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Overlapping Legal Rules in Financial Regulation and the Administrative State

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OVERLAPPING LEGAL RULES IN FINANCIAL REGULATION AND THE ADMINISTRATIVE STATE

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Reforms which seek to overhaul the Dodd-Frank Act have begun to gain support within the Trump Administration and Congress. The leading proposals go beyond technical matters and reflect a wholesale critique: financial regulation has become too burdensome, too complex, and grants too much discretion to regulators. This Article argues that what is really at stake in these debates is the distinct issue of "regulatory overlap"—the joint use of multiple legal rules to address a common market failure. It begins by developing a general framework for analyzing overlapping legal rules of all kinds. That framework is then applied in case studies of the two cornerstones of financial regulation: capital adequacy requirements and resolution authority procedures.

The most direct contribution of this Article is to substantive issues in financial regulation. Each case study yields insights about particular portions of the Dodd-Frank Act that pending reforms attempt to eliminate, as well as the big picture problems of systemic risk and banks that are "Too Big To Fail." On a more theoretical level, it also situates the concept of regulatory overlap within the law-and-economics literature on the

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optimal design of legal rules, where it is otherwise conspicuously absent. Lastly, this Article shows how an analysis of overlapping rules in finance carries lessons for the regulatory process as a whole. It thereby adds to scholarship on administrative law, especially to research in that area that deals with a related set of problems concerning agency jurisdiction, cost-benefit analysis procedures, and the role of uncertainty in the policymaking environment.

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I. INTRODUCTION

"Regulating in the dark" is one of the better labels that has been used to sum up the policymaking response to the global financial crisis.[1] When the Dodd-Frank Act was rushed through Congress in 2010, events were still being digested, and their underlying causes remained poorly understood.[2] Subsequent commentary on the merits of Dodd-Frank was not much more informed.[3] While the statute purported to be a comprehensive overhaul of financial regulation, its provisions only sketched the barest outlines of what that overhaul might entail. Instead, they kicked off a regime-building period that took place through notice-and-comment rulemaking at administrative agencies.[4] Almost a decade after the financial crisis, that rulemaking process is more or less complete, and the entire Dodd-Frank edifice can finally be considered as a whole.[5]

Yet just as the ink is drying on the post-crisis reform agenda, calls to dismantle it have begun to multiply and gain momentum. Two proposals stand out as especially ambitious. One is a series of Treasury Department white papers (the Treasury Reports), which have been produced pursuant to an executive order by the Trump Administration requiring federal agencies to undertake a comprehensive review of existing financial regulations.[6] The other

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[1] Roberta Romano, *Regulating in the Dark*, 1 J. FIN. PERSPS. 23, 23 (2013).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank].

[3] *See, e.g.*, Mark A. Calabria, *Dodd-Frank Law: Regulations Won't Fix What's Wrong*, CATO INST. (Dec. 6, 2011), https://www.cato.org/publications/commentary/doddfrank-law-regulations-wont-fix-whats-wrong (arguing that Dodd-Frank "ignores the underlying causes of the financial crisis while pursuing an unrelated partisan agenda").

[4] *See, e.g.,* Jacob E. Gersen, *Administrative Law Goes to Wall Street: The New Administrative Process*, 65 ADMIN. L. REV. 689, 726 (2013) (discussing the extended regulatory rulemaking process triggered by Dodd-Frank).

[5] *See* William C. Dudley, President & Chief Exec. Officer, Fed. Reserve Bank N.Y., Principles for Financial Regulatory Reform, Remarks at the Princeton Club of New York 2 (Apr. 7, 2017), https://www.bis.org/review/r170421d.pdf (stating that only as of 2017 "can [we] begin to evaluate" the Dodd-Frank Act). The Dodd-Frank Act requires federal agencies to promulgate 390 distinct regulatory rules. DAVIS POLK, DODD-FRANK PROGRESS REPORT 2 (July 19, 2016), https://www.davispolk.com/files/2016-dodd-frank-six-year-anniversary-report.pdf. According to the most recent comprehensive count, 274 of those rules have been finalized, thirty-six are still pending, and eighty have yet to be proposed. *Id.*

[6] Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017); *see also, e.g.*, U.S. DEP'T OF TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: CAPITAL

is a six-hundred page legislative rollback of Dodd-Frank, known as the Financial CHOICE Act (the CHOICE Act), which was passed by the House of Representatives in June 2017.[7] Both the Treasury Reports and the CHOICE Act reflect a wholesale rethink of regulatory philosophy rather than technical fixes to particular policies. And both are seen as making good on longstanding critiques that the Dodd-Frank Act is too complex, is too burdensome on the financial sector, and grants too much discretion to regulators.[8] It is therefore urgent to examine how these competing visions for the future of financial regulation measure up in light of first principles of regulatory design. Otherwise, there is a risk of deregulating in the dark.

This Article takes up that task. It argues that the fundamental policy questions which are once again on the table in financial regulation cannot be resolved without developing a more coherent account of the role of "regulatory overlap"—the joint use of multiple legal rules to address a single underlying market failure. Although references to the general notion of overlapping rules are easy to find, the term rarely enters the policy discourse in a coherent way and has received limited attention at a conceptual level in the legal scholarship.[9] Properly understood, however, overlap represents a

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MARKETS 3 (Oct. 2017) [hereinafter TREASURY CAP. MKTS. REP.] (explaining that the report was prepared "in response to that Executive Order"); U.S. DEP'T OF TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 3 (June 2017) [hereinafter TREASURY BANK'G REP.] (introducing the report and explaining its purpose).

[7] Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017). While the CHOICE Act ultimately foundered once under deliberation in the Senate, another statute was enacted in 2018—the Economic Growth, Regulation Relief, and Consumer Protection Act—which largely reflects a similar deregulatory agenda. Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, § 401(e), 132 Stat. 1296 (2018).

[8] *See, e.g.*, Letter from Mark J. Costa, Smart Regulation Comm. Chair, Bus. Roundtable, to Gary D. Cohn, Dir., Nat'l Econ. Council (Feb. 22, 2017), https://s3.amazonaws.com/brt.org/archive/Regulations%20of%20Concern%20Letter%20and%20List%20170222.pdf (arguing that the current framework for financial regulation is "burdensome"); Thomas M. Hoenig, Vice Chairman, Fed. Deposit Ins. Corp., A Market-Based Proposal for Regulatory Relief and Accountability, Remarks at the Institute of International Bankers Annual Washington Conference (Mar. 13, 2017), https://www.fdic.gov/news/news/speeches/spmar1317.pdf ("While well intended, [Dodd-Frank's] many and complicated regulations are burdensome for all banks . . . ."); Press Release, Sen. Elizabeth Warren, Senators Warren, McCain, Cantwell and King Introduce 21st Century Glass-Steagall Act (Apr. 6, 2017), https://www.warren.senate.gov/newsroom/press-releases/senators-warren-mccain-cantwell-and-king-introduce-21st-century-glass-steagall-act (criticizing the "thousands of pages of misguided and burdensome regulations imposed by Dodd-Frank").

[9] The closest precedent to this Article's theory of regulatory overlap is the framework applied in law-and-economics scholarship on the joint use of liability and safety regulations.

distinct dimension of regulatory design that can be distinguished from the separate concerns over regulatory discretion, intensity, and complexity with which it is often conflated.[10] These descriptive distinctions matter because the presence of overlap introduces novel normative considerations as well.[11] The unique complication that arises when evaluating overlapping rules is that they cannot be analyzed in isolation, since whether they function well or not depends on how they interact.[12] In law-and-economics terms, regulations that serve as substitutes become less effective if they are used in conjunction, while rules that act as complements generate efficiencies when they are jointly applied.[13]

The interdependence between overlapping rules raises issues that have been neglected by both sides of the debate over the appropriate structure of financial regulation.[14] For reformist proponents of streamlined deregulation, the standard move of condemning overlapping rules as duplicative or redundant skips a step.[15] Such a conclusion does not follow unless it is first established that the regulations act as substitutes; when overlapping rules are complements, they create efficiencies, not redundancies.[16] Meanwhile, advocates of the more multi-faceted interventionist status quo put in place since the financial crisis run into trouble as well.[17] While it is usually safe to assume that a regulation can be justified with a credible showing that it will further some legitimate policy goal, that assumption does not hold where there is overlap.[18] Implementing a rule that provides net benefits when viewed on its

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See generally Charles D. Kolstad, Thomas S. Ulen & Gary V. Johnson, *Ex Post Liability for Harm vs. Ex Ante Safety Regulation: Substitutes or Complements?*, 80 AM. ECON. REV. 888 (1990) (using the logic of substitutes and compliments to analyze pairs of safety regulations); Patrick W. Schmitz, *On the Joint Use of Liability and Safety Regulation*, 20 INT'L REV. L. & ECON. 371 (2000) (same); Steven Shavell, *A Model of the Optimal Use of Liability and Safety Regulation*, 15 RAND J. ECON. 271 (1984) (same); Steven Shavell, *Liability for Harm Versus Regulation of Safety*, 13 J. LEGAL STUD. 357 (1984) [hereinafter Shavell, *Liability for Harm*] (same).

[10] *See infra* Section II.A.
[11] *See infra* Section II.A.1.
[12] *See infra* Section II.B.
[13] *See infra* Section II.B.
[14] *See infra* Part III.
[15] *See infra* Part III.
[16] *See infra* Part III.
[17] *See infra* Part III.
[18] *See infra* Section II.B.

own will not improve the regulatory framework if a side effect of doing so is to crowd out reliance on another rule that is a superior substitute.[19] The failure to confront these dilemmas is a critical oversight because—despite endless sparring over the need to come down harder on Wall Street or rein in the discretion of unaccountable regulators—what is really at stake are two starkly divergent views about the optimal degree of regulatory overlap.[20]

As support for these claims, this Article presents case studies on the role of overlapping rules in connection with the twin pillars of financial regulation: capital adequacy requirements, which attempt to prevent banks from failing, and resolution authority procedures, which seek to minimize the economic fallout when they do.[21] Capital requirements are a microcosm of the larger legal landscape. On one hand, the Dodd-Frank Act's gamut of loss absorbers, stress tests, and capital buffers has escalated the scale of regulatory overlap past any conceivably useful limits. On the other hand, the CHOICE Act's signature "Off-Ramp" mechanism goes too far in stripping that overlap away and reduces all of capital regulation to a single rule. By contrast, this Article's analysis suggests that a well-functioning legal framework could consist of no greater or fewer than an overlapping trio of regulations: a leverage ratio, a risk-weighted asset requirement, and a liquidity rule. The second case study shows how the same extremes can be avoided in the bank resolution context by maintaining a limited but prominent role for one of the most controversial regulatory innovations to come out of the financial crisis: Dodd-Frank's mandate that banks develop resolution planning strategies known as "Living Wills."[22] Aside from these particular policy takeaways, the case studies also provide insight into how the many moving parts of the regulatory architecture relate as a whole, with lessons for the big picture problems of systemic risk and financial institutions that are Too Big To Fail.

Ultimately, this Article asks a very basic question that appears across every area of the law: when is it better to use two (or more) rules rather than one? This is the problem of overlap, and despite

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19 *See infra* Section III.B.

20 *See infra* Part III.

21 *See* Dudley, *supra* note 5, at 1 (referring to capital requirements and resolution authority as among the most important things an "effective regulatory regime" must do).

22 Dodd-Frank, *supra* note 2, § 165(d).

constantly being resolved one way or another as a practical matter, it is hardly ever examined on its own terms. A close look at how overlapping rules work in the financial system therefore provides an ideal platform for exploring the dilemmas that they raise for the regulatory process in general. Specifically, it points to some under-appreciated limitations of cost-benefit analysis procedures and models of policymaking under uncertainty, where it is standard to assume away the possibility of regulatory overlap at the outset.[23] It also sheds light on scenarios where regulatory authority is shared by multiple decisionmakers, which can be seen as a case of overlapping jurisdictional rules. The unifying thread that runs through each of these issues is that all three concern core governance challenges in financial regulation that also define the modern administrative state as a whole.[24]

As the discussion of these broader lessons makes clear, this Article's contribution to the law literature operates on a few related levels. The most immediate goal is to address a number of substantive policy questions in financial regulation, which in many respects are timeless but have also become quite timely over the past year. At a more theoretical level, it adds to the law-and-economics literature on the optimal design of legal rules, where a distinct framework for analyzing overlapping rules is conspicuously absent.[25] And lastly, by extending the overlap concept

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[23] *See infra* Sections VI.A–B.

[24] In contrast to administrative law scholarship on cost-benefit analysis and policymaking uncertainty, which generally avoids the question of overlap altogether, there is growing literature on overlapping congressional delegations to administrative agencies. *See, e.g.*, Daniel A. Farber & Anne Joseph O'Connell, *Agencies as Adversaries*, 105 CALIF. L. REV. 1375 (2017); Jody Freeman & Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131 (2012); Jacob E. Gersen, *Overlapping and Underlapping Jurisdiction in Administrative Law*, 2006 SUP. CT. REV. 201 (2006); Jennifer Nou, *Intra-Agency Coordination*, 129 HARV. L. REV. 421 (2015); Daphna Renan, *Pooling Powers*, 115 COLUM. L. REV. 211 (2015). While the administrative law research usually views the joint use of multiple regulators as an idiosyncratic problem of agency jurisdiction, this Article fits that practice into a more general theory of overlapping legal rules. *See infra* Section VI.C.

[25] Research in this area examines properties of legal rules that carry across particular substantive areas—the most famous example being the tradeoff between laws that are formulated as "rules versus standards." *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992) [hereinafter Kaplow, *Rules*]; *see also* Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65 (1983); Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Louis Kaplow, *A Model of the Optimal Complexity of Legal Rules*, 11 J.L. ECON. &

beyond finance to wider aspects of the regulatory process, this Article helps bridge the divide between administrative law and financial regulation, two fields that are closely connected on both historical and institutional levels yet have only recently begun to receive scholarly attention in conjunction.[26]

The discussion below is organized as follows. Part II introduces a framework for analyzing overlapping legal rules. Part III previews the policy implications of that framework for the reform of financial regulation. Part IV presents the case study on capital adequacy rules, while Part V provides the case study on resolution authority. Part VI shows how this Article's analysis of overlapping rules in financial regulation extends to problems of administrative policymaking more generally. Part VII briefly concludes.

II. OVERLAPPING LEGAL RULES & REGULATORY DESIGN

This Part provides a general theory of regulatory overlap. Section A develops a descriptive account of overlap by providing a working definition and distinguishing it from related concepts. Section B outlines a normative framework for analyzing overlap, which identifies the tradeoffs that determine whether the use of overlapping rules makes sense as a policy matter.

A. POSITIVE ASPECTS OF OVERLAP

1. Defining Regulatory Overlap.

As used in this Article, "regulatory overlap" refers to situations where multiple legal rules are jointly applied to the same set of conduct to correct the same market failure. This definition is useful

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ORG. 150 (1995) [hereinafter Kaplow, *Complexity*]. Of the three leading law-and-economics textbooks, direct reference to the concept of regulatory substitutes or complements appears only once and in passing. *See* ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 184 (6th ed. 2012) (explaining the distinction between substitutes and complements in a footnote); RICHARD A. POSNER, ECONOMIC ANALYSIS OF THE LAW (9th ed. 2014) (no mention); STEVEN SHAVELL, FOUNDATIONS OF ECONOMICS ANALYSIS OF LAW (2004) (no mention).

[26] On the existence of this divide, see Robert B. Ahdieh, *Notes from the Border: Writing Across the Administrative Law/Financial Regulation Divide*, 66 J. LEGAL EDUC. 64 (2016); Gillian E. Metzger, *Through the Looking Glass: The Evolving Relationship Between Administrative Law and Financial Regulation*, 78 LAW & CONTEMP. PROBS. 129, 129 (2015). For some recent articles that work across both areas, see Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463 (2009); Gersen, *supra* note 4; Matthew C. Turk, *Regulation by Settlement*, 66 KANSAS L. REV. 259 (2017).

for two reasons. On one hand, it makes the overlap concept flexible enough to be a property of legal rules in general. On the other hand, it can be interpreted narrowly to isolate the features of overlap that distinguish it from other dimensions of regulatory design.

The most straightforward case of overlapping rules involves substantive standards which define the scope of legally permissible conduct.[27] One example of this form of overlap that has received extensive scrutiny appears in law-and-economics scholarship on the regulation of accidents, which examines the joint use of safety requirements (such as a speed limit) and liability rules (for example, a negligence standard for drivers who are at-fault).[28] The joint use of multiple substantive policy interventions is not exclusive to the pairing of regulatory mandates with liability principles—most jurisdictions impose overlapping requirements that drivers maintain operational headlights and also avoid being intoxicated, neither of which are liability standards. Nor is overlap limited to the problem of safety regulation, and further illustrations can be drawn from nearly every area of the law.

Although the definition used here means that any kind of legal rule can overlap, it is also consistent with two limiting conditions that exclude many broader uses of the term. First, the requirement that both rules must intersect with respect to a particular course of conduct eliminates cases of regulatory "market division," where multiple rules address the same general policy problem but do so with respect to discrete groups of regulated parties.[29] Second, the

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[27] Second-order rules that influence the content of substantive legal requirements can also overlap. For example, rules that specify which enforcement mechanisms are available in response to violations of an underlying substantive rule. *See* Shavell, *Liability for Harm*, *supra* note 9, at 373–74 (noting the joint availability of different enforcement penalties, such as fines and injunctions). Another variety of second-order overlap involves the joint use of jurisdictional rules, where authority to determine the content of substantive policy is granted to multiple decisionmakers. *See infra* Part VI (discussing jurisdictional overlap).

[28] In that context, the relevant externality arises from the fact that the decision to engage in economic activity introduces risks to third parties, particularly in circumstances where there is no contractual relationship that could require the party who benefits from the activity to take those risks into account. *See supra* note 9 (citing this literature).

[29] The allocation of antitrust enforcement often follows this market division principle. Depending on the industry in question, the review of horizontal mergers is performed by either the Department of Justice or the Federal Trade Commission, but almost never both. *See* Joseph P. Bauer, *Reflections on the Manifold Means of Enforcing the Antitrust Laws: Too Much, Too Little, or Just Right?*, 16 LOY. CONSUMER L. REV. 303, 320 n.74 (2003). Other examples of parallel sets of rules that do not overlap because they apply to different

condition that rules jointly address a relatively well-defined market failure prevents the identification of overlap with the general thicket of the regulatory state (where a given firm or individual is inevitably subject to multiple rules at all times). A narrow application of the market failure criterion also means that overlap does not necessarily occur whenever multiple rules operate within the same overarching policy space.[30] The purpose of these limitations is not to split hairs, but instead to zero in on cases where pairs of legal rules are most likely to interact with each other in some non-trivial way.

In discussions of financial regulation, legal rules are often described as "overlapping," "duplicative," or "redundant," but those modifiers are rarely given explicit definitions or distinguished from one another.[31] An interesting exception, cited in the Trump Administration's Treasury Department Reports, appears in a study by the Government Accountability Office (GAO) from 2016.[32] The GAO study states that overlap exists "when multiple agencies or programs have similar goals, engage in similar activity or strategies

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populations would be the geographic division of federal courts into twelve circuits, as well as the internal affairs doctrine in state corporate law. Taking the joint use condition literally also eliminates many other cases, where a menu of regulations is potentially available, but a higher-level priority rule ensures that only one is ultimately applied. Examples of such priority rules are ubiquitous in the law and include federal preemption principles, the dormant Commerce Clause, choice-of-law procedures, and adjudicative doctrines like *res judicata*.

[30] This is arguably the standard definition used in administrative law scholarship on overlap in agency jurisdiction. *See, e.g.*, Gersen, *supra* note 24, at 206 (defining overlap as a case where the jurisdiction of multiple agencies intersects in a common "policy space"); *see also* Gersen, *supra* note 4, at 710 (interpreting "policy space" in broad terms so that financial regulators have overlapping jurisdiction with respect to nearly all aspects of the Dodd-Frank Act). A further restriction of this Article's definition of overlap is that it does not occur when different rules are affected by spillovers *across policy spaces* that are otherwise clearly distinct. *See, e.g.*, Stephen Choi & Andrew Guzman, *Portable Reciprocity: Rethinking the Global Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 935–36 (1997) (discussing the overlap between a country's securities regulation and its "criminal, corporate, and antitrust laws").

[31] *See* Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 312(a)(9) (2017) (requiring that agencies conduct an "assessment of the extent to which [regulations are issued by financial] authorities with overlapping jurisdiction"); TREASURY BANK'G REP., *supra* note 6, at 10 ("Treasury's recommendations seek to right-size financial regulation and remove unnecessary regulatory duplication and overlap."); TREASURY CAP. MKTS. REP., *supra* note 6, at 175 (discussing the need to address the "[r]egulatory fragmentation, overlap, and duplication").

[32] *See generally* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-175, FINANCIAL REGULATION: COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS (2016).

to achieve them, or target similar beneficiaries."[33] This definition's identification of overlap with any similarities that appear across the regulatory landscape means that it would potentially cover all of the over-inclusive uses listed above, and is no more precise than more casual uses of the term. For that reason, it is also indicative of the ambiguity that accompanies discussions of overlap in the current reform debate in financial regulation.

Vague invocations of overlap are problematic because they often blur the concept together with other dimensions of regulatory structure and thereby threaten to send the policy debate into incoherence before it has even begun. This is an issue for financial regulation in particular, where specific policy prescriptions are often derived in light of more fundamental aspects of regulatory design. The most central of those design variables turn on tradeoffs over: (1) how restrictive rules are made to be; (2) the choice between rules versus standards; and (3) the choice between simple versus complex rules. Accordingly, the best way to get a handle on what is unique about overlapping regulations is through a brief comparison to the way those three issues are framed in the law-and-economics of legal rules and incorporated into debates on financial regulation.

2. The Degree of Regulatory Intensity.

All legal rules can be described in terms of how they vary in intensity, meaning that some rules impose more compliance costs on regulated parties than others.[34] While the relative strictness of legal requirements is a major topic in most areas of the law, it is a particular fixation in financial regulation, where a focus on the intensity variable is often taken to reductive extremes. A hallmark of the policy commentary is to define entire historical eras along the single dimension of intensity, with the analysis then framed in

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[33] *Id.* at 7.

