual appointed official, an independent commission, or any other type—whose mission is to represent some form of public interest in the regulatory process.158

Designated consumer representatives. Some of the institutions in this category act as direct consumer representatives in ratemaking or other administrative proceedings, especially in the context of state regulation of public utilities.159 Thus, several states...
currently have so-called Offices of Public Counsel affiliated with their public utilities regulators. In a number of states, the office of the state's attorney general is assigned a duty to represent consumers in agency proceedings. Other states either created a proxy advocate within the relevant regulatory agencies or placed that responsibility elsewhere in their executive structure.

An interesting example of a proxy advocate outside the traditional context of public utility regulation is the Funded Consumer Liaison program of the National Association of Insurance Commissioners (NAIC), described by McDonnell and Schwarcz. It consists of 18 individuals, mostly academics and public interest group representatives, selected on the basis of publicly submitted nominations. Consumer liaisons do not have any administrative powers and do not receive compensation but are given free access to NAIC resources and discussions. They identify and present on a wide range of consumer-related issues at public meetings that NAIC organizes, advocate for specific action by insurance regulators, and follow these issues across all NAIC organizations.

**Ombudsmen.** Another set of institutions in this general category performs a somewhat different role of an ombudsman, a body or an individual "tasked with responding to complaints concerning a specific government agency or other type of institution." The Taxpayer Advocate Service (TAS) within the IRS is a well-known example of a relatively well-established and effective ombudsman. The TAS is an independent organization within the IRS, whose mission includes assisting taxpayers in resolving disputes with the IRS, identifying systemic problems in the IRS's practices, and recommending potential administrative and legislative changes to mitigate such problems. Importantly, the TAS submits an annual report to Congress, in which it outlines the key deficiencies in the IRS's performance and sets forth its proposals and

---

160. See, e.g., McDonnell & Schwarz, supra note 48, at 1655 (stating that California, Florida, Missouri, and Texas have such Offices, while Texas also has a separate Office of Public Insurance Counsel).

161. As Stein reports, five states mandate that the Attorney General performs this duty directly, while nine additional states establish a specific position in the Attorney General's office to represent consumer interests. See Stein, supra note 156, at 31 n.199.

162. According to Stein's study, "in ten states, the proxy advocate is a division of the agency that regulates utilities. Eighteen states have placed their proxy advocates elsewhere in the state's executive branch." Id. at 310.

163. McDonnell & Schwarz, supra note 48, at 1657–59. NAIC is an association of state insurance regulators.

164. Id. at 1657.

165. Id. at 1658.

166. Id. However, as McDonnell and Schwarcz note, the program's structure partially limits its effectiveness, as individual consumer liaisons sometimes fail to cooperate on issues that cause substantive disagreement. Id. at 1658 n.129. Because this is not individual members' primary employment, the degree of their commitment to fulfilling their duties also may vary.

167. McDonnell & Schwarz, supra note 48, at 1653. Notably, Stein explicitly excludes ombudsmen from his category of "proxy advocates" that is limited to consumer representatives discussed above. Stein, supra note 156, at 5.


recommendations. This direct line of communication with Congress, and the ability to make its criticisms of the IRS public, gives the TAS significant power to press for changes in the IRS’s practices from within the agency.

However, it is important not to overstate ombudsmen’s ability to act as an effective representative of the public interest in every context. These agencies deal primarily with specific disputes and grievances of consumers and other targets of specific regulatory schemes, typically a well-defined (if not always narrowly defined) constituency. They do not directly participate in the agency policymaking process. Thus, their role as independent public interest representatives is inherently limited.

More generally, all proxy advocates suffer from the same handicap: they operate in concrete, narrowly defined areas and, in effect, act as another “interest group.” They may be effective in resolving specific issues of consumer protection. However, the narrow scope of their subject matter and jurisdictional competency makes these actors incapable of counteracting regulators’ failure to act in the public interest in the area of broader systemic regulation.

2. Agency Monitors

This group includes a wide variety of government actors that perform the task of monitoring regulatory agencies’ efficiency and integrity in upholding the laws they implement and enforce. These institutions’ official mandates may not contain explicit references to protection of the public interest. However, their essential function is to ensure that regulatory agencies act in accordance with their stated objectives, which presumably reflect the legislature’s concept of public good. These agency monitors operate at several levels within the federal government: within individual agencies, as separate agencies, or outside the executive branch altogether.

Inspectors General. Many federal regulatory agencies have an independent office of Inspector General (IG) operating within their structure under a separate statutory authority. An IG’s mission is to detect and prevent fraud and abuse of administrative power and to promote government efficiency and effectiveness. Designed to act in a non-partisan manner, IGs are appointed without regard to their political views and, at
Bankers, Bureaucrats, and Guardians

least theoretically, solely on the basis of their integrity and expertise in law, finance, audit and accounting, or investigations. IGs conduct audits and investigations of their agencies, focusing on strict compliance with specific legal rules and regulations. IGs submit semi-annual reports to Congress which identify deficiencies in their agencies’ operation and contain recommendations for improvement.176 Although IGs do not have authority to interfere with agencies’ substantive regulatory activities, their investigations often identify serious problems in the agencies’ operations and shape internal agency reforms.177

A particularly relevant example in this respect is the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), which Congress established in October 2008.178 The head of SIGTARP is the Special Inspector General (SIG), appointed by the President, with the consent and advice of the Senate.179 Congress created SIGTARP specifically to protect the interests of taxpayers who fund the $700-billion Troubled Asset Relief Program (TARP), designed to bail out financial institutions affected by the financial crisis.180 SIGTARP’s official mission is threefold: to promote transparency in the administration of TARP, to provide coordinated oversight of the program’s management and operation, and to prevent and detect incidents of fraud, waste, and abuse of TARP funds.181 Under the statute, SIGTARP is required to audit the Treasury Department’s purchases, management, and sales of assets under TARP authority and to submit quarterly reports to Congress detailing its audit and law enforcement activities.182

SIGTARP has been generally praised for its ability to maintain its independence and to press aggressively for greater transparency and accountability in the administration of the bailout programs.183 To a great extent, this success is attributable to the first SIG, Neil Barofsky, who actively used the media to publicize his office’s findings and issued

---


177. A recent example of an investigation that sparked intense public interest is the SEC Inspector General’s report on the agency’s failure to detect and stop Bernard Madoff’s fraudulent activities. See SEC, OFFICE OF INVESTIGATIONS, INVESTIGATION OF THE FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF’S PONZI SCHEME—PUBLIC VERSION (2009), available at http://www.sec.gov/news/studies/2009/oig-509.pdf (detailing the SEC’s failure to stop Madoff’s fraudulent operations). Of course, it is quite ironic that the SEC IG itself failed to spur the agency into action before the fraud was finally revealed.


179. According to the EESA, “The appointment of the Special Inspector General shall be made on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations.” EESA § 121(b)(2). The SIG is removable under provision 3(b) of the Inspector General Reform Act, which gives the President the power to remove any Inspector General. Id. § 121(b)(4) (citing Inspector General Reform Act § 3(b)). When exercising his removal power with respect to the SIG, the President is required to communicate his reasons for removing the SIG to both houses of Congress. Id.


182. EESA § 121(f)(1).

scathing public criticisms of the government’s bailout of AIG and the foreclosure prevention efforts. Under Barofsky’s leadership, SIGTARP has established itself as an “important public agency” performing a critical public service by “publicizing perceived weaknesses and flaws in TARP.” However, as with all IGs, SIGTARP cannot interfere in substantive policy decisions. Its authority is clearly limited to maintaining the integrity of the process through which the agencies manage TARP funds.

In an effort to coordinate its own oversight activities with those of other federal agencies, the SIG founded the TARP Inspector General Council, comprising the IGs of the Treasury Department, the Federal Reserve, FDIC, SEC, and other agencies whose activities are relevant to TARP administration. In a similar vein, the Dodd–Frank Act seeks to strengthen the role of IGs at the federal financial regulatory agencies by creating a Council of Inspectors General on Financial Oversight. This Council would meet quarterly to discuss potential systemic risk issues and would report its findings to Congress and to the FSOC. This new mission to monitor systemic risk in the financial sector represents a significant deviation from the IGs’ traditional functions, and it remains to be seen how effective this new Council will be in practice.

