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PANEL II: DISCUSSION TRANSCRIPT

PROFESSOR KELLY: Professor Strauss.

PROFESSOR STRAUSS: Thanks very much. And I'm sure with everyone else shares my appreciation for two such thoughtful and extraordinarily rich and well informed papers.

If you listened carefully to the gracious introduction that I got, you heard no particular evidence of acquaintance on my part with the world of corporate law or financial regulation as such. I'm an administrative lawyer. I've served in government for a while, but on the health and safety side. And sitting here in some way reminds me uncomfortably of the one time I taught a private law course at Columbia, which was contracts. On the first day of class I remarked that they had, my students had probably worked out that I was a public lawyer by experience, but that really the basic moves and skills that we would be practicing were common to all lawyering and maybe it would be helpful to them to think of me as a football coach who this year was also assigned to help the lacrosse team. This apparently produced panic among my students and so far as I could tell was the only thing I said during the semester that stuck in their memory. Nonetheless, public lawyer, administrative lawyer that I am, and this shapes the perspectives and reactions that I bring to these two fine papers.

And maybe the place to start is with Eliot Spitzer, who has recurred again and again during today's talks. And perhaps it's possible to see this in a slightly different way by looking at Merrill Lynch as an example of the supermarket, of the integrated financial creation. That suffered, at least so it appeared through the eyes of Eliot Spitzer, and I tend to see some merit in it, suffered from some internal conflicts of interest that had not been identified in the regulatory sphere. So maybe this is emblematic of the problems presented to us by supermarkets, but I wonder if it's emblematic of the appropriateness of response through a single super regulator, or whether in fact the availability of an Eliot Spitzer or an SRO or a Securities and Exchange Commission, a variety of possible avenues of response to which the at least potentially mischievous participant in the supermarket will need to be responsive, of which it will need to be aware isn't a significant safeguard on the part of us, the folks who are subject to their power and possible market manipulation.

Well, you'll recognize in the comments a common feature of American thinking about law and constitutional affairs which sharply distinguishes us from our European colleagues, who tend to look for single grand schemes that will bring all things together beautifully in a coherent way. And we like to muddle. And checks and balances, that's an American theme and I suppose it's in some respect my response to the papers is to say, well, these are on the whole a good thing.

I have four principal areas of response, interrelated. One of them I can deal with very briefly, because Roberta [Karmel] said it so well, is the adventitious nature of the American developments.

The second, the challenges and possibilities of what I'll call cooperative federalism, but it extends past federalism to private organizations like the SRO's.

A third, and particularly important, I think, what I'll call the limitations of expertise as a premise for regulation. That is, the need to be concerned with the nature of the regulator. My colleague Jack Coffee was not able to be with us today, but if you looked at the original program you saw that he was going to deliver a paper on the problem of agency capture. Well, the problem of agency capture is a real problem, and if there's only one agency to capture it's a much larger problem than it is if there are twenty or thirty of them. That's harder to do, albeit that introduces as well some inefficiencies of a nature that's important to be aware of.

And finally, and related to that, the centrality of private interests to effective regulation.

So the adventitious nature of American developments. American politics simply aren't organized to produce rational design, a precision mechanism of government reflecting exquisite and comprehensive rationality. And it starts with the fact that we don't have parliamentary democracy in this country. And so members of Congress are free to go off on their own and not subject to the discipline of an executive who thinks he or she knows what it is he wants.

It seems to me not to have been an accident that the creation of the unitary system of regulation in Great Britain was attended by a remarkable political change in that country, although, Claire [Kelly], you didn't address it in quite that way. Here legislative action is rarely the result of thoughtful and comprehensive drafting, like the civil codes of Europe, but it

tends to be a spontaneous response to the perceived urgencies of the moment, developments in the nature of the market to developments in its size and the number of its firms, to economic crises, to particular outbreaks of unscrupulous or at least unacceptably hazardous behavior. And the resulting crazy quilt of institutions that can't be given a rational or scientific explanation. Its parts grew out of the crises, needs and changes of previous times and they stay with us until new crises, needs and changes cause us to adjust them.

And I noticed in this respect, that in talking about the possibilities of a comprehensive regulator, there's been this strange possible participant that's appeared and disappeared at various times during the course of the day.

