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## EXPLAINING AND CURBING CAPTURE

BY RACHEL E. BARKOW\*

*Rachel E. Barkow discusses the problem of agency capture, the undue influence of regulatory agencies by members of the industries they regulate. She explains how agency capture arises and how it manifests itself in the financial industry, a well-funded and well-organized sector. Finally, Barkow proposes ways to design agencies to greater insulate them from capture.*

I want to discuss the dynamics of capture, what we might mean by it, and why it might occur. I want to try to figure out why it might be the case that an agency would not listen to competing evidence or would seem to be prone to a particular view.<sup>1</sup>

Usually when we talk about capture what we mean is an agency that is more responsive to the desires of the entities it is supposed to be regulating than it is to the general public. So it is the idea of undue industry influence. The term “capture” sounds more robust than just undue influence. If an agency is captured, it sounds like it is completely overtaken; it is just a puppet with someone else controlling the strings. But I think it is more accurate to think about disproportionate influence in the context of agency capture. It is a question of degree.

Now there is a difficult empirical question about how you measure capture. How do you figure out that an agency is captured as opposed to a situation where the agency simply reached a result that you did not like, and you are tempted to say they must be captured by the other side because the agency ruled for them instead of for you. I am going to leave it to the political scientists to talk about how you measure capture and how prevalent it is. I am going to proceed on the assumption that capture does happen. I’ll explain why I have that working assumption even though I cannot tell you the degree of capture

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1. See Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15 (2010).

in any particular case.

I want to discuss why it is that this idea of disproportionate influence can develop at an agency. The first thing is that the entities that agencies regulate—and certainly this is true when we are talking about the financial sector and financial institutions—are well financed and they are well organized. What that means is that financial institutions are well placed (particularly as compared to the general consumer population) to monitor what it is that agencies are doing. Financial institutions can keep tabs on everything that might be happening and challenge anything that they do not like because they have the organization and the financial resources to do it. If consumer groups on the other side of an issue do not have sufficient resources to monitor and do not have the resources to challenge, they are going to be outmatched. A rational agency, all else being equal, will want to avoid being tied up with legal challenges and oversight, and somebody constantly coming down on them to say that they are doing something wrong. So an agency has an incentive to work with organized interests instead of antagonizing them. An agency could have that incentive in good faith to achieve its mission; because if an agency gets tied up constantly litigating with one organized interest, it really cannot do anything else. So taking the perspective of a rational, well-meaning agency, one can see why it still might be prone to listen to those well-financed, well-organized interests.

In addition, because the banking industry is so well-organized and financed, it is in a position not just to be at the heels of the agency, but to go to congressional overseers. The industry has the ability to make political contributions and to lobby Congress when it sees something it does not like. The agency has to be aware of this if it wants to get anything done. An agency will be constantly getting called into Congress if congressional overseers are angry with it because big contributors are telling them this agency has gone insane. Even agency heads acting in good faith will say to themselves, “We can’t get tied up that way. We have to figure out how we can appease these interests enough so that we are not constantly getting called in before congressional overseers.”

The other reason that you might see undue industry influence has to do with what is often referred to as the revolving door. People pursue careers in an area because they are interested in the subject.

They could go work either at a government agency or in the private sector. So a revolving door can develop where you have people who work at agencies who might, when they leave, go work for the industries they regulated because that is their area of substantive expertise. They are thinking about where they are going to go next. They are probably not going to say, "I really enjoy banking, but it's time to try telecommunications." They are probably going to go right into the banking industry. The effect and scope of the revolving door is a measurement question for the political scientists. But if you think about the incentive structures, agency employees might be thinking about how they are perceived by the very industry that they might ultimately join later.

Even if it is not a question about thinking where the next employment move is, there is a question of who goes to work at an agency in the first place. What kind of people? What kind of perspective do they have when they go there? I think you might see cognitive biases that people are not even aware that they have. If they came from a particular industry and then they go to work for an agency, they bring the perspective of where they used to be. If they were working in a banking context, then they understand and relate to bankers. When they go to the agency they can see things from the perspective of bankers. What you might end up with at the agency is a particular culture that is attuned and sensitive to an interest that employees know the best because that is precisely where they came from.

The other reason that you might see undue influence develop is information. The financial regulatory agencies have to think about the ramifications on the financial industry before they do something. Put another way, to regulate effectively, an agency needs information on how rules are going to affect the entities they regulate. Where does the agency get that information? What agencies usually do is listen to who is in front of them: the well-financed, organized entity that is so happy to help and explain the consequences of what the agency is going to do. The entity explains how the proposed action is going to affect it, and the question is does the agency have the requisite intelligence and data to second guess that? Are they in a position to say, "Will you really collapse and therefore send ripples throughout the economy and destroy the free world as we know it?" Or will they have the necessary

confidence to say, “I disagree with what you are predicting. I took a couple of classes on this in school and I think I’m going to give my own judgment a whirl and see how it goes?” It is a question of whether agency officials are confident enough to dispute what they are hearing.