[34] Compliance costs should be understood broadly, as the total amount of time, resources, and foregone opportunities that a regulated party loses due to the presence of a rule compared to a counterfactual scenario where it is absent. *See* Maciej H. Kotowski, David A. Weisbach & Richard J. Zeckhauser, *Rules and Standards When Compliance Costs Are Private Information*, 43 J. LEGAL STUD. S297, S298 (2014) (considering the implications of rules versus standards with respect to the private compliance costs of regulated parties); *cf.* Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253, 255–57 (2007) (studying the ways the varying levels of enforcement can function as a component of the intensity variable).

terms of whether there should be more or less "regulation."[35] That characteristic mode of thinking was on display after the financial crisis, which was widely seen as the outcome of several decades of misguided deregulation. The Dodd-Frank Act was inspired by the same narrative of deregulation run amok and conceived as a shift toward more intensive regulation of the financial industry.[36]

Conversely, the CHOICE Act and the Treasury Reports are animated by a set of critiques which argue that the current framework has become too burdensome and that the degree of intensity must be ratcheted back down.[37] When skeptics of Dodd-Frank note its widespread use of overlapping rules in the same context, that observation is typically meant to restate the original complaint about excessive regulatory intensity.[38] But the issues are distinct. Although there may be some *ceteris paribus* correlation between intensity and overlap (in the sense that complying with multiple rules is, all else equal, harder to do than complying with one), that correlation is weak. In practice, a pair of overlapping rules that are each light-touch may often be less intensive in the aggregate than a single stringent rule.[39] A consequence is that a strong prior commitment to the need for either deregulation or re-regulation of the financial industry does not provide much guidance when thinking through the proper scope of overlap.

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[35] *See* Paul Mahoney, *Deregulation and the Subprime Crisis*, 103 VA. L. REV. 235, 236–40 (2017) (diagnosing this tendency).

[36] *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT xviii (2011) [hereinafter FCIC REPORT] (attributing the financial crisis to "[m]ore than 30 years of deregulation" that "stripped away key safeguards, which could have helped avoid catastrophe"); RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION xii (2009) ("The movement to deregulate the financial industry went too far . . . ."); Barack Obama, *The Second Presidential Debate*, N.Y. TIMES (Oct. 7, 2008), https://www.nytimes.com/elections/2008/president/debates/transcripts/second-presidential-debate.html ("Let's, first of all, understand that the biggest problem in this whole process was the deregulation of the financial system.").

[37] *See supra* note 8 (quoting some prominent statements to this effect).

[38] *See, e.g.*, TREASURY BANK'G REP., *supra* note 6, at 6 (noting the regulatory intensity of Dodd-Frank); MATTHEW P. RICHARDSON ET AL., REGULATING WALL STREET: CHOICE ACT VS. DODD-FRANK 4 (2017).

[39] Compare two scenarios: (a) a single highway traffic rule that sets a thirty miles per hour speed limit, and (b) overlapping rules, which consist of a seventy-five miles per hour speed limit with the requirement that drivers must signal before changing lanes. Traffic regulation is more intensive in Scenario A, even when all of the rules in Scenario B are combined.

3. Rules Versus Standards.

Another basic question of regulatory design turns on whether a law is formulated as a "rule" or a "standard." Technically, this terminology is meant to make a temporal distinction.[40] A regulation functions as a "rule" when the policymaker invests in determining its content *ex ante*, before the conduct at issue has taken place; when the bulk of a law's content is specified *ex post*, it works as a "standard."[41] The descriptive distinction between rules and standards has normative implications because rules provide more predictability for regulated parties while standards allow regulators greater flexibility to exercise discretion.[42]

Despite the fact that predictability and discretion both can be virtues, depending on the circumstances, policy debates in financial regulation are often organized around a strong preference for one over the other.[43] A common source of dissatisfaction with the Dodd-Frank Act is the perception that it swings the legal pendulum too far toward regulatory discretion, and an explicit goal of the leading reform proposals is to reduce the role of *ex post* standards in financial regulation.[44] Discretionary standards tend to share a

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[40] A common misconception is that the rules versus standards terminology refers to the degree of linguistic specificity a law articulates, where the assumption is that rules are associated with precise language while standards are stated at a higher level of generality. That is not the case. Kaplow, *Rules*, *supra* note 25, at 560. Another misconception is that the distinction tracks particular institutions, with legislatures producing rules and courts producing standards. *See id.* However, agencies frequently promulgate regulations that function as standards and when courts develop precedents, they are producing rules. *See id.*

[41] *Id.* A law that prohibits drivers from exceeding a fifty-five miles per hour speed limit would be a rule in this sense, while a requirement that certain drivers yield to others is closer to a standard. *Id.* at 565. Securities law provides another set of examples: *ex ante* registration requirements for broker-dealers are rules, while the Rule 10b-5 prohibition against securities fraud is a classic standard. *Compare* 15 U.S.C. § 78c (4), (5) (2018) (registration rules), *with id.* § 78j, *and* 17 C.F.R. § 240.10b-5 (2019); *see also* Kaplow, *Rules*, *supra* note 25, at 618 (associating the regulation of fraud with standards).

[42] *See* Ehrlich & Posner, *supra* note 25, at 265 (discussing the greater predictability of rules); Kaplow, *Rules*, *supra* note 25, at 597–98, 608–11 (same); Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1179 (1989) (same).

[43] *See generally* Prasad Krishnamurthy, *Rules, Standards, and Complexity in Capital Regulation*, 43 J. LEGAL STUD. S273 (2014) (discussing the tradeoffs between rules and standards in financial regulation).

[44] *See, e.g.*, DAVID A. SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 9 (2010) (criticizing Dodd-Frank for "enshrin[ing] a system of ad hoc interventions by regulators that are divorced from basic rule-of-law constraints"); Hester Peirce, *Revisiting Dodd-Frank* 4 (Mercatus Ctr., Working Paper, Feb. 2017), https://www.mercatus.org/system/files/peirce-revisiting-dodd-frank-

negative association with regulatory overlap in these accounts, mainly based on a sense that Dodd-Frank is filled with duplicative mandates that give agencies latitude to intervene in any corner of the financial system at any given time.[45] There is really no direct logical linkage between the two, however. The degree of overlap is independent of whether laws are articulated as rules or standards, and overlapping regulations may consist of rules, standards, or a combination of both.[46]

4. Simple Versus Complex Rules.

A third foundational distinction drawn in the law-and-economics of legal rules categorizes regulations as relatively "simple" or "complex." The degree of complexity that characterizes a legal rule turns on the number of factors which must be taken into account to determine how it applies to a particular course of conduct.[47] Unlike the rules versus standards tradeoff, complexity is about the information costs associated with sorting states of the world into relatively fine or coarse categories rather than a timing issue of *when* that sorting process is undertaken by the policymaker.[48]

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primer-v1.pdf (describing Dodd-Frank as "a sprawling law" that "favors regulatory discretion over market-based regulation").

[45] *See* H. COMM. ON FINANCIAL SERV., 115TH CONG., REP. ON THE FINANCIAL CHOICE ACT 3, 13, 40 (Apr. 24, 2017) [hereinafter HOUSE CHOICE ACT REP.]; TREASURY BANK'G REP., *supra* note 6, at 88–92 (recognizing that Dodd-Frank grants agencies with duplicative authority and proposing greater limits on regulatory).

[46] *See* discussion *infra* Parts IV–V.

[47] *See* Kaplow, *Complexity*, *supra* note 25, at 161 ("[M]uch complexity . . . arises because of the benefits from rules that are more precisely tailored to particular behavior."); *see also* Vincy Fon & Francesco Parisi, *On the Optimal Specificity of Legal Rules*, 3 J. INST. ECON. 147, 149 (2007) (discussing the interrelation between specificity and complexity and noting that "[w]hen legislators choose between rules and standards, they must consider when, and at what cost, the rules and standards should be applied to specific situations"). The federal tax code is an example because it is highly complex due to the endless distinctions it makes among the sources and varieties of income. *See* Kaplow, *Rules*, *supra* note 25, at 566 ("It hardly seems plausible that [the federal income tax,] a standard requiring individuals to pay 'their appropriate share of the federal government's revenue needs,' . . . would generate a more detailed law . . . than the one embodied in the Internal Revenue Code and its accompanying regulations."). Another good illustration of complexity is provided by disclosure rules in the securities laws. *See* Frank H. Easterbrook & Daniel Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 669 (1984) (discussing the complexity of the distinctions that the SEC makes among firms and categories of information).

[48] Rules are often identified with simplistic mandates and standards are identified with complex, all-things-considered judgements, but there can be complex rules and simple standards. *See* Kaplow, *Rules*, *supra* note 25, at 565 ("[B]oth rules and standards can in fact be quite simple or highly detailed in their operation."); *see also id.* at 566 (providing some

The "complexity" of financial regulation is a constant theme that only occasionally maps onto this narrower information-cost sense of the term.[49] Regardless of the particular usage at issue, a common denominator in critiques of Dodd-Frank is that the statute represents an unjustifiable rise in regulatory complexity.[50] When the CHOICE Act or the Treasury Reports are promised as correctives to runaway complexity, the issue of overlap is almost always considered synonymous with the same problem—or as a dysfunctional side effect that accompanies it in mechanical fashion.[51] This obscures the limited correspondence between those concepts. Complexity and overlap cannot be lumped together outside of another crude syllogism: overlap implies the presence of at least two rules, and two of anything is more complicated than one. Since the amount of regulatory complexity introduced by a single precise rule can exceed that of many simple overlapping rules, that is where the relationship ends.[52]

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examples such as speed limits and the federal income tax); Diver, *supra* note 25, at 69 (illustrating the same misconception); Krishnamurthy, *supra* note 43, at S274–75 (same).

[49] The tradeoff between simple and complex rules is often mixed together with the issue of rules versus standards. To the extent that claims about complexity mean to say that banks must comply with a large and intimidating body of legal requirements, which is also frequently the case, they are interchangeable with statements about regulatory intensity. Another common expression is to describe the modern financial system itself as complex, which is more a statement about how those markets work than about the policies which regulate them. *See, e.g.*, Dan Awrey, *Complexity, Innovation, and the Regulation of Modern Financial Markets*, 2 HARV. BUS. L. REV. 235, 238 (2012) (discussing complexity in the context of modern financial markets and financial innovation); Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH U. L. REV. 211, 211 (2009) (reviewing the "complexities of modern financial markets and investment securities" as opposed to regulatory intensity).

[50] *See, e.g.*, RICHARDSON ET AL., *supra* note 38, at 11 ("The scope of Dodd-Frank is vast . . . . The resulting increase in regulatory complexity, compliance costs for financial institutions and coordination costs for the regulators has, not surprisingly, led to a backlash against the[se] excesses . . . .").

[51] *See supra* note 31 and accompanying text.

[52] Consider traffic regulation in two jurisdictions. Jurisdiction A has three overlapping rules, which require all drivers to: (1) follow a fifty-five miles per hour speed limit; (2) be at least sixteen years of age; and (3) carry insurance. Jurisdiction B has one rule, which provides that drivers must use their vehicles safely given the relevant weather conditions. It is plausible that the information costs facing policymakers in Jurisdiction B are greater.

B. NORMATIVE ASPECTS OF OVERLAP

An upshot of the preceding analysis is that a pair of overlapping rules can be simple, predictable, and light-touch just as easily as they are complex, discretionary, and burdensome. Sorting through the dimensions of regulatory design in this manner is more than a semantic exercise. There are real consequences for policy because the questions that must be asked to determine the optimal intensity, timing, and complexity of legal rules are all different from one another as well as those posed by overlap. As mentioned, the central consideration at issue with overlapping rules is their potential to interact in a way that renders each rule more or less effective when applied jointly rather than in isolation.[53] That regulations can influence one another may sound like a mundane or self-evident observation. But as the discussion below explains, a closer look at the interdependence between legal rules proves to be a classic case for the adage that "[t]he simplest things are often the most complicated to understand fully."[54]

1. Background Concepts.

A standard set of categories for analyzing overlapping rules already exists and relies on a distinction between regulatory substitutes and regulatory complements.[55] When those terms come up in public policy discussions, they are typically meant as allusions that borrow from the microeconomic analysis of consumer demand.[56] There, the textbook exposition of substitutes and complements revolves around what is known as the cross-price elasticity of demand between different pairs of goods.[57] Good A and Good B are substitutes if a decrease in the price of A leads a

[53] *See supra* Section II.A (discussing the positive aspects of overlap).

[54] Paul A. Samuelson, *Complementarity: An Essay on the 40th Anniversary of the Hicks-Allen Revolution in Demand Theory*, 12 J. ECON. LITERATURE 1255, 1255 (1974).

[55] *See* Troy A. Paredes, Comm'r, Sec. & Exch. Comm'n, Corporate Governance and the New Financial Regulation: Complements or Substitutes?, Speech at Transatlantic Corp. Governance Dialogue (Oct. 15, 2010) (discussing substitutes and regulatory complements to describe overlapping rules).

[56] For a standard textbook treatment of the concepts summarized below, see HAL R. VARIAN, INTERMEDIATE MICROECONOMICS: A MODERN APPROACH 73–89 (8th ed. 2010).

[57] *See* WALTER NICHOLSON & CHRISTOPHER SNYDER, MICROECONOMIC THEORY 183–88 (10th ed. 2004) (presenting the mathematical background of cross-price elasticities); Steve Berry et al., *Structural Models of Complementary Choices*, 25 MARKETING LETTERS 245, 247 (2014) (referring to cross-price elasticities as the "textbook" methodology to determine complements). For an intellectual history, see generally Samuelson, *supra* note 54.

consumer to purchase more of A and less of B.[58] Goods are complements when a decrease in the price of A leads to increased consumption of both A and B.[59] "Independent goods" represent a third category, where demand for Good A is unrelated to a change in the price of Good B.[60] The Cuba Libre cocktail provides a convenient illustration of all three relationships. The rum and coke are complements. Competing brands of each ingredient, such as Coca-Cola and Pepsi, are perfect substitutes.[61] The watch that you wear while drinking is an independent good.

Unfortunately, the textbook definition of substitutes and complements glosses over many important complications,[62] even in the original context of consumer demand.[63] Translating the two concepts into a format that is meaningful for policy analysis

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[58] *See, e.g.*, Allan D. Shocker et al., *Product Complements and Substitutes in the Real World: The Relevance of "Other Products,"* 68 J. MARKETING 28, 28 (2004) ("Products are considered . . . [substitutes] if . . . [raising] the price of one product leads to an increase in sales of another . . . .").

[59] *See, e.g.*, Berry et al., *supra* note 57, at 247 (describing goods as complementary when an "increase in the price of one good will result in a decrease in demand for the other").

[60] *See* Samuelson, *supra* note 54, at 1256 n.3 (describing independent goods as a "[t]hird way of defining complementarity").

[61] The substitutability of a pair of goods falls along a spectrum. Substitutes are "perfect" or "complete" if there is so much similarity between the two goods that consumption is exclusively allocated to whichever good has the lowest price. When substitutes are "partial" or "imperfect," there is enough differentiation between the goods that a consumer will have reason to choose some of both.

[62] *See* Samuelson, *supra* note 54, at 1261 (concluding that "[w]e have arrived at the finding that human beings do not, on careful examination, turn out to possess any one clear-cut notion of complementarity and substitutability").

[63] The basic textbook formulation introduces confusion by focusing on the consumer response to observable changes in price. Prices are not in fact essential to the distinction between substitutes and complements. They are only a measurement device that serves as a proxy for the underlying variable of interest, which is whether the joint consumption of different goods involves a (positive or negative) interaction between the pair that affects their *benefits*. This point is further obscured by a standard technique of econometric studies that rely on cross-price elasticities, which can only do so by applying a simplifying assumption known as "strong separability of preferences." Strong separability effectively means that no interaction between goods can ever take place. *See* Andrés Musalem, Kenneth C. Wilbur & Patricio del Sol, A Parsimonious Structural Model of Individual Demand for Multiple Related Goods 1–2 (Feb. 4, 2013) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2211820 (describing the disadvantages of additive separability); *see also* Matthew Gentzkow, *Valuing New Goods in a Model with Complementarity: Online Newspapers*, 97 AM. ECON. REV. 713, 714–16 (2007) (showing how conventional measures of substitutability give conflicting answers by assuming away the possibility of super-additive utility from joint consumption).

presents another degree of difficulty.[64] Perhaps for that reason, most references to regulatory complements or substitutes do not rise above loose metaphors.[65] That lack of precision means that they usually only provide a label for policy conclusions that have already been decided on other grounds. It therefore is worthwhile to think through how the jargon of substitutes and complements might inform questions of legal design in a more rigorous way. Although those terms most often appear in studies of people's grocery carts or newspaper bundles, the underlying logic they represent runs deep and is fundamental to any situation where multiple interdependent decisions are made.[66]

To give the notions of regulatory complements and substitutes actual substantive content, it is helpful to make some background assumptions more explicit. The ones used here are as follows. The relevant decisionmaker is a hypothetical social planner who maximizes social welfare by choosing among legal rules rather than a consumer choosing among goods. Selecting a policy rule provides benefits by correcting for the inefficiencies that accompany a particular market failure.[67] A rule improves social welfare to the

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[64] One difficulty is that little can be inferred about optimal levels of overlap by observing existing legal rules. That is because it is plausible to assume that consumers are rational utility maximizers for some purposes, but public choice considerations make it unwise to apply that same assumption to legal institutions. *See* Shavell, *Liability for Harm*, *supra* note 9, at 372 (referring to this issue as the problem of "social irrationality" in the selection of regulations).

[65] For two rare passages in the law-and-economics scholarship that attempt to clarify the meaning of regulatory complements and substitutes, see COOTER & ULEN, *supra* note 25, at 184 ("Some goods, called *complements*, are better consumed together, such as hot dogs and sauerkraut, and other goods, called *substitutes*, are better consumed separately, such as ice cream and sauerkraut."); Prasad Krishnamurthy, *Regulating Capital*, 4 HARV. BUS. L. REV. 1, 44 n.155 (2014) ("Two regulatory policies A and B are substitutes if an increase in cost of A results in an increase in the optimal use of B, and vice versa. . . . By contrast, two regulatory policies A and B are complements if an increase in the cost of A results in a decrease in the optimal use of B, and vice versa"). Besides its brevity, the main problem with Cooter and Ulen's explanation is that it is incorrect; ice cream and sauerkraut are best interpreted as independent goods, not substitutes. The formulation by Krishnamurthy is more accurate, but it is limited by an overly literal cut-and-paste of the textbook consumer demand definition (with its focus on changes in consumption patterns that are observed following a change in relative prices), which does not carry any straightforward application to questions of public policy.

[66] *Cf.* Xavier Vives, *Complementarities and Games: New Developments*, 43 J. ECON. LITERATURE 437, 437 (2005) ("At the heart of complementarity is the notion, due to Edgeworth, that the marginal value of an action or variable increases in the level of another action or variable.").

[67] In other words, the utility people get from realizing the gains from trade that were unavailable before the policy rule was adopted. *See* John H. Cochrane, *Challenges for*

extent that those benefits exceed the sum of the compliance costs imposed on regulated parties and the public administrative costs associated with implementation.[68] When legal rules do not overlap, they are equivalent to independent goods and should be chosen whenever they provide a net benefit. But in cases where the selection of multiple rules may result in regulatory overlap, the analysis cannot stop there. A further question is how to determine the optimal level of their joint use. The answer to that question depends on whether the relationship between those rules causes them to function as perfect substitutes, imperfect substitutes, or complements.

2. Regulatory Substitutes Versus Regulatory Complements.

Regulations act as perfect substitutes in two situations. One case is when a rule in the pair is always more effective than the other in correcting the market failure at issue. There, the optimal level of overlap is zero and the strictly superior member of the pair should be exclusively imposed. The other situation involves rules that are very similar to one another so that they tackle the same policy problem in nearly the same way. Rules of this kind conform to the intuition behind regulations that are considered duplicative or redundant, where the obvious policy solution is to avoid any overlap by picking one or the other but never both.[69] The common mechanism that makes zero overlap efficient in both scenarios is that, with perfect substitutes, the benefits from one rule in the pair

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Cost-Benefit Analysis of Financial Regulation, 43 J. LEGAL STUD. S63, S68 (2014) (arguing that it is sensible to frame the benefits from economic regulations in this way).

[68] Private costs track the prior definition of regulatory intensity and consist of the total value of individual activities and mutual gains from trade that were foregone as a result of a rule. *See supra* note 34 and accompanying text. This makes the costs of regulation much higher than direct expenditures on compliance services such as legal or accounting fees. *Cf.* John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882 (2015) (discussing the difficulty of accounting for the costs of regulation).

[69] An example of perfect regulatory substitutes (in the duplicative sense) can be found in the original dual structure of federal securities law. *See* John C. Coffee, Jr., *Re-Engineering Corporate Disclosure: The Coming Debate over Company Registration*, 52 WASH. & LEE L. REV. 1143, 1145–46 (1995) (describing the efficiencies that appeared when the SEC eliminated overlap by integrating the dual disclosure regime into a single set of rules, known as Regulation S-K).

completely crowd out any additional benefits that would be produced if the other rule was applied.[70]

A pair of rules will function as imperfect substitutes if they are differentiated in a way that allows them to address distinct aspects of the same problem, with the result that each member of the pair works better than the other under at least some circumstances. Two policy prescriptions follow from this relationship. First, unlike perfect substitutes, some degree of overlap is efficient for imperfect substitutes, because each rule provides a unique set of benefits that cannot be crowded out by the other. Second, the optimal joint use of imperfect substitutes requires that the intensity of each rule be reduced in proportion to the intensity of the other (and relative to a counterfactual case where it used in isolation).[71] In other words, the policy prescription is a regulatory regime that overlaps both rules but relies slightly less on each one. Since there is a wide range of market failures where it is plausible that no single rule will consistently provide the most effective solution, the need to apply a menu of imperfect regulatory substitutes is likely the predominant justification for regulatory overlap.[72]

Regulatory complements exist whenever the joint use of multiple rules causes at least one rule to yield greater benefits than it does when acting alone.[73] With complementary rules, the most efficient arrangement is a form of overlap that ratchets up the intensity of each member of the pair. This more-of-both strategy is unrelated to

[70] The underlying logic is that the externalities produced by a given course of conduct can only be internalized once. Assuming that Regulation A effectively assures that I will drive safely along a certain stretch of road, the social cost of that trip cannot be further reduced by Regulation B, because the relevant risk to third parties no longer exists. As a result of this crowding-out dynamic, the decision to jointly apply Regulation B carries no benefits, only costs.