We've tended to talk about banking, insurance and securities. Every now and then the CFTC and what it regulates has reared its head and then it's disappeared again. Commodities aren't on the general map that we've been talking about today, but I thought we heard enough about commodities this morning, and particularly about those things that people could pretend were commodities, manipulate into regulation by commodities regulators instead of securities regulators, to think that that too is a necessary part of the theoretical structure.

Well, I have to say that, in a similar way, it seems to me that Europe's issues and institutions are and will be precisely the product of becoming Europe, of having to accommodate to new realities of markets and the information age. The old jealousies, languages, preferences, legal systems, governmental styles, and expectations and habits of Europe. And it's a lot tougher, with twenty languages and governments that have been in place for two or three centuries or longer, than it has proved to be — much bnger — than it has proved to be here, I would suppose.

We've been talking about Europe and the United States, but I suppose it's also hard to imagine in a globalizing economy that these developments are going to stop with Europe. As the nature of markets and market participation change, law and institutions are going to follow, because they have to. And so tomorrow this conference will be talking about some global regulator of the securities markets.

But the institutions and professional alignments and expectations will grow up around whatever arrangements we make, as they have around the arrangements we've already made, and

then became stuck. Not rational, necessarily, but not unworkable, either. And so we live with them until they're proved inadequate.

So the challenges and possibilities of cooperative federalism. Europe, as I now understand it, faces the imperatives that drove the expansion of our federal government's activity during the New Deal, when the Securities and Exchange Commission was born. There is now a European economy. It didn't used to exist in the way in which it does today. It has needs that can't be safely entrusted to individual states that might be too easily tempted into efforts to favor their own citizens, that could produce a race to the bottom or, worse, war, economic or real. It certainly has done that in the past, in the history of that continent.

So I think we have to expect European institutions to emerge. But what will be the character of their political control in a Europe that still lacks for itself genuine democracy? That's an issue that we haven't heard talked about really at all today, the nature of the political controls over these institutions, either within the nation or, perhaps more importantly, within Europe, itself. How can we expect these institutions to interact with the still empowered state institutions, each in this case acting under unique conditions of language, political history and governmental institution?

I think among the lessons of the American experience is that ideas like subsidiarity, however powerful they may be intellectually, will not inevitably constrain the growth of central institutions. Thomas Jefferson, in a corresponding situation long ago characterized the reasoning possible under the equivalent American principle as the house of cards, as house of cards reason. You can just build on it until you get to the point of intellectual collapse, I suppose.

As the economy of Europe becomes more and more interdependent, what individual states can effectively accomplish, each within the limits of its own jurisdiction, will become more and more subject to rational question. And the destruction of such arguments by experience was almost precisely the experience that we had during the Great Depression of the 1930's that brought central federal regulation of the financial markets.

So then the thing to see, it seems to me, is that the federalist argument doesn't just produce regulation here or there, but one has the SEC operating in cooperation with the SRO's, with pri-

vate regulators who must also in some respects cooperate with state authorities in many federal regulatory programs — if not the SEC, state regulators in turn operate under the supervision of federal as well as state authorities. And that's what we hear about as being in the future of Europe, subject to the loss of their powers, or some of them, if they don't satisfy their federal overseers that they are satisfactorily carrying out their responsibilities.

Politically, I suppose, having national authorities carry out European policies under supervision — one way to understand the elegant charts of Professor Di Giorgio's and Dr. Di Noia's paper is both politically and legally attractive. It appears to retain national power and it subdues possible questions of legality and authority for the imposition of legal sanctions. But when they're thought to be national departures from the European norm, when the question is sanctions against those national authorities or perhaps the suspension of their responsibilities in favor of direct European action, which are the things that can happen in this federal system, then the difficulties indeed may be substantial. No one looking at the contortions that our Supreme Court is now going through over the relations between the state and federal authority, even under a system as long established and as firmly grounded as our own, could possibly think otherwise.

So then the limitations of expertise as a premise for regulation. Both papers, again, and perhaps especially the Di Giorgio-Di Noia paper, are written from a perspective of confidence in what I might call virtuous objectified expert regulation. This is the unseen quality of Professor Schooner's superheroes this morning. It was not just that they were men of steel or superb detectives. It's also that they were rigorously honest, and they always acted on the public's behalf. Do we have that kind of confidence about all of our regulators all of the time? And what mechanisms do we have in place to secure their honesty, their responsibility, their political accountability?

