Regulating in the Dark

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Abstract

Foundational financial legislation is typically adopted in the midst or aftermath of financial crises, when an informed understanding of the causes of the crisis is not yet available. Moreover, financial institutions operate in a dynamic environment of considerable uncertainty, such that legislation enacted even under the best of circumstances can have perverse unintended consequences, and regulatory requirements correct for an initial set of conditions can become inappropriate as economic and technological circumstances change. Furthermore, the stickiness of the status quo in the U.S. political system renders it difficult to revise legislation, even though there may be a consensus to do so. This essay contends that the best means of responding to this dismal state of affairs is to include, as a matter of course, in crisis-driven financial legislation and its implementing regulation two key procedural mechanisms: (1) a requirement of automatic subsequent review and reconsideration of the legislative and regulatory decisions at some future point in time; and (2) regulatory exemptive or waiver powers, that encourage, where feasible, small scale experimentation, as well as flexibility in implementation. Both procedural devices will better inform and calibrate the regulatory apparatus, and could thereby mitigate, at least on the margin, the unintended errors which will invariably accompany financial legislation and rulemaking originating in a crisis. Given the centrality of financial institutions and markets to economic growth and societal well-being, it is exceedingly important for legislators acting in a financial crisis with the best of intentions, to not make matters worse.

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I. Introduction

How should one regulate in the midst of a financial crisis? This is a fundamental question for financial regulation, and it is not readily answerable, as the issues implicated are truly complex, if not intractable. Yet foundational financial legislation tends to be enacted in a crisis setting (e.g., Romano 2005:1591-94), and over the past decade, when confronted with this question, the U.S. Congress has answered it reflexively by enacting legislation massively increasing the scope and scale of the regulation of business firms, and especially, financial institutions and instruments, in a manner seemingly oblivious to the cost and consequences of its actions. A simple, but telling, comparison of a commonly-used measure of legislative complexity, a statute's published length, conveys what Congress has wrought. The Sarbanes-Oxley Act of 2002 is 66 pages long and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is an astounding 848 pages, whereas, the 20th Century foundational federal banking legislation, the Federal Reserve Act and the Glass-Steagall Act, are 24 and 37 pages, respectively (Perry 2010).[1]

In addressing how to regulate in a financial crisis, there is a related question, whether there is something different about financial institutions and markets, compared to other regulatory domains, that makes regulation more challenging and crisis responses more prone to legislative failure? This essay addresses both questions by contrasting three recent examples of financial regulation which, I contend, are, in the main, misguided: Sarbanes-Oxley, the response to the accounting scandals and bankruptcies of several large public corporations accompanied by a sharp stock market decline in the early 2000s; Dodd-Frank, the response to the global financial crisis originating in the subprime mortgage crisis of the late 2000s; and the Basel capital accords, through which central banks and banking regulators of the leading industrial nations have sought to harmonize international financial regulation since the late 1980s.

The answer to the two questions regarding crisis-generated financial regulation is, I believe, not really an issue of institutional competence, that is, of Congress's lack of the requisite expertise to understand technically complicated financial products and markets. For financial regulators, in promulgating permutations of internationally harmonized capital requirements, have not fared much better in protecting the global financial system from catastrophic systemic risk, and, I would contend, have, albeit unintentionally, contributed to it – though one would have a hard time figuring that out from media accounts (Romano 2012).

Rather, the nub of the regulatory problem derives from the fact that financial firms operate in a dynamic environment in which there are many unknowns and unknowables and state of the art knowledge quickly obsolesces. In such a context, even the most informed regulatory response – which Congress's reaction in the recent crises was not – will be prone to error, and is likely to produce backward-looking regulation that takes aim at yesterday's perceived problem, rather than tomorrow's, for regulators necessarily operate under considerable uncertainty and at a lag behind private actors. But using market actors' superior knowledge to inform regulation is not necessarily an effective solution, as indicated by the utter failure in the recent crisis of Basel II, which relied on banks' internal risk ratings to measure capital requirements. This only further highlights the fluid, fast-moving, and uncertain environment in which financial institutions operate – even firms' state of the art risk management techniques proved inadequate in the confluence of events that produced the global financial crisis.

In order to understand financial regulation undertaken in a crisis, we need to take account, as Frank Knight (1965:270) put it, of "human nature as we know it." Human nature in this context is that legislators will find it impossible to not respond to a financial crisis by "doing something," that is, by ratchetting up regulation, instead of waiting until a consensus understanding of what has occurred can be secured and a targeted solution then crafted, despite the considerable informational advantage from such an approach, which would, no doubt, improve the quality of decisionmaking. Compounding the problem, Congress tends not to move nimbly to rework financial legislation when it becomes widely acknowledged as flawed or seriously deficient. For instance, it took decades to repeal the Glass-Stegall Act's separation of commercial and investment banking; eleven years to make relatively small revisions to accounting and bribery provisions of the Foreign Corrupt Practices Act; and eight years to amend the Sarbanes-Oxley Act to exempt only the smallest firms from the auditor attestation of internal controls' effectiveness requirement, despite substantial consensus regarding the statutes' problems.

This essay contends that the best means of responding to the typical pattern of financial regulation – legislating in a crisis atmosphere under conditions of substantial uncertainty followed by status quo stickiness – is for Congress and regulators to include as a matter of course in financial legislation and regulation enacted in the midst or aftermath of a financial crisis, procedural mechanisms that require automatic subsequent review and reconsideration of those decisions, along with regulatory exemptive or waiver powers that create flexibility in implementation and encourage, where possible, small scale, discrete experimentation to better inform and calibrate the regulatory apparatus. Such an approach, in my judgment, could mitigate, at least at the margin, errors which invariably accompany financial legislation and rulemaking originating in a crisis atmosphere. Given the fragility of financial institutions and markets, and their centrality to economic growth and societal well-being, this is an area in which it is exceedingly important for legislators acting in a crisis with the best of intentions, to not make matters worse.

II. Legislating Financial Regulation in Times of Crisis

Most significant financial regulation is adopted in response to financial crises (Banner 1998:257; Romano 2005:1591-1594). This pattern is consistent with the political science literature on policy agendas. According to that literature, issues move to the top of the legislative policy agenda in conjunction with "focusing events" and shifts in national mood, which render the public receptive to government action to redress a specific problem (Kingdon 2011:19-20). This constellation of events opens a window in which individuals (referred to as "policy entrepreneurs") present their preexisting preferred policies as "solutions" to the problem at hand (Kingdon 2011: 20). A typical pattern in a financial crisis is a media clamor for action, reflecting, if not spurring, a similar popular demand, and as a crisis intensifies, an accompanying suggestion that government inaction is prolonging the pain and suffering.[2] A risk averse legislator, whose objective is reelection, will, no doubt, conclude that there is a need to respond without seeking to ascertain, if it were even possible, whether such demands are media-driven, or popularly shared, or, in fact, necessary to resolve the problem.

There is a theoretical and empirical political science literature, based on agency models of political representation, supporting that hypothesized course of legislators' action: it indicates a close connection between an issue's salience in the media, election outcomes, and implementation of policy.[3] For a legislator, "doing something" in response to a crisis is both easier to explain to anxious constituents, and more likely to be positively reported in the media, than inaction, and therefore it would appear to be a clear-cut superior route to reelection, which is the posited focus of legislators.

The heightened issue saliency, or in the vernacular "media frenzy," that accompanies the exigency of a financial crisis compels legislators not only to respond, but to respond quickly, even though they will be aware that they cannot possibly determine what would be the best policy to adopt in the circumstances: there would be considerable uncertainty in the first place about what has just occurred and why. Yet without an understanding of the causes of a crisis, regulatory fixes, except by fortuity, are bound to be off the mark. Indeed, paralleling the political science literature's explanation of how policy proposals reach the congressional decisionmaking agenda, legislation adopted in financial crises typically contains recycled proposals fashioned to resolve quite unrelated problems, imagined or real, which policy entrepreneurs advance as ready-made solutions to immediate concerns, to a Congress in need of off-the-shelf proposals that can be enacted quickly (e.g., Kingdon 2011: 139-43,181-82; Bainbridge 2011:1796-1819,1821 on Dodd-Frank governance provisions; Romano 2005:1568-1585, on Sarbanes-Oxley governance provisions). Given this reality, the repeated legislative failures that we have witnessed with regard to financial regulation should not be a surprising outcome.