Office of Information and Regulatory Affairs (OIRA). OIRA, which operates as part of the Office of Management and Budget (OMB), provides an example of a government entity established solely for the purpose of monitoring federal regulatory agencies across the entire executive branch. The key responsibility of OIRA and OMB is to conduct coordinated review of regulatory agencies’ rule-making activities in order to provide centralized oversight of the increasingly complex administrative state. This review

186. EESA § 121(b)(5).
187. Moreover, the office will remain active only for as long as TARP has any outstanding obligations or assets under management. SIGTARP, QUARTERLY REPORT TO CONGRESS 35 (2011), available at http://www.sigtarp.gov/reports/congress/2011/April2011_Quarterly_Report_to_Congress.pdf.
190. Id. § 989E(a)(2)(A)–(B).
191. Thus, the fact that the IG of the SEC has notoriously failed to uncover the SEC’s failure to take action to end Bernie Madoff’s fraudulent activities further exacerbates these concerns with the IGs’ capacity to serve as effective systemic risk monitors.
also serves to ensure the Administration’s control of agency decision-making.\textsuperscript{193} Thus, OIRA reviews proposed agency regulations for their cost-benefit justification.\textsuperscript{194} All agencies are also required to submit to OIRA a complete agenda of all regulations under development. In addition, OIRA reviews legislation and congressional testimony proposed by the administrative agencies under its jurisdiction.\textsuperscript{195}

The focus of OIRA’s review is on the cost-benefit analysis of proposed agency rules, which tends to overstate the more easily quantifiable costs of the proposed regulation and to discount its potential public benefits.\textsuperscript{196} Not surprisingly, commentators have criticized OIRA for serving as a tool of political control over the regulatory apparatus, impeding agency rule-making, and effectively acting as a front for deregulation.\textsuperscript{197} Thus, despite its considerable powers to monitor regulatory agencies, OIRA does not appear to establish itself as an effective counterweight to regulatory capture, myopia, or sheer incompetence.

The Government Accountability Office (GAO). The GAO is “an independent, non-partisan agency that works for Congress.”\textsuperscript{198} Congress established the GAO explicitly to operate outside the executive branch.\textsuperscript{199} The President selects the head of the GAO, who serves as the Comptroller General of the United States, from a list of Senate nominees and appoints the GAO head to serve a 15-year term.\textsuperscript{200} These protections seek to insulate the GAO from executive influence and to enable it to act as an independent congressional watchdog.

The GAO supports congressional oversight by investigating the use of public funds, auditing government agencies, assessing various government programs, performing policy analyses, conducting extensive research, and providing information requested by Congress.\textsuperscript{201} In its reports, the GAO often makes general recommendations on how to remedy identified problems in agency performance.\textsuperscript{202} Thus, the GAO combines the

\begin{itemize}
  \item Starting in 1981, President Reagan, by Executive Order, significantly expanded the powers of the OMB and OIRA, requiring administrative agencies to submit to OMB complete regulatory plans and cost-benefit analyses for all of their “major rules.” See Steven Croley, White House Review of Agency Rulemaking: An Empirical Investigation, 70 U. CHI. L. REV. 821, 824–26 (2003) (outlining the history and impact of Executive Orders 12291 and 12498 on OMB).
  \item All regulatory agencies other than those specifically exempted under the Paperwork Reduction Act, Pub. L. No. 96-311, 94 Stat. 2812 (1980) (codified at 44 U.S.C. §§ 3501–20), are required to submit to OIRA drafts of their proposed rules that constitute “significant” regulatory action (generally, rules that have an expected annual effect on the economy of $100 million or more) for review. See Barkow, supra note 70, at 31 (describing OIRA’s responsibility for reviewing proposed agency rules and testimony).
  \item Id.
  \item See, e.g., Bagley & Revesz, supra note 196, at 1304–12 (criticizing OIRA).
  \item See 31 U.S.C. § 702(a) (2006) (stating that the GAO is an instrumentality of the U.S. government independent of the executive departments).
  \item See id. § 703(a)(1)–(2) (stating a method of appointment and term length of the Comptroller General).
  \item See About GAO, supra note 198.
  \item The GAO makes its reports and testimonies publicly available on its website. See Reports and Testimonies—Browse By Date, U.S. GOV’T ACCOUNTABILITY OFFICE, http://www.gao.gov/browse/date/week
\end{itemize}
functions of an auditor, investigator, and policy adviser. The GAO’s investigative and information-gathering efforts, however, focus on government agencies, not private market participants.\textsuperscript{203} In addition, one could argue that the sheer breadth of the GAO’s research and policy analysis potentially undermines its ability to develop truly deep expertise in such a specialized and complex area as financial sector regulation.

\section*{C. Technical Expert Councils}

This group of institutional actors includes a wide range of specialized scientific and technical expert committees that are frequently established by administrative agencies, such as the Environmental Protection Agency (EPA) or the Food and Drug Administration (FDA).\textsuperscript{204} To the extent that these independent experts participate in the regulatory process in order to ensure better protection of public health, safety, and environment, they can be viewed as “quasi-guardians” of the broader public interest.

For instance, the FDA currently uses 49 scientific expert committees that provide independent expertise and advise the FDA on scientific issues of regulatory importance.\textsuperscript{205} The agency relies heavily on these scientific advisory committees for advice on such important issues as approval of new products and the scientific and clinical issues in product development and evaluation.\textsuperscript{206} The FDA also uses advisory committees “to legitimize the soundness of its analysis of a given product, as a public forum for discussion of controversial issues, and, on occasion, as an ‘appeals court’ for disputed agency decisions.”\textsuperscript{207}

Generally, either the Secretary of Health and Human Services or the FDA Commissioner establishes the FDA’s advisory committees.\textsuperscript{208} The FDA solicits public nominations and applications for its scientific advisory committees, but clearly states that the members must be technical experts in their fields, which include “clinical medicine, engineering, biological and physical sciences, biostatistics, and food sciences.”\textsuperscript{209} Besides the proven expertise, the key concern in the process of selecting the members of the FDA’s technical advisory committees is potential financial conflicts of interest.\textsuperscript{210}
Bankers, Bureaucrats, and Guardians

Congress generally views the use of technical advisory committees by regulatory agencies as an important mechanism of improving the quality of administrative decision-making under the condition of scientific uncertainty. As some scholars have noted, these committees also represent an attempt to resolve the fundamental tension between technocratic expertise and democratic participation. Not surprisingly, these institutions have also generated considerable controversy. Thus, one of the common criticisms of the FDA expert advisory committees is that they are not truly independent from the agencies they advise and merely serve as a legitimizing device for the agency’s decisions. There are also persistent suspicions that the FDA experts tend to favor the industry because of various hidden or indirect financial conflicts of interest. Despite these criticisms, the FDA’s use of technical advisory committees serves as an important example of a tripartite regime that incorporates outside experts as the third party in the decision-making process, for the purpose of imposing an independent check on the industry’s and the agency’s assessments of public risks.

D. Congressional Advisory and Investigatory Commissions

An independent advisory commission is a unique institution “that can arise from but does not neatly fit into executive, legislative, or judicial archetypes of governmental power.” Such commissions can be established by nearly any branch of the federal government: Congress, the President, or an administrative agency. While these special commissions vary widely in their functions and powers, as a general rule, they fall into one of two groups: commissions set up to study specific public policy problems (policy commissions) and commissions focusing on past catastrophic events that had a great public impact (investigatory commissions).

The following discussion will focus on congressional advisory and investigatory commissions. A congressional commission is typically established by statute, which defines its mandate and powers. These commissions function independently from

211. See Lars Noah, Scientific “Republicanism”: Expert Peer Review and the Quest for Regulatory Deliberation, 49 Emory L.J. 1033, 1034 (2000) (“Congress has come to view expert peer review as a method for improving agency decision making.”).
212. Id. at 1043. Noah expresses some ambivalence about the undemocratic potential of the practice of “routinely asking independent scientists to referee the work of federal regulatory agencies,” which he views as “something of a throwback to the New Deal’s enthusiasm for decision making by expert regulators.” Id. at 1037.
213. See id. at 1060 (stating that “soliciting expert input at the front-end of the regulatory process more closely resembles peer collaboration than peer review”).
214. Hutt et al., supra note 206, at 1588.
216. Id. at 1428 (“Investigatory commissions may be constituted by virtually every department of Anglo-American government.”).
217. Id. at 1436. See also Matthew Eric Glassman & Jacob R. Strauss, Cong. Research Serv., R40076, Congressional Commissions: Overview, Structure, and Legislative Considerations 1 (2011) (characterizing congressional commissions as focused on policy, commemorations, or investigations).
218. Although there is no legal definition of a congressional commission, it has been defined as “a multi-member independent entity that (1) is established by Congress, (2) exists temporarily, (3) serves in an advisory capacity, (4) is appointed in part or whole by Members of Congress, and (5) reports to Congress.” Glassman & Strauss, supra note 217, at 2.
Congress, and their membership may or may not include any members of Congress. Commission members are often selected on the basis of technical expertise in the subject area, as well as their reputation for integrity and proven record of public service. These commissions typically have no real administrative authority, so that their only task is to produce reports and policy recommendations to Congress. Once they complete their fact-finding and produce reports that detail their conclusions and recommendations for legislative or executive action, these commissions are typically disbanded. These features potentially shape the incentives of commission members in a way that enhances their relative independence.