[71] Kolstad et al., *supra* note 9, at 889; *see also* Schmitz, *supra* note 9, at 374–76 (arguing that joint use of tort liability and safety regulations is only effective when wealth varies among tortfeasors); Shavell, *Liability for Harm*, *supra* note 9, at 365 (examining *ex post* tort liability and *ex ante* safety regulations as possible solutions to the control of activities that create risks of harm to others). Shavell concluded that "neither tort liability nor regulation could uniformly dominate the other as a solution to the problem of controlling risks." *Id.* "A complete solution to the problem of the control of risk evidently should involve the joint use of liability and regulation . . . ." *Id.*

[72] An illustration of imperfect substitutes is the joint use of liability standards and safety mandates that are at issue in the law-and-economics scholarship in the regulation of accidents. A command-and-control mandate in the form of a minimum regulatory floor patches holes in the liability regime. The latter is sometimes insufficient to enforce an effective standard of care, due to the problem of judgment-proof defendants or because of absentee plaintiffs who have insufficient monetary incentive to bring suit.

[73] Kolstad et al., *supra* note 9, at 889.

the some-of-both dynamic that governs imperfect substitutes. The logic of jointly increasing marginal returns that is implied by the complementarity concept also has a slightly mysterious aspect in the policy context. In practice, it will generally require that a pair of rules play highly differentiated roles that nonetheless interlock in some subtle, mutually reinforcing way. For that reason, bona fide complementarities among overlapping regulations may be relatively scarce.[74]

The two biggest misconceptions surrounding regulatory overlap relate to the "some of both, but less of each" prescription that applies to imperfect substitutes. First, the some-of-both principle gets lost due to a widespread assumption that the joint use of substitutes is never efficient, which wrongly suggests that overlap only makes sense where a complementarity exists between a pair of rules.[75] That has things exactly backwards, since situations that call for overlapping regulations skew heavily toward the joint use of imperfect substitutes. It also means that imperfect regulatory substitutes are constantly mischaracterized as regulatory complements. Second, a failure to appreciate the less-of-each caveat often causes overlap to be wrongly associated with a more onerous regulatory regime. Proposals for greater regulatory overlap should only be identified with a corresponding increase in regulatory

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[74] In fact, there is probably only one well-established example of complementary financial regulations, which involves the relationship between bank supervision and deposit insurance. *See generally* Emmanuel Farhi & Jean Tirole, *Shadow Banking and the Four Pillars of Traditional Financial Intermediation* (Nat'l Bureau of Econ. Research, Working Paper No. 23930, Oct. 2017), http://www.nber.org/papers/w23930 (demonstrating the deposit insurance-supervision complementarity); Matthew C. Turk, *The Banking-Sovereign Nexus: Law, Economics & Policy*, 55 COLUM. J. TRANSNAT'L L. 592 (2017) (showing how a similar complementarity exists for international financial regulations). There, a more-of-both policy is sensible because extending public insurance on deposits encourages banks to make riskier loans, which in turn increases the need to ensure that they are carefully monitored by bank examiners.

[75] This misunderstanding can be traced back to the original law-and-economics literature on the joint use of rules. *See* Kolstad et al., *supra* note 9, at 888 (exemplifying how the issue exists in a publication dating back to the late twentieth century). The research question there was framed in terms of whether a complementarity could be discovered between *ex post* liability principles and *ex ante* safety mandates that would justify their joint use. *Id.* An implication was that overlapping the two regulations was otherwise inefficient—a notion equivalent to saying that it is irrational to ever own both coffee and tea because they are not complements. For another example of how this paradigm exists in earlier literature, see Schmitz, *supra* note 9, at 371 (revisiting the joint use of *ex post* liability and *ex ante* safety regulation.

intensity in the outlier case where the rules at issue are complements.

III. Implications for the Reform of Financial Regulation

The parade of abstractions outlined above will become more concrete when they are applied to capital requirements and resolution procedures in the case studies that follow. Those discussions each rehearse the same overall critique, however, which can be spelled out at a high level now. The argument is that both the Dodd-Frank status quo and the recent reform proposals back themselves into extreme positions on the role that overlap should play in the regulatory structure. Because those positions involve some implausible assumptions about the way the overlapping legal rules work, they are unlikely to hold up across a wide range of cases. And once the confusions relating to overlap are made clear, the broader policy justifications that underpin those competing perspectives unravel as well.

A premise of policymaking following the crisis was that gaps had been exposed in nearly every corner of the existing regulatory regime.[76] In response, the Dodd-Frank Act adopted a strategy that "threw the proverbial kitchen sink at the financial system,"[77] with statutory provisions that directed federal financial agencies to promulgate nearly four hundred regulations, most of which eventually were finalized in final administrative rules that themselves span hundreds of pages and contain dozens of discrete legal commands.[78] Parsing out how each particular rule targeted a specific dysfunction in financial markets was not a central part of the process.[79] In general, the Dodd-Frank regulations were seen as converging on a common, overarching goal—such as protecting Main Street from Wall Street or safeguarding the stability of the financial system.[80] The result, in which an endless number of rules

[76] The congressional report that followed upon the passage of Dodd-Frank claimed to have "identified ten causes that are essential to explaining the crisis," an inauspicious starting point from a diagnostic perspective. *See* FCIC REPORT, *supra* note 36, at 413.

[77] RICHARDSON ET AL., *supra* note 38, at 4; *see also* Cochrane, *supra* note 67, at S70 (referring to Dodd-Frank's philosophy of "all of the above and more").

[78] *See generally* POLK, *supra* note 5 (tracking the rulemaking process).

[79] *Id.*

[80] This is not a matter of political sloganeering. Even when framed in technical cost-benefit analysis terms, the benefits of Dodd-Frank's regulations have been estimated by the extent they reduce a single homogenous harm, conceptualized as the "social cost of a financial crisis."

are brought to bear on a single policy mission, is that the current legal framework is structured around a commitment to maximal regulatory overlap.[81] A feature which further defines that commitment is the presumption that Dodd-Frank's network of overlapping rules all fit together well, and therefore take the form of regulatory complements.[82]

Skeptics of the Dodd-Frank Act framework have in effect arrived at the polar opposite view. From the reformist's perspective, the optimal degree of regulatory overlap approaches zero, not infinity. One route to that conclusion is indirect. To the extent that overlap is seen as a byproduct of rules that are overly burdensome, complex, or discretionary, there is guilt by association.[83] Another is more direct. When the joint use of multiple rules is considered more explicitly, overlap is thought to be "duplicative" or "redundant" and therefore bad per se.[84] Translated into the framework of this Article, the skeptics claim that Dodd-Frank is inefficient because it overlaps with rules that almost always consist of perfect substitutes rather than imperfect substitutes or complements. The natural solution, which can be seen at work throughout the CHOICE Act and the Treasury Reports, is to replace any reliance on regulatory overlap with a radically streamlined structure that only applies the most effective rule in a given area.

The theory of regulatory overlap that animates Dodd-Frank is suspect on a number of grounds. There is a good prima facie reason to doubt that the statute encompasses hundreds of regulatory complements, even before looking at any particular substantive area on the merits, since genuine complementarities between legal

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Eric A. Posner & E. Glen Weyl, *Why and How the Government Should Assess the Costs and Benefits of Financial Regulations*, CTR. FOR STUDY FIN. REG., Summer 2014, at 4, https://pdfs.semanticscholar.org/0177/dcd9ec2f8788ece5cd0bef01c195c2e1fc9f.pdf; *see also* Coates, *supra* note 68, at 944 (applying the concept to the "social cost of carbon in climate change analysis").

[81] For an alternative view on the organizing principle behind Dodd-Frank, see generally Aaron M. Levine & Joshua C. Macey, Note, *Dodd-Frank Is a Pigouvian Regulation*, 127 YALE L.J. 1336, 1336 (2018) (arguing that "Dodd-Frank has had an effect analogous to that of a Pigouvian tax—what we call a 'Pigouvian regulation'").

[82] *See infra* notes 151–153 and accompanying text.

[83] *See supra* Sections II.A.2–4 (discussing regulatory intensity, discretion, and complexity).

[84] HOUSE CHOICE ACT REP., *supra* note 45, at 47, 108.

rules are rare.[85] That assumption becomes even less plausible in light of the massive uncertainties that surrounded post-crisis policymaking.[86] It is difficult to link rules together in a mutually reinforcing way when they are designed in the normal course, but nearly impossible to do so with any confidence when you are "regulating in the dark."[87] There is an irony here. While the post-crisis imperative to ratchet up the intensity of financial regulation was perfectly sensible, realizing that goal through Dodd-Frank's particular mode of endless overlap produced a collection of rules that in many instances cannot be justified.

Advocates of reforming the Dodd-Frank Act embrace a theory of overlap that is also questionable. While some market failures may be resolved by a single intervention, the joint use of multiple rules is closer to the norm in many legal areas. And in many of those cases the overlap of at least a handful of rules is defensible on the grounds that they are imperfect substitutes which serve distinct, useful functions.[88] Given the inherent complexity of global markets, along with the ability of financial engineers to constantly innovate around existing rules, banking regulation would appear to be a strong candidate for the latter category. If nothing else, the 2008 financial crisis demonstrated that the banking system imposes a set of externality problems that are not limited in scope or easy to contain. An irony arises here as well. The fundamental critique of Dodd-Frank is that the statute's elaborate Rube Goldberg design

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[85] *See supra* Section II.B.2 (discussing the difficulty of identifying regulatory complements).

[86] *See infra* Section VI.B (discussing the additional problems posed by regulatory uncertainty).

[87] *See* Romano, *supra* note 1, at 23 ("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."). An alternative justification for the overlapping rules in Dodd-Frank may be that they are imperfect substitutes. But that theory fits poorly with the statute. For one, it is incompatible with Dodd-Frank's joint use of dozens or hundreds of rules—there are quickly diminishing returns once you get past a handful of imperfect substitutes. A premise of the eighth rule must be that is solves some sliver of the externality problem that the previous seven did not, which is a heroic assumption in most cases. Furthermore, since the optimal intensity of imperfect regulatory substitutes decreases with the number of rules, the eighth rule must be extremely light-touch. That is also an awkward fit with Dodd-Frank, which was conceived as an all-around increase in "more stringent regulatory capital requirements." MORRISON & FOERSTER, THE DODD-FRANK ACT: A CHEAT SHEET 24 (2010), http://media.mofo.com/files/uploads/Images/SummaryDoddFrankAct.pdf.

[88] *See supra* Section III.B.2 (discussing imperfect regulatory substitutes).

embodies technocratic hubris at its worst.[89] But a premise of alternatives such as the CHOICE Act is that, for any given problem in finance, it is possible to whittle all available interventions down to a set of perfect substitutes and identify the single best rule of that group. This reflects a policymaking ambition that is equally far-fetched.

An immediate objection to this line of argument is that, in stylizing all of financial regulation into competing "sides," it rests on a pair of strawmen. But as the case studies aim to show, the main point of that simplification is to draw out the essential elements of each perspective rather than caricature their weakest claims. Nor are the case studies cherry-picked to conveniently fit a common narrative. Instead, they provide a template that can be used to perform a similar analysis in many other corners of post-crisis financial regulation—including Dodd-Frank's new rules for derivatives trading, mortgage lending, asset-backed securitization, or consumer protection.[90] The same conflicting views appear across those areas as well.

In one sense the disagreement about overlap is good news. That is because it involves technical issues that, to a large extent, have simply been overlooked rather than more intractable philosophical disputes over the wisdom of regulation versus deregulation, or government discretion versus rule-of-law values. Accordingly, a final purpose of the case studies is to move beyond critique by identifying some common ground for incremental changes to the current use of overlapping rules that would make financial regulation work better.

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[89] *See* HOUSE CHOICE ACT REP., *supra* note 45, at 4 ("[T]he ultimate monument to regulatory complexity and bureaucratic hubris is the Dodd-Frank Act . . . ."); *see also id.* at 10 (noting the "folly of relying upon the 'expertise' of regulators to achieve financial stability").

[90] *See generally* Joshua C. Macey, Note, *Playing Nicely: How Judges Can Improve Dodd-Frank and Foster Interagency Collaboration*, 126 YALE L.J. 806 (2017) (discussing derivatives); Matthew C. Turk, *Securitization Reform After the Crisis: Regulation by Rulemaking or Regulation by Settlement?*, 37 REV. BANKING & FIN. L. 861, 863 (2018) (discussing securitization).

IV. CASE STUDY #1: CAPITAL ADEQUACY REQUIREMENTS

Capital adequacy requirements are widely considered the cornerstone of banking regulation. Broadly construed, they consist of rules that limit the risk-profile of a bank's balance sheet by influencing the kinds of assets it may invest in or the mix of debt and equity used to fund its lending.[91] The primary goal of those rules is to avoid the economic damage that results from instability in the financial system by preventing bank failures before they occur. The spectacular series of collapses at major financial institutions over the course of 2008 exposed fundamental defects in the existing capital adequacy regime and placed the reform of those regulations at the forefront of the post-crisis policy agenda.

A. IDENTIFYING THE POLICY PROBLEM

Determining whether and how legal rules overlap requires a reasonably clear understanding of the market failure they aim to resolve. This presents some threshold issues for capital requirements, since it is not immediately obvious why they should exist at all. For firms outside of the financial system, no equivalent set of regulations applies. The rationale behind that default hands-off approach stems from a foundational insight in corporate finance, known as the Modigliani & Miller theorem (M&M).[92] Where the M&M propositions apply, the costs and benefits of all possible variations in a firm's financial structure fall exclusively on either

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[91] The Volcker Rule and similar "regulations of scope" would fall under this category as well but are omitted from the discussion to save space. Unless otherwise stated, this Article uses the labels "financial institutions" and "banks" interchangeably. The latter is a technical legal category which only covers entities that are formally chartered at the state or federal level as banks. For traditional deposit-taking banks, assets usually take the form of loans to borrowers. Demand deposits made by account-holders are liabilities of the bank and the most common kind of bank debt. *See* MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 235–36, 259–66 (2016).

[92] Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance, and the Theory of Investment*, 48 AM. ECON. REV. 261 (1958). The M&M theorem demonstrates that, under certain simplifying assumptions, the relative proportions of debt and equity that a firm uses to finance its operations are irrelevant to its overall value as a going concern. For example, if a firm takes on more leverage (i.e., relies more heavily on debt), the impact of its new financial structure is automatically offset by a change to the risk-return profile enjoyed by its shareholders and creditors. The three limiting conditions of the M&M theorem are efficient capital markets, no tax distortions, and no bankruptcy costs. *Id.*; *see also* DANIEL K. TARULLO, BANKING ON BASEL: THE FUTURE OF INTERNATIONAL FINANCIAL REGULATION 16–18 (2008).

its shareholders or creditors, and therefore do not have any impact on third parties that would warrant a regulatory intervention.[93] Capital requirements are relevant in the banking sector, however, because it is generally accepted that "financial institutions begin where the conditions for the application of the Modigliani-Miller theorem ends."[94]

The M&M propositions do not apply to banks for two reasons. First, the financial industry is organized around a complicated mix of information asymmetries and network externalities, often bundled together as the problem of systemic risk.[95] Even the prospect of a possible bank failure or a temporary period of distress can jeopardize other entities in the financial system.[96] As uncertainty spreads from bank to bank, it can eventually frustrate the dual functions that financial institutions are supposed to perform for the broader economy: to serve as intermediaries by matching savers with investors, and to provide reliable payment infrastructure for day-to-day transactions.[97] The negative externalities associated with systemic risk create an incentive for financial institutions to adopt an excessively fragile business model from society's perspective, since no individual bank bears the full set of costs that follow from its potential failure.[98]

A second deviation from the M&M theorem is due to the presence of explicit and implicit government guarantees on bank debt. Explicit guarantees are extended through the federal deposit insurance program administered by the FDIC, which protects

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[93] Anil K. Kashyap, Dimitrios P. Tsomocos & Alexandros Vardoulakis, *Principles for Macroprudential Regulation*, 18 FIN. STABILITY REV. 173, 180 (2014).

[94] Xavier Freixas & Anthony M. Santomero, *An Overall Perspective on Banking Regulation* 2 (Fed. Reserve Bank of Phila., Working Paper No. 02-1, 2002). *But see* Merton H. Miller, *Do the M&M Propositions Apply to Banks?*, 19 J. BANKING & FIN. 483 (1995) (providing a contrarian take that was not accepted by the other half of the M&M theorem).

[95] *See* Matthew C. Turk, *The Convergence of Insurance with Banking and Securities Industries, and the Limits of Regulatory Arbitrage in Finance*, 3 COLUM. BUS. L. REV. 967, 989 (2015) (breaking down the specific aspects of systemic risk).

[96] This is known as the problem of "information contagion." When creditors observe that Bank A is financially distressed, they are more likely to withdraw funding from other banking institutions that appear exposed to similar risks. *See* Viral V. Acharya & Tanju Yorulmazer, *Information Contagion and Bank Herding*, 40 J. MONEY CREDIT & BANKING 215, 216 (2008).

[97] *See* Stijn Claessens, *Capital and Liquidity Requirements: A Review of the Issues and Literature*, 31 YALE J. ON REG. 735, 736 (2014).

[98] *Id.*

account-holders from losses they might incur when a bank goes under.[99] Other bank creditors enjoy a more implicit form of insurance, based on the expectation that authorities such as the Federal Reserve may act as a "lender[] of last resort" providing bailouts to failing financial institutions during a financial crisis.[100] Both kinds of government guarantees raise the problem of moral hazard, a dynamic where insured parties benefit from taking risks that are hard for the insurer to price into the insurance contract *ex ante*.[101] As a consequence, although government guarantees may reduce the likelihood of runs on the financial system, they also encourage banks to take on greater risk.[102]

Financial institutions are able to raise their overall risk-profile in response to these incentives with strategies on either side on the balance sheet.[103] On the asset side, a bank can chase higher returns by selecting more volatile investments—for example, with a portfolio that favors junk bonds over treasury bonds or sub-prime over prime mortgages. This exposes it to greater "credit risk" or "solvency risk"—if enough of the bank's bets go bad, it will eventually hold assets that are worth less than its debts and be forced into default. On the liability side, banks can increase the return on a given set of investments by financing them with a leveraged funding model that relies more heavily on debt than equity. Particularly when that debt is short-term (or is used to purchase unique assets that cannot be sold quickly at a predictable price), leverage makes banks more vulnerable to what is known as "run risk" or "liquidity risk." Both terms refer to the possibility that a financial institution may fail, even when its investment model is

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[99] *See* John Crawford, *The Moral Hazard Paradox of Financial Safety Nets*, 25 CORNELL J.L. & PUB. POL'Y 95, 104–05 (2015) (explaining the deposit insurance fund as "a cornerstone of a financial regulatory system").

[100] *Id.* at 114.

[101] *Id.* at 98; *see also* Krishnamurthy, *supra* note 65, at 22 (noting "[d]eposit insurance makes bank depositors insensitive to the risks in a bank's investment portfolio," leading to "excessively risky investments").

[102] *See* Anjan V. Thakor, *Bank Capital and Financial Stability: An Economic Trade-Off or a Faustian Bargain?*, 6 ANN. REV. FIN. ECON. 185, 185 (2014) (The overarching message from research is that lower capital in banking leads to higher systemic risk.").

[103] *See* FREDERIC MISHKIN, THE ECONOMICS OF MONEY, BANKING AND FINANCIAL MARKETS 220–27 (10th ed. 2013) (reviewing the structure of bank balance sheets and their relationship to a financial institution's risk-return profile).

fundamentally sound, due to sudden market fluctuations or creditor panics.[104]

As will be seen, it can be useful to slice-and-dice the underlying sources of financial instability by distinguishing solvency risk from liquidity risk or the problem of moral hazard from that of systemic spillovers. Those distinctions, however, should not obscure the fact that there is really one fundamental market failure that applies across the entire banking sector: the optimal level of risk-taking is higher from the perspective of individual financial institutions than for society as a whole.[105] Capital adequacy requirements are the centerpiece of financial regulation because they are the primary tool to limit the pursuit of balance sheet risk by banks.

B. ROLE OF OVERLAP IN CAPITAL REGULATION

This Section presents the relevant legal background on capital requirements. It also shows how that background supports the descriptive thesis of this Article: namely, that the most pressing policy question which currently hangs in the balance for financial regulation is the role of regulatory overlap rather than other aspects of regulatory design that have received more attention. The defining feature of post-crisis policymaking under Dodd-Frank is its dramatic escalation of overlapping legal requirements, while the primary thrust of the CHOICE Act and related reforms is to reverse that process.

1. The Pre-Crisis Legal Framework.

The details of banking regulation, and capital adequacy rules in particular, are notoriously arcane. That said, the historical development of those rules provides a surprisingly accessible tour of the formal design features that were earlier shown to characterize

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[104] *See* Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401 (1983). Even if a bank facing a liquidity crunch is able to remain in business, it may still impose costs on the system if it must resort to dumping assets at depressed "fire sale" prices to stay afloat. *See* Andrei Shleifer & Robert Vishny, *Fire Sales in Finance and Macroeconomics*, 25 J. ECON. PERSPS. 29, 30 (2011).

[105] *See* ERIC POSNER & GLEN WEYL, BENEFIT-COST PARADIGMS IN FINANCIAL REGULATION 13 (2014) (illustrating "the most important market failure in finance" by noting that "equity holders of banks and their agents have excessive incentives to take on debt and other commitments to make payments that risk throwing them into bankruptcy").

legal rules of all kinds. The earliest relevant period for capital requirements spans roughly from World War II to the late 1970s.[106] Regulation during this era was almost purely discretionary, carried out by bank examiners who would eyeball an institution's investment portfolio, funding sources, profitability, and the quality of handshakes from management.[107] The end goal of this form of supervision, which eventually became formalized in what is known as the CAMELS approach, was to arrive at a holistic assessment of the bank's overall safety-and-soundness.[108] Thus, capital adequacy requirements at this time were quintessential regulatory standards.[109]

A major transition took place in the early 1980s. This came via a set of guidelines issued by the federal banking agencies in 1981 along with a piece of federal legislation from 1983, the International Lending Supervision Act.[110] The thrust of these reforms was to substantially displace the discretionary, qualitative posture of bank oversight with a pre-specified quantitative benchmark, commonly known as a bank's leverage ratio.[111] The leverage ratio was calculated with a rudimentary formula which compared the total book value of a bank's assets against its outstanding equity.[112] The result was a clear shift from reliance on regulatory standards to an approach based on simple rules.

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[106] Eric A. Posner, *How Do Bank Regulators Determine Capital Adequacy Requirements?*, 82 U. CHI. L. REV. 1853, 1865 (2015).

[107] *Id.*

[108] *Id.* The CAMELS approach was codified in a set of 1978 regulations known as the Uniform Interagency Bank Rating System. The acronym refers to the fact that bank regulators primarily examine the quality of an entity's Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to market risks. *See* Krishnamurthy, *supra* note 43, at S278.