Sarbanes-Oxley, for instance, is a case study of legislative failure. The statute's highly touted governance mandates of independent audit committees, restrictions on auditor services, and certifications of internal controls, essentially "off-the-rack" initiatives that had been advocated by policy entrepreneurs for some time, had minimal support in the academic literature, publicly available both before and even more so after the legislation's enactment, regarding their efficacy at improving performance or reducing audit failures (Romano 2005). Not surprisingly, those ostensible reforms apparently had no bearing on financial institutions' ability to withstand the 2007-09 financial crisis (Beltratti and Stulz 2009; Cheffins 2009). Yet Sarbanes-Oxley's governance mandates are still law, imposing considerable costs on firms (e.g., Ahmed et al. 2010; Bargeron et al. 2009; Linck et al. 2009; Romano 2009), and it will take a Herculean effort to repeal them given the organization of government.

In addition, a considerable portion of Dodd-Frank and, to a far lesser extent, Sarbanes-Oxley, consists of substantive rulemaking instructions to federal regulators. Dodd-Frank requires 400 final rulemakings and 67 studies, the vast majority of whose legislative deadlines will, no doubt, be missed (DavisPolk 2011:10-11; DavisPolk 2010:ii).[4] Indeed, at the statute's one-year anniversary, 104 rulemaking deadlines had already been missed (DavisPolk 2011:2). This legislative strategy of delegation would appear, at first glance, to be attentive to the informational concern regarding decisionmaking in a crisis that I have mentioned, as the contemplated rulemaking process could generate, in theory, needed information to improve the quality of policy making. Such an explanation works hand in glove with the conventional rationale for delegation and deference, that among government institutions, "agencies are the repositories of expert knowledge and experience" (Eskridge and Ferejohn 2010:276).

However, it is difficult to posit seriously that in delegating so extensively Congress was concerned with improving the information available for decisionmaking, given the statute's absurd demands on agencies, in both the plenitude of rulemakings and implementation timetable.[5] An illustration, underscoring how agencies cannot be expected to accumulate, let alone assimilate, relevant, available information in the rulemaking process contemplated by the statute, involves the SEC's proxy access rule, which Dodd-Frank expressly authorized. The rule was struck down by the U.S. Court of Appeals for the D.C. Circuit in *Business Roundtable v. SEC* (2011), as "arbitrary and capricious" for having been adopted with an inadequate cost-benefit analysis of its effect. Yet the proxy access rule had been in the making for well over a decade, in contrast to the vast majority of the statute's required rulemakings.

A strand of the political science literature provides an alternative rationale for regulatory delegation, that it is a means by which legislators can avoid responsibility for adverse policy consequences (Fiorina 1982:46-52). That explanation offers a more compelling account of Dodd-Frank's large-scale delegation strategy than the interpretation of a Congress earnestly seeking to cope with having to legislate under uncertainty by creating a window for additional information gathering and regulatory fine-tuning. Rather, in this scenario, delegation enables legislators to "do something" in a crisis, by passing "something" and thereby mollifying media and popular concerns, while at the same time shifting responsibility to an agency for potential policy failures, outcomes that legislators may well suspect to be possible, given the paucity or poor quality of information available concerning a crisis's causes when the legislation is being crafted. If that possibility were to be realized, legislators, without missing a beat, would be positioned to criticize the agency, with the policy failure attributable to faulty implementation rather than an ill-conceived congressional mandate, and would have the further possibility to provide valuable constituent services, assisting firms and individuals to navigate difficulties created by administrative action (e.g., Fiorina 1982:47,53). But if the policy implementation were to be successful, legislators could, of course, still take credit (Nichols 1982:68). In short, by means of delegation, legislators can have their cake and eat it too, so to speak.

From a legislator's perspective, the delegation strategy would appear to have minimal cost, under both the benign and more manipulative explanations. But many members of the business and academic communities view Dodd-Frank as having exacerbated the severe economic downturn that has followed the global financial crisis. As banks are spending in the billions of dollars on Dodd-Frank compliance (Protess 2011), the statute quite plausibly adversely affects the price or availability of credit. But equally, if not more important is the increase in business uncertainty generated by the immense number of required rulemakings. Until proposed, let alone promulgated, regulatory compliance costs cannot be estimated with any confidence, which deters investment. Moreover, because Dodd-Frank was enacted on a party line vote, in contrast to the bipartisan, unanimous, or near unanimous, support crisis-driven financial legislation has typically received, an additional source of uncertainty affecting business investment is the possibility that, in the near future, control of Congress and the Presidency could shift before all of the required rulemakings are completed and dramatically alter the implementation of the law.

The full cost of Dodd-Frank is rendered further opaque by regulators finding, as they attempt to implement the statute, that Dodd-Frank's mandates pose unanticipated operational issues that create new risks, complicating implementation. For example, in order to decrease the risk of trading customized off-exchange derivative securities, Congress required derivative trades, wherever possible, to be cleared on exchanges (Dodd-Frank Act, Title VII). Yet, this requirement, it turns out, increases risk for pension funds and asset managers due to the way exchanges handle margin collateral, and changing exchange brokerage arrangements to reduce the risk significantly increases costs (Grant 2011).

In short, by requiring agencies to enact a multitude of rules often devoid of guidance and consideration of how the rules would interact with institutional practice, Dodd-Frank's delegation strategy has created a minefield for business planning. Moreover, adding insult to injury, Dodd-Frank does not even attempt to address the financial crisis's ground zero, Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs) that back mortgages, which are estimated to require hundreds of billions of dollars in taxpayer support by the end of the decade (Acharya et al. 2011; Congressional Budget Office 2011; Wallison 2011a, 2011b). Perhaps that omission should not be surprising: throughout their pre-bailout existence, the GSEs have been considered "too influential and too politically connected to be regulated," with "each successive presidential administration turn[ing] a blind eye" to their unconstrained, highly-leveraged and increasingly risky lending activities (Acharya et al. 2011: 22, 28).

But there are also in Dodd-Frank delegations to agencies (along with statutory provisions that require agency action without discretion in implementation) that have at least some connection to the financial crisis, those explicitly directed at reducing systemic risk, such as the creation of a Financial Stability Oversight Council (Dodd-Frank Act, Title I), and regulatory directives on minimum leverage and risk-based capital requirements (Dodd-Frank Act §171). This suggests a helpful comparative benchmark would be the efforts of the international financial regulatory community to reduce systemic risk by harmonizing capital requirements in the Basel accords. Given the greater technical expertise of regulatory agencies compared to Congress, if institutional competence were to explain flaws in legislated financial regulation, then financial regulators would be expected to do a better job than Congress.

Moreover, the negotiations of financial regulators over the Basel accords do not receive as intensive media coverage, and accompanying popular attention, pressing for immediate action, as does congressional deliberation in times of financial crisis. Basel II, for example, whose initiation in 1998, Daniel Tarullo (2008:90-91) contends, "was not impelled by a crisis specific to banks in member countries," was not approved until 2004.[6] But even Basel initiatives motivated by crises took years to bring negotiations to conclusion, in contrast to Congress's relatively quick crisis-response legislative output.[7] And the notable exception, the relatively quick approval of Basel III in 2010 within two years of the onset of the global financial crisis contains an extended timetable for implementation and observational reassessment, which, for some key provisions, ranges from five to ten years (Basel Committee on Banking Supervision: 2010:77). Therefore, in further contrast with Congress, international regulators have more time to obtain additional information concerning a crisis's causes and consequences, to refine their regulatory responses.