I am not taking a position on the normative worth of any of this. I am just trying to explain to you where this capture dynamic might develop to address the puzzle of why agencies do not do more. In the case of financial services, the “too big to fail” problem is enormous. If the agencies guess wrong, they are being told that it is going to impact the entire economy. The agencies need to be right about their information if they are going to second guess what the institutions are telling them. The dynamics I have discussed develop together and coalesce and create cultures at agencies.

There have been case studies about how cultures develop within agencies. It gets really hard to change those cultures once they have been established. They are historically based. You may have to go back to the turn of the century to find out how things got off the ground at a particular agency, to understand how an agency might have become the way it is. If you read *Bailout* by Neil Barofsky,<sup>2</sup> he describes what it was like to deal with the banking regulators. He writes a lot about how the regulators he worked with talked about how the bankers have reputational risk to think about.<sup>3</sup> Barofsky says in the book that he did not want to hear that anymore because bankers’ concern for their reputations did not stem the tide of what was happening. What is most interesting for the capture discussion is the description in the book of regulators believing in a sense of reputation. That reflects the culture that develops over time.

So, however we measure it, undue influence is going to exist. There is going to be this pressure for an agency to take a regulated entity’s interest into account in a disproportionate way as compared to the way the agency considers the interest of the public.

I could put any agency into that model, but I want to give you a couple of specific capture dynamics that are in play in some of the financial services sectors. This is not my area of expertise; I’m a generalist administrative law person. But I do think there are some

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2. See NEIL BAROFSKY, *BAILOUT: AN INSIDE ACCOUNT OF HOW WASHINGTON ABANDONED MAIN STREET WHILE RESCUING WALL STREET* (2012).

3. *Id.* at 131.

interesting dynamics in this context that are important to note. First, if you set up an agency and you give it more than one mission, it is going to play favorites. And the agency is going to favor the mission that is the dominant mission, the one that Congress cares about. The agency is not like a parent who wants to love all its children equally. Let's say you set up financial regulators and you tell them that they are charged with paying attention to monetary policy, bank supervision, and safety and soundness. And you say, we would also like you to do consumer protection. The dynamic you have just created is an agency that is going to have multiple missions. At least one of these missions is going to fall by the wayside, and what we have seen historically is that one is consumer protection.<sup>4</sup> Consumer protection is not the favored child, to carry the analogy further. So when you create these multiple mission agencies, you really have to think about which mission is going to dominate.

The other thing that really surprised me in looking at financial regulatory agencies – that they were ever set up this way – is that an entity could decide how it wanted to charter itself. It could move around within either the state or federal system, from bank to thrift or vice versa.<sup>5</sup> A deposit-taking entity could thus pick its regulator. Furthermore, those agencies were funded by fees from the entities they regulated. So the agencies were in a competition with each other to have the financial institutions charter with them. I could not have devised a more ill-considered scheme if you had asked me to think about it and try. This system creates a race to the bottom. The agency wants to appease the entity to charter with it. What is the best sales pitch an agency has to get somebody to charter with it? “I am not going to regulate you at all. I am going to do whatever you want. I am going to preempt state regulations that you do not like. I would like you to come on over.” If it is not said explicitly, the incentives are all there to do that. So that is something that is specific to this context. This system

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4. See Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. Pa. L. Rev. 1, 90 (2008) (“These agencies are designed with a primary mission to protect the safety and soundness of the banking system. This means protecting banks’ profitability. Consumer protection is, at best, a lesser priority. . . .”).

5. In the United States, banks may operate under state or federal charters as part of the “dual banking system.” For further information on state versus federal bank charters, see LISSA L. BROOME & JERRY W. MARKHAM, *REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES: CASES & MATERIALS* 184-88 (4th ed. 2011).

gives additional reasons why you might see capture in this particular context.

I want to use my remaining time to highlight what you could do if you wanted to guard against capture from developing, assuming you had the political will and the incentive to do it.

First, if you had something like the OTS-OCC dynamic I described above, where banks could pick their regulator, you would either have to make it so that the organizations could not pick their own charter and regulator; or you would need to give the agencies a funding source that did not depend on the entities themselves; or you would merge the agencies into one entity which obviously was done in Dodd-Frank.<sup>6</sup>

For other agencies and other dynamics, what else can you do to minimize capture? In the law school world, law students are typically told when they are talking about setting up independent agencies that the key thing to consider is whether the head of the agency can be removed by the President for cause or not. Although that is the big issue in law schools, I think that one actually does not matter very much because it is hard to remove an agency head even if the President has the ability to do it at will. That does not seem to be the linchpin.