It's striking, in a way, that the agencies we've been talking about at the federal level are all so-called independent regulatory commissions. That is to say, they're at some remove from the President, maybe a little vulnerable to the Congress. The chairman of one of the IRC's once remarked that being the chair of an independent regulatory commission meant that you had to

appear naked in front of the 535 members of the United States Congress.

Maybe they're a little bit vulnerable to the Congress, but we've set them up with the idea that they ought to be outside politics. No one has solved the constitutional question of how we can have the Federal Reserve in relationship to the Constitution that we have, given the extraordinary independence that it's had. We've been rather lucky. But what does the fact of these, I'll say for the moment, three independent regulators — the SEC, the CFTC and the Fed — suggest for the possibilities of a committee of coordination?

We have a committee of coordination. It's called the President, right? And what Congress has deliberately done for its own reasons, which one can find explained in political history — Alexander Hamilton argued rather strongly for this — we have to separate the money supply from politics — is to put these regulators at the farthest remove possible within the framework of our constitutional structure from the committee of coordination. And whatever that impulse is, shouldn't we expect it also to work and to trouble the possibilities of coordination in this context?

Capture is seen as corruption or failure — and it sometimes is — and not as the product of legislative choice — as it also sometimes is — or political change — as it equally may be. The general administrative law scholarship has at least moderated, if it hasn't entirely abandoned, its faith in expertise for visions that attempt more room for politics as a desirable, honest, inevitable element of government. And we need to think about how that can be achieved in these areas.

So a consequence, then, seems to me is to bring into prominence questions about the transparency of regulatory decision-making, about expansive participation in regulatory decision-making, about political controls over its outcome, that so far today I really haven't heard addressed. But it seems to me if we're engaging in discussions about institutional design, in matters as important to us as the monetary supply or the stability of our financial markets, we ought to be thinking about it. It's particularly important in respect of policy making, rule making, in the American jargon.

In the past, Europeans have been content to treat policy-making simply as an output of parliamentary government and not be very concerned about how it happened. It's changing a

little bit, and I should think gratifyingly. The American approach is very different. Particularly as policy-making moves out of the hands of ministries who can be controlled by a vote of no confidence in the parliament, it warrants a good deal of attention.

If independent regulatory commissions offer no assurance of pure expertise, one rule maker for all financial institutions would diminish further the claim to expertise and raise further the needs for mechanisms to assure consensus and transparency. So when we're thinking about how we want regulatory regimes constructed, I think it behooves us to think rather aggressively about the controls and politics that will operate on them and in them, not only in the first flush of enthusiasm for their mission, but also over the longer term.

I mean, you may know the story of the creation of the first American independent regulatory commission, the Interstate Commerce Commission. The railroads were at first alarmed because this had come about out of basically a populist upswell in response to the inability of the states to control the price gouging by the railroads. The Attorney General took the president of some railroad aside and said, don't worry about it. You'll live with this for five or ten years and then it will be yours. And he was, of course, right.

The failures of many agencies can, I think, be ascribed to the absence of such thinking. The great American scholar, Louis Jaffe, in a wonderfully titled piece he wrote near the end of his long career, *The Myth of the Ideal Administration*, remarked on his conviction that we get about as much regulation as our political leaders are convinced we're going to effectively demand. Keeping the conditions of public awareness necessary for effective political demand is a challenging task. And I expect it will be a particularly challenging task in Europe.

So, finally, the centrality of private interests, of the many voices to effective regulation. Both papers do express a concern with the problem of capture, which can be a problem. Yet, depending on how we look at it, it might also be a strength, or even a precondition.

One of the things about having any number of agencies is that different participants in the regulatory framework may tend to be served by different agencies among the groups that are there. Certainly Professor Di Giorgio and Dr. Di Noia might be right, that one risk of a single unitary regulator is that

it might more easily succumb to the subversion of collusive relationships with the intended object. And regulatory competition has the possible virtue of avoiding this problem at the cost of the inefficiencies that Professor Jackson suggested this morning. But I do think it's worth paying attention to all those groups that are interested in the nature and extent of regulation as well as the bureaucrats and politicians, themselves, and acknowledging that they have different ends and views, that they're competing.