Despite the seemingly decisive differences between financial regulation initiated by Congress and central bankers, which would suggest that the latter might be better positioned to get things right, the ongoing financial crisis suggests, to the contrary, that such an expectation would be misplaced. In fact, the harmonized international financial regulation produced by the Basel accords contributed to the ongoing global financial crisis, perversely increasing systemic risk, by encouraging banks to hold, in levered concentrations, the assets at the epicenter of the ongoing crisis, residential mortgages and residential mortgage-backed securities and sovereign debt (Friedman and Kraus 2011; Romano 2012). Because the accords were global, banks worldwide were incentivized to follow broadly similar business strategies, so when the value of the mortgage-related assets preferred by Basel collapsed, it led to a global financial crisis, rather than one more localized where the subprime mortgage crisis originated. Basel's flawed regulatory architecture is also implicated in the ongoing Eurozone sovereign debt crisis, as sovereign bonds have an even greater preference in the Basel risk-weighted capital schema than residential mortgages and mortgage-backed securities.

Why would financial regulation produced by central bankers and banking regulators of the most developed economies, with sophisticated technical knowledge and resources at their disposal and without media demands for quick action, end up so profoundly mistaken? One possible answer is bad luck. Although there may well have been some bad luck, the answer seems to me to be more a function of dynamic uncertainty in financial markets, and explicit political considerations' affecting the Basel agreements. Dynamic uncertainty, a term used in the literature on terrorism,[8] refers to the fact that the action of the regulated in response to regulation alters risk in unanticipated ways that evolve nonlinearly, rendering it extremely difficult to predict the impact of regulation over time.

The truth is that the current state of knowledge does not permit us to predict, with any satisfactory degree of confidence, what the optimal capital requirements or other regulatory policies are to reduce systemic risk, or, indeed, what future categories of activities or institutions might generate systemic risk. Regulations that are appropriate when initiated can rapidly become inappropriate as a financial system's business, legal and technological conditions change. Moreover, institutions and individuals adapt their behavior in response to regulation, and their reactions change over time, interacting with the regulatory environment, in nonlinear ways, greatly complicating analysis.

Notwithstanding considerable advances in knowledge, the fast-moving and constantly changing dynamic of financial markets also renders it improbable that any future state of knowledge would enable us to make predictions with confidence. Risk management in today's context of large and interconnected financial institutions and complex financial instruments, must grapple with unknown and unknowable, and not simply known, risks (Diebold et al. 2010:3). Yet the Basel approach has focused the attention of the private sector, regulators and academic researchers on knowns, that is, on measuring capital adequacy through statistical probabilities of risks, disregarding the equal, if not more important, need to create internal control and regulatory systems that emphasize adaptivity to the challenge of unknown, and unknowable risks (Diebold et al. 2010:5). Moreover, knowledge of past relations across asset returns, used in risk management, can be misleading, for in times of financial stress, asset correlations not only change (Diebold et al. 2010:25), but also increase significantly (Erdorf and Heinrichs 2010). In such an environment, regulators are bound to make mistakes, and Basel's global harmonization template is poorly-suited to catch them, as it neither adapts readily to change, nor fosters diversity, strategies that increase system survivability (e.g., Haldane 2009:4); rather, it may well increase the likelihood of systemic failure (Romano 2012; see also Herring and Litan 1995:134-135).

But the failure of the Basel accords is not solely due to inappropriateness of a top-down harmonized regulatory approach for the dynamic uncertainty of financial markets; the accords are also informed by political judgments (Romano 2012: 39, 43-44; Tarullo 2008:87), which have had adverse consequences for financial system stability. The most critical terms in the Accord, the definition of core (tier one) capital and the choice of risk weights, have been a subject of repeated political log-rolling. A case in point is the tripartite agreement devised under Basel I in which Japanese negotiators obtained their desired core capital treatment for deferred tax assets, U.S. negotiators for mortgage servicing rights, and European (French and German) negotiators for minority interests in other financial institutions, a logroll carried forward in Basel III, with all three assets continuing to qualify as tier one capital albeit limited to the precise same 10% (Basel Committee on Banking Supervision 2010:26). There is no economic or prudential justification for the three asset categories to be treated equivalently, let alone characterized as equity capital. And, as earlier mentioned, favorable Basel risk weights for residential mortgages are illustrations of political considerations influencing risk weight assignments so as to be in conformance with, and furtherance of national policies (e.g., Dewatripont et al. 2010:30).

By tending to enact comprehensive financial legislation only in reaction to an immediate financial crisis, Congress acts most swiftly precisely when greater deliberateness is called for, given the paucity of information available to produce a high quality decision. The Basel regulatory architecture premised on global harmonization is equally poorly suited for the need, as it is not designed for generating information concerning what new risks might require regulation, let alone what regulation would be best suited for specific risks. Nor is it nimble enough to adapt and change course rapidly to scotch looming problems, when information becomes available that a regulatory approach is likely to be mistaken or no longer appropriate. Although Congress is not about to restrain itself from acting in a crisis, nor are Basel committee members about to abandon their commitment to harmonization, any time soon, the unintended consequences likely to accompany their decisions can, in my judgment, be mitigated by deploying systematically procedural mechanisms that require the revisiting of enactments and by fostering experimentation in regulatory approach.

III. Improving the Quality of Crisis-Based Financial Regulation

There are two key components that should be included in financial regulation to mitigate the effect of legislative and regulatory failure: (i) a sunset requirement that regulation be reviewed and reconsidered within a fixed period after enactment (e.g., five to six years) to stay on the books; and (ii) a structure that is hospitable to regulatory experimentation wherever possible. By permitting legislators and regulators to incorporate new information into the decisionmaking process, and simultaneously increasing the likelihood that new information will be generated from the regulatory variety generated by experimentation, the quality of decisionmaking has a better chance of being improved.

A. Sunsetting Financial Regulation

Sunsetting – providing that a statute expires on a specified date unless reenacted – is a time-honored legislative tool.[9] It has been used by Congress and state legislatures since the nation's founding, although its use as a lawmaking strategy has ebbed and flowed over time. For instance, in the late 1970s, sunset legislation rapidly coursed through the states, with 35 legislatures enacting sunset laws to review administrative agencies, widely perceived to be ineffective and wasteful (Davis 1981; Price 1978). At the same time, Congress considered, but did not enact, a broad sunset statute, yet it still followed the trend in sunsetting the newly created Commodity Futures Trading Commission (CFTC) in the Commodity Futures Trading Commission Act of 1974.

By 1990, enthusiasm for administrative agency sunsetting waned, given the time and cost of reviews, but over twenty states still have some form of active sunset review, and in recent years, as states' fiscal situations have deteriorated, states have once again adopted or reinvigorated the process (Kearney 1990; Weaver 2011). Articles discussing the effectiveness of state sunset reviews in their heyday in the 1970s indicate that they were on balance successful, resulting in the termination of agencies (although no major entities were terminated), and improvements in agency operations, even in states that discontinued sunset reviews (Kearney 1990:52-55; Price 1978:440).[10]

Sunsettting is particularly well-suited for crisis-driven financial legislation. Of the rationales for adopting a sunsetting strategy, the key justification in the financial regulatory domain is that sunsetting mitigates the predicament of legislating with minimal information, and therefore running the risk of getting things seriously and, for all practical purposes, permanently wrong. Congress can, of course, in principle modify crisis-legislation that turns out to be misplaced. But the U.S. political system's organizing principles of separation of powers and checks and balances create numerous veto points throughout the legislative process (e.g., approval of both chambers, then presidential approval, or approval by a supermajority of both chambers) that make repealing a statute extremely arduous. Sunsetting loosens the institutional stickiness of the status quo, by putting a statute in play, with a need for affirmative legislative action at a specific date to remain in effect.

But more important, in the financial regulation context, sunsetting sets in motion a process by which post-enactment information can be incorporated into the regulatory regime. For instance, by the time of a statute's sunset review, several years after enactment, there should be a better understanding of the causes of the crisis that the legislation sought to address, along with knowledge of the enacted legislation's consequences, information indispensable for getting regulation right, but unavailable when a crisis necessitates a response. In addition to permitting a more clear-eyed assessment, with the benefit of hindsight, of the crisis-enacted regulation, economic and technological conditions may have dramatically changed in the interim, with financial innovation occurring apace, and that information can also be taken advantage of in the legislative "second look," for the most appropriate regulatory responses will undoubtedly have shifted as well.