[109] Krishnamurthy, *supra* note 43, at S276–77; Posner, *supra* note 106, at 1865.

[110] International Lending Supervision Act, Pub. L. No. 98-181, 97 Stat. 1278 (1983) (codified at 12 U.S.C. § 3907 (2018)). The three agencies responsible were the Federal Reserve, Office of Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC). *Capital Adequacy Guidelines*, 68 FED. RES. BULL. 33 (1982) (a joint Federal Reserve and OCC guidance document); Statement of Policy on Capital Adequacy, 46 Fed. Reg. 62693 (Dec. 17, 1981).

[111] *See* Krishnamurthy, *supra* note 43, at 280.

[112] Two complications should be noted. First, equity was split into two groups, labeled Tier 1 Capital (mainly common stock) and Tier 2 Capital (preferred stock and some kinds of subordinated debt). Second, slightly different ratios were required of larger regional banks compared to community banks. Those institutions needed to have a "Total Capital" ratio (Tier 1 plus Tier 2) of 6.5% and 7%, respectively. *See* BARR, JACKSON & TAHYAR, *supra* note 91, at 259–67; Posner, *supra* note 106, at 1867.

The modern era of capital regulation is usually dated to the late 1980s, when federal banking agencies began coordinating with regulators from other advanced economies under the auspices of an international forum called the Basel Committee on Banking Supervision.[113] Those efforts yielded a comprehensive body of new capital rules, embodied in a non-binding cross-border protocol known as Basel I.[114] The major innovation of Basel I was to move beyond the nominal dollar value of bank assets and drill down on bank portfolios by assigning a set of risk weights to different categories of investments.[115] In attempting to account for the variation in risk across asset classes, Basel I imposed a significantly greater informational burden on policymakers than did the prior leverage ratio. It therefore signaled another shift in regulatory philosophy, from simple to complex rules.[116]

Basel I was soon considered primitive by banking regulators, who spent much of the 1990s debating the unrealistic assumptions built into its risk-weighting formulas.[117] The eventual fix was a subsequent generation of rules, Basel II, which were finalized at the international level in 2004 and gradually incorporated into the domestic regulations of Basel Committee members thereafter.[118] Basel II sought to fine-tune the measurement of a bank's portfolio risk with such precision that performing the relevant calculations exceeded the capacity of the regulators who designed them, and

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[113] Krishnamurthy, *supra* note 43, at 288.

[114] *See generally* BASEL COMM. ON BANKING SUPERVISION, INT'L CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS (1988) [hereinafter BASEL I]; TARULLO, *supra* note 92.

[115] In other words, assets would be sorted into groups—such as corporate bonds, government bonds, home mortgages, corporate stock, and so on—with the face value of those assets discounted based on their perceived riskiness. This changed the numerator of the capital ratio to the discounted (risk-weighted) value of bank assets. More complicated measures were also applied to bank equity, which remained the denominator.

[116] *See generally* Andrew G. Haldane, The Dog and the Frisbee, Federal Reserve Speech at Jackson Hole, Wyoming (Aug. 31, 2012) (providing an influential overview of the consensus that capital regulation has evolved in the direction of greater complexity).

[117] It was hard to overlook discrepancies in the risk weights of Basel I, which gave AAA-rated corporate bonds the same treatment as junk bonds and weighted U.S. treasuries on par with sovereign debt issued by countries like Greece or Argentina. TARULLO, *supra* note 92.

[118] BASEL COMM. ON BANKING SUPERVISION, INT'L CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS: A REVISED FRAMEWORK (2006) [hereinafter BASEL II].

much of that exercise was outsourced to the credit ratings agencies or to risk management modelers at the banks themselves.[119] As a result, Basel II pushed the already substantial level of complexity in capital regulations exponentially higher.[120]

Throughout the sixty-year post-war period—in which capital requirements cycled from standards to rules, and then from simple to ever-more complex rules—one policy dimension that remained more or less constant was the degree of regulatory intensity. While the intensity of capital adequacy rules has a number of components, it essentially turns on the difference between two variables: (a) "economic capital," understood as the limits on balance sheet risk that a bank's business partners would demand in a world of total *laissez-faire*; and (b) "regulatory capital," meaning the capital and asset levels that a bank is legally required to maintain.[121] No matter how the formal legal requirements have historically been framed on paper, the delta between regulatory and economic capital has stayed quite low (arguably, close to zero). In other words, the regulatory constraints on bank capital levels were never very stringent.[122]

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[119] *See generally* TARULLO, *supra* note 92 (providing an extensive analysis of risk-weighting procedures under both Basel I and Basel II).

[120] Basel II imposed such daunting information costs on the regulatory framework that some expert observers of the time were left with a feeling that the entire project had spun out of control. *See generally* Haldane, *supra* note 116; *see also* David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT'L L. 547, 572–80 (2005) (noting the complexity of Basel II).

[121] *See* Abel Elizalde & Rafael Repullo, *Economic and Regulatory Capital in Banking: What Is the Difference?*, 3 INT'L J. CENT. BANKING 87, 88 (2007). It is common for the intensity question to be answered from a more formalistic perspective, which compares different regulatory requirements in terms of the percentage points in stated capital ratios. That method has a superficial precision that is ultimately less meaningful, because it ignores the fact that the demand for economic capital is endogenous to market conditions and likely to vary widely over time. In any case, nominal levels of regulatory capital did not fluctuate much prior to 2008 and always stayed in the single digits. *See* James R. Barth & Stephen Matteo Miller, *A Primer on the Evolution and Complexity of Bank Regulatory Capital Standards* 3–4 (Mercatus Ctr., Working Paper, Feb. 2017), https://www.mercatus.org/system/files/mercatus-barth-primer-capital-standards-v1.pdf.

[122] *See generally* ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT (2013); Anat R. Admati, Peter DeMarzo, Martin F. Hellwig & Paul Pfleiderer, Fallacies, Irrelevant Facts and Myths in the Discussion of Capital Regulation: Why Bank Equity is *Not* Expensive (Fed. Reserve Bank of Atlanta, Mar. 23, 2011) (unpublished manuscript, Fed. Reserve Bank of Atlanta), https://www.frbatlanta.org/~/media/Documents/research/seminars/2011/seminaradmati081811.pdf. For the pre-1980s safety-and-soundness regime, see Posner, *supra* note 106, at 1882–93 (arguing that bank supervisors applying the CAMELS procedure followed an approach Posner calls "norming," in which only a small subset of outlier banks failed to satisfy the relevant regulatory standards). On the use of a basic leverage ratio during the 1980s, see

2. Post-Crisis Policymaking.

The inadequacy of capital adequacy requirements was widely regarded as a key regulatory failure that contributed to the financial crisis.[123] As it turned out, even the most aggressively risk-seeking institutions, such as Bear Stearns and Lehman Brothers, were considered fully compliant with Basel II up to the eve of their collapse.[124] The response was a frenetic stretch of policymaking that began to take shape in 2010, when Congress passed the Dodd-Frank Act and the Basel Committee issued a revised set of international accords, Basel III.[125]

a. The Dodd-Frank Act Rulemakings.

Dodd-Frank introduced three noteworthy changes to what can be thought of as the "traditional style" capital requirements, all of which were packaged in a final agency rule released by federal banking regulators in 2013.[126] First, there was a comprehensive

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Julie Andersen Hill, *Bank Capital Regulation by Enforcement: An Empirical Study*, 87 IND. L.J. 645 (2012) (finding that enforcement actions premised on shortfalls in bank capital remained rare after the switch to a quantitative regulatory rule). A look at the "legislative history" of Basel I reveals that it was intentionally crafted to require no changes in capital levels for financial institutions based in the United States and United Kingdom, while putting pressure on Japanese banks, which had been gobbling up market share during the 1980s. *See* DAVID ANDREW SINGER, REGULATING CAPITAL: SETTING STANDARDS FOR THE INTERNATIONAL FINANCIAL SYSTEM 45, 53–59 (2007); TARULLO, *supra* note 92, at 71–72. Basel II is usually seen as equally or less stringent than Basel I. *See, e.g.*, Pierre-Hugues Verdier, *The Political Economy of International Financial Regulation*, 88 IND. L.J. 1405, 1452 (2013).

[123] The only real point of controversy was whether existing capital regulations did nothing to prevent the collapse of the international financial system or actively hastened its demise by herding banks into especially risky assets. *See generally* Charles K. Whitehead, *Destructive Coordination*, 96 CORNELL L. REV. 323 (2011) (arguing for the latter scenario).

[124] On the compliance of Bear Stearns and Lehman Brothers with Basel II, see John F. Rosato, *Down the Road to Perdition: How the Flaws of Basel II Led to the Collapse of Bear Stearns and Lehman Brothers*, 17 CONN. INS. L.J. 475, 490–91 (2011). As of the summer of 2006, the FDIC reported that "more than 99 percent of all insured institutions met or exceeded the requirements of the highest regulatory capital standards." DIV. INS. & RES., FED. DEPOSIT INS. CORP., FDIC QUARTERLY BANKING PROFILE: SECOND QUARTER 2006, at 3 (2006).

[125] BASEL COMMITTEE ON BANKING SUPERVISION, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS (2010) [hereinafter BASEL III]. The basic structure of capital rules in Dodd-Frank and Basel III were designed in parallel and roughly track one another.

[126] The federal banking regulators are the FDIC, the OCC, and the Federal Reserve Board. The final rule is also known as Regulation Q. *See* 12 C.F.R. § 217 (2019); Regulatory Capital Rules, 78 Fed. Reg. 62,018 (Oct. 11, 2013).

revision to the prior risk-weighted asset requirements.[127] The primary effect of that revision was to further complicate the calculations necessary to measure the risk profile of bank balance sheets while retaining the mandated asset-to-capital ratio at its previous level of eight percent.[128] Second, the old leverage ratio concept was reintroduced with a rule known as the Simple Leverage Ratio, which sets a unweighted floor of three percent for the ratio of assets-to-capital.[129] Third, the agencies created a new mechanism called the Capital Conservation Buffer.[130] This rule calls for a risk-weighted capital ratio that is 2.5% above the eight-percent baseline and subjects banks to increasing supervisory scrutiny as their capital levels drift below the extra buffer.[131]

The Dodd-Frank Act also directed federal regulators to develop a pair of liquidity requirements, which are a new genre of quantitative benchmarks that had not been seen before in capital adequacy regulation. One of these, the Liquidity Coverage Ratio (LCR), requires banks to hold a certain amount of "high-quality liquid assets," a category meant to capture investments that can be sold at a reliable price on short notice.[132] The other liquidity requirement, known as the Net Stable Funding Ratio (NSFR), has yet to be finalized by the banking agencies.[133] As envisioned in a notice of proposed rulemaking from 2016, the NSFR would focus on bank liabilities rather than assets, requiring a threshold level of funding sources that are likely to remain available in the event of a market-wide credit freeze.[134]

Another significant feature of the Dodd-Frank Act is an additional body of rules which specifically apply to Too-Big-To-Fail financial institutions.[135] Part of these rules is a suite of "enhanced

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[127] Regulatory Capital Rules, 78 Fed. Reg. at 62,018.

[128] *Id.* at 62,021.

[129] The leverage ratio had always been retained in some corners of the regulatory regime, mainly in the FDIC's domestic rules for deposit-taking banks. But it gained a revitalized and much more prominent role in the post-crisis framework. *See id.* at 62,018.

[130] *See id.* at 62,033.

[131] *See id.* at 62,034.

[132] Liquidity Coverage Ratio, 79 Fed. Reg. 61,440, 61,442 (Oct. 10, 2014) (to be codified at 12 C.F.R. pt. 329). Specifically, the LCR is premised on the sale of assets during a hypothetical 30-day period in which a bank experiences disruption to its expected cash flows.

[133] *See* Net Stable Funding Ratio, 81 Fed. Reg. 35,124 (proposed June 1, 2016) (to be codified at 12 C.F.R. pt. 329).

[134] *Id.* at 35,126.

[135] *See* Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17,240, 17,242 (Mar. 27, 2014) (to be codified at 12 C.F.R. pt.

prudential standards," each of which nudge the baseline capital and liquidity ratios upward by another percentage point or two.[136] Those standards are themselves enhanced by another pair of rules: a "Total Capital Surcharge" and "Counter-Cyclical Capital Buffer." The Total Capital Surcharge further hikes the required risk-weighted capital ratio based on an institution-specific set of calculations.[137] The Counter-Cyclical Capital Buffer grants regulators discretion to temporarily expand the Capital Conservation Buffer to account for fluctuations in the business cycle.[138]

A final innovation of the post-crisis reforms is the rise of regulatory stress tests. Generally speaking, those tests require regulators to draw up hypothetical scenarios in which macroeconomic variables experience a series of adverse shocks, and then ask banks to run simulations that show how their balance sheets would perform under those conditions.[139] After an initial round was run by the Federal Reserve on an ad hoc basis in 2009, the Dodd-Frank rulemakings subsequently formalized that program into two parallel exercises: the Dodd-Frank Act Stress Tests (DFASTs) and the Comprehensive Capital Analysis and Review (CCARs).[140] There is also a lesser-known stress test that

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252). A bank may be eligible for Too-Big-To-Fail treatment if it falls into one of a few technical categories: (1) bank holding companies with $50 billion or more in assets; (2) firms designated as "systemically important financial institutions" (SIFIs) by Dodd-Frank's new Financial Stability Oversight Council; and (3) financial institutions that qualify as "global-systemically important banks" (G-SIBs) under the Basel III rules. *See generally* MARC LABONTE & DAVID W. PERKINS, CONG. RESEARCH SERV., R45036, BANK SYSTEMIC RISK REGULATION: THE $50 BILLION THRESHOLD IN THE DODD-FRANK ACT (2017).

[136] Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17,240 (Mar. 27, 2014) (to be codified at 12 C.F.R. pt. 252).

[137] Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 Fed. Reg. 49,082 (Aug. 14, 2015) (to be codified at 12 C.F.R. pts. 208 & 217).

[138] Regulatory Capital Rules: The Federal Reserve Board's Framework for Implementing the U.S. Basel III Countercyclical Capital Buffer, 81 Fed. Reg. 63,682 (Sept. 16, 2016) (to be codified at 12 C.F.R. pt. 217).

[139] *See generally* Mehrsa Baradaran, *Regulation by Hypothetical*, 67 VAND. L. REV. 1247 (2014).

[140] Stress Tests: Final Rule, 77 Fed. Reg. 62,377 (Oct. 12, 2012). The original Treasury Department test was called the Supervisory Capital Assessment Program (SCAP). The main distinction between the two Dodd-Frank tests is that the DFASTs focus mainly on quantitative modeling, while the CCARs have a greater qualitative component and involve

specifically covers the liquidity requirements.[141] Should a bank fail its stress test, the primary remedy is a regulatory directive to raise its existing capital levels, for example by withholding dividends to boost retained earnings.[142]

b. Impact on Regulatory Structure.

There is a paradoxical aspect to these post-crisis reforms once they are considered as a whole. While the Dodd-Frank Act managed to revolutionize the regulation of bank capital, it did so without attempting to settle any of the policy debates that have dominated that area over the past several decades. Rather than side with either predictable or discretionary regulations, the Dodd-Frank Act piles a laundry list of *ex ante* rules atop an equally long list of *ex post* standards.[143] And rather than opt for an approach that favors complexity or simplicity, it imposes the simplest rule in the policy toolkit (a leverage ratio) alongside the most complex capital regulation ever devised (the risk-weighted asset ratio in Basel III).[144]

Perhaps more remarkably, the same basic story also holds for regulatory intensity. At the level of individual rules, there is a noticeable randomness. Some capital ratios are less demanding than their predecessors, others more demanding, while still others are about the same.[145] Likewise, the stringency of stress tests and

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the evaluation of narrative documents that the banks must submit, referred to as their "capital plans." *See id.* (describing the SCAP).

[141] The obligatory acronym here is CLAR (Comprehensive Liquidity Assessment Review). *See* TREASURY BANK'G REP., *supra* note 6, at 147 (providing an overview of the CLAR stress test).

[142] *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., SUPERVISION AND REGULATION REPORT 20 (2019).

[143] The capital ratios, liquidity requirements, and Total Loss-Absorbing Capacity (TLAC) mandate should be considered "rules" in the law-and-economics sense. All of the stress tests as well as the counter-cyclical capital buffer are "standards." *See supra* Section II.A.2 (discussing the rules versus standards distinction).

[144] Granted, Dodd-Frank's overall framework looks extremely "complex" in the colloquial sense. It is nonetheless agnostic as to the optimal level of legal complexity, properly understood, because it regulates the risk-taking strategies of banks by sorting them into categories that alternate from extremely crude to extremely precise.

[145] The Simple Leverage Ratio, both in its baseline and enhanced versions (3% and 5–6%, respectively), is lower than leverage ratios from the 1980s (which varied from 6.5%–7%). *See* ADMATI & HELLWIG, *supra* note 122, at 96 (arguing that a three percent requirement is very weak). The 8% baseline ratio for risk-weighted capital under Basel III is identical to the applicable figure under Basel II. *Id.* After accounting for additional requirements that may apply to the largest banks—such as the Counter-Cyclical Buffer, Capital Surcharge, and so

other novelties with no prior analogue are all over the map.[146] Most importantly, the Dodd-Frank rulemakings do not represent a substantial uptick in intensity even when viewed in the aggregate.[147] In terms of the critical differential between the required level of regulatory capital and the economic capital that banks will otherwise hold due to market demand, several commentators have persuasively argued that the current rules are only marginally more restrictive than those which were in place prior to 2008.[148]

By contrast, there is no precedent for the sheer number of regulations that now converge on the problem of bank capital after Dodd-Frank. Across the various eras of modern capital regulation, the degree of legal overlap did not alter appreciably and usually hovered around the joint use of two or three requirements.[149] The

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on—the total amount of risk-weighted capital could potentially rise to a maximum level of 14.5%. *Id.*

[146] Stress tests show the amount of variation within a single rule from year to year. When the Treasury Department ran its inaugural tests in 2009, nearly all the banks failed. For 2016 and 2017, every institution that was subject to the DFAST and CCAR procedures passed both tests. *See* Matthew C. Turk, *Stress Testing the Banking Agencies*, 105 IOWA L. REV. (forthcoming 2020) (reviewing the results of post-crisis stress tests).

[147] The legal, accounting, and other fees that banks must pay compliance professionals in order to navigate the new capital rules are not trivial. But they have been estimated in the low millions, which means that they are not the main source of compliance costs at institutions that have $50 billion or more in assets under management. *See* TREASURY BANK'G REP., *supra* note 6, at 49 n.17 (citing U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-17-48, FEDERAL RESERVE: ADDITIONAL ACTIONS COULD HELP ENSURE THE ACHIEVEMENT OF STRESS TEST GOALS 30 (2016) (providing compliance costs for the stress tests)).

[148] ADMATI & HELLWIG, *supra* note 122, at 96 (pointing out later rules that are not significantly more restrictive); Barth & Miller, *supra* note 121, at 4 (discussing how the Basel requirements have changed); *see also* Thomas M. Hoenig, Vice Chairman, Fed. Deposit Ins. Corp., Basel III Capital: A Well-Intended Illusion, International Association of Deposit Insurers 2013 Research Conference, Basel, Switzerland (Apr. 9, 2013) (calling the contrary impression the Basel III "illusion"). The observation that reported capital levels in the bank system have steadily increased since the passage of Dodd-Frank misses this point. Regardless of what rules are put in place after a financial crisis, investors become warier and balance sheets gradually begin to heal. This means that economic capital is likely to rise as fast or faster than regulatory capital.

[149] This estimate depends to a certain extent on how you parse the relevant legal materials. Technically, the Basel Rules are structured around a "three-pillar" approach. Pillar I includes the risk-weighted capital protocols, Pillar II contains procedures for qualitative safety-and-soundness supervision, and Pillar III includes disclosure requirements. The domestic analogue to these pillars also varies somewhat, depending on the regulator and financial institution in question. *See* BARR, JACKSON & TAHYAR, *supra* note 91, at 285–332 (detailing departures from the baseline Basel Committee rules by banking agencies in the United States); TARULLO, *supra* note 92, at 9 (on the three-pillar structure of the Basel Rules).

question of whether the regulatory portfolio should expand or contract also received limited attention. Instead, policymaking was premised on the idea that a single instrument should predominate, with disputes held over what form that rule ought to take.[150] By contrast, if any governing principle characterizes the capital adequacy regime which has emerged from the financial crisis, it is the all-of-the-above logic of unbounded regulatory overlap.

The accompanying view that Dodd-Frank's overlapping requirements all take the form of regulatory complements also consistently appears on the face of the final agency rules and associated policy statements. According to the Basel Committee, there is a complementarity between leverage and risk-weighted asset ratios.[151] According to the Federal Reserve, the capital ratios are complemented by the DFAST and CCAR stress tests, which enjoy a complementarity with one another as well.[152] Dodd-Frank's liquidity requirements are also complements to each other and to the other capital ratios.[153] And so on. The underlying source attributed to those complementarities varies or is stated in conclusory boilerplate fashion. But the uniform theme is that of positive spillovers among the post-crisis capital regulations rather than a dynamic of mutual interference.

3. Proposals for Reform of the Post-Crisis Framework.

The two most comprehensive alternatives that have been developed in response to the Dodd-Frank Act rulemakings are the CHOICE Act and the Trump Administration's Treasury Department reports, in particular its Report on Banks and Credit Unions (the Treasury Banking Report).[154] Although those documents were each released around the same time in the summer of 2017, they were not prepared in parallel and span hundreds of

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[150] *Cf.* Haldane, *supra* note 116, at 1 (arguing in favor of simplicity in financial regulation).

[151] BASEL COMM. ON BANKING SUPERVISION, REVISED BASEL III LEVERAGE RATIO FRAMEWORK AND DISCLOSURE REQUIREMENTS 1 (2014) (describing the complementary relationship between risk-based requirements and the leverage ratio).

[152] Stress Testing Policy Statement, 82 Fed. Reg. 59,528, 59,529 (Dec. 15, 2017); Tim P. Clark & Lisa H. Ryu, *CCAR and Stress Testing as Complementary Supervisory Tools*, BD. GOVERNORS FED. RES. SYS., https://www.federalreserve.gov/bankinforeg/ccar-and-stress-testing-as-complementary-supervisory-tools.htm (last updated June 24, 2015).

[153] Daniel K. Tarullo, Bd. of Governors of the Fed. Reserve Sys., Liquidity Regulation, Remarks at the Clearing House Annual Conference 1, 2, 4 (Nov. 20, 2014).