So among those that come to mind in respect of the regulatory schemes we've been talking about today are individual investors, institutional investors like pension funds, investment professionals, like the folks at, I'll say Merrill Lynch, but they're more than a brokerage house these days, banks, insurance companies, entrenched corporate management — we haven't heard so much talk about them, but they're in many respects the real objects of regulation, whether they're interested in securing capital or maintaining power — politicians, that is to say, legislators and executive officials, members of the entrenched civil service, who have their own axes to grind and their own strong sense of how their activities serve the public interest.

And we might also think here about the implications of those private recoveries and the defense fee. The defendants in those cases have to pay their lawyers in order to keep the price as low as \$4 million. So it must be higher than that. The implication of all of this for the regulated.

Real problems for rationalization. But it really is harder to capture the SEC and Eliot Spitzer than it would be to capture the SEC or Eliot Spitzer alone. So these are perhaps also elements of the complex systems by which we hope to keep scoundrels in their holes and public confidence in our financial markets high. Thanks a lot.

PROFESSOR KELLY: I'd like to give the presenters a chance to perhaps respond and then we have some time for questions from the floor.

PROFESSOR DI GIORGIO: Just a quick comment to the very interesting points that you raised. Of course, yes, what you said about the political control is what we call the accountability. You want to have independent but accountable agencies, and this is an important problem that probably deserves one or more papers.

It is already a big issue in the European Monetary Union, because . . . we have delegated monetary policy to the European Central Bank, which is a fantastic institution, technically well equipped, and has all the instruments to reach its targets. But the problem is that it also sets the targets. So usually you don't want to have a central bank which is politically completely independent, because inflation rate is a tax and in democracies taxes are usually selected by the parliament.

So this is already a problem in Europe and we have to deal with this problem also in the context of financial market regulation.

PROFESSOR STRAUSS: It's a tax only on creditors.

DR. Di NOIA: Another quick point. Also you raised the question if we can trust — I mean, the . . . honesty of these regulators. I hope — I'm coming from a regulator, so I think we can trust them. Probably we cannot trust their ability to regulate and to supervise. So the real problem is, at least for the Italian institutions in this period in the last years, is that they really are . . . lacking expertise. And in a sense they are — many people like me go away, go in the market. But there is not a tradition of the other way back.

So in a sense they're not specializing enough. This morning it was pointed out in order to supervise derivatives you need really in financial innovation, you need people that really know the market and specialized people. And probably this is what the institution, even the European institutions, still lack. And this is, I think one of the biggest problems.

PROFESSOR STRAUSS: Who will watch the watchers is in some respect the defining question of American constitutional law.

DR. Di NOIA: This is off the topic.

PROFESSOR DE GIORGIO: For this you should provide a good mechanism to have incentives for good regulation. But you cannot just trust the regulator. That I agree.

PROFESSOR KARMEL: I would say only that I think the issue of accountability is indeed a very important issue. And it's probably because Americans don't trust power, whether it's in the private sector or in government, that we have such a tremendously chaotic system of regulation. Because I think there is a fear that if a single regulator gets too much power, that power will be abused and that there will be insufficient accountability.

And at the federal level, our system of accountability primarily is Congressional oversight committees. And watching that process over the course of much of my career, I would say it's not very inspiring. And it doesn't give one a sense that it would be a good idea to have too much power in a single agency that has accountability only to some Congressional oversight committee.

PROFESSOR KELLY: I know it's late in the day. We have time, though, for a couple of questions from the floor.

QUESTION FROM AUDIENCE: I just want to make it clear that Batman is a vigilante [laughter]. I actually had a question for Professor Di Giorgio about your comments on the Bundes Bank. I wonder if in Europe, in the Euro area countries — those few countries where the bank supervisor is at the central bank which is no longer central — whether that fact might be an impediment to a working proposal. Are those banks going to be reluctant to give up what little task — the one thing that they still have is really a formal role in supervisory, since they no longer make monetary policy. I'm just curious what you think about that.

PROFESSOR Di GIORGIO: Of course they are reluctant. And they also have another powerful instrument, which is the European Central Bank General Council. The governing body, is made up of twelve national governors and six central ones. And so the weight of the decision is in the periphery and not in the center of the body.

Actually, there is a paper that before Carmine mentioned of the European Central Bank, in which there is big support for the important role of central banks in banking supervision, although the trend in Europe is totally the opposite.

PROFESSOR STRAUSS: Is it possible to remark that that scheme, like our Fed, I think, is institutionalized capture? That is to say, it is the banking business that is essentially in control of the banking regulator.