John Coffee (2012) critiques sunsetting crisis-driven financial regulation on two grounds.[11] First, he maintains that the review process will be captured by financial institutions and produce outcomes at odds with the public interest that he contends characterizes emergency legislation.[12] Second, he asserts that flaws in crisis legislation go away over time because the administrative process through which the legislation is implemented will eventually revise the more problematic parts. Although the significance Coffee draws from this second claim with regard to sunset review is not made explicit, he would appear to be arguing that over time bad laws can be undone by administrative agency action. Whatever the intended interpretation, his bottom line is that the "greater danger" is that too little or no regulatory "reform" will be enacted in a crisis, because "overbroad" regulation "is usually repealed or curtailed relatively quickly (and without the need for mandatory sunsets)" and the "forces of inertia will veto or block all change" (Coffee 2012:79-80).

Coffee's first claim regarding the legislative process is, however, mistaken, in depicting crisis-driven financial legislation as a triumph of a dispersed public interest, unrepresented in times of normal politics, against the concentrated interest of business.[13] There are, in fact, highly organized and powerful interest groups on both sides of financial regulation issues, and solutions appearing in crisis-driven legislation are often policies that a range of those groups have advocated, sometimes for an extended period of time (e.g., Bainbridge 2011), and not simply the work of "champions" of investors whose voices would never be heard by Congress or regulators in the absence of a crisis, as Coffee (2012:13) contends.

In particular, the counterpart in the political arena of Coffee's "concentrated" business interest is certainly not a dispersed investor public in need of a crisis-induced "political entrepreneur" to be represented against business, but rather, well-funded and politically influential labor unions, public pension funds,[14] and the plaintiff's bar, along with the corporate governance cottage industry and a variety of trade groups, whose leadership regularly is called to testify in congressional hearings (Romano 2005). Moreover, these groups are full-time political players, and do not just spontaneously emerge as a counterweight to business interests solely in a crisis, as Coffee would have it. Such groups are equally active in the normal politics of the administrative process which Coffee contrarily characterizes as the domain of one concentrated interest – "business." Although the objectives of those groups in relation to the public good or the interests of individual investors can be deeply problematic (e.g., Agrawal forthcoming; Anabtawi and Stout 2008; Coffee 1985, 2006; Romano 1993; Rose 2007), their prominent presence in the policy process, in crisis and non-crisis times, is an incontrovertible fact and it tends to counterbalance business influence.

In addition, business is not a monolithic interest group (Hart 2004), as Coffee's invocation of Mancur Olson suggests. Rather, business firms are quite often divided on legislative issues, including those related to financial regulation. For example, large and small companies split over supporting Sarbanes-Oxley (Romano 2005), and the securities, futures and banking sectors of the financial industry were in continual conflict over the regulation of derivatives in the 1990s (Romano 1997). Of course, even if business were in unison on a specific proposal, it would be incorrect to assume, as does Coffee, that simply because business supports a particular policy, it cannot be good public policy. To the contrary, a comprehensive study of business lobbying found that when a united business front "wins" in a deliberative process over controversial regulation, it is because the public supports business's policy position, rather than business's having "captured" legislators (Smith 2000).[15]

Coffee's second contention, that problematic components of crisis-driven financial legislation are revised over time through the administrative process, is inconsistent with his first claim, that the administrative process is captured by business: an administrative process that is properly revising problematic legislation would not simultaneously be eviscerating legislation in the "public" interest. Coffee cannot have it both ways. Moreover, the example Coffee provides of "quick" regulatory adjustment to the problematic internal controls provision of Sarbanes-Oxley proves the precise opposite of what he claims. It took eight years and an act of Congress to undo by a bit costly regulation, and much of the agency action that was directed at the problem in the intervening years was not self-correcting administrative action, as Coffee contends, but rather, undertaken in response to action, or the threat of action, by Congress (see Romano 2009).[16]

Finally, and most important, both of Coffee's concerns that motivate his objection to sunsetting, contrary to his contention, would, in fact, be addressed, not exacerbated, by a sunset requirement. If his first objection to sunsetting were correct and the post-crisis administrative implementation process is captured by business interests that undo publicly-regarding legislation, then sunsetting should, all the more, be endorsed. Sunset review entails a far more transparent public process than administrative action, with congressional hearings that would attract media attention, rendering it more difficult for any one organized interest group or groups to control the process. And, if Coffee's second objection were accurate and the post-crisis administrative process is one in which all or nearly all statutory flaws are eventually ironed out, as he claims, then sunset review would reduce the cost of such errors by further facilitating and accelerating the revision process.

But to be effective, it is important that the sunsetting process be crafted in light of the states' experiences with what works. To guide the collection and analysis of information in a sunset review, and hence the reassessment of whether legislation should be retained or revised, evaluative criteria for the sunset review, and not simply an expiration date, need to be specified in the statute responding to the crisis. Otherwise, a review will lack focus and may become a pro forma process, as legislators will often have more immediate concerns that they wish to pursue rather than undertake a serious reassessment, especially if, as is probable, constituent concerns in a crisis that motivated the statute in the first place have drifted to new matters (Davis 1981:394, 396-401). The evaluative criteria will, of course, vary depending on the specific legislation.

Taking Dodd-Frank as an illustration, a crisis-specific evaluative criterion would be whether implemented regulations have had a positive (or at least nonnegative) effect on financial system stability (banks' safety and soundness), along with a more general criterion of whether the benefits (e.g., the increase in bank soundness) outweigh the costs. An example of the latter might be whether there has been an increase in the cost of credit to small businesses, which, because they are more reliant on bank financing than large corporations that can access public capital markets, are considered the parties most at risk from a reduction in bank lending that the statute may cause. Estimation of the economic effect of financial regulation is a quite feasible, albeit most certainly imperfect, endeavor, as academics and bank regulators' technical staff routinely analyze the impact of regulatory changes on individual banks and the economy. In any event, such a calculation is not only simply better than operating in total darkness, but essential for attempting to evaluate what crisis-driven regulation has wrought.

The availability of new information at the time a second vote on a statute is required for it to remain in force does not guarantee that legislators will engage in a serious reassessment, rather than a pro forma review, of course (Breyer 1982:365). To increase the likelihood that new information will be conscientiously acted upon, there is another component that should be included in a sunset provision, in addition to an expiration date and evaluative criteria, establishment of a sunset review panel to perform the review along with a timetable for action (Breyer 1982:366). A sunset review panel should be tasked to recommend what action – repeal, reenactment, revision – Congress should take, and a timetable should set out the interval in which a panel recommendation would be considered by the House and Senate committees with jurisdiction over the legislation, after which the panel's recommendation would be automatically discharged as a bill for a floor vote if the committees do not themselves bring it, or an amended version, to the floor.[17]

The sunset review panel should consist of independent experts, who are neither government employees nor officials, and be empowered to obtain information from relevant regulatory agencies and firms to undertake its review. The advantage of independent experts is that they tend to self-identify more strongly with professional norms and are more concerned about reputational damage if peers perceive them to be doing the bidding of interest groups or party politics, than government employees who are in a hierarchical chain of command. For the review panel to be both politically accountable and independent, it should be appointed by Congress and the President, paralleling the practice used for creating blue ribbon government panels. Although Congress could establish a standing blue ribbon review panel, which would reduce the cost to future Congresses of forming a panel, reviews would be more effective if undertaken by panels created specifically for the legislation to be evaluated, as the relevant expertise is likely to vary with a statute's focus. For example, expertise in macroeconomics would be pertinent for reviewing much of Dodd-Frank, but not Sarbanes-Oxley.