[154] *See generally* Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017); TREASURY BANK'G REP., *supra* note 6.

pages that diverge on many points of detail. Nonetheless, a central goal of both proposals is to overhaul the existing framework for capital adequacy requirements, and they share a similar regulatory philosophy on how to do so.

a. The CHOICE Act & Treasury Reports.

At the core of the CHOICE Act is a mechanism known as the "Dodd-Frank Prudential Regulation Off-Ramp" (the Off-Ramp).[155] To be eligible for the Off-Ramp, a bank must satisfy the conditions for being considered a "Qualified Banking Organization."[156] Those conditions have evolved over various iterations of the bill, but more or less consist of a single substantive hurdle: maintaining a leverage ratio of at least ten percent.[157] For financial institutions that can invoke the Off-Ramp, essentially all other capital adequacy requirements introduced under Dodd-Frank fall away. The risk-weighted asset ratio and its accompanying Capital Conservation Buffer no longer apply; both of the new liquidity rules (the LCR and NSFR) disappear; and none of the stress test programs must be performed.[158] The Enhanced Prudential Standards, Total Capital Surcharge, and Counter-Cyclical Capital Buffer are all out as well.[159]

The Treasury Banking Report expresses "support" for the CHOICE Act, including its Off-Ramp provisions, which the Treasury describes as an "approach . . . that should be considered."[160] At the same time, its Banking Report is somewhat more cautious in advocating the full repeal of existing rules. Most notably, the Treasury Department suggests that the risk-weighted capital ratio should be retained in some form.[161] Regarding the liquidity rules, it recommends that the LCR be preserved in part

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[155] *See* Financial CHOICE Act of 2017, H.R. 10, 115th Cong. §§ 601–03 (2017) (describing Off-Ramp relief mechanism for banks).

[156] *Id.*

[157] *Compare* DAVIS POLK, TRUMP TRANSITION: FINANCIAL CHOICE ACT—ONLY THE BEGINNING (Nov. 17, 2016) (summarizing the original House draft), *with* SULLIVAN & CROMWELL LLP, FINANCIAL CHOICE ACT "2.0" (Apr. 21, 2017) (reviewing changes in the revised draft that is currently with the Senate).

[158] *See* POLK, *supra* note 157, at 2–4; SULLIVAN & CROMWELL, *supra* note 157, at 2–4.

[159] *See* POLK, *supra* note 157, at 2–4; SULLIVAN & CROMWELL, *supra* note 157, at 2–4.

[160] TREASURY BANK'G REP., *supra* note 6, at 53.

[161] *Id.* at 37–56.

and that the pending NSFR rulemaking be abandoned.[162] It also proposes that Dodd-Frank's dual stress tests be reduced to a single program by ending the CCAR's qualitative review while keeping the DFAST in effect.[163] Lastly, there is language in the Banking Report that signals the Treasury's willingness to scrap the Counter-Cyclical Capital Buffer in its entirety.[164]

b. Impact on Regulatory Structure.

The CHOICE Act and Treasury Reports have been marketed as remedies for a post-crisis policy framework that has become overly burdensome, complex, and discretionary.[165] As with the changes introduced under Dodd-Frank, however, there is *less* than meets the eye when it comes to any of those three aspects of the regulatory structure. This is easiest to see in connection with the degree of regulatory intensity, where it is simply unclear whether the proposed reforms are more or less strict. The main source of this uncertainty is the ten-percent leverage ratio required under the Off-Ramp, which is over three times higher than the Simple Leverage Ratio in Dodd-Frank and about twice that of the enhanced ratio mandated for the biggest banks.[166] Because a leverage ratio is arguably the core measure of a bank's balance sheet risk, the CHOICE Act's Off-Ramp provision may very well be harder to meet than all of Dodd-Frank's rules combined.[167]

The anticipated move from complex standards to simple rules should not be overestimated either. For one, the primary vehicle that reformers would use to restore predictability and simplicity is a leverage ratio—the exact same policy instrument that was a centerpiece of the changes made by Dodd-Frank. The Treasury Department's emphasis on "fine-tun[ing]," "tailoring," or "right-sizing" the reach of various rules based on different

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[162] *Id.*
[163] *Id.*
[164] *Id.* at 17–18.
[165] *See supra* Section II.A.2.
[166] *See supra* note 145 and accompanying text.
[167] According to an estimate by economists at the IMF, a leverage ratio of 9% translates into a risk-weighted capital ratio of 15 to 23%. That range is higher than the 14.5% level that would be required when all of various buffers and surcharges in Dodd-Frank are combined. *See* RICHARDSON ET AL., *supra* note 38, at 41–49 (reviewing the literature on the relationship between weighted-capital totals and a leverage ratio). *See generally* JIHAD DAGHER ET AL., BENEFITS AND COSTS OF BANK CAPITAL (Mar. 2016), https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf (evaluating the benefits of bank capital in relation to its ability to absorb losses).

institutional categories is also a clear nod toward regulatory complexity.[168] Similarly, the original House draft of the CHOICE Act retains a significant role for safety-and-soundness oversight pursuant to the CAMELS rating system, which is the classic form of discretionary banking supervision.[169] To be sure, the claim here is not that no reduction in regulatory complexity or discretion would materialize at all. It is only that any shift in those directions would be partial at best, and stand in contrast to a much more unambiguous change of course in terms of overlap. Particularly in the case of the CHOICE Act, the most salient feature of the current proposals is to rollback essentially all of the capital requirements in Dodd-Frank responsible for pushing the degree of regulatory overlap above its pre-crisis level.

Despite the aggressive reformist posture of the CHOICE Act and Banking Report, it would be a mistake to interpret those initiatives as unreflective deregulatory hatchet jobs. In fact, the Off-Ramp concept implements the most influential academic perspective on capital adequacy rules that came out of the crisis, which was set forth across a number of publications by co-authors Anat Admati and Martin Hellwig.[170] For reasons that will be unpacked below, they argue that the imposition of a dramatically higher leverage ratio is the only step that must be taken to manage the problem of systemic risk in the banking sector.[171] By embracing the Admati and Hellwig strategy, the Off-Ramp also commits to a specific theory of overlap that implicitly drives their analysis.[172] That theory amounts to a view that capital regulations are all near perfect substitutes,

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[168] TREASURY BANK'G REP., *supra* note 6, at 40, 48, 57.

[169] *See generally* POLK, *supra* note 5 (summarizing the progress of Dodd-Frank).

[170] *See, e.g.*, ADMATI & HELLWIG, *supra* note 122; Admati, DeMarzo, Hellwig & Pfleiderer, *supra* note 122.

[171] Admati, DeMarzo, Hellwig & Pfleiderer, *supra* note 122; *see also* Anat R. Admati & Martin Hellwig, Good Banking Regulation Needs Clear Focus, Sensible Tools, and Political Will 5 (Dec. 2011) (unpublished manuscript), https://admati.people.stanford.edu/sites/g/files/sbiybj1846/f/admati-hellwig_good_regulation.pdf ("This problem is reduced if capital ratios are much higher and with a form of counter-cyclical provisioning, as proposed under Basel III.").

[172] Admati is listed as a member of the advisory group that assisted with the Treasury Banking Report. *See* TREASURY BANK'G REP., *supra* note 6, at 112. Admati and Hellwig's research is also cited in the House report accompanying the CHOICE Act. *See* HOUSE CHOICE ACT REP., *supra* note 45, at 19 n.59.

an efficient regulatory framework need only apply one of those rules, and a leverage ratio is the best rule for the task.

C. OPTIMAL OVERLAP IN CAPITAL REGULATIONS

As has been previewed, the theories of regulatory overlap behind Dodd-Frank as well as the reform agenda of its critics both miss the mark. But what makes overlap especially challenging is that the problems it poses for the regulatory structure cannot be solved with generic calls to moderation. Splitting the middle with an arbitrary subset of the Dodd-Frank requirements will not do. Instead, capital adequacy regulations are a typical case where the optimal joint use of legal rules turns on subtle aspects of how those rules function with respect to one another as well as the economic environment in which they collide.

At the same time, quick progress can be made with a first cut that looks at whether any of the post-crisis capital regulations function as complements. While such a claim has been made in connection with nearly every rule in Dodd-Frank, it is doubtful that any genuine complementarity can be found among those regulations. A simple thought experiment shows why. Assume a leverage ratio requirement of one hundred percent.[173] Applying such a rule would have two effects. First, by definition, it would eliminate systemic risk: banks with zero leverage cannot "fail" in the usual sense of defaulting on creditors because they must fund their operations exclusively with equity and cannot raise any debt to default on. Second, the leverage ratio would entirely crowd out the risk-prevention function of other capital rules. Dodd-Frank's buffers, stress tests, liquidity requirements, or weighted-asset ratios would serve no purpose since each of those rules act to constrain a set of balance sheet vulnerabilities that no longer exist.[174] The common sense intuition this highlights is that dialing up the intensity of any particular capital requirement allows the

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[173] *Cf.* Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. CHI. L. REV. 357, 413 (2016) (arguing that such a requirement is in fact feasible and desirable); John H. Cochrane, *Toward a Run-Free Financial System*, GRUMPY ECONOMIST (2014), https://faculty.chicagobooth.edu/john.cochrane/research/papers/run_free.pdf (same).

[174] The same hypothetical is even more revealing when reimagined at the margin, with a leverage ratio that is gradually raised from its current level to one hundred percent. Intuitively, there is no step in that process where a liquidity requirement or stress test program needs to become *more* stringent.

stringency of other rules to be dialed down. This is precisely the logic of substitutes, not complements.

The CHOICE Act's Off-Ramp structure does not withstand scrutiny either. To see why requires a closer look at shortcomings in the Admati & Hellwig theory of banking on which it depends. Their claim that a very high leverage ratio is the only necessary capital adequacy rule rests on a few subsidiary arguments:

> *Premise a*: the ultimate cause of financial crises is imprudent investment decisions by banks;
>
> *Premise b*: a leverage ratio is sufficient to safeguard bank balance sheets from the risks associated with those poor investment decisions;
>
> *Premise c*: leverage requirements are costly to bank shareholders but always costless for society as a whole, in light of the M&M theorem.[175]

If all three of these propositions prove to be sound, the conclusion that a leverage ratio perfectly substitutes for all other capital regulations follows as a matter of simple logic. As it happens, none of them do, at least not in a strong sense.

Many commentators have observed that the free lunch thinking behind *Premise c* is overly optimistic. To meet a higher leverage ratio, banks encounter a number of short-term adjustment costs and, more significantly, also tend to shift activities away from otherwise socially valuable forms of financial intermediation.[176] The costs associated with a leverage rule open the door to additional

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[175] *See* ADMATI & HELLWIG, *supra* note 122, at 38, 179 (discussing the centrality of credit risk); *id.* at 183, 187 (discussing the sufficiency of leverage ratios); *id.* at 148, 191 (discussing the social cost of bank leverage).

[176] *See generally* Charles W. Calomiris, *How to Regulate Bank Capital*, 10 NAT'L AFF. 41 (2012) (arguing that issuing equity is costly due to capital market imperfections); John Crawford, *Capital Accounts: Bank Capital, Crises, and the Determinants of an Optimal Regulatory Approach*, 66 HASTINGS L.J. 1161 (2015) (stressing that leverage ratios limit the ability of banks to take deposits or offer similar money-like claims); Reint Gropp et al., *Bank Response to Higher Capital Requirements: Evidence from a Quasi-Natural Experiment*, 31 REV. FIN. STUD. 266 (2018) (positing that banks may pull back on lending in order to meet higher capital requirements).

requirements that act as imperfect substitutes because raising existing ratios past a certain threshold will be inefficient if another rule can deliver the same stability benefits with more precision and less collateral damage. The stress tests and counter-cyclical capital buffer are prime examples of regulations that, in theory, could fill such a role. As implemented in their current form, however, it is hard to defend the overlapping use of those rules alongside Dodd-Frank's Simple Leverage Ratio. The stress tests do not simulate crisis conditions in a realistic or meaningful way and are easily gamed by banks.[177] The counter-cyclical buffer relies upon heroic assumptions about regulatory discretion and foresight.[178]

A more promising case for overlap is the combination of a leverage ratio and a risk-weighted asset ratio. The rationale turns on weaknesses of *Premise b*. Technically, the two rules measure distinct aspects of credit risk: a leverage ratio focuses exclusively on the magnitude of an investment risk (loss given default), while a risk-weighting asset ratio accounts for the likelihood that a loan will fail (probability of default). Under a static analysis, which takes a snapshot look at bank balance sheets for a given point in time, distinguishing between those variables may appear unimportant. But everything changes when shifting to a dynamic perspective, where financial institutions are able to strategically respond to capital rules with innovative avoidance tactics. Because a leverage ratio takes every asset at face value regardless of its risk profile, these regulatory arbitrage tactics are simply too easy.[179] The joint use of risk-weighted requirements with a simple leverage ratio is therefore defensible on the ground that they are imperfect substitutes which hem in a bank's ability to take on risk from two different angles.

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[177] *See generally* Turk, *supra* note 146.

[178] *See generally* Jonathan S. Masur & Eric A. Posner, *Should Regulation Be Countercyclical?*, 34 YALE J. ON REG. 857 (2017) (arguing that regulation should be countercyclical); Brett H. McDonnell, *Designing Countercyclical Capital Buffers*, 18 N.C. BANKING INST. 123 (2013) (questioning whether design flaws in the countercyclical buffer will prevent it from being triggered by regulators at the right times).

[179] All a bank must do to increase its balance sheet risk while maintaining a constant level of regulatory capital is select assets with a higher return; leverage ratios are just as easily met with a portfolio of junk bonds as they are by holding treasury bonds. *See generally* Andreas Ita, How Do Banks Adapt Their Asset Holdings to Binding Leverage Ratio and Liquidity Requirements Under Basel III? (July 31, 2017) (unpublished manuscript), https://ssrn.com/abstract=2884961 (analyzing the ways banks can circumvent leverage ratios).

Another strong candidate for overlap is a liquidity rule. The justification stems from a classic debate in finance: do banking crises happen because investors discover that certain banks have made bad bets? Or, are they the product of market-wide runs which are divorced from the fundamentals of any particular institution?[180] With their *Premise a*, Admati & Hellwig take an unqualified stand in favor of the former interpretation.[181] But there is a lot to be said for an intermediate view—namely, that liquidity risk and insolvency risk are often inseparable sides of the same coin and most crises involve a combination of both.[182] An implication is that the use of some form of liquidity requirement in addition to existing capital ratios is optimal.[183]

While a comprehensive review every rule would be beyond the scope of this analysis, the preliminary conclusion is that an efficient structure for capital adequacy regulations involves the joint use of at least three rules: a leverage ratio, a risk-weighted asset ratio, and

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[180] In the seminal Diamond & Dybvig model, bank runs are self-fulfilling prophecies that turn entirely on depositors' expectations about each other's behavior rather than the bank which actually holds their money. *See* Diamond & Dybvig, *supra* note 104, at 404 (describing that bank runs are caused by changing expectations). For a discussion of the origins of different types of financial crises, see generally Italy Goldstein & Assaf Razin, *Three Branches of Theories of Financial Crises* (Nat'l Bureau of Econ. Research, Working Paper No. 18670, 2013), http://www.nber.org/papers/w18670.

[181] *See* ADMATI & HELLWIG, *supra* note 122, at 38–39 (describing banks' liquidity problems).

[182] It is fair to characterize this "intermediate" theory as the current majority position among financial economists. With any crisis there is revelation of genuinely weak banks, which then undermines confidence in the system as a whole and sparks a broader withdrawal of liquidity that threatens well-managed banks. *See* GARY GORTON, MISUNDERSTANDING FINANCIAL CRISES: WHY WE DON'T SEE THEM COMING 32 (2012) (describing how financial crises come about as a result of mistrust and bank runs); Charles W. Calomiris & Joseph R. Mason, *Fundamentals, Panics, and Bank Distress During the Depression*, 93 AM. ECON. REV. 1615, 1618 (2003) (describing how individual bank weaknesses led to the process of bank failure in the Great Depression).

[183] In other words, there are likely to be decreasing returns to the reduction of solvency risk through a leverage ratio or risk-weighted asset requirement, such that introducing a minimal liquidity requirement would be more efficient at some margin. *See* Xavier Vives, *Strategic Complementarity, Fragility, and Regulation*, 27 REV. FIN. STUD. 3547, 3527 (2014) (arguing for solvency and liquidity ratio requirements); Anil K. Kashyap, Dimitrios P. Tsomocos & Alexandros P. Vardoulakis, *Optimal Bank Regulation in the Presence of Credit and Run Risk* 3 (Saïd Bus. Sch., Research Paper No. 2017-17, 2017) (arguing for a liquidity coverage ratio that "makes the bank hold more short-term liquid assets when it uses more runnable funding"). Since the pair of liquidity rules in Dodd-Frank are best understood as near perfect substitutes, the basic prescription is to just pick one. *See* Ansgar Walther, *Jointly Optimal Regulation of Bank Capital and Liquidity*, 48 J. MONEY CREDIT & BANKING 415, 417 (2016).

a liquidity requirement. A final point is that although the proposal to rely on those three instruments would considerably shrink the menu of rules currently in place under Dodd-Frank, it says nothing about the desirability of greater or lesser regulatory intensity. A necessary condition of this Section's argument is that any move toward fewer rules should be offset by stricter application of the remaining regulations.[184] In that sense, analyzing the optimal level of overlap in capital rules is not only an overlooked question of regulatory design that is crucial for the future of financial system. It also provides a pathway out of stale debates about regulation versus deregulation and a way to work around partisan commitments over how burdensome government intervention in the banking industry should be.

V. CASE STUDY #2: RESOLUTION AUTHORITY

Resolution authority refers to the procedures that apply when a financial institution is insolvent or otherwise on the brink of default. Given the potential for costly ripple effects to follow from institutional failures in the banking system, resolution rules sit alongside capital adequacy requirements as the second cornerstone of financial regulation. The chaotic meltdown of many large financial firms during the crisis made Too Big To Fail a household term and exploded the notion that anything resembling an efficient resolution regime was in place. In response, the Dodd-Frank Act set in motion a series of reforms that were arguably even more transformative than those in the capital adequacy area. Likewise, the overhaul of those post-crisis reforms contemplated by the CHOICE Act and the Treasury Department is no less comprehensive. As the case study presented in this Section will show, the central policy dilemmas in bank resolution once again revolve around a collection of disagreements and misunderstandings concerning the proper scope of overlapping rules.

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[184] Thus, the CHOICE Act gets the relationship between intensity and overlap right but settles on a suboptimal number of rules. Meanwhile, the Treasury Reports get nearer to the efficient amount of overlap but err by suggesting that the Dodd-Frank rules that are retained should be made less stringent.

A. LEGAL AND POLICY BACKGROUND

1. Defining the Policy Problem.

Distressed financial institutions pose a few problems that do not usually apply to other firms. One is that a relatively robust intervention is often required to preserve the going concern value of banks.[185] This means that resolution procedures must maximize the speed with which a financial institution can access liquidity.[186] A further difficulty arises from systemic risk, which has the consequence that the general public is always in some sense a potential "creditor" of financial institutions.[187] An inevitable question this raises is how to determine the conditions under which regulators should play the role of liquidity provider by extending funding on the taxpayers' behalf.[188]

The answer to that question depends on the way a resolution mechanism performs two functions: screening and precommitment. Screening involves the diagnostic task of weeding out false positives

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[185] Strictly speaking, this has nothing to do with systemic risk per se and is instead a product of the "very particular capital structure" of financial institutions, which is usually characterized by what is known as "maturity mismatch" between long-term assets and short-term liabilities. *See* Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. CORP. L. 469, 474–75 (2009). An implication of maturity mismatch is that an episode of economic disruption can "severely dissipate the value of a [financial] firm's assets" on relatively short notice. *See id.* at 470.

[186] *See* Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., at the Federal Reserve Board and Federal Reserve Bank of Richmond Conference: Toward Building a More Effective Resolution Regime: Progress and Challenges 4 (Oct. 18, 2013) ("It is vital that a resolving authority be able to move very quickly from non-resolution to resolution status.").

[187] For banks insured by the FDIC, this is almost literally true. Deposit insurance creates a subrogor-subrogee relationship, in which the FDIC stands in the shoes of the depositor as its legal alter-ego under the loan contract in the event of default. *See generally* David A. Skeel, Jr., *The New Synthesis of Bank Regulation and Bankruptcy in the Dodd-Frank Era* (Univ. Pa. L. Sch., Faculty Scholarship Paper 1564, 2015), http://scholarship.lawupenn.edu/faculty_scholarship/1564 (describing regulatory agency authority over bankruptcy and bank liquidation). For creditors who hold uninsured deposits or other forms of bank debt, there is one level of removal in terms of the predictability and timing of public guarantees. While the government has no preexisting legal obligation to cover those losses, it may decide to step in after the fact. *See* Anthony J. Casey & Eric A. Posner, *A Framework for Bailout Regulation*, 91 NOTRE DAME L. REV. 479, 482 (2015) (describing agency discretion in deciding when to intervene in bailouts).

[188] "Never" is unlikely to be the correct answer here. Some positive amount of public liquidity insurance is socially optimal given externalities from instability in the banking system. *See* Casey & Posner, *supra* note 187, at 482 (describing principles of when the government should use bailouts).

and false negatives. Public money will only be well spent when it is used to keep open the operations of banks that are fundamentally sound in the long term (solvent), but temporarily cash-constrained in the short term (illiquid).[189] In the heat of the moment, however, it can be hard to tell which is which.[190] Precommitment is a dynamic agency problem that turns on conflicts of interest rather than incomplete information. Even if the optimal resolution strategy can be identified in the abstract beforehand, there is often some unpleasantness in its execution, and bank supervisors may be tempted to avoid those tougher choices when it is time to act.[191]

The overall goal of any resolution authority is to facilitate the socially optimal supply of private and public funding to distressed firms. But to get there, policymakers in financial regulation must navigate a daunting threefold challenge. That is to design a set of rules which simultaneously: (a) provide banks access to large volumes of funding on short notice; (b) filter out those cases where such funding should not be forthcoming; and (c) constrain government officials so that they only extend public resources in the right set of cases.[192] If any of those three objectives are not met, a resolution regime may either overshoot or undershoot the intended policy target, and serious economic damage can follow.[193] When rules allow for too much access to liquidity, resolution procedures subsidize the failure of reckless financial institutions and thereby induce moral hazard on an industry-wide scale. When rules are too restrictive, fundamentally stable banks will be forced out of

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[189] The distinction between illiquid and insolvent banks in financial regulation parallels the textbook distinction in bankruptcy law between firms that experience "financial distress" versus "economic distress." *See* BARRY E. ADLER, DOUGLAS G. BAIRD & THOMAS H. JACKSON, BANKRUPTCY: CASES, PROBLEMS, AND MATERIALS 28 (4th ed. 2007).