QUESTION FROM AUDIENCE: This is for Professor Karmel. Would you comment in terms of the federal/state dynamic in the securities area that perhaps the state role is really one maybe of accountability to the SEC. When you look through the history, that the states brought the issue of the penny stocks and the blank check line pools, and you had the 1990 Act, they brought to the attention — and there were federal rules then with respect to those, Rule 419.

Then you had the states bring the issue of the microcap fraud and federal rules on that. Online trading, day trading, and even as late as Sarbanes-Oxley, we now have in federal law that state enforcement actions, certain state enforcement actions now become the statutory disqualification under the '34 [Securities Exchange] Act for certain brokers and associated persons.

So I'm thinking in terms of not so much state and federal in regulatory competition, in the sense of competing against each other, but more or less an accountability, and when something is brought to the federal government's attention through state actions, whether they be studies done by the states or whether they be actions by attorneys general such as Eliot Spitzer, that the federal government then, for national problems, should address it and then the states kind of recede. And that's really kind of our accountability.

PROFESSOR KARMEL: You could look at it that way.

I think another way to look at it is that it has something to do with this problem of capture.

The SEC is focused on the markets and on the securities industry, on capital formation, and to some extent institutional investors. Whereas the states think of securities regulation more as consumer protection, that they're more focused on protecting individual investors who believe they've been ripped off by some fraud in the market.

So I think it's in part this difference in focus that gets the states very excited about some kinds of frauds that you wonder, well, why didn't the SEC ever focus on this. Because that's not what they're looking at most of the time.

And, yes, you can look at it as an accountability, but I don't think the purpose of the states acting is really to make the SEC more accountable. It's to protect the residents within their state that they feel need some protection.

QUESTION FROM AUDIENCE: In terms of this accountability concept, I know the French have a delict that sounds in the Americanese as the failure of a supervisor, a public supervisor to do its job.

I think the House of Lords has twice in recent years been seized of the question of whether community law sets up such a tort against the Bank of England. They said no, but it has refused in a separate decision, summary judgment, what we call summary judgment, when one makes out that the common law should evolve to consider a tort of administrative neglect.

Now, this, of course, would be startling news over here. But does that have a controlling element in Europe? Is there such a delict, tort, I have no idea of the Italian usage.

PROFESSOR FERRAN: In the U.K., at least, the FSA enjoys immunity from claims for negligence, which I believe is sort of common practice for banking regulators to have, and that's been extended to the FSA generally. But it doesn't have immunity from deliberate misfeasance. And that's what the issue has been in the cases you mentioned. It also doesn't have immunity for human rights violations, which is the European Convention dimension. And it's as yet unclear what exactly that will allow in sort of challenges.

QUESTION FROM AUDIENCE: [Unintelligible]

PROFESSOR FERRAN: Exactly.

DR. Di NOIA: Formally, Italy, at least, for example, CONSOB [Commissione Nazionale per le Società e la Borsa], but there is not a formal immunity. Some judges actually — I mean, there are some cases not yet solved, and some people tried to take CONSOB to court in cases of not having controlled or supervised that well. But it's not clear, and we are actually curious, because there is no final decision in many of the cases, because according to some people, when they sued CONSOB of the administrative authority, and they want to pay a lot of money.

On the other side, there's an administrative authority, of course, all the decisions of CONSOB go to the administrative court there to separate decision. But of course they have no direct input on, let's say, private investors for the central bank.

And then also for the sanctions that are issued by CONSOB or by the Bank of Italy against the, let's say, banks or securities firms, there is a sort of appeal. Formerly, the sanctions are proposed by the bank or by CONSOB to the treasury. Then the treasury issues a decree with a fine, let's say. And you can also go to appeal to court for that.

PROFESSOR KELLY: Any other questions?

Well, I think I'd like to take this opportunity to thank all of our presenters today and our commentators. Also to thank our hosts, the *Center for the Study of International Business Law* and the *Brooklyn Journal of International Law*. In particular, Professor Karmel and Professor Fanto for organizing this event. Also Michelle Scotto and our symposium editor, Jessica Lubar-sky, as well as the students of the *Journal* and the student fel-

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lows of the *Center* who worked here today. And we look forward to seeing the papers and commentaries published in the *Brooklyn Journal of International Law*. Thank you.