To ensure that the sunset process is meaningful, the authorizing legislation would need to include adequate funding for a review. Budgets of prior congressionally-appointed blue ribbon investigatory panels could be used to provide guidance. Given budgetary concerns, Congress could impose a fee on the relevant sector affected by the legislation to cover a review panel's operating cost. It could also mandate that governmental research organizations, such as the Congressional Research Service or General Accounting Office, and the relevant regulatory agencies, provide evaluations of the sunsetting regulations to the panel, for use in its review. But that would probably not substantially reduce the expense of a sunset review, as the panel would likely want to seek to conduct its own evaluation de novo.

The rationale for this review mechanism, an expert panel and a timetable, is that, the threat of a required floor vote on a recommendation made by outside experts would compel a higher quality reassessment of a statute by all concerned, and in particular, by congressional committee members who know they cannot prevent a vote on a recommendation they might otherwise be able to oppose merely by inaction. It should also better incentivize review panel members, as they would know that a floor vote on their work product is assured. The use of a review panel has a further benefit, of reducing the time required by legislators and their staff to engage in a sunset review, for the panel would collect data and perform the analyses necessary for the legislature's reassessment. It would thereby mitigate a key operational problem experienced by states in their 1970s sunset reviews and that led several states to abandon the procedure: legislators, particularly in states where they were part-time, did not have the time or resources to engage in the demanding process of reviewing numerous state agencies (Kearney 1990:55).

A variant of legislative sunset, which would reduce even further demands placed on Congress of a required review, would be to impose the sunset review on agencies implementing the regulation. In this alternative, crisis-driven financial legislation would mandate agency reassessment of regulations implemented under the statute, with an automatic expiration in five years unless they are found to be cost-effective, and with the technical analysis undertaken by independent experts, rather than agency staff, to minimize potential bias from an agency's being too closely involved in the rules it administers to evaluate them objectively (Coglianese 2011; Romano 2005:1601). Further, to guard against an agency's inherent bias in interpreting the independent experts' analysis in support of the regulatory status quo or its agenda, a congressional vote on the agency's determination should be required in an administrative sunset review regime.

The availability of sunsetting as a well-known technique in the congressional playbook suggests a puzzle: why, given the compelling informational benefit from sunsetting crisis-driven financial regulation, Congress has chosen not to do so? I offer three possible explanations, one prudential, one political, and one pragmatic. First, there may be a prudential concern that a sunset law would impose costs on firms and individuals by decreasing regulatory certainty, given an expiration date. I do not find this to be a plausible explanation. In the financial regulation context, the multi-year interval before a sunset is often long enough for the completion of business planning surrounding the regulated financial investments and instruments, especially given how rapidly the financial environment changes. The business planning affected by financial regulation, in short, does not typically consist of projects with a long development lead, such as the research and development of a pharmaceutical drug. Furthermore, experience teaches otherwise. The CFTC's being a sunset agency, with the possibility that it would cease to exist, along with its regulatory framework, did not hinder a remarkable degree of innovation in financial derivatives, that were under the agency's jurisdiction.

Second, and, in my judgment, a more compelling explanation, sunsetting imposes political costs on legislators because it shifts decisional control over the content of a statute from current legislators to a future Congress.[18] That creates a strong disincentive to permit a second look. This might have been especially so in the case of Dodd-Frank, enacted by a Congress with very large Democratic majorities not likely to be of the same margin in the future, because it contains provisions of great interest to Democrats' core political supporters but with minimal support in the broader electorate, and that, more likely than not, would not have survived separate up or down votes. Instances of this type of provision are the requirement that public companies hold shareholder votes on executive compensation (Dodd-Frank §951) (a labor union issue, which had been introduced as a bill in prior sessions, but had languished in the Senate), and the requirement of affirmative action in hiring by federal financial agencies and any business (e.g., banks and law firms) regulated by, or participating in programs or contracts of the agencies (Dodd-Frank Act §342) (a black caucus issue, advocated by Representative Maxine Waters [2011], a member of the House committee responsible for drafting the bill). Legislators recognizing that the crisis environment guaranteed passage of a bill, opportunistically worked to include those provisions, and would not have wanted to tempt fate with a subsequent reconsideration that might cull their legislative contributions.

Finally, human nature and practical concerns of party leadership would seem to have a role in explaining the puzzle. Lawmakers drafting emergency financial statutes may think, out of hubris, that they have indeed crafted landmark legislation which is the best of all possible regulatory solutions. As a consequence, the idea of including a sunset provision would not cross their minds and if suggested, would most likely be perceived as a rebuke of their work product, rather than a needed mechanism for improving rules that are bound to be imperfect. In addition, drafters typically personally identify with legislation, which sometimes bears their names. In such a setting, legislators would perceive sunsetting as potentially diminishing or threatening what they consider to be their "legacy." Reinforcing such foibles of human nature, party leadership rarely has a strategic interest in entertaining a need to employ sunsetting in financial legislation enacted in a crisis, for it is typically supported by large majorities, with the backing of the media and a panicked public. Such pragmatic considerations would seem to explain why the USA PATRIOT Act had a sunset provision but Sarbanes-Oxley, enacted less than a year later, did not. Not only was the USA PATRIOT Act an administration bill with no legislator's name attached, but also, party discipline alone could not lockup passage because a sufficient number of members in both parties felt uneasy over its considerable expansion of law enforcement powers, provisions also considered problematic by the media.

Given that lawmakers' incentives often work at odds with sunsetting, a key item on an agenda for improving the quality of financial regulation decisionmaking, then, is the development of public awareness and suasion to overcome those hurdles. A starting point would be to educate the media, political elites and public concerning what is needed for value-enhancing financial regulation: that sunsetting, at least in this context, is good governance. The view that sunsetting and good government go hand in hand was, for a brief time, widely shared by political elites, when then President Jimmy Carter espoused the approach and Common Cause assisted the Colorado state legislature in drafting a sunset statute (Kysar 2005:353).

Because there is a literature indicating that the media can and does influence policy outcomes by affecting an issue's salience (Romano 2009: 255-257), pursuing a media educational campaign to foster an ethos of sunsetting would seem to be an excellent initial strategy for advancing sunsetting on the legislative agenda. However, this task will not be easily accomplished. To affect public opinion, the benefits of sunsetting would need to be concretized in a vivid example or event, for the literature further suggests that public attention is more likely to be engaged, and thereby influenced, by concrete issues, such as the drama of human interest stories, rather than abstractions (Severin and Tankard 2001: 228-29). In keeping with this observation, the media tends to cover items of interest, and information in the form preferred by, its audience (Hamilton 2004).

B. Opening Financial Regulation Up to Experimentation

The harmonization premise of contemporary international financial regulation is inhospitable to regulatory innovation: notwithstanding an absence of an enforcement mechanism, nations agreeing to comply with the Basel accords implement the standards through domestic legal processes (in the United States, for instance, through administrative rule-making), incorporating them into domestically enforceable obligations (Barr and Miller 2006). As a consequence, negotiations over changes to the accord tend to be intense and extended, as nations vie for provisions that will advantage or, at least not disadvantage, domestic financial institutions, and that are consistent with national policies. Such an understandably politically-infused process makes the outcome less than ideal and revision cumbersome, and at the same time it blocks experimentation or encourages violations of the accord.

Yet the dynamic environment in which financial institutions operate calls for a nimble regulatory apparatus that can both adapt to new products and accompanying risks and safeguard the international financial system from systemic regulatory error. Regulatory experimentation and diversity are safety valves that address both concerns. But to introduce the capacity for regulatory diversity into international financial regulation, the Basel architecture needs to be altered: experimentation deviating from the accord's strictures should be permitted and encouraged, albeit in a structured fashion, to mitigate the possibility that a nation's experiment could adversely impact systemwide stability.

A mechanism for introducing diversity and experimentation into the international financial regulatory architecture, while safeguarding against an increase in systemic risk, is a peer review process, with three components.[19] First, a nation wishing to adopt a rule or regulatory approach different from that taken by Basel would submit to a Basel Committee-designated committee of peer regulators, a proposal which would include a description of the proposed departure accompanied by an econometric forecast (or formal modelling, where the requisite data for forecasting are unavailable) of its effect on financial system stability. Second, the review process in which a committee would evaluate a proposal, seeking further information or undertaking its own economic analysis, would operate with a presumption of approval: unless it found concrete evidence that the proposed departure would increase systemic risk and thereby adversely affect financial system stability, a departure would be approved. Third, approved departures would be subject to ongoing monitoring and periodic reassessment, so that approvals could be withdrawn, for instance, when an approved regulatory departure is seen to have a negative systemic impact, which could not have been ascertained in an initial review, or when the regulatory impact has changed with new economic and technological conditions.