However, academics and political observers often criticize congressional commissions for being used as a purely strategic device, shifting responsibility for difficult political choices away from Congress. Another common criticism points to the high costs and potential inefficiency of congressional commissions. While their work is typically funded through budget appropriations, there is no guarantee that these commissions will produce truly unbiased and valuable policy recommendations that Congress will, in fact, incorporate into its decisions. On the other hand, lack of sufficient funding often significantly hinders congressional commissions' abilities to fulfill their missions effectively. Finally, these commissions, whose members are appointed and not elected, are criticized for their lack of democratic accountability.

Despite these criticisms, congressional commissions have a great potential to provide a highly visible public forum for discussing important policy issues and to advocate policies and reforms that serve the broad public interest. The combination of technical expertise and the relative independence of commission members potentially enhances the credibility of commissions' findings and increases the likelihood of congressional action. Congressional investigatory commissions, which focus on the causes and impacts of past catastrophic events, typically achieve the highest level of

---

219. However, members of congressional commissions are appointed either directly by Congress or by the President, with congressional participation or recommendation. The statutes often mandate that commissions be bipartisan. Id. at 2, 11. For a detailed discussion of the appointment process, see MATTHEW ERIC GLASSMAN, CONG. RESEARCH SERV., R133313, CONGRESSIONAL MEMBERSHIP AND APPOINTMENT AUTHORITY TO ADVISORY COMMISSIONS, BOARDS, AND GROUPS (2009).

220. Importantly, congressional commissions are typically supported by professional staff of technically skilled lawyers, investigators, and other experts in the relevant subject-matter. Simon, supra note 215, at 1431.

221. According to Simon:

Appointment to a commission, either to membership or staff, may bring prestige that will add social capital to a person's career, but it typically creates neither long-term obligations nor enduring opportunities for profit. Thus, in contrast to normal permanent institutions of government, commissions can exercise judgment from a position of relative independence.

Id.


223. See GLASSMAN & STRAUSS, supra note 217, at 10 (stating that one criticism of congressional commissions is that they often have high costs and low returns).

224. Id.
political visibility and generate massive public interest.\(^{225}\) A well-known recent example of such a high-profile commission is the National Commission on Terrorist Attacks Upon the United States (9/11 Commission), established on November 27, 2002, by President George W. Bush and Congress to provide a “full and complete accounting” of the attacks of September 11, 2001, and to issue recommendations on preventing such attacks in the future.\(^{226}\) The financial crisis that erupted in 2007 led Congress to establish two such important investigatory commissions. First, in 2008, Congress established the Congressional Oversight Panel for the Emergency Economic Stabilization Act (COP), charged with overseeing the Treasury Department’s administration of the $700 billion TARP bailout.\(^{227}\) During its tenure, the COP issued several important reports providing rich empirical detail and analysis on the financial crisis and regulatory reform.\(^{228}\) Second, on May 20, 2009, President Obama signed into law the Fraud Enforcement and Recovery Act of 2009, which created the bipartisan Financial Crisis Inquiry Commission (FCIC).\(^{229}\) Responding to the growing public outrage at revelations of numerous instances of blatant misconduct in the financial sector,\(^{230}\) the statute gave FCIC a broad mandate to investigate any issue relevant to establishing “the causes, domestic and global, of the current financial and economic crisis in the United States.”\(^{231}\) The Act granted the FCIC the authority to hold hearings and subpoena witnesses and documents in connection with its investigation.\(^{232}\) Its final report, published in January 2011, presented a wide-ranging examination of the causes of the crisis, which would not have

\(^{225}\) See id. at 6 (discussing potential value of congressional commissions). This is despite the fact that the overwhelming majority of congressional commissions established in the last 22 years have been purely policy commissions. Thus, between 1989 and 2010, Congress established a total of 92 congressional advisory commissions, but only 7 of them were investigative bodies. Id. at 5.


\(^{229}\) In particular, the statute identified the following areas for investigation by the FCIC: fraud and abuse; the role of federal regulators; international capital markets; monetary policy and the flow of credit; accounting standards; tax issues; capital structures; credit-rating agencies; lending practices; relationships between banks, securities, insurance and other non-banking institutions; size and strength of certain companies; corporate governance; executive compensation; the housing market; unregulated financial products (including derivatives and credit default swaps); short-selling practices; and the role of government-sponsored enterprises. Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, § 5(c), 123 Stat. 1617, 1626–28 (2009).

\(^{230}\) Id.
been possible to assemble without the broad statutory authority to gather information from regulatory agencies and private actors. However, only the Democratic members of the Commission signed the FCIC’s final report, while its Republican members issued dissenting opinions. Besides potentially undermining the credibility of the FCIC’s findings, this partisan split demonstrates inherent limitations of bipartisan commissions.

Despite their shortcomings, the 9/11 Commission and the FCIC illustrate the potential for a congressional investigatory commission to move beyond its purely fact-finding missions and serve as a public forum for a far more powerful “critical engagement with the government” than is attainable through the ordinary political and administrative channels. As such, these commissions may function as the modern medium for a collective exercise of democratic citizenship. However, the temporary nature of these commissions and their focus on retrospective assessments of the causes and policy implications of one-time events—typically, major disasters—inevitably limit their potential to fulfill that role.

E. Summary

To sum up, even a cursory overview of the four principal groups of “quasi-guardians” of the public interest—public interest organizations, certain government actors, scientific expert councils, and congressional commissions—highlights the importance of regulatory design for such groups’ effectiveness and independence. The degree of democratic legitimacy of these institutions, their legal status and position in the political and administrative hierarchy, the nature and scope of their formal and informal powers, the source and availability of funding, and access to information and technical expertise all shape the ability of these institutions to act as effective representatives of the public interest in the regulatory process.

As this Part demonstrated, the actors in each of these four categories play an important role in the regulatory process. They formulate and advocate a public point of view on specific policy issues, help to broaden regulatory agencies’ horizons and improve their decision making, monitor the agencies’ compliance with applicable laws and regulations, and litigate and investigate causes of regulatory failure. Nevertheless, these “quasi-guardians” generally operate within certain limited areas of competence, depending on the substantive policy issue or agency decision in question, available resources, jurisdictional mandates, or functional roles. Largely due to such inherent constraints, none of these existing mechanisms of public interest representation seem well-suited for the task of protecting the public interest in preserving long-term systemic stability in the financial services sector.

V. ENTER THE GUARDIANS: DESIGNING TRIPARTISM IN FINANCIAL SERVICES REGULATION

This Part outlines a proposal to introduce tripartism in financial sector regulation by establishing the Public Interest Council (Council), a special body whose sole mission is to represent the public interest in preserving financial stability and minimizing systemic
risk. The proposed approach seeks to synthesize various normative and descriptive aspects of the concept of tripartism discussed above. In effect, the Council is envisioned as a body that combines direct participatory aspects of a public interest group with the technical expertise of scientific advisory committees, enjoys broad information-gathering and investigative powers typically granted to administrative agencies, and is structurally independent from the executive branch of the government. Overall, the proposed Council is similar to a congressional advisory and investigatory commission functioning on a permanent rather than temporary basis.\textsuperscript{236}

The outlined approach is not a fully developed legislative proposal and leaves many important details to be filled in later. Practical implementation of such a radically novel mechanism is bound to face numerous challenges and raise difficult questions. Rather than providing complete answers to those questions, this Part pursues a far more modest goal: to sketch out the principal framework within which a new form of tripartite systemic risk regulation might emerge.

\textit{A. Public Interest Council: A Proposal Outline}

This Article argues that, in order to address effectively the problem of systemic risk in the financial sector, it is necessary to introduce the public interest directly into the regulatory process. It is critical that the Council represents broader societal interests in preserving long-term financial systemic stability, rather than the more narrowly drawn consumer interests. To the extent there are viable public interest organizations in the financial services sector, however, they typically engage in the traditional consumer advocacy. Moreover, the complexity and the technical nature of the key issues in systemic risk regulation decrease the likelihood that a grassroots movement with an explicit focus on such issues would organically emerge in the area of financial services regulation. To remedy this problem, this Article proposes the creation of a special government body that would act as a functional equivalent of such a public interest group: the Public Interest Council.

In designing the Council, the key challenges are to ensure that it (1) possesses the requisite expertise; (2) is able to influence regulatory outcomes; and (3) is sufficiently independent from the regulators and the industry.\textsuperscript{237} Developing a comprehensive blueprint for this new entity is a complex task that would require meticulous consideration of numerous legal details. The following discussion offers a broad outline of the proposed Council’s composition, powers, and responsibilities. Some of the potential difficulties and objections to this proposal are addressed in Part V.B below.

\textit{1. Creation and Status}

Congress would establish the Council by statute as an independent, non-partisan government instrumentality that is outside both the legislative and executive branches. This special status would make the Council similar to both the GAO and a congressional

\textsuperscript{236} In that sense, this Article envisions a form of tripartism that is different from the Ayres and Braithwaite’s original model commonly associated with this term.