What I want to do is highlight for you some of the key mechanisms that do not get a lot of attention, or at least have not so far in law school settings. But I think policymakers are starting to pay attention to them. The first one is how the agency is funded. Where does the agency get its money?<sup>7</sup> If the agency gets its money from Congress, then that link is right there. Every time the agency wants to do something, it knows it is going to be risking its funding source if it

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6. See Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 312, 124 Stat. 1376, 1521 (2010) (codified at 12 U.S.C. § 5412) (Dodd-Frank merged the OTS functions into the OCC and the FDIC. The OTS's authority over state savings associations was given to the FDIC. The OCC received authority over federal savings associations.)

7. The Board of Governors of the Federal Reserve is funded by assessments received from Federal Reserve Banks in accordance with the Federal Reserve Act of 1913. The Board of Governors is self-sufficient, receiving no government appropriations. See OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, APPENDIX: BUDGET OF THE U.S. GOVERNMENT 1336 (2014), available at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/appendix.pdf>. The Consumer Financial Protection Bureau (CFPB) is funded by appropriations from the Board of Governors of the Federal Reserve, capped and adjusted for inflation. If this allocation is inadequate, the CFPB may also request funds through the congressional appropriations process. *Id.* at 1206.

makes Congress mad. If what makes Congress mad is the agency appearing hostile to well-financed and well-organized interests, the capture dynamic is going to persist. So if you could find a way to fund agencies without having them so directly tied to Congress, that would obviously be ideal if the goal is more insulation. When the Consumer Financial Protection Bureau (CFPB) was set up, its funding was set up as a percentage of the Fed's budget.<sup>8</sup> That, by the way, is one of the leading features of the agency that is being attacked by the financial industry. But obviously that funding gives the agency a lot more heft to do what it wants to do. It does not have to worry about funding issues.

The other thing you could do is you could think about appointments. You could think about who you want to have work at the agencies in the first place to try to break up that agency culture of capture just a little bit. Perhaps you need to have on your top management team or heading the agency or as a member of the commission, somebody who has worked in consumer protection or somebody who has worked for whatever the outside interest is that has otherwise gotten no or little air time at the agency. This will not be a cure-all, but at least it would go some step towards breaking this cycle. You could also think about putting in employment restrictions on where people go after they leave the agency. You could slow down the revolving-door—because you are not really going to be able to stop it. You could think about having there be some limit on how quickly people can move to the very industries they have regulated.

Another idea to reduce capture is to think about where else in government there are agencies that care about the interest that you are trying to get more attention. For instance, if you are thinking about consumer interests, you would try to think where else we have in position an agency that might help be kind of a watchdog to pressure the financial services agencies. You could think about something like the FTC. The idea is if you have an agency that is already thinking about consumer interests, to think about how you plug them in so that they can also be a voice to issues that are not getting enough airtime.

We usually think about all this as a national issue, but there are a lot of state attorneys general out there who did some pretty amazing things in the run-up to this crisis and tried to do more before they were

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8. See Dodd-Frank Act, 12 U.S.C. § 5497 (2012).

preempted. So when you are setting up these regulatory schemes in the first place, you can think about how you want to use states as partners and have the states either help you enforce the federal laws or maybe create regulations of their own. This idea is vehemently opposed by all the financial interests, particularly when it is a question of state substantive laws and that is a thornier issue. But on the enforcement question, if you think about the state AGs just being extra cops on the beat to enforce the rules the federal entities set up, then the idea could be that they could help what might otherwise be an under-resourced federal agency enforce the national laws.

Another capture reduction technique is to give an agency more political weight if it is out there trying to protect, for example, the consumer interest. How do you think about getting more focus on Main Street for an agency? The media cares about Main Street, but who gives information to the media? How do they get their stories? You know agencies have top-level officials who speak on the condition of anonymity, who tell the media about various things. But, how do they get other information out there? You can think about giving agencies the kind of tools they need to generate information the media is going to care about. Give agencies a data operation and let them speak directly to the media without having to get approval first from some oversight agency or body. The idea would be, in the financial world for example, to let the agency gather data on mortgages or credit card terms or whatever the issue is, and have a platform to get that information to the American people.

Another opportunity for capture reduction is to think about which congressional oversight committee is going to look over the agency's shoulder. It really matters whether or not you set up an agency that has to answer to the Banking Committee or whether it is answering to a Subcommittee on Consumer Protection.

One last thing that you can think about is setting up consumer advocates within the agency. They would be internal watchdogs that would exist within the agency who could try to keep tabs on or always be the voice representing consumer interests at the agency.

None of these things is going to be the magic bullet to solve agency capture, but these would be the kind of steps you would have to take if you were trying to figure out how you get the agency to second guess the instincts it may have developed over time to favor a particular

industry. One thing to keep in mind is not to view the agencies as evil, but to rationally figure out why they might be in the place that they are. Why might they have got to that point that it is hard to get an airing of opposing interests? Once you break that down, it lends some insight into how you go about getting us closer to the ideal of having an agency that is able to pursue the public interest as much as it pursues the interest of one particular group.