All of the documentation in the three stages of the review process should be made publicly available. A transparent decision process should improve the quality of regulatory decisionmaking, as participants will have a stronger incentive to provide well-reasoned justifications, with analytical support, for their positions on deviations from Basel requirements, and other nations will be able to learn from that experience and thereby be better able to make informed regulatory choices. The transparency of the ongoing review process offers a critical additional benefit to that of the initial review procedure: it provides a mechanism for comparing the efficacy of the Basel regime to departures from it. Because the reassessment should provide data on the effectiveness of alternative regulation, it will also encourage a reevaluation of the Basel requirements by other nations, and emendations to Basel itself.

I have provided a thumbnail sketch of how regulatory experimentation could be introduced into international financial regulation, but experimentation could also be incorporated into domestic financial legislation. It is the genius of the federal organization of the U.S.

government that makes it quite amenable to such an approach (Romano 1993b). Moreover, structuring financial regulation to be more hospitable to experimentation is consistent with a contemporary trend in economics to introduce experimentation into policymaking, as the gold standard for policy evaluation (e.g., Greenstone 2009). Greenstone (2009:118) advocates implementing regulatory initiatives through a process that either starts with small scale randomized experiments or permits states to implement different regulatory approaches. The expectation is that coverage would be expanded nationwide were these initial experiments successful, essentially on a cost-benefit metric. Although this approach, as he notes, is most feasible for environmental, health, labor market and safety regulations, where discrete programs can be implemented using randomized trial experiments or "quasi" experiments, on the model of Food and Drug Administration testing requirements for new drugs, there is, I think, an analogue in the financial setting. That could be done by providing agencies with expanded exemptive and waiver power and an accompanying directive to use the authority to permit individual or classes of institutions to operate under different regulatory arrangements.[20]

Congress has, in fact, used such an approach in crisis-driven financial legislation, but it has been limited in scope. For example, Sarbanes-Oxley's mandate of independent audit committees (by requiring the SEC to direct stock exchanges to prohibit the listing of any firm without an independent committee), states that the SEC can establish exemptions to the statutory criteria of director independence (Sarbanes Oxley Act § 301). Such an approach could be more broadly applied, and agencies instructed to implement rules along the lines of a small scale experiment, with incremental expansion only after a cost-benefit analysis undertaken by independent experts.

One means by which experimentation could be implemented within a waiver setting is by permitting a firm or class of firms to request a regulatory waiver, and by not leaving the matter solely up to an agency's initiative. The standard for approval of an exemption could be an assessment of minimal adverse impact on the statutory objective (e.g., on systemic risk or financial statement fraud, objectives, respectively, of Dodd-Frank and Sarbanes-Oxley). Because an agency could be expected to be predisposed to believe that whatever regulation exists is good and hence to oppose exemptions, it could be required to accept, or at least to have to rebut in a meaningful way, an analysis of the proposed waiver provided by independent experts. Maintenance of the statutory purpose would be safeguarded by having the agency engage in ongoing monitoring and review of approved waivers, to make sure no adverse impact developed. And paralleling Greenstone's (2009) contemplated regulatory reform process, were the waivers deemed successful, the agency would be expected to extend them to more, or all, firms or sectors. Where the proposed waiver is a private sector initiative, the firms could be required to cover the agency's cost of evaluating and administering the experiment.

The interaction between statutory experimentation through waivers and required sunset reviews can however, be complicated. When exempted firms are nonrandom, one cannot evaluate properly either the impact of the waiver with an eye to generalization, or the efficacy of the regulation under sunset review, for the analysis would be subject to selection bias, as covered and excluded firms would not be comparable. For instance, firms that request a waiver would most likely be those that would be most adversely affected by a rule. This difficulty could be addressed if regulatory waivers were constructed as natural experiments, in which firms receiving a waiver were selected by lot.[21] But such an approach would, in my judgment, in many instances be politically infeasible and inappropriate, as it could seriously interfere with market competition, where the exempted firms' operating cost would be less than that of the regulated firms. In addition, if the exemption was for a limited time frame – for instance, until the "experiment" would be evaluated by the agency for its effectiveness – then firms' behavior may not represent how they would respond to a permanent rule, as they strategize to affect the outcome. In short, there is an inherent tension between sunset reviews and experimentation. But I do not believe the potential conflict is sufficient to reject the proposed dual-pronged regulatory approach.[22] Given the sunset review panel's expertise, it should be well attuned to the selection issue and able to recalibrate the analysis when undertaking its regulatory evaluation in the context of experimental data.

Although I believe that a review mechanism permitting departures from, and thereby introducing experimentation and diversity into, financial regulation requirements, and especially into the Basel international financial regulatory regime, is quite feasible, as with sunsetting, there are powerful incentives working against its adoption. Financial regulators, in particular, confront determined lobbying by banks and legislators to harmonize rules in order to not impact negatively large, internationally-focused domestic banks. This is, in essence, an attempt to legislate modern-day mercantilism and ought to be resisted. In addition, regulators may be subject to a status quo bias (Samuelson and Zeckhauser 1988), leading them to evaluate adversely waiver requests, particularly those that are most innovative, and legislators, out of hubris, may resist permitting deviation from mandates. This is, then, another area in which a media and public educational campaign, on the value-added of financial regulation experimentation and diversity, will be critical.

IV. Conclusion

Determining how to regulate financial institutions effectively is challenging under the best of circumstances, given the uncertain and dynamic environment in which they operate. What would appear to be an optimal regulatory policy can become a serious mistake as new risks materialize as financial institutions and products interact with regulation in unanticipated ways. Yet Congress typically legislates on financial matters in a crisis environment, which is not conducive to high-quality decisionmaking. International financial regulators have not fared better, as their focus on harmonizing global financial regulation has limited the generation of information on regulatory alternatives and hindered the making of a nimble and adaptable rulemaking process, better suited to the environment.

There is a useful legislative tool that could mitigate legislative failure in the field of financial regulation: a sunsetting statute. One could also make headway in improving the quality of decisionmaking in international financial regulation through adoption of a structured peer review process, that permits regulatory experimentation and diversity, subject to procedural safeguards. Experimentation and diversity could be incorporated into the legislative process as well, by Congress's directing agencies to use regulatory exemptive and waiver powers to foster such objectives. In tandem with sunsetting, the greater flexibility arising from use of such tools would facilitate timely updating of the legislative and regulatory architecture, which is a matter particularly appropriate to financial regulation.

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Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, Pub. L. No. 107-56, 115 Stat. 272, codified as amended in scattered sections of 8, 15, 18, 22, 31, 42, 49 and 50 U.S.C.

Notes

1. The Dodd-Frank figure is a single-spaced page count; a longer page count of 2,319 pages, often publicized in the media and provided by Perry (2010), references an official bill format that is double-spaced. Perry's counts for the two earlier statutes are undercounts in relation to the two newer statutes, because the page margins are narrower, but even if we were to adjust for a formatting difference, the point is still broadly accurate: Dodd-Frank dwarfs those pieces of legislation.

2. For example, a media frenzy over corporate accounting scandals, calling for a government response, was a key factor in the enactment of the Sarbanes-Oxley Act (see Romano 2005:1559,1567). In the ongoing global financial crisis, media coverage, on a daily basis, includes repeated calls for a wide variety of government action to resolve the crisis.

3. The models suggest that by raising the salience of an issue, the media facilitates citizens' ability to monitor their elected representatives, and thereby bring about government adoption of policies the citizenry prefers. There are numerous empirical studies that support the theory, finding a link between policy, election outcomes, and media coverage. For a summary of the literature, see Romano (2009:255-57). Kingdon (2011: 58-61) contends that rather than affecting a policy issue's movement onto a legislative agenda directly, the media exerts an indirect effect on policy, either by affecting public opinion on an issue and thereby influencing legislators, who pay attention to public opinion, or by magnifying "movements that had already started elsewhere" in the policy process.