\textsuperscript{237} This approach is similar to Levine’s argument that “[t]he major design challenges are to create a Sentinel that is (1) politically independent, (2) independent of financial market, and (3) expertly staffed.” Levine, supra note 99, at 22.
It is critical that Congress does not set the Council up as an administrative agency, along the lines of Levine’s Sentinel.\textsuperscript{239} Being a creature of Congress, directly accountable to it, the Council would enjoy structural and political independence from the President and the regulatory agencies. Its actions and decisions would not be subject to the constraints and requirements of the administrative process and would not be vulnerable to internal veto or other bureaucratic interference. Besides the freedom from direct political and administrative pressure, this outside location would enhance the Council’s ability to bring a fresh external perspective on the substantive regulatory issues, which is essential for its ability to counteract financial regulators’ cognitive biases and ossification. From this perspective, the proposed Council would be potentially far more effective than any designated “regulatory contrarian” located inside, or attached to, a regulatory agency.\textsuperscript{240} This special status as an independent body outside the traditional government branches would also strengthen the Council’s claim to legitimacy as a third party representing the public interest in the regulatory process. Public perceptions and reputational factors are critically important to the Council’s credibility and, ultimately, ability to fulfill its mission effectively.

The Council would be funded through congressional appropriations. An alternative approach could be to fund the Council from the Federal Reserve’s budget or through some form of industry assessments.\textsuperscript{241} If feasible, this arrangement would enhance the Council’s political independence from Congress and ensure sufficient financial resources for its operations.\textsuperscript{242} In any event, it is crucial that the Council has sufficient financial resources to support the hiring of technically skilled permanent staff at competitive salary levels and, if necessary, temporary outside consultants.\textsuperscript{243}

\textsuperscript{238} See supra notes 198–203, 215–35 and accompanying text (detailing the background of the GAO and congressional advisory commissions).
\textsuperscript{239} See supra notes 99–110 and accompanying text (describing Levine’s proposal).
\textsuperscript{240} See supra notes 122–30 and accompanying text (discussing the concept of “regulatory contrarians” advanced by McDonnell & Schwarcz).
\textsuperscript{241} There are examples of various regulatory bodies obtaining funding through industry assessments. Thus, the Dodd–Frank Act provides that the OFR, located in the Treasury Department, will fund itself through special fee assessments on certain financial institutions subject to supervision by the Federal Reserve. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 155, 124 Stat. 1376, 1419 (2010) (codified at 12 U.S.C. § 5345). Similarly, the Public Company Accounting Oversight Board (PCAOB), a non-profit corporation established by Congress to oversee audits of publicly-traded companies, is funded through industry assessments. About the PCAOB, PCAOB, http://pcaobus.org/about/Pages/default.aspx (last visited Mar. 25, 2012).
\textsuperscript{242} For example, under Levine’s proposal, the Sentinel would receive 30% of the Federal Reserve’s profits and would return the unused funds to the Treasury Department. Levine, supra note 99, at 23.
\textsuperscript{243} The Council’s permanent staff should include not only lawyers, accountants, and economists, but also experts in organizational behavior, psychology, information science, sociology, and a variety of other disciplines.
2. Membership: Composition, Selection, Removal

It is important that membership of the Council is a highly paid full-time job rather than a part-time avocation. The members of the Council would be appointed by Congress for staggered terms, based on publicly solicited nominations. The Council would be explicitly set up as a non-partisan body so that its members would be appointed without regard to their party affiliations.

One possible approach would be to establish two classes of Council membership: (1) “expert” members, who would constitute at least two-thirds of the Council’s membership, and (2) “public advocate” members. Members of both classes would have identical rights and obligations on the Council, but their nomination and appointment would follow technically separate processes.

Specifying qualifications for appointees in the statute is important not only in order to ensure the Council’s technical expertise, but also to ensure its greater political independence and to limit the potential for partisan or ideologically driven appointments. Thus, all expert members would have to meet strict qualification criteria, including having proven ability to understand, analyze, and critically assess public policy implications of issues in financial services regulation. These expert members would have to have an established academic or technical expertise in economics, business, financial law and regulation, political economy, social sciences, and other areas relevant to financial services regulation. As a result of this “recognized expertise” requirement, the majority of the Council’s expert members would comprise

244. Thus, as Rachel Barkow argues, “representing the public cannot be a part-time job. It is a full-time task that requires sufficient staffing and funding to allow public advocates to properly monitor agency actions and to challenge those actions where appropriate.” Barkow, supra note 70, at 63.

245. The limited term of the members’ service on the Council would help to shape their incentives in a way that enhances their independence. See Simon, supra note 215 (discussing how limited appointment terms allow commission members to exercise independent decision making). As noted before, the temporary nature of congressional advisory commissions is one of the mechanisms of ensuring their independence. Id. This is one of the key reasons to doubt the ability of any regulatory agency to act as an effective guardian of the public interest. Id.

246. The FCIC’s experience shows how a bipartisan structure can be divisive and counter-productive.

247. It is difficult to define, at this point in the project, what would be an optimal number of members for the Council to have. Thus, one starting point could be a total of 12: 8 expert members and 4 public advocate members. The statute could also set the range for the number of members (e.g., between 9 and 18). In any event, for the various reasons discussed below, it is important that expert members significantly outnumber public advocate members, as it would potentially enhance the Council’s ability to fulfill its mission, by raising its overall level of technical expertise and potential independence.

248. It may also make sense to set a shorter tenure term for expert members of the Council than for public advocate members. Partly, it may be necessary as a practical consideration, because members of academia who are appointed to serve on the Council may have to return to their universities or other academic institutions to resume their teaching and research activities.

249. See Barkow, supra note 70, at 47 (arguing that specifying qualifications for agency appointees in the statute limits the possibility of partisan appointments).

250. It is critical not to limit this list of potential areas of expertise to the usual realm of law, economics, and finance. To overcome the intellectual shortcomings of the pre-crisis regulatory paradigm, the Council should also include experts in psychology, political science, sociology, history of business and finance, and other academic disciplines typically excluded from the conversation on financial regulation. Expanding the Council’s intellectual breadth and range of scholarly perspectives would greatly increase its ability to take a fresh critical look at many regulatory issues.
academics in these various disciplines, although it would also allow the inclusion of non-academic experts in this area.\footnote{251} Public advocate members would have to satisfy less rigorous technical expertise requirements, as their key qualification would be a proven record of public interest service.\footnote{252} These members would most likely be representatives of consumer protection groups, public interest organizations, public pension funds, possibly major labor unions—a broadly defined universe of PIGs, as Ayres and Braithwaite envisioned it.\footnote{253} All members of the Council would also have to satisfy the strict independence criteria; they can neither be employed by nor receive compensation from financial services industry or financial regulatory agencies on the date of their nomination or at any time during some reasonable period—which probably should not be less than two years—prior to such a date.\footnote{254} Members of the Council would also be prohibited from accepting such employment or compensation from the financial institutions and regulators for a reasonable period of time after they complete their service.\footnote{255} These provisions would decrease the possibility of the “revolving door” effect distorting the incentives of the Council members to act purely in the public interest.\footnote{256}

To further reduce the chances of politically or ideologically motivated appointments, it would be important to provide additional checks in the congressional appointment

\footnote{251}{Such non-academic experts may include former industry insiders or financial regulators who have been openly critical of their former brethren. Former Federal Reserve Chairman, Paul Volcker, or former investment banker, William D. Cohan, come to mind as examples of such individuals.}

\footnote{252}{Of course, this in no way implies that these public advocate members are intellectually inferior to academics or other technical experts on the Council. In fact, many of the public interest representatives, as that term is used in this Article, are going to have a wealth of knowledge and practical experience in dealing with the financial industry and its regulators, and their opinions and unique perspective would be just as valuable as those of any other Council member.}

\footnote{253}{See supra Part III.A. The process of public nomination and selection of the representatives of these different PIGs may, in some ways, approximate the contestability regime envisioned by Ayres and Braithwaite.}

\footnote{254}{This conflict of interest provision is critically important and needs to be crafted carefully, taking into account a variety of situations in which overly strict formalistic prohibitions may be counterproductive. Thus, the statutory provisions would have to be drafted in a way that provides for certain exceptions (e.g., a small honorarium received by a candidate for speaking at a public event partially sponsored by a financial institution, if the sponsor neither selected the speaker nor in any way influenced the contents of the speaker’s statements). The length of the “look-back” period may also be adjusted to accommodate certain situations.}

\footnote{255}{Non-compete provisions typically found in certain private contracts may provide a basis for drafting this provision. Two years seems to be an optimal length of this prospective “black-out” period, but there could be exceptions.}

\footnote{256}{Imposing post-employment restrictions is a well-known and generally embraced method of countering the pernicious effects of the “revolving door.” See Levine, supra note 99, at 23 (stating that the senior members of the Sentinel would be prohibited from receiving compensation from the financial services industry after the completion of their tenure at the Sentinel). See also Barkow supra note 70, at 48 (describing the “standard solution” to the revolving door problem by placing “meaningful limits” on employment choices of agency executives after their service has ended). However, as Barkow notes, these restrictions have a cost, as they make it potentially more difficult to attract highly qualified people to join the agency in question. Id. at 49. Importantly, the fact that the majority of the Council members are likely to be scholars and employees of public interest organizations may significantly mitigate this chilling effect. In particular, academics holding tenured appointments at their home institutions are less likely to be deterred by the potential foreclosure of prospective private industry employment. Even for non-tenured academics, or those interested in private consulting opportunities, the prestige, professional recognition, and intellectual satisfaction associated with serving on the Council are likely to provide a strong incentive to accept nomination.}
process. One potential check could be a requirement to publish a list of all nominees and invite public comments on their qualifications. Depending on the number of nominations it may make sense to create a shorter list of finalists whose credentials would then be vetted through some form of a "peer review" after the general public comment period. This would allow Congress to base its appointment decisions on a firmer basis, while also limiting its discretion. Finally, members of the Council would be subject to removal by Congress only for good cause, which would create an additional layer of political insulation for the Council.