[190] *See* Tarullo, *supra* note 186, at 2–3 (describing characteristics that inform bailout decisions).

[191] *See* Craig O. Brown & I. Serdar Dinç, *Too Many to Fail? Evidence of Regulatory Forbearance When the Banking Sector Is Weak*, 24 REV. FIN. STUD. 1378, 1385 (2011) (noting factors that influence regulatory decisionmaking); Ansgar Walther & Lucy White, *Rules Versus Discretion in Bank Resolution* (Ctr. for Econ. & Pol. Research, Research Paper No. 14048, 2019) (noting that discretion leads to weaker decisionmaking).

[192] *See generally* Magdalena Ignatowski & Josef Korte, *Wishful Thinking or Effective Threat? Tightening Bank Resolution Regimes and Bank Risk-Taking* (European Cent. Bank, Working Paper No. 1659, 2014) (providing a useful conceptual overview of the necessary elements for a successful resolution system).

[193] *See generally* Steven L. Schwarcz, *Beyond Bankruptcy: Resolution as a Macroprudential Regulatory Tool*, 94 NOTRE DAME L. REV. 709 (2018) (discussing three different regulation schemes and resolutions).

business during market downturns in a seemingly erratic manner that undermines confidence in the financial system as a whole.

2. Legal Background on Pre-Crises Resolution Rules.

The pre-crisis framework for bank resolution was based on an approach that categorized financial institutions according to a handful of bright-line rules which then determined the set of procedures that would apply. For traditional deposit-taking banks and thrifts, resolution was handled through an administrative process overseen by the FDIC.[194] Insurance companies and securities broker-dealers were subject to separate specialized regimes, and most other financial firms were resolved in federal court pursuant to the bankruptcy code.[195]

FDIC resolution authority dates back to the New Deal era and is built upon a baseline of unfettered discretion.[196] Banking supervisors can unilaterally initiate the resolution process by placing a bank into federal receivership or conservatorship without its consent.[197] Once that process is underway, they wield a suite of so-called "super-powers" that allow for the reallocation of assets without much regard to the priority of creditors' pre-existing contractual rights.[198] Particularly since the 1980s, a number of significant statutory reforms have been introduced which seek to constrain either the timing of FDIC interventions or its ability to

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194 The FDIC has long held resolution authority for depository banks, pursuant to the Federal Deposit Insurance Act of 1950. 12 U.S.C. § 1823 (2018). It gained thrifts after the 1980s savings-and-loan crisis, pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). 12 U.S.C. § 1811 (2018).

195 As a result of the McCarran-Ferguson Act of 1945, insurance companies are resolved through an administrative process run at the state level by state insurance supervisors. 15 U.S.C. §§ 1011–15 (2018). Securities broker-dealers are subject to special liquidation procedures created in the Securities Investor Protection Act of 1970. *Id.* §§ 78aaa *et seq.* The relevant portions of the federal bankruptcy code were first set forth in Chapter 7 and Chapter 11 of the 1978 Bankruptcy Reform Act.

196 The formative statutes for FDIC resolution authority are the Glass-Steagall Banking Act of 1933, 12 U.S.C. § 227 (2018), and the Federal Deposit Insurance Act of 1950 (FDIA), *id.* § 1823. The latter established the current procedural framework for the FDIC-administered liquidation ("receivership") or reorganization ("conservatorship") of distressed banks. The FDIC's resolution authority was expanded to cover thrifts following the 1980s savings-and-loan crisis, pursuant to the FDICIA. *Id.* § 1811.

197 *Id.* § 1821(c).

198 *Id.*; *see also* BARR, JACKSON & TAHYAR, *supra* note 91, at 910–11 (providing an overview).

kick in public money.[199] A typical bank resolution has nonetheless remained much the same over time. The standard practice is for the FDIC to complete the entire process within the span of a weekend, play a central role in setting its terms, and guarantee an outcome in which both insured depositors and uninsured creditors are made whole as a matter of course.[200]

Things look much different for financial institutions that go through bankruptcy. There, the decision to file is governed by the firm or its creditors, as is the subsequent restructuring of claims.[201] The Article I bankruptcy judges who oversee those negotiations are more like umpires than active participants.[202] Their primary responsibility is to ensure that the parties reach a bargain that is consistent with priority rules and *pari passu* principles requiring equal treatment of similarly situated creditors.[203] Bankruptcy is therefore usually considered a slower and more rule-bound process than FDIC resolution, albeit one that carves out room for judicial discretion and facilitates speedy access to liquidity in some subtle but important ways.[204] Prior to 2008, that process also lacked any obvious route for a distressed financial institution to receive public

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[199] Three of these are worth noting. First, the FDIC's authority to provide Open Bank Assistance—the term for direct bailout-style injections of public funds—was restricted to extraordinary circumstances, as defined by the "systemic risk exception" provided in the Garn-St. Germain Act of 1982. 12 U.S.C. § 1823(c)(4) (2018). Second, a so-called Least Cost Rule was introduced under the FDICIA statute, which requires the FDIC to implement the resolution strategy which imposes the lowest cost on the federal insurance fund. *Id.* Third, a set of requirements known as Prompt Corrective Action were developed, which force the FDIC to initiate the resolution of certain banks according to a pre-determined timeline. *Id.* § 13(c)(1)(G).

[200] *See* BARR, JACKSON & TAHYAR, *supra* note 91, at 898 (providing an overview).

[201] *See* 11 U.S.C. § 301 (2018) (allowing firms to initiate bankruptcy proceedings); *id.* § 303 (providing rules for creditors to "involuntarily" place a firm into bankruptcy court).

[202] Thomas H. Jackson & David A. Skeel, Jr., *Dynamic Resolution of Large Financial Institutions*, 2 HARV. BUS. L. REV. 435, 450 (2012) ("Casual observers of bankruptcy often assume that the bankruptcy judge dictates the terms of a reorganization plan and makes the other important decisions in the case. In reality, the bankruptcy judge functions more like an umpire than a player in most respects. The parties themselves decide whether to sell assets or to propose a reorganization, and the judge either approves or disapproves their handiwork.").

[203] *See* Jackson & Skeel, *supra* note 202, at 1 ("When a commercial bank fails, bank regulators determine how the failure will be resolved, exercising broad discretion that is subject to very little second guessing. In bankruptcy, by contrast, the parties themselves make many of the key decisions, the process is slower and more transparent, and priority rules are more closely adhered to.").

[204] Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy Law as a Liquidity Provider*, 80 U. CHI. L. REV. 1557, 1622 (2013); Robert R. Bliss & George G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes: A Comparison and Evaluation*, 2 VA. L. & BUS. REV. 143, 155 (2007).

funding. The lone mechanism a bank could invoke to obtain direct liquidity assistance from the government was section 13(3) of the 1913 Federal Reserve Act, an obscure provision that had not been used since the Great Depression.[205]

B. POST-CRISIS RESOLUTION RULES

The 2008 financial crisis carried two lessons for bank resolution beyond the headline fact that none of the preexisting regulatory framework worked well.[206] First, the basic logic of a traditional run on bank deposits can apply to financial intermediaries of all kinds—including insurance companies like AIG, investment banks like Lehman Brothers, and the many esoteric financing vehicles which have come to comprise the shadow banking system.[207] The recognition that those institutions perform fundamentally similar economic functions cast doubt on the historical practice of using formalistic legal distinctions to sort them into different resolution regimes. Second, resolution procedures which appear to constrain agencies on paper will only do so in practice if the precommitment devices they employ are "credible," in the sense that they can realistically be applied in a crisis atmosphere.[208] Otherwise, they will simply be ripped up and replaced with new rules. The lack of a credible resolution framework became clear over the course of 2008 and 2009, as the Federal Reserve, the FDIC, and the Treasury Department all took actions which exceeded statutory limits on their lending authority.[209]

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[205] 12 U.S.C. § 343(3) (2018) (allowing the Federal Reserve to make secured loans to individuals, partnerships, and corporations if a super-majority of the Board of Governors determines that they are justified in light of unusual and exigent circumstances).

[206] *See generally* David Zaring, *A Lack of Resolution*, 60 EMORY L.J. 97 (2010) (discussing lessons learned from the Financial Crisis).

[207] *See* John Crawford, *Lessons Unlearned?: Regulatory Reform and Financial Stability in the Trump Administration*, 117 COLUM. L. REV. ONLINE 127, 128 (2017) (arguing that several provisions from the CHOICE Act threaten to undermine U.S. financial stability); Jonathan Macey, *It's All Shadow Banking, Actually*, 31 REV. BANKING & FIN. L. 593, 593 (2011) (discussing the parallels between shadow banks and traditional banks); Turk, *supra* note 95 (discussing the convergence of insurance companies with other financial institutions).

[208] John Crawford, *Credible Losers: A Regulatory Design for Prudential Market Discipline*, 54 AM. BUS. L.J. 107, 146 (2017).

[209] *See* Eric A. Posner, *What Legal Authority Does the Fed Need During a Financial Crisis?*, 101 MINN. L. REV. 1529, 1530 (2016) (discussing how updating the law would provide government agencies with the legal authority needed to resolve a financial crisis). To

1. Dodd-Frank Act.

The biggest step that post-crisis policymakers took in response to those lessons is found in Title II of the Dodd-Frank Act. Those provisions direct federal regulators to establish what is known as the Orderly Liquidation Authority (OLA), an entirely new resolution regime which they require to be drawn up from scratch.[210] They further state that the OLA will be administered by the FDIC and apply to certain large financial institutions that were previously covered by the bankruptcy code.[211] Even for firms under the OLA, the presumptive resolution venue under Dodd-Frank remains bankruptcy. Banks eligible for the OLA, however, can be involuntarily transferred into the FDIC's authority on an expedited basis after a series of procedural hurdles set forth in Title II are satisfied.[212] Most importantly, there must be a consensus finding among the federal banking agencies and the Treasury Department allowing a bank to persist with bankruptcy, as its resolution option "would have serious adverse effects on the financial stability of the United States."[213]

The substantive details of the OLA remained largely incoherent until a 2013 rulemaking fleshed them out with a strategy known as Single Point of Entry (SPOE) resolution.[214] The point-of-entry the rule refers to is the bank's umbrella holding company, which is envisioned as the only entity that the FDIC ever takes into receivership and liquidates.[215] Under the SPOE scheme, losses are

authorize the federal TARP program, Congress hastily rewrote the rulebook on the Federal Reserve's lending authority with the Emergency Economic Stabilization Act in October of 2008. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765. But the Federal Reserve soon exceeded those limits too. *See* Posner, *supra*, at 1558–59 (reviewing the legality of the Federal Reserve's HAMP program for home mortgages); Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 732 (2010) (analyzing the Federal Reserve's post-TARP bailout of the auto companies).

[210] Dodd-Frank, *supra* note 2, § 204.

[211] The OLA covers two groups of financial institutions that would otherwise be in bankruptcy: (1) bank holding companies with more than fifty billion dollars in assets; and (2) any "financial company" that is designated as a "Systemically Significant Non-Bank Financial Institution" by the Financial Services Oversight Council (FSOC), a new umbrella agency for banking supervision that was also created by Dodd-Frank. *Id.* §§ 111–13 (establishing the FSOC and granting it authority to designate non-bank financial companies).

[212] *Id.* § 113.

[213] *Id.*

[214] Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 77 Fed. Reg. 76,614 (Dec. 18, 2013).

[215] *See id.* (discussing what the point of entry rule would apply to).

concentrated exclusively at the holding company level because all of the bank's operating subsidiaries are automatically transferred to a new bridge holding company with their assets untouched.[216] The SPOE procedure is often regarded as an ingenious piece of administrative engineering.[217] At least in theory, it reduces resolution to a mechanical process that eliminates the threat of runs overnight while also obviating the need for publicly funded bailouts.[218]

In addition to its new resolution procedures, Dodd-Frank also introduced a pair of regulations that banks must comply with during the normal course of business so that they are better prepared for any potential resolution proceeding. One requirement, known as the TLAC Rule, seeks to enhance banks' "total loss absorbing capacity" by mandating that they maintain a minimum proportion of long-term relative to short-term debt.[219] The TLAC Rule resembles a capital adequacy regulation on its face, and is sometimes interpreted as such. Its primary purpose, however, appears in the context of the SPOE resolution, where the long-term debt at issue is intended to serve as a prepackaged "bail in" fund that can be tapped by the FDIC when liquidating the bank holding company.[220]

The other novel pre-resolution regulation in Dodd-Frank is a requirement that large financial institutions develop planning documents called Living Wills.[221] In its Living Will, a bank is expected to provide a detailed roadmap for how its legal and financial structure would be amenable to "rapid and orderly resolution" in the event the firm encounters a period of material financial distress.[222] The Living Wills must be submitted to the

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[216] *Id.* at 76,615–19.

[217] *See* John Crawford, *Resolution Triggers for Systematically Important Financial Institutions*, 97 NEB. L. REV. 65, 79 (2018) (calling SPOE an "ingenious two-pronged solution").

[218] For an overview, see generally John Crawford, *Single Point of Entry: The Promise and Limits of the Latest Cure for Bailouts*, 109 NW. U. L. REV. ONLINE 103 (2014) (discussing long-term debt requirements and the probability of bailouts).

[219] Total Loss-Absorbing Capacity (TLAC): Final Rule, 12 C.F.R. § 252 (Dec. 15, 2016).

[220] *See* Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 77 Fed. Reg. 76,615 (Dec. 18, 2013).

[221] Dodd-Frank, *supra* note 2, §165(d).

[222] *See* Resolution Plans Required, 76 Fed. Reg. 67,323 (Nov. 1, 2011) (to be codified at 12 C.F.R. pt. 381) (setting forth the final administrative rule for Living Wills); *see also* BD. OF

Federal Reserve and the FDIC, which are responsible for determining whether the bank's game plan is either "credible" or instead "would not facilitate an orderly resolution."[223] An adverse finding on that count triggers a round of revision by the bank. If a Living Will is still not approved upon subsequent re-reviews, the agencies are authorized to impose an increasingly draconian schedule of penalties.[224]

Dodd-Frank's preamble declares that the statute is meant "to end too big to fail, [and] to protect the American taxpayer by ending bailouts."[225] Dodd-Frank also enacts a set of changes which directly target that goal. Most notably, it narrows the lending power provided under section 13(3) of the Federal Reserve Act, which was dusted off by the Fed as the legal grounds for its *ad hoc* bailouts of Bear Stearns and AIG in 2008.[226] It also amends the statutory bases for emergency lending by the FDIC and Treasury Department by revising those provisions so that they expressly prohibit any repeat of the bailout programs that were deployed during the crisis.[227]

2. The CHOICE Act & Treasury Report Proposals.

If the CHOICE Act were to become law, essentially none of the post-crisis resolution reforms summarized above would remain intact. For large banks that satisfy the bill's Off-Ramp safe harbor, the TLAC Rule and Living Wills requirements in Dodd-Frank do not apply.[228] While Dodd-Frank narrows the statutory lending authority of the Federal Reserve, the FDIC, and the Treasury Department, the CHOICE Act removes that authority altogether (so that bailout-style funding is no longer available under any circumstances).[229] And most impressive of all, it eliminates the OLA

GOVERNORS OF THE FED. RESERVE SYS. & FED. DEPOSIT INS. CORP., RESOLUTION PLAN ASSESSMENT FRAMEWORK AND FIRM DETERMINATIONS (2016) [hereinafter RESOLUTION PLAN] (providing further detail on what Living Wills must include).

[223] RESOLUTION PLAN, *supra* note 222, at 3.

[224] *Id.*

[225] Dodd-Frank, *supra* note 2, § 1.

[226] Ian Katz, *Federal Reserve Pressured to Narrow Emergency Bailout Powers*, INS. J. (Nov. 18, 2015), https://www.insurancejournal.com/news/national/2015/11/18/389295.htm.

[227] *See* 12 U.S.C. §§ 5611–13 (2018) (modifying the FDIC's systemic risk exception); *id.* § 5236(b) (stating that the Treasury Department may not use its "Exchange Stabilization Fund" to bailout mutual funds or securities broker-dealers).

[228] Financial CHOICE Act of 2017, H.R. 10, 115th Cong. §§ 601–03 (2017).

[229] *See* Financial CHOICE Act of 2016, H.R. 5983, 114th Cong. § 707 (2016) (repealing the Federal Reserve's section 13(3) powers); *id.* § 242 (eliminating the systematic exception for FDIC Open Bank Assistance).

by repealing Title II of Dodd-Frank in full.[230] In its place, the CHOICE Act incorporates another bill, the Financial Institution Bankruptcy Act of 2017 (FIBA), which has also been passed by the House of Representative on a standalone basis.[231]

By adopting the FIBA, the CHOICE Act moves big banks that were formerly eligible for the Orderly Resolution Authority back into federal bankruptcy court, while also amending traditional bankruptcy procedures to accommodate the unique issues posed by large financial institutions.[232] A couple aspects of the FIBA are particularly significant. The first is that it grants the federal agency responsible for supervising a bank standing to intervene as a party to the bankruptcy proceeding, where it can then enter motions with the court.[233] Second, the FIBA provides a mechanism that allows the bank holding company to refinance its operating subsidiaries on a wholesale basis by transferring them to a new bridge entity which is then to be managed by a court-appointed trustee.[234] A critical feature of this setup is the timeline under which it takes place. For a number of legal and practical reasons, terms of the transfer must be finalized by a bank and approved by its bankruptcy judge within the first twenty-four hours that it has filed a petition for bankruptcy under Chapter 11.[235]

The Treasury Department has also issued a report that proposes a comprehensive remake of the resolution rules which have been adopted since the financial crisis.[236] As in the capital adequacy context, the Treasury is broadly favorable to the general orientation

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[230] *See* H.R. 10, 115th Cong. § 111 (repealing OLA); *id.* § 211 (removing FSOC designation authority).

[231] *See id.* §§ 121–23 (adopting Financial Institution Bankruptcy Act of 2017, H.R. 1667, 115th Cong. (2017)).

[232] Those accommodations are contained in a new Subchapter V which the FIBA adds to Chapter 11 of the Bankruptcy Code and its rules for corporate reorganizations. H.R. 1667, 115th Cong. § 1181; *cf.* Adam Levitin, *Financial CHOICE Act: Unworkable*, 35 AM. BANKR. INST. J. 8 (2016) (providing a skeptical overview).

[233] H.R. 1667, 115th Cong. § 1187(a).

[234] *Id.* §§ 1185–87.

[235] To approve the transfer, the bankruptcy judge must find that it is necessary to prevent serious adverse effects on the financial stability of the United States. *Id.*

[236] *See generally* U.S. DEP'T OF TREASURY, REPORT ON ORDERLY LIQUIDATION AUTHORITY AND BANKRUPTCY REFORM (Feb. 21, 2018) [hereinafter TREASURY OLA REP.]; *see also* U.S. DEP'T OF TREASURY, REPORT ON FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATIONS (Nov. 17, 2017); Memorandum on Orderly Liquidation Authority, 2017 DAILY COMP. PRES. DOC. 266 (Apr. 21, 2017).

of the CHOICE Act while nonetheless suggesting a more measured approach. It cautions against scrapping Dodd-Frank's OLA outright, while acknowledging that it should only serve as a resolution "option of last resort in extraordinary circumstances."[237] Like the CHOICE Act, the Treasury would modify the bankruptcy code to better deal with large financial institutions. The details on how to do so follow a prominent proposal for a new "Chapter 14" bankruptcy process, laid out by scholars at the Hoover Institution, on which the FIBA is loosely based.[238] Lastly, the Treasury Department's reports on the OLA signal its willingness to retain the TLAC Rule and Living Wills requirements, but in a substantially more limited form.[239]

3. Impact on Regulatory Structure.

Especially for critics of the Dodd-Frank Act, post-crisis reforms have fundamentally changed the legal framework for bank resolution in two ways. First, they are seen as marking a massive shift toward discretionary standards and administrative fiat. Resolution authority after Dodd-Frank has been called an affront to rule-of-law values,[240] described as a vehicle for the unconstitutional seizure of private property,[241] and likened to the monarchical "Star Chamber" from medieval Britain.[242] A second common assertion is that post-crisis rules have effectively reduced the intensity of bank resolution procedures by establishing implicit government guarantees for distressed institutions. Specifically, the OLA has allegedly "institutionalize[d] bailouts" for Too Big To Fail banks and

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[237] TREASURY OLA REP., *supra* note 236, at 28.

[238] *Id.* at 24–31; *see also* HOOVER INST., MAKING FAILURE FEASIBLE: HOW BANKRUPTCY REFORM CAN END "TOO BIG TO FAIL" (Kenneth E. Scott et al. eds., 2015) (discussing how to update the bankruptcy code).

[239] On Living Wills, see TREASURY OLA REP., *supra* note 236, at 13–16. On the TLAC Rule, see *id.* at 15–17 and TREASURY BANK'G REP., *supra* note 6, at 67–68.

[240] *See* SKEEL, *supra* note 44, at 9 (arguing that Dodd-Frank's resolution rules are "divorced from basic rule-of-law constraints").

[241] *See* Thomas W. Merrill & Margaret L. Merrill, *Dodd-Frank Orderly Liquidation Authority: Too Big for the Constitution?*, 163 U. PA. L. REV. 165, 172 (2014) (concluding that the OLA is an unconstitutional in light of the Fifth Amendment's Takings Clause, among several other grounds).

[242] C. Boyden Gray, *Dodd-Frank, the Real Threat to the Constitution*, WASH. POST (Dec. 31, 2010), https://www.washingtonpost.com/wp-dyn/content/article/2010/12/30/AR2010123003482_pf.html (using the Star Chamber metaphor).

thereby replaced market discipline with moral hazard.[243] Neither of these are even-handed assessments.

First, if anything, there has been a modest drift away from *ex post* standards in bank resolution relative to the pre-crisis status quo.[244] With respect to the OLA, new requirements in Dodd-Frank take the form of *ex ante* rules about as often as they are framed as standards.[245] In fact, the mix of resolution rules versus standards enacted since the crisis is roughly the same as those found in the CHOICE Act or the Treasury Reports. The SPOE resolution framework in Dodd-Frank seeks to make the traditional administrative process more mechanical and predictable; the FIBA and Chapter 14 proposals build a greater role for speed and bureaucratic judgment into the bankruptcy format; and as an end result, the two approaches come close to meeting in the middle.[246]

Second, in light of the numerous restrictions that Dodd-Frank explicitly places on the availability of government liquidity assistance to big banks,[247] the idea that post-crisis regulations have institutionalized bailouts makes little sense on paper. The real argument, of course, is that the OLA is structured in a way that will lead regulators to disregard those restrictions as a practical matter. But that argument cuts both ways. When the next crisis hits, the Federal Reserve may decide to ignore the CHOICE Act's constraints on its authority too. In reality, the market discipline which actually gets imposed under either the FIBA or the OLA is equally limited by the extent that those rules are perceived as plausible options for a systemically interconnected bank. The two regimes therefore do not reflect any profound disagreement over the optimal intensity of

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[243] *See* HOUSE CHOICE ACT REP., *supra* note 45, at 154.