4. The mind-boggling number of regulatory actions mandated by Dodd-Frank is so daunting for a business to follow that law firms have introduced paying client services that track agencies' progress on the statute's required rulemakings and reports.

5. Congress frequently imposes unrealistic deadlines. There is no compelling explanation for the widespread use of this practice. One theory is that Congress, fully aware that its deadlines will not be met or will produce "incomplete or flawed" rules, uses deadlines as a mechanism of accountability, by providing a tactical advantage for constituents to challenge rulemaking in court, and to exert influence over the content of the rule (Kerwin and Furlong 2011:226). The Dodd-Frank related rulemaking litigated so far, the SEC's proxy access rule, did not have a deadline, and although the *Business Roundtable* litigation technically comports with the explanation, it is the opposite of what its legislative proponents intended, as their political supporters – labor unions – were vigorous advocates of the SEC's adoption of the rule.

6. Although some might contend that Basel II was initiated in response to the Asian financial crisis of 1997, Tarullo (2008:90-91) maintains that was not the causal initiating factor because Basel members' banks were not seriously impacted by that crisis.

7. For example, Tarullo (2008:91 n.9) notes that Basel I, which was adopted in 1988, was set in motion as a response to the Latin American debt crisis of the early 1980s.

8. In the literature on terrorism, "dynamic uncertainty" has been commonly used to differentiate terrorist risk from natural disasters: the materialization of risk in both instances is highly uncertain, but terrorists adapt their behavior in response to targets' protective actions, and thus affect risk over time (Michel-Kerjan 2005).

9. For an overview of the use of temporary legislation, of which sunset statutes are one variety, see Gerson (2007). The U.S. income tax code is, in fact, rife with time-delimited provisions, often referred to as "extenders" (because they typically are automatically rolled over), rather than "sunsets." For a critical appraisal of the political dynamics of tax sunsets, which, being related to evasion of restrictive budgetary rules, is orthogonal to the issues concerning the use of sunsets in this paper's context of crisis-driven legislation, see Kysar (2005).

10. John Coffee (2012:19 n.39) questions the intellectual consistency of my critique of Sarbanes-Oxley and my advocacy of sunset as a means of mitigating the adverse consequences of emergency legislation, quoting another article criticizing my advocacy of sunset review for offering "no empirical evidence that sunshine laws provide any benefits on balance," and commenting that "It seems inconsistent for Professor Romano to criticize Congress for enacting many of SOX's provisions without (in her view) adequate empirical support and then for her to propose a legislative remedy (a mandatory sunset rule) that has no empirical support." Coffee and the authors to whom he refers (Prentice and Spence 2007) ignore the long and well-established U.S. experience with sunset legislation, as an instrument in legislators' conventional toolkit, as well as the literature, such as it is, evaluating the results. Although empirical research on sunset reviews is limited, those studies that do exist, noted in the text, provide positive, albeit mostly qualitative, assessments. My response to the Prentice and Spence (2007) article that Coffee cites can be found at Romano (2009: 260-61).

11. Coffee sweepingly seeks to dismiss the scholarship with which he disagrees by engaging in name calling, referring to Steve Bainbridge, Larry Ribstein and me as "the 'Tea Party Caucus' of corporate and securities law professors" (a claim that would have been humorous had it not been said earnestly) (e.g., Coffee [2012]: 7 and *ad passim*) and "conservative critics of securities regulation," (a claim, at least in my case, that would be accurate if he had dropped the adjective) (id.: 5), and by further referring to Bainbridge and Ribstein, as "[my] loyal allies" (id.: 7).

One should at least get labels right when attempting to disparage intellectual foes. In point of fact, in the American political tradition and academic literature, advocacy of sunsetting and in particular as a means to implement cost-effective regulation, has historically cut across political party lines. It has had a distinguished liberal pedigree, having been advocated by, among others, President Jimmy Carter, Senator Edward Kennedy, political scientist Theodore Lowi, and the "good government" advocacy organization Common Cause (Breyer 1982; Kysar 2005). A more recent instance is the bipartisan support of sunset provisions in the USA PATRIOT Act (O'Harrow 2002). Moreover, the aim of sunsetting is to eliminate regulations that are either ineffective, lacks intelligence, or has had perverse consequences--not all regulation, as Coffee (2012:7) suggests with his comment: "Such an outcome [a sunset review of the federal securities laws undertaken in the 1930s that would result in their elimination in entirety] seem[s] sensible only if one believes (as she [Romano] may) that markets need little regulation (and thus that regulatory interventions should be short-lived, disappearing like snowflakes in the sun)." The historical experience with sunsetting demonstrates that Coffee misunderstands the legislative technique: states did not terminate all or even most administrative agencies subject to their sunset reviews in the 1970s, as opposed to specific programs, practices and entities thought to not be cost-effective (see, e.g., Kearney [1990]), nor has Congress eliminated the CFTC, which, created as a sunset agency, comes up for periodic reconsideration and renewal.

Coffee (2012:5) further claims that I (and others who have similarly critiqued Sarbanes-Oxley) see democratic politics as "dismaying, dangerous, and need[ing] to be discouraged." He has it precisely backwards. Advocacy of sunset review in this context – emergency financial legislation – perfects democratic politics by seeking to have elected representatives--legislators–make decisions. It is Coffee who would leave the revision of flawed crisis-driven legislation or its inept implementation to unelected functionaries with their own private and institutional agendas, whose decisions are often beyond public scrutiny or, when visible, so technical as to be beyond public comprehension. Coffee's critique, in the very same paper, of regulators' implementation of Dodd-Frank's executive compensation rules, among others, for eviscerating Congress's objectives makes my point.

12. Coffee asserts that his argument about the administrative process's undoing or "watering down" of crisis-driven financial legislation does not assume that regulators are captured (e.g., Coffee 2012:13,82). But much like Hamlet's mother and the player queen, despite his protestations, Coffee's analysis bespeaks otherwise. For example, he states that "financial regulators are often so closely intertwined with those they regulate that they respond in an equivocal and even timid fashion (id.: 81). By most lights, that description aptly conveys what is conventionally understood to be a "captured" agency.

13. Coffee (2012:5-6 n.11) cites Mancur Olson's (1965) celebrated work on the collective action problem in support of his claim that emergency financial legislation is in the public interest whereas interest groups will dictate the output of sunset review, asserting that my analysis of the emergency legislative process and the role of policy entrepreneurs is not used in "any theoretical sense" and "seems unaware of the political science literature and focuses exclusively on empirical economics." This is a strange assertion. The work that he is criticizing (Romano 2005) refers extensively to both the economics and political science literature in those analyses. It just does not cite or discuss Olson's work on collective action because, in this context, it would be a mistake to do so, as elaborated in the text.

14. Coffee (2012:17) dismisses the political significance of public pension funds because they do not make campaign contributions. But that misses the mark: public pension funds are often led by prominent state political figures (Romano 1993a) whose positions and contacts provide considerable clout and a bully pulpit that can further political ambitions.

15. Coffee (2012:16-17 n.35) cites a law review article (Apollonio et al. 2008) in support of his view that business dominates politics, for the proposition that business outspends unions on

lobbying, and is apparently unaware of the comprehensive research on lobbying by Baumgartner et al. (2009) which details the offsetting lobbying resources that coalesce against large organized lobbying expenditures by business, and the data indicating that resources spent do not explain lobbying success. The error in relying on the article Coffee cites is that Apollonio et al. use aggregate lobbying expenditures, without examining how the funds were allocated across issues, to ascertain how they line up; not only are businesses affected by many more issues than unions because there are many different business sectors affected by different laws, but also, on many issues business and unions are not at odds. More important, contrary to the article's correlative claim that business outspends unions in campaign contributions, and Coffee's contention that unions are outspent by banks, the Center for Responsible Politics (2012), which tabulates campaign contributions, has constructed a list of the "all-time" top campaign contributors over 1989-2012. Of the top fifteen donors, nine are unions, one is the trial bar, one is the national realtors' trade association, and the number one is ActBlue, a collector of funds for Democratic party candidates, while only three are corporations (AT&T, Goldman Sachs and Citigroup). Another three unions, but no corporations or corporate trade groups, are in the top twenty on the list. And of course, these contributions do not include the in kind campaign contributions that unions, not businesses, make in the form of "get out the vote" and other candidate support efforts.