3. Powers and Responsibilities

In order to create a working tripartite system in the financial sector regulation, it is critical to ensure that the Council has statutory powers enabling it to influence the regulatory process so it does not serve as a merely consultative body or a token public interest representative. Being outside the executive branch, the Council would not have any direct administrative powers. It would not have any rule-making or enforcement authority and would not be able to override regulatory agencies' decisions or to compel them to take, or refrain from taking, any specific action. In effect, the Council would

---

257. This type of review would be similar to academic peer review for purposes of granting academic tenure, or to soliciting input from character witnesses for purposes of admitting lawyers to the bar. For example, Congress would ask several (three or five) people, who are professionally active and respected in the same general field as the individual nominee, to evaluate his or her qualifications to serve on the Council. For academics or other expert members, the peers would be other academics or experts in the field. For public advocate nominees, the appropriate peers may include other recognized members of the public interest community. The reviewers would be asked to evaluate not only the expertise and technical ability of the nominees but also their personal and professional integrity and dedication to public service. Of course, one of the key issues that needs to be addressed here is how to select the proper "peers" for each individual nominee so as to avoid biased assessments.

258. It has long been recognized by administrative law scholars that limits on the power of removal is one of the key tools to ensure political independence of the government actors. See, e.g., Lawrence Lessig & Cass Sunstein, The President and the Administration, 94 COLUM. L. REV. 1, 94-106 (1994) (analyzing the scope and nature of the President's removal powers).

259. It is critically important to limit the Council's powers and activities to those related strictly to gathering and dissemination of information, in order to avoid potential violations of the constitutional doctrine of separation of powers. In the context of the modern regulatory state, the strictest interpretation of this doctrine has been largely replaced by a more nuanced concept of the constitutional checks and balances among the three main branches of the U.S. government. See Peter L. Strauss, The Place of Agencies in Government: Separation of Powers and the Fourth Branch, 84 COLUM. L. REV. 573, 616-21 (1984) (discussing the "checks and balances" approach to understanding interactions among the branches of the government). The precise scope of the doctrine of separation of powers continues to be the subject of a complex and constantly evolving debate among constitutional scholars and courts. See, e.g., M. Elizabeth Magill, Beyond Powers and Branches in Separation of Powers Law, 150 U. PA. L. REV. 603 (2001) (arguing that the doctrine of separation of powers law needs to be reconstructed); Jack M. Beermann, An Inductive Understanding of Separation of Powers, 63 ADMIN. L. REV. 467, 468-69 (2011) (contrasting the strong ideal of separation of powers with the reality of a complex expansion of the regulatory state).

For the purpose of the present discussion, the key is to ensure that the proposed Council's functions and powers stay within the bounds of constitutionality, as set forth in the existing precedent. See, e.g., Bowsher v. Synar, 478 U.S. 714, 732-34 (1986) (holding the vesting of an enforcement or judicial power in a legislative agent, subject to removal only by Congress, violates the principle of separation of powers); Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138, 3151-60 (2010) (holding that imposing dual for-cause limitations on the President's power to remove members of a body that exercises executive and enforcement
function as a kind of permanent congressional advisory commission, whose core mission would be to put the financial services industry and the regulators overseeing it under a constant and intense public scrutiny. It would focus on detecting potential sources of systemic risk or instability in the financial system and identifying the gaps and inefficiencies in regulatory and legislative responses to such risk. In a very fundamental sense, the Council would function as the public guardian of long-term stability and integrity in financial markets, seen as a public good and a matter of utmost public concern.

Like a congressional commission, the Council would have broad statutory authority to request any information it deems necessary from any governmental or non-governmental actor. To bolster its information-gathering ability, the statute would have to grant the Council full subpoena powers with respect to any documents or any testimony that would assist the Council in fulfilling its duties. The Council would conduct interviews, informal inquiries, and more formal hearings. It would also hold informational meetings and discussions on any issue it determines to be deserving of attention.

It is critically important to ensure that the Council’s members and staff work closely with the FSOC and the OFR, an independent research office inside the Treasury Department established under the Dodd-Frank Act. The OFR’s primary objective is to support the FSOC’s regulatory functions by researching and identifying sources of potential systemic risk. The OFR has broad authority to collect data from financial institutions and to standardize the data that other regulators provide to the FSOC. Besides leveraging the Council’s resources, full access to OFR’s data and expertise would allow the Council to fulfill its mission far more effectively and to become a fully authority violates the constitutional principle of separation of powers). To avoid crossing these constitutional lines, Congress may delegate to the Council only those powers that are constitutionally vested in Congress, which generally include the investigative and publicity powers of the kind envisioned under this proposal. See, e.g., Kalah Auchincloss, Congressional Investigation and the Role of Privilege, 43 AM. CRIM. L. REV. 165, 167–79 (2006) (detailing the historical evolution and scope of the congressional investigative powers).

260. By contrast, Levine’s Sentinel, whose sole task is to monitor and assess regulatory agencies’ performance, would not have the power to demand and collect information from private market participants. For a discussion of Levine’s model, see supra Part III.B.1.

261. This power to demand documents and compel testimony would allow the Council to overcome the fundamental problem that all public interest groups face: access to privileged information. Government “quasi-guardians”—proxy advocates and agency monitors—have access to information inside regulatory agencies but typically lack such access to private market information, which is the key to effective assessment of regulatory responses to market developments.

262. Thus, some of these discussions and meetings would be purely informational, as the members of the Council would gain a better understanding of a particular issue or practice in financial markets. It would invite financial industry professionals, lawyers, accountants, or any other private experts to make presentations to the Council or to answer specific questions on the issue. Based on this information and its internal staff’s research, the Council may decide not to pursue the issue further, to flag it for ongoing monitoring, or to expand the scope of its inquiry.


264. Id. § 153(a) (to be codified at 12 U.S.C. § 5343).


266. Id. § 153(c)(2) (to be codified at 12 U.S.C. § 5343).
integrated party in the emerging architecture of systemic risk regulation.\textsuperscript{267} It would also be helpful to ensure that the Council collaborates and coordinates its research and policy analysis with the GAO and the CFPB.

Members of the Council would have the right to participate in interagency meetings—including the meetings of the FSOC—where major policy issues are discussed. Upon request, they would be included in internal meetings at regulatory agencies.\textsuperscript{268} All financial regulators would be obligated to inform the Council in advance of any proposed or planned rule-making and to include members of the Council in the process of negotiating and writing their rules and regulations.\textsuperscript{269} Moreover, financial regulators would be required to provide periodic overviews of their activities to the Council, whereby each agency would describe all significant developments in their formal and informal rule-making and enforcement activities, identify key items on their ongoing regulatory agenda, and explain their policy priorities.\textsuperscript{270}

Importantly, in these periodic status reports, the agencies would have to include an overview of significant trends and issues in their informal decision-making, such as issuance of individual orders, interpretations, guidance documents, policy statements, and similar administrative actions that often fly under the public radar.\textsuperscript{271} Not subject to the

\textsuperscript{267} It is important to acknowledge the inherent difficulty with providing the Council with such a broad access to private market information. Financial institutions, whose profitability often hinges on their ability to capitalize on the next great innovative financial product that is yet unknown to their competitors, guard the information on their products and clients very closely. Given the firms' heightened concern with the privacy and confidentiality of the data they consider pertinent to their trading or investment strategies, it is a near certainty that any proposal to share such proprietary information with non-regulators would meet with the powerful industry opposition. Some commentators have criticized the Dodd--Frank Act's information collection and transparency provisions as creating a lot of uncertainty with respect to confidentiality of sensitive market data, and questioned the scope of the FSOC's and OFR's statutory authority to gather detailed transactional data from market participants. See Margaret E. Tahyar & Annette L. Nazareth, \textit{Transparency and Confidentiality in the Post Financial Crisis World—Where to Strike the Balance?}, 1 HARV. BUS. L. REV. 145, 158–80 (2011) (discussing "threats to the confidentiality of information obtained by the FSOC and OFR").