[244] None of the rules governing the FDIC's resolution authority for traditional deposit-taking banks are more discretionary after Dodd-Frank, while several are less so. In addition, many non-bank financial institutions remain subject to the exact same bankruptcy rules that applied as of 2007.

[245] While the Living Wills take the form of discretionary standards, the TLAC regulation is an *ex ante* rule. Eligibility for OLA is based partially on a rule (which automatically covers large bank holding companies) and partially on a standard (which allows the FSOC to designate institutions for the OLA on a discretionary basis).

[246] *See* HOOVER INST., *supra* note 238, at 15–16 (describing the SPOE strategy as model for the FIBA); Stephen J. Lubben & Arthur E. Wilmarth, Jr., *Too Big and Unable to Fail*, 69 FLA. L. REV. 1205, 1239 (2016) (arguing that proposals like the CHOICE Act "do little more than allow the use of SPOE in bankruptcy proceedings outside of OLA").

[247] *See supra* Section IV.B.2.a (summarizing the Dodd-Frank provisions to this effect).

resolution procedures—the common goal in each case is a credible set of rules that allow large financial institutions to be resolved without the need for bailouts. The only debate is over how that is best accomplished.

The clearest dividing line in that debate again turns on regulatory overlap. Although post-crisis policymaking on bank resolution has not produced the sheer volume of rules that were seen in the case of capital adequacy, its impact is similar in scale. Dodd-Frank overlays the bankruptcy process for large financial institutions with an elaborate parallel administrative authority (the OLA), and further overlays those procedural mechanism with an unprecedented body of pre-resolution planning regulations (the TLAC Rule and Living Wills).[248] Meanwhile, the most immediate result of the CHOICE Act is to reverse every rule in Dodd-Frank that is required to return the degree of overlap to its pre-crisis level. The underlying rationales are familiar as well. Overlap in the resolution rules of Dodd-Frank is often explicitly justified on the grounds that they form a network of regulatory complements.[249] A premise of the CHOICE Act is that, after the FIBA has tailored the bankruptcy code to the needs of large financial institutions, those procedures can perfectly substitute for all the rules they displace.[250]

C. OPTIMAL REGULATORY OVERLAP IN BANK RESOLUTION

Once the optimal scope of regulatory overlap in bank resolution is properly understood, many of the central open questions over what to do with Too Big To Fail financial institutions are resolved as well. An obvious entry point on the front concerns the relationship between Dodd-Frank's OLA and bankruptcy rules under the FIBA. A recent letter to Congress on behalf of a number of leading bankruptcy and banking scholars (the OLA Letter) appears to express the view that those procedures are complements,

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[248] *See* Howell E. Jackson & Stephanie Massman, *The Resolution of Distress Financial Conglomerates* 49–50 (Harv. Pub. L., Working Paper No. 17-14, 2017), https://ssrn.com/abstract=2912980 (discussing the interplay between Dodd-Frank and the OLA).

[249] *See infra* note 251 and accompanying text.

[250] *See* Jackson & Skeel, *supra* note 202, at 446 (arguing that the bankruptcy code should be reformed so that OLA is unnecessary); Stephen Lubben, *The FDIC's Lehman Fantasy*, N.Y. TIMES: DEALBOOK (Apr. 29, 2011), https://dealbook.nytimes.com/2011/04/29/the-f-d-i-c-s-lehman-fantasy/ ("Once a financial firm has become in need of resolution, there has already been a failure of regulation.").

stating that "bankruptcy cannot substitute for resolution via the [OLA]" because the "financial system will still need [the] OLA to make [the] FIBA work."[251]

While a fair reading of the OLA Letter as a whole suggests that the above-quoted passages may involve some clumsy language, when taken at face value, they reflect a fundamental mistake. The OLA does not make the FIBA work better, any more than coffee makes tea taste better. Instead, it serves as a substitute for the FIBA in cases where regulators have strong reasons to suspect that administrative resolution would be preferable to bankruptcy. By preserving the OLA alongside a modified Chapter 14 bankruptcy mechanism, the Treasury Department's proposal adopts the position that at least a sliver of such cases may exist. That position also aligns with the main thrust of the OLA Letter, which urges that the FIBA and OLA should be jointly applied as partial (rather than perfect) substitutes.[252]

A deeper source of confusion involves Dodd-Frank's Living Wills, which have been widely criticized from a variety of angles and are perhaps the most controversial of all the post-crisis regulatory innovations.[253] One common critique is that because Living Wills are entirely speculative documents that do not legally bind any bankruptcy judge or administrative authority, they amount to "sham, meaningless boilerplate, and box checking."[254] Another prominent source of skepticism stems from the fact that the FDIC and Federal Reserve have consistently determined that nearly all

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[251] Letter from Jeffrey Gordon, Professor, Harvard Law Sch., and Mark Roe, Professor, Columbia Law Sch., to the Chairs and Ranking Members of the Senate and House Banking and Judiciary Committees (May 23, 2017), https://corpgov.law.harvard.edu/wp-content/uploads/2017/05/Scholars-Letter-on-OLA-final-for-Congress.pdf.

[252] *See id.* ("Bankruptcy cannot substitute for resolution via the Orderly Liquidation Authority administered by the FDIC.").

[253] David K. Suska, *Reappraising Dodd-Frank's Living Will Regime*, 36 REV. BANKING & FIN. L. 779, 783 n.19 (2017) (observing that the academic commentary on Living Wills has been mostly critical).

[254] Brad Miller, *Regulators, Demand Credible Living Wills Now—Not "Ultimately*,*"* AM. BANKER (Dec. 26, 2013), https://www.americanbanker.com/opinion/regulators-demand-credible-living-wills-now-not-ultimately (quoting MIT economist Simon Johnson); *see also* Baradaran, *supra* note 139, at 1307–08; Nizan Geslevich Packin, *The Case Against Dodd-Frank Act's Living Wills: Contingency Planning Following the Financial Crisis*, 9 BERKELEY BUS. L.J. 29, 30 (2012) (concluding that living wills are not a "satisfactory regulatory solution to the too-big-to-fail problem").

of the resolution plans submitted for their review are "not credible."[255] Those determinations are usually seen as demonstrating that Living Will requirements do not contribute to solving the problem of Too Big To Fail banks.[256]

Most of these claims miss the mark, however, because they only look at resolution plans in isolation. Within a framework of overlapping rules, the criticism that those requirements are non-binding or non-credible lose force, since it is clear that Living Wills are ancillary to the credibility of the bankruptcy code or related resolution procedures which *are* legally binding. Once Living Wills are examined in conjunction with the applicable resolution regulations, a surprising set of interactions appears. On one hand, it turns out that Living Wills share a complementarity with core components of the reforms which otherwise seek to marginalize or repeal them. On the other hand, resolution plans primarily function as substitutes for rules in Dodd-Frank which they were originally designed to complement.

Living Wills complement the new bankruptcy procedures provided in the CHOICE Act and make them work better. The primary effect of the FIBA is to accelerate the resolution process and concentrate responsibility for its outcome in the hands of the bankruptcy judge, who must determine within a twenty-four-hour period whether a bank may go forward with its reorganization strategy.[257] This timeline places a premium on a bank's ability to simplify its existing legal structure, partner with private liquidity providers in the midst of market disruptions, and provide access to the information that a court would need to make an informed judgment on short notice. By forcing large financial institutions to invest in all of these capacities *ex ante*, resolution plans raise the likelihood that a disorderly bankruptcy such as the one that took place at Lehman Brothers can be avoided. Simply put, the faster and more binding you want bankruptcy for Too Big To Fail banks to be, the more you need Living Wills. The Treasury Department's

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[255] Joint Press Release, Bd. of Governors of the Fed. Reserve Sys. & Fed. Deposit Ins. Corp., Agencies Provide Feedback on Second Round Resolution Plans of "First-Wave" Filers (Aug. 5, 2014), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20140805a.htm (rejecting all eleven of the first group of Living Wills, submitted in 2013); *see also* RESOLUTION PLAN, *supra* note 222 (rejecting many of the second-round of Living Wills submitted in 2015).

[256] *See, e.g.*, Edward Cho et al., *Did Dodd-Frank Miss the Mark? Financial Experts' and Regulators' Perspective on Resolution Plans*, 80 J. BANKING REG. 80 (2017) (assessing the perspectives of experts close to the resolution plans).

[257] *See* Financial Institution Bankruptcy Act of 2017, H.R. 1667, 115th Cong. (2017).

Chapter 14 model is flawed for this reason as well.[258] In proposing a less intensive role for Living Wills while also seeking to make bankruptcy the resolution vehicle of choice, it runs counter to the more-of-both logic of regulatory complements.[259]

By contrast, Living Wills are either perfect or imperfect substitutes for many of the post-crisis regulations which they accompanied. A defining feature of the SPOE strategy developed under Dodd-Frank is its automation of the resolution process at its earliest stages to avoid scenarios where time is of the essence for regulators to take decisive action;[260] the TLAC Rule "pre-positions" a readymade source of short term liquidity that the FDIC can use for the same purpose as well.[261] Thus, for the OLA—and even more so for traditional bank resolutions overseen by the FDIC—other procedural mechanisms substitute for the nimble decisionmaking that Living Wills aim to facilitate in the bankruptcy context.[262] The same substitutability also holds between Living Wills and capital adequacy requirements in Dodd-Frank, despite the guidance issued by the Federal Reserve which describes those rules as complements.[263] The more equity a bank has, the less likely it is to enter into distress, and therefore it is less important (at the margin) to anticipate how that contingency might be managed with resolution planning.

Shifting to a perspective that focuses on the effects of overlapping rules provides a clearer picture of how the regulatory architecture governing bank resolution functions as a whole. As with the case study of capital requirements, it also allows for a relatively balanced, deliberative approach to what has otherwise been a vitriolic policy debate. Rather than reflecting an excess of technocratic ambition, using the OLA mechanism as a backstop that overlaps with the FIBA in exceptional circumstances is a way to

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[258] *See* TREASURY OLA REP., *supra* note 236.

[259] *See id.*

[260] *See* Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 77 Fed. Reg. 76,614 (Dec. 18, 2013).

[261] *See* David A. Skeel, Jr., *Single Point of Entry and the Bankruptcy Alternative* (explaining why timing is less of an issue under SPOE), *in* ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS 311–33 (Martin Neil Baily & John B. Taylor eds., 2014).

[262] Accordingly, the Treasury Department's proposal to eliminate Living Wills for FDIC-insured banks makes good sense. TREASURY OLA REP., *supra* note 236.

[263] *See, e.g.*, RESOLUTION PLAN, *supra* note 222, at 5.

recognize the limits of what the bankruptcy process may reasonably be expected to do. Likewise, rather than escalating the problems of regulatory complexity or bureaucratic fiat, the joint use Living Wills with the FIBA *enhances* rule-of-law values by making resolution through bankruptcy a more viable, tractable option.[264] The overlap of Living Wills with bankruptcy procedures increases predictability of resolution procedures and supports market discipline by making it less likely that government officials will intervene in a disorderly bankruptcy process to prevent wider market panics. Particularly given the amount of public outrage over the way that bailouts were handled during the financial crisis, the common ground that a regulatory overlap framework can forge on resolution issues makes it especially valuable.

VI. OVERLAP AND THE ADMINISTRATIVE STATE

The model of regulatory overlap provided in this Article can apply to legal rules in any form: constitutions, statutes, agency regulations, municipal ordinances, or even the standards set within private organizations such as corporate bylaws. At the same time, analyzing overlap in the context of financial regulation provides insights which are especially relevant to the administrative process. This Part surveys three aspects of administrative law where this Article's theoretical framework and case studies combine to have broader implications: (1) cost-benefit analysis requirements, (2) the role of uncertainty in the regulatory environment, and (3) the structure of agency jurisdiction. An overarching point is to suggest that progress can be made on many important questions in administrative law and financial regulation by bridging the divide that currently exists between those disciplines and exploring them in conjunction.

A. LIMITATIONS OF COST-BENEFIT ANALYSIS PROCEDURES

Over the past three decades, cost-benefit analysis (CBA) has emerged as a fixture of the administrative state due to a series of bipartisan executive orders requiring agencies to undertake CBA

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[264] *Cf.* Adam Feibelman, *Living Wills and Pre-Commitment*, 1 AM. U. BUS. L. REV. 93, 108–12 (2011).

when formulating significant regulations.[265] While the use of CBA has always generated controversy, the epicenter of those contests has drifted squarely toward financial regulation in recent years. The underlying cause has been a number of high-profile decisions in the U.S. Court of Appeals for the D.C. Circuit which extend the scope of CBA requirements to financial agencies previously unbound by the applicable executive orders (or otherwise use the failure to satisfy CBA as a basis for striking down regulations via a kind of quasi-hard look review).[266] The resulting debate's focus is twofold. First, regarding the wisdom of CBA as device for holding agencies accountable pursuant to judicial review,[267] and second, as it is used by the agencies themselves, where many argue that the CBA process suffers from various methodological weaknesses which limit its value as a tool for evaluating policy in financial regulation.[268]

Despite the critiques levelled at CBA, however, one important methodological limitation of those procedures has not received widespread attention. That is that the agencies typically perform a CBA by examining one rule at a time without taking into account whether it overlaps with other regulations. To be sure, relevant case law and executive branch directives contain language instructing agencies to analyze their rules in light of alternative rulemaking options, or against the backdrop of preexisting regulations, and so on.[269] But that language tends to be largely hortatory and, in

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[265] *See* Coates, *supra* note 68, at 1002–03 (summarizing legal bases for administrative CBA requirements).

[266] *See, e.g.*, Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011); Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166 (D.C. Cir. 2010); Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005). The reason why CBA requirements do not necessarily apply is that many financial regulators, such as the SEC and Federal Reserve, are considered "independent agencies" and are therefore not automatically subject to executive orders. *See* Coates, *supra* note 68, at 885–89 (summarizing the legal bases for CBA requirements).

[267] *See generally* Cass R. Sunstein, *Financial Regulation and Cost-Benefit Analysis*, 124 YALE L.J. F. 263 (2015).

[268] *See* Coates, *supra* note 68, at 887 (arguing that a CBA of financial regulation presents a number of methodological challenges, with the result that it "amounts to no more than 'guesstimation'"); Jeffrey Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351, S352 (2014) ("[T]he idea of BCA as applied to financial regulation is a serious category mistake. For any nontrivial problem it is conceptually wrongheaded, empty. It misunderstands the origins and utility of BCA and, in particular, the difference between natural and constructed systems.").

[269] *See, e.g.*, Inv. Co. Inst. v. SEC, 720 F.3d 370 (D.C. Cir. 2013).

practice, has not been implemented in any formalized or credible manner.[270] For the most part, the costs and benefits of a given rule are tallied up on a standalone basis. The failure to factor in overlap leads the standard CBA procedures astray because it means that they overestimate the benefits of regulatory substitutes (which crowd each other out) and underestimate the benefits of regulatory complements (which amplify one another).[271]

Although the final administrative rulemaking for Dodd-Frank's Living Wills was never subject to an official CBA,[272] the policy debate surrounding that regulation provides a nice illustration of the relevant blind spots. For critics who have characterized resolution plans as non-binding "shams" that do not credibly end Too Big To Fail, the implicit claim is that those requirements provide minimal benefits and would therefore fail a CBA.[273] Outside of an overlap framework, it is hard to see where that analysis goes wrong. But in light of the efficiencies that arise from Living Wills in connection with the resolution of financial institutions through the bankruptcy code, it becomes equally easy to see how a regulation that would fail a CBA on its own terms may ultimately provide a net benefit when it overlaps with a complementary rule.[274] Resolution plans also exemplify the converse case, where the joint use of regulatory substitutes delivers decreasing benefits. When Living Wills are imposed on deposit-taking banks, which cannot file for bankruptcy and are exclusively resolved by the FDIC, most of their value added to the resolution process is lost.[275]

The massive scale of administrative rulemaking following the crisis exposes further problems that appear when CBA does not account for regulatory overlap. A standard approach that agencies use to conceptualize the benefits of rules in Dodd-Frank is to

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[270] *See generally* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-101, AGENCIES' EFFORTS TO ANALYZE AND COORDINATE THEIR RULES (2012).

[271] The basic aggregation problem can be simplified as follows. In the extreme case of perfect substitutes, each of which increases social welfare by a hypothetical magnitude of "two" when use in isolation, there is total redundancy in the overlap scenario so that two plus two equals four. For imperfect substitutes, two plus two equals somewhere around three. The enigmatic "super-additive" property of complements means that their joint use makes it possible for two plus two to equal five. *See supra* notes 54–61 and accompanying text.

[272] The financial agencies that jointly issued the rule for Living Wills—Regulation QQ—were not required to perform a formal CBA under existing executive orders. Suska, *supra* note 253, at 793.

[273] *See supra* notes 216, 255 and accompanying text.

[274] *See supra* notes 216, 255 and accompanying text.

[275] *See supra* notes 216, 255 and accompanying text.

stipulate the "total social cost" of a future financial crisis and multiply that figure by the probability that the rule in question would prevent its occurrence.[276] Suppose that, on average, the agencies predict each rule would reduce the chance of another crisis by a modest one percent (along with a number of other generous assumptions).[277] Something curious happens when the official CBA procedure is no longer applied to the 390 rulemakings required under Dodd-Frank on a rule-by-rule basis: as of Rule 100, the possibility of a future financial crisis in the United States has been entirely eliminated.[278] Even stranger, it is logically impossible for Rules 101 through Rule 390 to have any benefits for society, because they seek to prevent an outcome that now has a zero percent chance of happening. The result is that, by its own terms, CBA in its current form becomes self-refuting as the degree of overlap rises past a certain point.[279]

Neither CBA mandates nor overlapping rules are unique to financial regulation, which merely provide extreme examples of what are otherwise pervasive features of the administrative state.[280] The joint use of multiple rules is a staple at agencies responsible for labor and employment regulation, transportation policy, and health-and-safety standards, to name just a few.[281] This

[276] As an example, the benefit of a rule that reduces the likelihood of a $100 crisis by fifty percent is $50. *See* POSNER & WEYL, *supra* note 105, at S25 (explaining this methodology).

[277] For instance, this assumes that the rules in question all, in fact, produce a net benefit and that CBA can provide an unbiased measure of that benefit.

[278] For more information about the required rulemakings, see *supra* note 5. This logical conclusion, that the first one hundred rules adequately safeguard against future financial crisis, rests on the assumption that each rule reduces the current likelihood by one percent.

[279] *See* Chester S. Spatt, *Complexity of Regulation*, 3 HARV. BUS. L. REV. ONLINE 1, 4 (2012) (providing a rare recognition of this conceptual problem for CBA).

[280] *See* POSNER & WEYL, *supra* note 105, at S1–2 (identifying uses by the EPA, NHTSA, OMB, and OIRA).

[281] The National Highway Traffic Safety Administration (NHTSA), for example, administers multiple disclosure and minimum safety standard rules in connection with car tires. *Compare* 49 U.S.C. § 30119(a)(5) (2018), *with id.* § 30120(d), *and id.* § 30123. In 2005, the NHTSA issued a final rule in connection with its Tire Pressure Monitoring System regulations, which is over 200 pages long and contains numerous overlapping requirements on the issue of tire pressure monitoring. Federal Motor Vehicle Safety Standards: Tire Pressure Monitoring Systems; Controls and Displayers, 49 C.F.R. §§ 571, 585 (2019). As another example, the Occupational Safety and Health Administration has issued multiple regulations concerning the risks of falling in the workplace. *See, e.g.*, 29 C.F.R. § 1926.501 (2019) (fall protection: construction); 29 C.F.R. § 1926.503 (2019) (fall protection: training

means that the limitations of CBA as a decisionmaking procedure for overlapping rules in finance apply to a substantial extent at the wholesale level for the regulatory process in general.[282] Two basic takeaways follow from this observation.

First, regardless of whether congressional or judicial efforts to broaden the scope of CBA requirements prove successful, these measures will only represent a small step toward measuring the actual costs and benefits of regulations.[283] As the analysis of CBA in the context of Dodd-Frank shows, the need to incorporate regulatory overlap is a matter of basic logical consistency—rather than perfecting an ideal methodological framework—and the current failure to do so leaves much more than rounding errors at stake. Thus, granting that the present version of CBA is a useful and important practice, its results should still be interpreted as providing but one data point among others. The lesson from financial regulation is that quantification does not necessarily provide a more precise picture of the world than verbal descriptions or other more intuitive assessments. A further requirement is that the assumptions used to generate those calculations are coherent.

A second point, which builds directly on the first, is that it would be worthwhile to invest in the research and development of CBA methodologies that attempt a more realistic view of regulatory overlap. In fact, several executive branch entities which serve as umbrella regulators of other agencies—such as the Office of Information and Regulatory Affairs (OIRA), the Financial Stability Oversight Committee (FSOC), and the Federal Reserve—have already been tasked with rationalizing and improving the nuts-and-bolts of agency CBA.[284] Placing the complications posed by overlapping rules at the top of those programs' to-do lists makes good sense. Those efforts are likely to pay off, despite the considerable practical and conceptual hurdles which must be

requirements). *See generally Top 10 Most Frequently Cited Standards for Fiscal Year 2018*, OSHA, https://www.osha.gov/top10citedstandards (last visited Feb. 18, 2020).

[282] *Cf.* POSNER & WEYL, *supra* note 105, at S13–16 (responding to potential objections concerning CBA as applied to financial regulations).

[283] *Cf.* Financial CHOICE Act of 2017, H.R. 10, 115th Cong. §§ 311–21 (2017) (calling for agencies to perform more extensive CBA); TREASURY CAP. MKTS. REP., *supra* note 6, at 180 (same).