Coffee further cites as a "smoking gun" for his thesis that emergency legislation is the ideal working of democracy while post-crisis government action is dictated by business interests, the fact that financial firms are spending large sums lobbying on Dodd-Frank's required rulemaking, in contrast to members of the general public or unions. While it is a self-evident proposition that financial firms will expend more resources due to their keener interest than any other entities in the Dodd-Frank rulemaking process, as their economic viability is at issue, Coffee misses the correlative irony embedded in his assessment of these expenditures. Much of the expenditure has been called for by the agencies themselves, as their multitude of regulatory proposals contain hundreds of questions directed to the private sector to assist in their proposed rulemaking. Most important, Coffee's position regarding the import of business lobbying is incoherent. He is contending –in favor of the "democratic" nature of emergency legislation over a more deliberative legislative process as would be occasioned by sunset review–that business's lobbying of agencies post-crisis enables it to dominate the rulemaking process, but a few pages later, in arguing against sunsetting and advocating that any reconsideration of crisis-driven legislation should be left to agencies, he buttresses his position against sunsetting by asserting that the only reason to support sunsetting would be a belief that an agency is "captured" (Coffee 2012:22).

16. Coffee (2012:26-29) contends that the problem with the internal controls provision was not the fault of Congress and the crisis-based haste in which the statute was crafted, but rather, due to the Public Company Accounting Oversight Board's (PCAOB) implementation. As earlier discussed in the text at pp. 7-9, emergency legislation often adopts a delegation strategy in order to deflect blame for the consequences of a poorly-thought out legislative strategy by placing it on the implementing agency, as Coffee has done. In making such a distinction, Coffee misunderstands the scope and intention of sunset review of crisis-driven legislation: it

encompasses problems in regulatory implementation as well as in statutory drafting. Moreover, what Coffee regards as a problem of implementation cannot be readily separated from the legislative process as he attempts to do, for the difficulties in implementation are, in fact, a product of hastily drafted crisis-driven legislation that encourages the use of readily available solutions, which, upon more sober reflection, would be recognized as inapt. The internal controls provision is an illustration of this phenomenon. It was simply lifted from a provision in the Federal Deposit Insurance Corporation Improvement Act of 1991 requiring banks to submit reports on their internal controls, with auditor attestation, to banking regulators as part of the bank examination process (Senate 2000:31); unfortunately, no one attempted to consider, let alone analyze, whether such a template could costlessly be imposed on all sizes and types of public companies as part of the public audit process.

17. I am advocating a modified version of a proposal of Justice (then professor) Breyer (1982:366-367), for review of federal regulatory programs for waste and inefficiency. Breyer (1982: 367) rejected a sunset approach because he was concerned that a congressional minority could "destroy" an existing program by preventing a bill from coming out of a committee or by filibustering or otherwise blocking a floor vote to reapprove a majority-supported program. His proposal therefore would continue a program were Congress to not adopt a recommendation. Breyer's proposed automatic discharge eliminates the issue of committee blocking, but not, of course, minority blocking on the floor. But sunset could be retained and the latter issue eliminated with a rule for sunset review analogous to the reconciliation process applicable to budget legislation, which limits debate and bypasses filibusters.

18. Although sunset laws can also be seen as a mechanism by which current Congresses control future Congresses – by forcing legislation to be considered (e.g., Gerson 2007) -- it seems to me that an enacting majority, particularly if it is risk-averse, would be far more concerned about preserving the legislation it has enacted than influencing the agenda of a future Congress, especially given uncertainty over what a future Congress might do to its "landmark" law. To the extent that sunsetting decreases the present value of a statute to constituents, it could impose a further political cost by lowering "rents" (such as campaign contributions) legislators can obtain from interest groups seeking a provision's enactment. I do not emphasize this cost as there is dispute in the literature over whether sunsetting decreases or increases such "rents." Kyser (2005), for example, contends that sunsetting increases rents because interest groups must lobby for legislation's renewal.

19. For elaboration of the proposed procedural mechanism, including cost implications for international financial institutions, see Romano (2012).

20. In critiquing my advocacy of sunsetting crisis-driven financial regulation, Coffee (2012:21) contends that I "never discuss" what he considers the "most feasible remedy," agency exemptive authority. This is an astonishing assertion. Both of my papers that Coffee critiques for this ostensible omission explicitly discuss agency exemptive authority. In my 2005 article, I suggested that the easiest way to revamp misconceived provisions in Sarbanes-Oxley was for the SEC to use its exemptive authority, but noted that it was not likely to do so (Romano

2005:1595). This essay advocates congressional directives to agencies to use such authority in implementing emergency regulation. I consider explicit instruction necessary because history teaches that the SEC will not voluntarily use its exemptive powers to remedy flawed rules that it has adopted in implementing emergency legislation. The well-known cognitive bias to favor the status quo (Samuelson and Zeckhauser 1988) aids in explaining why agency exemptive power alone is not, as Coffee contends, an effective means of revising flawed legislation. Indeed, Coffee's principal example of the administrative process's remedying flawed legislation refutes his contention: Congress mandated the exemption of non-accelerated files from Sarbanes-Oxley's internal controls auditor attestation requirement because the SEC failed to do so.

Coffee's odd assertion regarding my supposed ignorance of the SEC's exemptive authority is part of a piece: his paper contains numerous misstatements of my position regarding emergency-based legislation. To take an example, Coffee depicts my critique of crisis-driven financial legislation as directed at Sarbanes-Oxley's creation of the PCAOB (Coffee 2012:24) and Dodd-Frank's resolution authority-related provisions (id. 58). But my 2005 article critiquing Sarbanes-Oxley was directed solely at corporate governance mandates, for which the best available empirical evidence indicates they would not have remediated the accounting frauds that motivation the legislation. The PCAOB's creation is never mentioned in my article because, of course, as the regulator of auditors, it has no relation to corporate governance mandates. I have never written on Dodd-Frank's resolution authority-related provisions, nor has Stephen Bainbridge, whose critique of Dodd-Frank, like mine of Sarbanes-Oxley, was directed solely at its corporate governance mandates, yet Coffee links Bainbridge's critique of the statute, along with mine of crisis-driven legislation, as directed at the resolution authority-related provisions. Coffee's strategy would seem to be to minimize the meliorating properties of sunset review by implying that the position entails treating every provision in crisis-driven legislation as equally wrongheaded. But blanket repeal is not the gist of sunset proposals. The point of sunsetting is to produce a more deliberative drafting process that weed out the ill-founded from the wise, a reflection impossible to undertake in the heat of a crisis, and not likely thereafter to be willingly undertaken by an agency, given limited time and resources, which work hand in glove with the aforementioned status quo bias to blunt reconsideration.

21. The Securities and Exchange Commission (SEC) undertook a random experiment to investigate the effect of relaxing restrictions on short selling in 2004 (SEC 2007a). The experimental results led the agency to repeal the uptick rule restricting short sales (SEC 2007b). Despite the change in policy's grounding in a "gold standard" natural experiment, in the wake of the financial crisis, pressed by opponents of the rule change, the SEC reinstated a limited version of the rule (SEC 2010).

22. Greenstone (2009), it should be noted, recommends automatic sunsets along with experimentation in his regulatory reform agenda and does not view them to be in tension. This is most likely because he envisions experiments undertaken on a randomized, small-scale basis, which would not be likely to interfere but rather would assist in the cost-benefit evaluation of the sunset review he contemplates. In addition, he advocates automatic sunset for all regulations, many of which would not have been subjected to experimentation.