Finding a sensible compromise on the issue of data confidentiality is one of the critical challenges in the implementation of the proposal advanced here. The process of defining that important balance in the operation of the already existing OFR and FSOC may provide a valuable template, and define certain parameters, for addressing this problem with respect to the proposed Council's activities. Moreover, given the nature of the Council's own investigations, not involving direct access to the information gathered by the FSOC and OFR, it seems unlikely that the Council would ever require private market participants to divulge the especially sensitive individual trade and position data. Nevertheless, protecting market participants' legitimate expectations of data confidentiality remains an important concern that requires a fair and carefully crafted solution.

\textsuperscript{268} However, there may be certain exceptions for agency meetings that require a higher degree of confidentiality. See \textit{supra} note 267.

\textsuperscript{269} This is a very important provision, insofar as financial regulators often conduct extensive informal discussions of proposed rules with the financial services industry representatives, and that is where much of that "undue influence" and "ideological capture" actually happens. See \textit{supra} notes 51–52 and accompanying text. Giving the Council direct access to these discussions would introduce an important check on this process.

\textsuperscript{270} As part of this periodic review, it would make sense for the Council to have a separate discussion with the IG of the relevant agency regarding any significant trends in the agency's compliance with the applicable rules and regulations and other issues that the IG internally monitors. Again, the Council would use these periodic reviews purely for the purposes of information-gathering and analysis.

\textsuperscript{271} For a discussion of these forms of administrative decision-making, see M. Elizabeth Magill, \textit{Agency Choice of Policymaking Form}, 71 U. CHI. L. REV. 1383, 1385 (2004) (arguing that "agencies are permitted to
"notice and comment" requirements of the Administrative Procedure Act, these administrative decisions are frequently used for de facto substantive rule-making, which may have far-reaching consequences. The Council would be in a position to scrutinize each agency's pattern of using this subterranean form of administrative decision-making and to detect any potential public policy concerns it may raise.

In this respect, the Council should be explicitly given statutory authority to probe regulatory agencies' determinations that any particular informal administrative action it took was "in the public interest." This is a common condition that statutes impose on the agencies' grant of exemptions from statutory requirements, extensions of certain grace periods, and other exercises of regulatory discretion to ease the burden on private market participants. Currently, there is no regularized external review of agencies' determinations that any such discretionary action was in the public interest, unless a particular agency decision is challenged in court. Often, financial regulators exercise their discretion to grant important benefits to financial institutions, while including only a standard cursory reference to the "public interest." Knowing that they may have to defend their reasoning and explain the basis for their "public interest" determinations in front of the Council would force financial regulators to take their "public interest" charge far more seriously, and to engage in a real analysis of the broader systemic effects of their actions.

Another important tool for monitoring potential sources of systemic risk, and for keeping both the regulators and the industry under constant watch, would be the Council's targeted investigations of specific issues in financial markets. For instance, if members of the Council—or its staff—notice a recent spike in trading volume or overall size of the market in a particular complex financial product, the Council may initiate an inquiry into the issue. As part of that inquiry, the Council would hold a series of interviews and informational meetings with representatives of various financial firms,
asking them to explain to the Council and its staff how exactly that particular product works, what economic and financial needs it is designed to satisfy, who the clients for the product are, what its potential uses and systemic linkages are, and how the dealers and market participants manage specific risks associated with that product. The Council would also question representatives of regulatory agencies as to their views on the subject and ask them to describe and explain specific agency actions—or, more importantly, lack of action—with respect to that particular market. If necessary, the Council would also bring in outside researchers and consultants to advise it on the potential risks and benefits of the financial product. In essence, this process would be somewhat similar to the FCIC’s hearings (albeit less formal, in most cases). One crucial difference, however, is that the Council would conduct an inquiry before the catastrophe hits, while there may still be plenty of opportunities to correct potential problems.

Having academics as members of the Council would be especially valuable in the context of this type of ex ante investigations because it would be very difficult for any investment banker or agency technocrat to dismiss their inquisitors as intellectually inferior, technically incompetent, or unable to understand complicated concepts. Academics are professionally trained to question assumptions and methodologies underlying assertions, and typically do not hesitate to voice their curiosity or doubt. While not all of the expert members of the Council may, in fact, be experts in specific methods of financial engineering, it seems fair to say that if, after hearing all the explanations and examining all the data presented to them, these academics remain less than fully convinced that the industry and the regulators have the new product’s risks “under control,” there is a high likelihood their doubts need to be taken seriously.

If the Council determines that, as a result of its information-gathering, reviews, and investigations, it has significant concerns with respect to certain potentially risky market developments or inadequacies in regulatory oversight, it would have the authority to take the following actions. First, the Council would have the right to submit a formal request to the relevant agency to take certain actions: to conduct a study of the identified issues, to issue regulations, or to consider taking various supervisory or enforcement measures. The Council’s request would become a part of the administrative record, and the agency would be obligated to provide a written response to the Council detailing its plan to address the Council’s concerns or explaining its reasons for refusing to do so.

276. Anecdotally, this stereotype seems to be deeply ingrained in the common attitude of Wall Street insiders toward “outsiders,” particularly “public interest die-hards” or those who are critical of the financial industry’s practices (and, thus, presumed to be largely ignorant). In fact, elite bankers and their lawyers in New York City often privately express the same disdain for the regulators, some of whom they nevertheless later welcome through the “revolving door.” Treating personal financial success as a direct measure of an individual’s merit and intellectual capacity is an integral part of Wall Street’s ontology. Forcing the industry to face an intellectually powerful and well-credentialed group of “public interest die-hards” with the statutory authority to demand answers to tough questions may be a necessary first step toward changing the financial industry’s culture in the long run.

277. In particularly troublesome cases, the Council may ask the agency to impose either a temporary ban or a permanent prohibition on a particular product or activity until all necessary studies or rule-making are completed.

278. It is important to reiterate that in order to avoid violating the constitutional principle of separation of powers, the Council would not have the authority to compel any regulatory agency to take the requested action,
Secondly, the Council would submit a formal statement to Congress describing its conclusions, concerns, and detailing its communications with the regulatory agency. At a minimum, this statement would put Congress on notice with respect to what the Council considers to be a potential problem in systemic risk regulation. The Council would also have a separate right to petition Congress to take legislative action, or to conduct further hearings at the congressional level, on specific issues. Congress would not be legally obligated to act in response to the Council’s statements. However, having this direct warning in the public record would limit lawmakers’ ability to shift blame by claiming innocence and lack of knowledge, if the Council’s fears come true in the future. This factor is likely to shape their incentives to take some action.

The Council’s key statutory duty would be to provide periodic (annual or semi-annual) reports to Congress and the President containing its expert assessment of the current state of systemic risk regulation, identifying significant potential sources of risk in the financial sector, and outlining its policy recommendations. In addition, the Council would have to issue an annual public report—a version of “The State of Our Financial Union” address—which would convey directly to the members of the general public, in a clear and popularly accessible manner, the Council’s key concerns, conclusions, and priorities for the next year. After all, if the Council is an official representative of the public, it must keep the public fully apprised.

There are also important strategic reasons for the Council to cultivate and maintain strong public communication channels. In the absence of independent rule-making or enforcement powers, the key weapon in the Council’s political arsenal would be its power to mobilize public opinion around pertinent issues in financial services regulation. That goal requires an ability to communicate the Council’s findings and concerns directly to the public. In today’s world of social media and other innovative forms of mass communication, the Council can harness the power of its word to educate the public on important trends in systemic risk regulation, which typically do not receive much public attention, and to generate mass political support for the actions it considers necessary. Skilled use of the media would allow the Council to build its independent or to unilaterally override any agency action.

279. The statute may provide that, whenever the Council submits an official action request to any regulatory agency, it must notify Congress of such request. 280. The Council should also be able (or even required) to submit either a separate statement, or copies of its formal submissions to the regulators and Congress, to the President. 281. In this public report, the Council would evaluate, among other things, the individual regulatory agencies’ responsiveness to its requests and disclose the instances when an agency refused to take an action requested by the Council in connection with its targeted issue reviews. This evaluation would put additional pressure on financial regulators to collaborate with, and be responsive to, the Council. 282. Conversely, members of the public should be able to have access to the Council, so citizens can communicate their concerns and ideas to the Council’s members and staff. It is also necessary to consider whether it makes sense to establish some form of public evaluation of the Council’s performance. 283. Thus, as Simon notes, the 9/11 Commission had a far greater public impact than previous investigative commissions because the Commission had extraordinary access to intelligence information and skillfully used the media to effectively communicate its ongoing findings and activities to the public. See Simon, supra note 215, at 1447–48 (describing the 9/11 Commission’s “highly innovative” approach to publicizing its findings). 284. Of course, there are important considerations of confidentiality of certain market information that would have to be taken into account when the Council issues any public communications.
power base, which is necessary for the emergence of a functioning system of tripartism.\footnote{Again, the fact that the Council members would be mostly academics and public leaders, who are typically skilled public speakers used to "performing" in front of an audience, and who can explain complex concepts in relatively simple terms, should help the Council to master the art of using media to educate and organize ordinary citizens.} In the apt words of Ayres and Braithwaite: "Where there is no power base and no information base for the weaker party, tripartism will not work. The tripartism idea is fundamentally about transcending the shallow liberal notion that all you need to do to solve the problem of weaker parties is to give them legal rights."\footnote{AYRES & BRAITHWAITE, supra note 80, at 59.} The proposal to create the Public Interest Council seeks to empower the weaker party in the financial regulation game: the broader society that exists outside the confines of Wall Street but inevitably bears the brunt of the financial and economic crises created by its wizards.

\textbf{B. Potential Challenges on the Path to Tripartism}

This Article calls for a radical change in the existing regulatory paradigm. As any intellectual experiment, this proposal is bound to face numerous implementation challenges and to invite many criticisms. Some of these challenges and criticisms, and the issues for further research such criticisms raise, are outlined below.

\textit{1. Defining "Public Interest"}

The normative justification for the creation of a tripartite system of financial services regulation, advanced in this Article, rests on the perceived necessity to introduce public interest representation directly into the process of systemic risk regulation.\footnote{See supra Part II.B.} This raises the fundamental question: What exactly is the "public interest" in this context, and who defines the substantive meaning of that term? As scholars have long recognized, defining "public interest" as an independent rationale for economic regulation is inherently vulnerable to criticisms as excessively abstract, vague, and analytically weak.\footnote{Thus, according to one commentator, "the process of regulating in pursuit of public interest objectives faces two fundamental problems: the elusiveness of the concept at the theoretical level, and its (consequent) fragility as the basis for practical regulation." Mike Feintuck, Regulatory Rationales, Beyond the Economic: In Search of the Public Interest, in THE OXFORD HANDBOOK OF REGULATION 39, 45 (Robert Baldwin et al. eds., 2010).} In the context of financial services regulation, it is particularly difficult to defend regulation restricting activities of private market participants on the basis of a generalized "public interest," as opposed to economic or market "efficiency."\footnote{Id at 46 ("[P]rinciples relating to regulation in pursuit of collective objectives are consistently much less clearly elaborated and less developed than those relating to private interests.")} It is hard to deny that more profitable banks or more liquid capital markets generally contribute to the common good, so that economic and regulatory policies promoting these outcomes also operate in the public interest. Private profit and public gain are not, and do not have to be, mutually exclusive. Policies aimed at preserving financial stability, taken to the extreme, may stifle beneficial innovations and even result in long-term economic stagnation.

Given this inherent indeterminacy, it may be that the best we can do is to cast the
concept of public interest in financial stability as a form of precautionary approach to avoiding excessive risks to society's economic and social welfare that private actors' profit seeking activities potentially pose, rather than any substantive notion of the common good.290 The problem, of course, is balancing potential harms and benefits—both private and public—of any specific financial activity or regulatory policy.291 The precautionary approach would consciously tip the balance in favor of avoiding potential harm to the public, even where such harm may not be readily quantifiable or certain to happen. Nevertheless, articulating the underlying principles for conducting this delicate balancing act in individual situations is a difficult task that is beyond the scope of this Article. Ultimately, it is a political, and contestable, act.292

Yet, acknowledging these conceptual difficulties hardly obviates one simple truth: where there is public money, there is also public interest. When taxpayers are forced to pay for the failure of private financial markets, taxpayers have a clear interest in making those markets less likely to fail again. Unfortunately, the ideological and intellectual dominance of the economic approaches to public policy and law in recent decades effectively foreclosed any serious scholarly debate about the broader democratic, communitarian, or republican aspects of financial sector regulation. Perhaps outlining the contours of a tripartite regulatory structure, incomplete as it is, would help to start that important debate.293

---

290. This concept of precaution, however, is broader than the so-called "precautionary principle" frequently invoked in the context of environmental protection as a method of decision-making under conditions of uncertainty. See Noah Sachs, Rescuing the Strong Precautionary Principle From Its Critics, 2011 U. ILL. L. REV. 1285 (2011) (examining the role of precautionary principle in risk regulation). Despite variations in its formulation, the precautionary principle generally holds that if a particular action may potentially cause substantial public harm, even though there is no clear scientific evidence that such harm would occur, the burden of establishing that taking such action would not cause the harm feared should fall on the party that proposes it. Id. at 1295. The precautionary principle is based on the notion of social responsibility to protect the public from potential harm, whenever scientific (or other form of objective) investigation uncovered plausible risk. Id. For a discussion of the origins and the renewed significance of the precautionary principle in the context of rapid technological progress, see Roberto Andomo, The Precautionary Principle: A New Legal Standard for a New Technological Age, 1 J.I.B.L. 11 (2004).

291. Not surprisingly, the efficacy and normative underpinnings of the precautionary principle continue to be at the center of intense academic debate. Scholars have long criticized precautionary principle for ignoring various risk trade-offs and even increasing the overall level of risk in the system. See Cass R. Sunstein, LAWS OF FEAR: BEYOND THE PRECAUTIONARY PRINCIPLE (2005); Cass R. Sunstein, Beyond the Precautionary Principle, 151 U. PA. L. REV. 1003, 1003 (2003); James K. Hammitt & Peter Sand et al., THE REALITY OF PRECAUTION: COMPARING RISK REGULATION IN THE UNITED STATES AND EUROPE (Jonathan B. Weiner et al. eds., 2011). It is not this Article's intent, however, to stake a claim in this broader debate on the pros and cons of the precautionary principle.

292. See Feintuck, supra note 288, at 57 (stating that unpacking the concept of "public interest" exposes "a set of core values which are essentially political and contestable but which are embedded in legal discourse").

293. Some critics may find the idea of creating a body of designated public interest "guardians" inherently elitist and, therefore, anti-democratic. Moreover, a proposal to entrust such guardianship function to academics pushes directly against the strong tradition of anti-intellectualism in American history. However, these ideological debates, despite their divisive potential, may themselves be viewed as an integral part of the process of refining our concept of democracy in the increasingly complex modern world. By sparking controversy, the proposal advanced in this Article may help to move that positive process forward and, ultimately, enrich our democratic experience.
2. Effectiveness and Accountability

The proposed model of the Public Interest Council aims to resolve the fundamental tension between technical expertise and democratic accountability.294 However, it may not be able to achieve that ever-elusive balance in practice. For instance, even trying to “pack” the Council with academics and other people with knowledge of financial markets and regulation does not guarantee that they would, in fact, possess the necessary level of sophistication in understanding complex systemic risk dynamics. In addition, the members of the Council may disagree on substantive issues or have different approaches to setting the Council’s priorities. Many highly knowledgeable and well-established experts, selected to serve on the Council, may genuinely oppose the concept of more proactive regulation of financial markets on theoretical grounds. All of these factors may significantly limit the Council’s effectiveness.

Another problem is the possibility of individual members of the Council being “captured” by the financial industry. Statutory provisions aimed at ensuring the Council’s independence from the industry, described above, do not guarantee such independence in practice. Capture is a pervasive and insidious phenomenon that can take many forms.295 The financial industry’s massive and well-paid lobbying machine is particularly skilled at controlling the regulatory and political debate. Members of the Council may be just as susceptible to this type of undue influence as the regulators.296 The ever-present threat of capture highlights the importance of ensuring public accountability of the Council, which is likely to pose one of the key regulatory design challenges.

It can be argued that, ultimately, the Council’s effectiveness would depend greatly on personal qualities and character of its individual members, including their superior sense of moral and professional integrity. It is impossible to ensure the presence of such qualities through regulatory design alone.297 Drafting the statutory selection criteria so as to increase the chances of appointing only the candidates with a strong personal commitment to defending the public interest against the financial industry’s self-interested behavior would be a very delicate legal exercise.298 Yet, this may not be an insurmountable obstacle. As Ayres and Braithwaite note, “there exist individuals who for all practical purposes are incorruptible and immune to all available forms of capture.299 Individuals of this sort are particularly likely to be found among PIG activists. What

---

294. See, e.g., K. Sabeel Rahman, Envisioning the Regulatory State: Technocracy, Democracy, and Institutional Experimentation in the 2010 Financial Reform and Oil Spill Statutes, 48 HARV. J. ON LEGIS. 555, 556 (2011) (“Ultimately, the regulatory state raises several fundamental tensions, between technocratic expertise and democratic accountability and between insulated policymaking and democratic participation.”).
295. See supra notes 46–60 and accompanying text.
296. This danger of industry capture is particularly heightened because, in order to do its job effectively, the Council would have to have extensive contacts with, and secure collaboration of, private financial institutions and their individual representatives.
297. In fact, the same problem persists with respect to any regulatory agency’s ability to act in the public interest. Even though an individual agency’s statutory mission may remain the same, the rigor with which such agency discharges its oversight duties and pursues publicly minded policies often differs significantly over time, depending on the ideological, political, and personal views and preferences of its key officers and decision-makers. Alan Greenspan’s influence on the Federal Reserve’s policies and institutional culture provides a classic example of this phenomenon.
298. The statutory provisions cannot explicitly condition appointment of any individual as a member of the Council on such individual’s ideological or political views.
company would be foolish enough to consider offering Ralph Nader a bribe?"  299

Finally, there is a potential concern that even a well-appointed and independent Council may fail to establish itself as an equal partner in the regulatory process. Once again, regulatory design is of limited value in trying to ensure the political relevance of this new body. It is possible that the regulatory apparatus would successfully marginalize the Council and relegate it to playing a largely ceremonial role. Such marginalization could also enable the captured regulators to use the Council’s acquiescence to legitimize their actions and deflect public criticisms.

On the other hand, even if the Council is less effective in practice than originally intended, its very existence may serve to strengthen the regulatory framework by altering the legal and regulatory landscape. Thus, the simple fact of knowing that they may be called to explain and defend their practices in front of the Council would alter the incentives of both the regulators and the firms and force them to pay greater attention to their actions. 300 In addition, the existence of the Council may empower the publicly minded regulators to pursue more assertive substantive regulatory policies by giving them “cover” from the industry’s pressure.

3. Political Feasibility and Potential Alternatives

The most obvious challenge on the path to tripartism in financial regulation is its political feasibility. Given the current political dynamics, it seems unlikely that Congress would pass any reforms along the lines proposed here in the foreseeable future. The substantive limitations of the Dodd–Frank Act show the absence of real political will to go beyond partial measures. That fact should not, however, preclude the search for more comprehensive and innovative regulatory solutions to the problem of systemic risk containment. 301 Nevertheless, it is important to consider some of the less radical and potentially more feasible alternative methods of ensuring a more effective direct representation of the public interest in systemic risk regulation. 302

299. Ayres & Braithwaite, supra note 80, at 73.
300. See, e.g., Saule T. Omarova, Wall Street as Community of Fate: Toward Financial Industry Self-Regulation, 159 U. PA. L. REV. 411 (2011) (arguing that pressure from public interest groups is an important factor facilitating the emergence of more socially responsible forms of industry self-regulation).
301. In the words of one commentator, “if what is politically feasible is only Dodd–Frank, then perhaps our attention needs to focus most immediately on changing our politics and thereby expanding the domain of the politically feasible.” David A. Dana, A Simple Approach to Preventing The Next Housing Crisis—Why We Need One, What One Would Look Like, and Why Dodd–Frank Isn’t It, 38 FORDHAM URB. L.J. 721, 722 (2011).
302. One such potential alternative could be enhancing the ability of the public interest groups and citizens to enforce existing laws and regulations by bringing lawsuits against the financial institutions and regulatory agencies. See, e.g., Schooner, supra note 61. The general limitations of using “private attorneys-general” to police financial firms’ and regulators’ behavior are discussed above. See supra notes 140–44 and accompanying text. The principal problem with this alternative is that private litigation is a fundamentally ex post, or “back-end” right to challenge the results of wrongful conduct. It does not function as an effective mechanism of ex ante regulatory intervention, which is the key to effective prevention of systemic crises. See, e.g., Bamberger, supra note 20, at 678 (“At the same time, the public interest in mitigating risk ex ante, rather than after harm has occurred, is clear.”). The outcomes of litigation are not guaranteed and depend on the facts and circumstances of individual cases, as well as on the applicable standards of judicial review and other procedural factors. Not all court cases receive wide publicity or have broader legal or political implications. In short, while the threat of litigation brought by the private attorneys-general may shape incentives of the financial market participants and regulators, it’s unlikely to provide an effective method of systemic risk regulation. For this reason, expanded
It is possible to argue that the proposed model of tripartism may be easier to implement on a more limited scale. For instance, the newly created FSOC may establish, by regulatory action, an independent council of experts to advise the FSOC on issues of systemic risk regulation. This arrangement would remove some of the thorniest legal and practical issues the Public Interest Council proposal raises. Importantly, Congress would not need to get involved. There is well-established precedent for federal agencies setting up such advisory councils, subject to certain statutory requirements, and financial regulators have a long-standing practice of working with similar advisory bodies. The FSOC would select the members of the council, in accordance with its own criteria, thus obviating the need for complicated legislative drafting of selection criteria and other provisions. Because the FSOC would retain all decision-making power, the council’s tasks would be relatively clearly defined and less controversial than the inevitably broad charge of the proposed Public Interest Council. In essence, the FSOC’s new advisory body would function as a kind of a “regulatory contrarian,” envisioned by McDonnell and Schwarcz, whose main role would be to help the FSOC identify potential sources of systemic risk by providing an independent outside perspective.

However, this solution also has significant potential drawbacks, largely common to all regulatory contrarians housed inside or attached to regulatory agencies. Because the FSOC would retain full control over the selection of the council members and the actual decision-making, it would be much easier for the new advisory body to be “captured” by the industry or marginalized by the regulator. Without an independent status and ability to reach outside the FSOC, the advisory council is not likely to be in a position to shape regulatory outcomes in a meaningful way, especially where the council’s views on specific issues in systemic risk regulation differ from the views of the FSOC members.

A potentially more fruitful form of tripartism on a limited scale could emerge, for example, in a regulatory regime where complex financial products were subject to mandatory government approval. Under such a regime, the regulatory agency

use of “private attorneys-general” is not discussed here.

303. Importantly, an agency setting up such an advisory body must comply with the requirements of the Federal Advisory Committee Act (FACA). See Federal Advisory Committee Act, Pub. L. No. 92-463, 86 Stat. 770 (1972) (codified at 5 U.S.C. app. 2). Among other things, the FACA requires that an advisory council includes representatives of the broad spectrum of interests involved and that its meetings are open to the public. Id.

304. The Federal Reserve’s Consumer Advisory Council, discussed above, is one well-known example of such an advisory body. See supra note 136 and accompanying text. On June 3, 2011, the FDIC announced the creation of a new Advisory Committee on Systemic Resolutions, to advise the agency on a wide range of issues in connection with resolution of systemically important financial institutions. Press Release, FDIC, FDIC Board Creates Advisory Committee on Systemic Resolutions (June 3, 2011), available at http://www.fdic.gov/news/news/press/2011/pr11099.html. The new Committee has 18 members, including academics and public figures, such as Paul Volcker. Id.

305. See supra notes 122–30 and accompanying text.

306. To satisfy the FACA requirement of a balanced representation of views on an advisory council, this new body is likely to include a fair number of industry representatives or experts with pro-industry views, which would significantly undermine its potential to act as a counterweight to the financial industry’s agenda-setting power.

307. For a theoretical discussion of product approval as a regulatory model, see, e.g., Daniel Carpenter & Michael M. Ting, A Theory of Approval Regulation (Feb. 10, 2004) (unpublished manuscript) (on file with author). For recent proposals to introduce some form of a mandatory financial product approval scheme, see
administering the product approval scheme could establish an advisory council similar to the Council proposed here, but with a more specific charge to represent the independent public interest-oriented perspective in the process of licensing individual financial products.\textsuperscript{308} This advisory body would function much like the FDA's scientific expert councils, which could provide a model for working out the details of the system.\textsuperscript{309}

Of course, instituting a financial product approval scheme is itself a major regulatory reform that is currently not on the legislators' agenda. Debating the pros and cons of such a reform is outside the scope of this Article.\textsuperscript{310} Rather, it is used as an example of a fundamental shift in the regulatory philosophy, which could create the basis for a potentially more concrete and viable form of tripartism. In the absence of political will to enact truly fundamental regulatory reforms in the financial services sector, the prospects for creating a successful model of regulatory tripartism, even on a limited scale, are likely to remain remote.

VI. CONCLUSION

This Article advocates the statutory creation of a new form of tripartite regulatory regime aimed at the detection and prevention of systemic risk in the financial sector. Although it leaves many significant details blank and many important questions unanswered, this Article offers a radically new vision of the financial services regulation as a process involving three equal participants: bankers, bureaucrats, and guardians of the public interest. Admittedly, this vision is not likely to become reality in the near future. Nor is it meant as a comprehensive plan to solve the problem of effective systemic risk regulation in the financial sector. The main purpose of this Article is to expand the scope of the ongoing policy discussions beyond purely technocratic solutions and to encourage the debate on the future of the publicly minded financial services regulation.

\begin{thebibliography}{99}


\bibitem{308} For a similar idea in the context of consumer financial product safety scheme, see Daniel Carpenter, Proposal for a Financial Product Approval Process with Modified File-and-Use Elements, Public Scrutiny, and Commitment Experimentation (June 10, 2009) (unpublished manuscript), \textit{available at} http://people.hmdc.harvard.edu/~dcarpent/finreg/file&use-carpenterproposal2009.pdf (proposing a system of public scrutiny for consumer financial products subject to pre-market approval).

\bibitem{309} See supra notes 205–10 and accompanying text.

\bibitem{310} For a discussion of such pros and cons, see Omarova, supra note 307; Posner & Weyl, supra note 307.
\end{thebibliography}