[284] *See generally* Ryan Bubb, Comment, *The OIRA Model for Institutionalizing CBA of Financial Regulation*, 78 LAW & CONTEMP. PROBS. 47 (2015); Richard L. Revesz, *Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation*, 34 YALE J. ON REG. 545, 575–93 (2017).

cleared to rigorously quantify the consequences of overlap.[285] That is because models which directly account for overlap would serve an ancillary function often cited by advocates of CBA. Namely, that no matter how unreliable agencies' estimates are, there is value in making those estimates more explicit to improve transparency by forcing regulators to lay bare their assumptions.[286] As the case studies in this Article indicate, agencies constantly make assumptions about the implications of regulatory overlap—including the assumption that it can be ignored altogether—but most are anything but transparent.

B. POLICYMAKING UNDER UNCERTAINTY

The preceding discussion explained why a neglect of regulatory overlap can undermine the validity of CBA, even in an ideal world where the costs and benefits of individual rules can be determined with absolute precision. A separate issue concerns the role of overlap where there is uncertainty in the policymaking environment.[287] Although there are many models of policymaking under uncertainty, a standard simplifying assumption in the vast majority of cases is that only a single policy rule can be chosen at any given time. The issue is then framed as how to choose the best rule under challenging, low-information circumstances.[288] A number of solutions have been proposed along these lines, many of which are tailored specifically to the administrative rulemaking

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[285] *See, e.g.*, Charles A.E. Goodhart et al., *Financial Regulation in General Equilibrium* 43 (Nat'l Bureau of Econ. Research, Working Paper No. 17909, 2012) (providing a recent attempt at modeling regulatory overlap and noting its limitations).

[286] *See* POSNER & WEYL, *supra* note 105, at S11 (arguing transparency inhibits agencies from promulgating rules "on ideological, political, or other improper grounds").

[287] As used here, "uncertainty" refers to any situation where it is difficult to estimate the effects of implementing a particular rule in advance. In general, there are two basic sources of policy uncertainty. First, there is often a baseline "epistemic" uncertainty about the source and magnitude of market failures. In other words, the nature of the policy presents a problem itself. Second, there is uncertainty about the future behavior of regulated parties, who have an incentive to develop avoidance strategies in response to a new rule. In short, the problem is one of regulatory arbitrage.

[288] *See, e.g.*, Krishnamurthy, *supra* note 43, at S294; Jonathan S. Masur & Eric A. Posner, *Unquantified Benefits and the Problem of Regulation Under Uncertainty*, 102 CORNELL L. REV. 87, 92 (2016) (arguing agencies can still reasonably estimate CBA results with little information).

process—including proposals for "staged" or "phased" rulemakings, "experimental" regulations, and "real options" approaches.[289]

In all of those models, however, the possibility of overlap is assumed away at the outset. That is a major oversight because one of the most significant implications of policymaking under uncertainty is that it changes the optimal degree of regulatory overlap. Specifically, uncertainty makes it difficult to say *ex ante* whether any given pair of rules are perfect substitutes, because that would require knowing that there is complete redundancy in the effects that those rules have on regulated parties and the corresponding benefits they provide. In effect, uncertainty means that the level of overlap should increase, since a broader set of rules must be treated as imperfect substitutes. The theoretical claim here sounds abstract, but it is disarmingly simple. It is a restatement of the folk wisdom that cautions against putting all of one's eggs in the same (policy) basket. It also restates the basic logic of diversification as set forth in modern portfolio theory, which explains why the strategy of investing in a single "best" security is almost always sub-optimal whenever there is variance in its expected return.[290]

The use of overlapping rules as a diversification strategy can be seen at work in this Article's case study of capital adequacy regulations. There, a decent argument could be made that the seemingly manic spree of overlapping capital rules that arrived after the crisis were in fact justified at the time of Dodd-Frank's passage. Given the vast uncertainty which events from 2007 to 2009 introduced, a sensible approach was to formulate a broad menu of rules, while keeping each rule relatively light-touch. What makes less sense is the subsequent expansion of overlap that continued after 2010, such as the development of additional stress test procedures.[291] Uncertainty naturally decreases with distance from

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[289] *See, e.g.*, Zachary J. Gubler, *Experimental Rules*, 55 B.C. L. REV. 129 (2014) (experimental regulations); Yoon-Ho Alex Lee, Essay, *An Options Approach to Agency Rulemaking*, 65 ADMIN. L. REV. 881 (2013) (real options); Matthew Spitzer & Eric Talley, *On Experimentation and Real Options in Financial Regulation*, 43 J. LEGAL STUD. S121, S126–28 (2014) (real options); Charles K. Whitehead, *The Goldilocks Approach: Financial Risk and Staged Regulation*, 97 CORNELL L. REV. 1267 (2012) (staged rulemakings).

[290] Portfolio theory demonstrates that there are gains from dividing a single investment across multiple securities—including securities that have identical expected returns—whenever the returns on those securities are not perfectly correlated with one another and are unpredictable in advance. *See generally* Harry Markowitz, *Portfolio Selection*, 7 J. FIN. 77 (1952) (providing the seminal theoretical framework).

[291] *See supra* Section IV.B.1 (reviewing Dodd-Frank rulemakings relating to stress tests and other capital rules).

an initial policy shock. Accordingly, so too should the degree of overlap, as information is gathered that allows the relationship between different rules to be ascertained more precisely.[292] The Treasury Reports therefore embody a sounder approach.[293] That is, to gradually phase out overlap as the fog lifts from an underlying policy problem and certain rules can be whittled away on the grounds that they are perfect substitutes.[294]

Financial regulation is perhaps the preeminent area where policymaking is dominated by the problem of uncertainty. When dealing with the financial system, the dynamics of "regulating in the dark" never fully go away.[295] But uncertainty is endemic to many other issues faced by the administrative state, and looms largest with respect to some of its biggest challenges. A prime example is environmental law, where uncertain risk assessments are a staple of the policymaking process.[296] This suggests that the frequent debates in environmental law over the most efficient form of regulatory intervention is at least partially misplaced.[297] Rather,

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[292] *See supra* Section IV.B.1

[293] *See supra* Section IV.B.2 (summarizing the Treasury's proposed reforms to the Dodd-Frank capital rules).

[294] This is different from a real options model, despite some superficial similarities. Reversing a decision after discovering that it no longer makes sense is unrelated to the concept of option value, properly understood. *See generally* Ron Adner & Daniel A. Levinthal, *What Is* Not *a Real Option: Considering Boundaries for the Application of Real Options to Business Strategy*, 29 ACAD. MGMT. REV. 74 (2004) (explaining how the real options framework tends to be over-extended to cases where it does not apply); Roberto S. Vassolo et al., *Non-Additivity in Portfolios of Exploration Activities: A Real Options-Based Analysis of Equity Alliances in Biotechnology*, 25 STRATEGIC MGMT. J. 1045 (2004) (demonstrating that portfolio theory is necessary to analyze investments whenever they take the form of multiple overlapping real options).

[295] *See* Cochrane, *supra* note 67, at S68 (arguing that a central problem in financial regulation is how to address high "behavioral elasticities" to policy change; essentially, uncertainty due to regulatory arbitrage); Romano, *supra* note 1 (discussing regulating in the dark).

[296] *See generally* Richard L. Revesz, *Quantifying Regulatory Benefits*, 102 CALIF. L. REV. 1423 (2014) (describing the challenges that arise when estimating the impact of environmental regulations). For climate change regulation in particular, the geographic and temporal scale of those risk assessments reaches an all-time high. Martin L. Weitzman, *On Modeling and Interpreting the Economics of Catastrophic Climate Change*, 91 REV. ECON. & STAT. 1 (2009) (analyzing the "structural uncertainties" associated with identifying the appropriate policy response to climate change).

[297] *See generally* Robin Kundis Craig, *Stationarity Is Dead—Long Live Transformation: Five Principles for Climate Change Adaptation Law*, 34 HARV. ENVTL. L. REV. 9 (2010) (focusing specifically on the choice among adaptation, mitigation, and preventative measures in response to climate change); Nathaniel O. Keohane et al., *The Choice of Regulatory*

the optimal response to uncertainty regarding environmental risks will likely involve multiple overlapping policy instruments that are imperfect substitutes for one another and are jointly applied at the same time.

C. THE STRUCTURE OF AGENCY JURISDICTION

This Article's model of overlapping rules has thus far been applied to regulations that impose substantive standards defining the scope of legally permissible conduct. But it can also apply to second-order rules which indirectly influence the content of those standards. An example is overlapping grants of enforcement power, such as in securities and antitrust law, where both regulators and private parties have standing to bring claims in connection with the same underlying conduct.[298] The multi-enforcer scenario essentially reflects joint jurisdiction over the penalty for violations of a substantive rule. Second-order "jurisdictional rules" can also provide concurrent grants of legislative authority to formulate substantive policy.[299] A final extension of this Article's theory of regulatory overlap concerns these allocations of policymaking authority across administrative agencies.

1. Substitute Versus Complement Jurisdictional Rules.

Jurisdictional rules can be organized around the same three-part taxonomy that was introduced at the outset: (1) perfect substitutes, (2) imperfect substitutes, and (3) complements.[300] Secondary rules are perfect substitutes whenever a particular policymaking institution is uniquely well-situated to set the underlying

Instruments in Environmental Policy, 22 HARV. ENVTL. L. REV. 313 (1998) (discussing environmental regulation in general).

[298] *E.g.*, Bauer, *supra* note 29 (showing an example for antitrust law); Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173 (2010) (showing an example for securities law); *see also* Shavell, *Liability for Harm*, *supra* note 9, at 373–74 (discussing the joint availability of multiple penalties for a common source of liability, such as overlapping fines and injunctions).

[299] For some important attempts to identify genres of jurisdictional overlap and work through ambiguous cases, see Gersen, *supra* note 24; Francesco Parisi, Norbert Schulz & Jonathan Klick, *Two Dimensions of Regulatory Competition*, 26 INT'L REV. L. & ECON. 56 (2006); Renan, *supra* note 24, at 213 (associating overlap with the "pooling" of administrative agencies).

[300] *See supra* Section II.B.2.

substantive rule.[301] Or, when multiple actors may potentially design a given policy rule, none of which have any distinguishing feature that would make them relatively more competent to do so.[302] The optimal level of jurisdictional overlap in both cases is zero. In other words, a single decisionmaker should be granted exclusive policymaking jurisdiction. This is the logic of traditional "dual federalism" principles, where either the state or federal government has authority to legislate in a certain area, but never both.[303]

By contrast, jurisdictional rules function as imperfect substitutes when policy-relevant information or expertise is diffused among multiple actors, so that no single decisionmaker is likely to identify the most efficient rule on its own.[304] The optimal allocation of jurisdiction in this instance could be considered a form of "constrained overlap," where the policy decision is jointly delegated to multiple parties, but each one is partially constrained by the need to reach a consensus or by some kind of veto power. A constrained overlap structure reflects the "some of both, but less of each" principle that governs imperfect substitutes and is a common arrangement.[305] It describes legislative bicameralism, such as in the U.S. Congress, as well as statutory delegations that direct agencies to engage in joint rulemakings.[306]

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301 *See supra* Section III.B.2 (explaining that rules act as perfect substitutes where no value can be added from joint use because one rule is strictly superior to the other).

302 *See supra* Section III.B.2 (explaining that rules are perfect substitutes when they are equally effective at performing the same function).

303 *See* Robert A. Schapiro, *Toward a Theory of Interactive Federalism*, 91 IOWA L. REV. 243, 246 (2005) (defining dual federalism as "the concept that the state and national governments enjoy exclusive and non-overlapping spheres of authority").

304 Within this Article's framework, the benefits of secondary jurisdictional rules depend on the relative "agency costs" and "decision costs" of different policymaking institutions. Decision costs are a function of a policymaker's expertise, or its efficiency at gathering information. *See* Cass R. Sunstein & Edna Ullmann-Margalit, *Second-Order Decisions*, 110 ETHICS 5, 11 (1999) (discussing decision costs). Agency costs represent a different scenario, where a policymaker has incentives to exercise its discretion in an opportunistic way that is inconsistent with a goal of social welfare maximization. Two key dimensions of agency costs are those that take the form of agency aggrandizement (pushing regulatory intensity too high) or agency shirking/capture (setting the level of regulatory intensity too low). *See* Parisi, Schulz & Klick, *supra* note 299, at 63–65.

305 *See supra* note 279 and accompanying text.

306 *See* Saul Levmore, *Bicameralism: When Are Two Decisions Better than One?*, 12 INT'L REV. L. & ECON. 145 (1992). What Levmore refers to as "two decisions" can also be interpreted as one decision split up among multiple parties—after a legislative provision is approved in both the House and Senate, it is only entered once in the U.S. Code. *Cf.* Parisi, Schulz & Klick,

As was the case for substantive rules, the more-of-both dynamic that characterizes regulatory complements has an inherent weirdness when applied to jurisdictional rules. In practice, it requires a form of "unconstrained overlap," in which the overall policy level is set by aggregating the uncoordinated policymaking decisions of multiple actors. The potentially chaotic piling-on of discretion that unconstrained overlap entails is not a natural fit for many policy contexts and, like overlap in primary substantive regulations, the joint use of secondary jurisdictional rules is more likely to involve imperfect substitutes than complements.[307] That said, one area where complementary secondary rules may appear is in the multi-enforcer scenarios found in securities, tort, or antitrust law.[308] Another plausible case would be instances of "interactive federalism," where neither federal preemption nor Tenth Amendment principles apply, so that it is possible for legislatures at both the state and federal level to jointly intervene in a common policy space.[309]

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supra note 299, at 58 (explaining how the scope of jurisdiction that is jointly exercised by overlapping policymakers is often equal in the aggregate to the exclusive jurisdiction of a single policymaker).

[307] *See, e.g.*, Andrew J. Fuller, *A "Procedural Nightmare": Dueling Courts and the Application of the First-Filed Rule*, 69 FLA. L. REV. 657 (2017) (detailing problems that arise when there is unconstrained overlap among trial courts).

[308] The standard justification for unconstrained overlap in enforcement authority is an agency cost rationale. Specifically, the possibility that there will be shirking by each individual enforcement entity due to insufficient incentives to vigorously prosecute underlying violations. *See* Eric Helland & Jonathan Klick, *The Tradeoffs Between Regulation and Litigation: Evidence from Insurance Class Actions*, 1 J. TORT L. 1 (2007) (making this argument in the torts context); Rose, *supra* note 298, at 2177–78 (stating that "in a world with imperfect government agents, a multienforcer approach to securities fraud deterrence may be efficient, but only if three conditions are met," while going on to doubt whether those conditions are often satisfied in practice).

[309] *See* Schapiro, *supra* note 303 (describing interactive federalism). A final scenario worth noting is where overlapping jurisdictional rules are highly differentiated, so that one rule authorizes an institution to supervise or "calibrate" the policymaking authority of another decisionmaker. An example here would be the U.S. Supreme Court's power to set the procedural rules which determine how the lower federal courts may exercise *their* jurisdiction over substantive legal matters. *See* Amy Coney Barrett, *The Supervisory Power of the Supreme Court*, 106 COLUM. L. REV. 324, 328–33 (2006) (reviewing the various ways in which the U.S. Supreme Court has authority to set procedural rules regarding the administration of lower federal courts). This supervisory structure is arguably distinct from standard appellate jurisdiction, in which courts of first impression may have certain portions of their substantive decisions overturned by a reviewing court. In that case, overlap is constrained and the decisions of courts within the judicial hierarchy serve as imperfect substitutes for one another. *See generally* Scott Dodson, *Jurisdiction and Its Effects*, 105 GEO. L.J. 619 (2017).

2. Overlapping Agencies.

Financial regulation provides an extensive window into the workings of overlapping jurisdictional rules at the level of administrative rulemaking, just as it does for the joint use of regulatory requirements. In general, it confirms the theoretical intuition that many jurisdictional rules will be perfect or imperfect substitutes while genuine complementarities among rules are likely rarer.

One good example from the post-crisis rulemakings is Title VII of Dodd-Frank, which requires the construction of an elaborate new trading infrastructure for over-the-counter derivatives markets, and grants the CFTC and the SEC overlapping jurisdiction to design that framework.[310] Neither agency had an obvious claim on that task, nor any special institutional expertise that would provide a comparative advantage in carrying it out.[311] In other words, the SEC and the CFTC are near perfect substitutes as swaps regulators. The results from their overlapping policymaking authority were therefore predictably dismal: the agencies' rules were either duplicative or worked at cross-purposes, often lacked a consistent policy perspective, and were issued on uncoordinated timelines that sowed confusion in international markets.[312] Although exceptional cases certainly exist where complementary jurisdictional rules in finance can be found,[313] the broader historical record in banking

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[310] Dodd-Frank, *supra* note 2, §§ 721, 761. Technically, Dodd-Frank divides jurisdiction over derivatives markets between the SEC (making it responsible for "securities-based swaps") and the CFTC (responsible for "non-securities-based swaps"). But the statute leaves it to the agencies to define those terms, and they did not do so in a mutually exclusive way. Dodd-Frank also expressly provides the CFTC and the SEC joint authority over a third category of derivatives, which it calls "mixed swaps." *Id.* For a comprehensive analysis of the SEC and CFTC's overlapping authority under Title VII, see generally Macey, *supra* note 90.

[311] *Cf.* Dan Awrey, *The FSA, Integrated Regulation, and the Curious Case of OTC Derivatives*, 13 U. PA. J. BUS. L. 1 (2010); Jerry W. Markham, *Merging the SEC and CFTC—A Class of Cultures*, 78 U. CIN. L. REV. 537 (2009); Macey, *supra* note 90.

[312] *See* Macey, *supra* note 90 (detailing the disorganized process of joint SEC and CFTC rulemaking in the swaps area).

[313] The best counterexamples from Dodd-Frank are provisions that authorize the Financial Services Oversight Council (FSOC) to designate certain institutions as systemically significant, which makes them subject to the substantive policy rules promulgated by other federal banking regulators. Dodd-Frank, *supra* note 2, §§ 111–13. In that sense, the allocation of designation authority to the FSOC complements the rulemaking authority of the FDIC, OCC, and Federal Reserve. *See generally* Jeremy Kress et al., *Regulating Entities and*

regulation points in the same direction. By most accounts, it reflects a series of experiments that extend overlapping, unconstrained policymaking discretion across multiple agencies which have, on the whole, worked poorly together.[314]

An analysis of overlapping jurisdictional rules in financial regulation is instructive for the growing body of administrative law scholarship that looks at the functionality of overlapping agencies in general.[315] Specifically, it provides both theoretical and empirical grounds for skepticism on a frequent theme which has emerged in that literature. That is, that there are a number of mechanisms which allow overlapping agencies to take advantage of subtle synergies from working together in a shared regulatory space.[316] The overall impression, in effect, is that complementarities among jurisdictional rules are commonplace.[317] The conflicting view that comes from financial regulation is admittedly suggestive, not definitive. But it does suggest that, as a practical matter, statutory rules that establish jurisdictional overlap are more likely to reflect various pathologies of the legislative process than they are to reflect Congress as chess-master of the administrative state.

Of the three topics reviewed in this Section, the problem of overlapping agency jurisdiction highlights the unfortunate academic divide between scholarship on financial regulation and

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Activities: Complementary Approaches to Nonbank Systemic Risk, 92 S. CAL. L. REV. 1455 (2019) (analyzing the FSOC).

[314] *See, e.g.*, Sumit Agarwal et al., *Inconsistent Regulators: Evidence from Banking*, 129 Q. J. ECON. 889 (2014) (presenting some general grounds for skepticism about the efficacy of overlapping banking agencies); Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677 (1988) (providing a pessimistic assessment of overlapping federal and state regulators in banking); Richard J. Rosen, *Is Three a Crowd? Competition Among Regulators in Banking*, 35 J. MONEY CREDIT & BANKING 967 (2003) (concluding yes); Clifford S. Stanford, *Toward a Coherent and Consistent Framework for Treatment of Confidential Supervisory Information*, 22 N.C. BANKING INST. 41 (2018) (detailing the drawbacks of overlapping bank examiners).

[315] *See supra* note 24 (providing references to this literature).

[316] *See* Todd S. Aagaard, *Regulatory Overlap, Overlapping Legal Fields, and Statutory Discontinuities*, 29 VA. ENVTL. L.J. 237, 239 (2011) (observing the trend among administrative law scholars toward "noting ways in which overlapping jurisdiction in some circumstances may actually improve the effectiveness of regulatory programs" but stating that "much of this work has been theoretical and institutionalist in its analysis, abstracted from the subject matter of the regulation and drawing on analogies from other fields").

[317] *See, e.g.*, Freeman & Rossi, *supra* note 24, at 1138–45; Gersen, *supra* note 24, at 211–16; Jason Marisam, *Interagency Administration*, 45 ARIZ. ST. L.J. 183 (2013); Renan, *supra* note 24, at 275–80; Bijal Shah, *Uncovering Coordinated Interagency Adjudication*, 128 HARV. L. REV. 805 (2015); Michael Ting, *A Strategic Theory of Bureaucratic Redundancy*, 47 AM. J. POL. SCI. 274 (2003); Miranda Yaver, Inter-Agency Learning in US Regulatory Policymaking (July 31, 2016) (unpublished manuscript), https://ssrn.com/abstract=2817073.

administrative law most of all. While the proper allocation of decisionmaking authority across government actors is rightly considered the quintessential problem of administrative law,[318] it has also been a defining obsession of policy debates in financial regulation for over a century.[319] Yet the optimal organizational structure of banking regulation and that of other administrative agencies have largely been analyzed in isolation from one another. That represents a missed opportunity. As this Article's examination of the post-financial crisis policy response demonstrates, the dilemmas of overlapping financial regulation are the same as those which reappear across the regulatory state, blown up on a grand scale.

VII. CONCLUSION

Recent proposals from Congress and the Trump Administration's Treasury Department aim to comprehensively overhaul the framework for financial regulation that was put in place after the financial crisis. This Article's argument is that evaluating how these reforms measure up against the status quo under Dodd-Frank turns on a very fundamental question that is rarely analyzed in a systematic way: when is it better to address a given policy problem with two (or more) legal rules rather than one? It calls this question the problem of "regulatory overlap." In developing an answer, this Article provides a number of new perspectives on key policy debates in financial regulation. It also goes beyond financial regulation and weaves together contributions to a number of scholarly literatures. In particular, its theoretical framework adds to law-and-economics research on the optimal structure of legal rules by presenting a general model of overlapping regulations that can be applied to

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[318] *See*, *e.g.*, Gersen, *supra* note 24, at 201.

[319] Rosen, *supra* note 314, at 968 (2003) ("There have been debates over the optimal structure of bank regulation in the United States since at least the National Banking Act of 1863. As the three quotes above indicate, the controversy is focused on the question of whether regulatory authority should be spread among different agencies rather than be vested in a single agency."); *see also* Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 THEORETICAL INQUIRIES L. 649 (2001) (explaining the persistence of these debates). And that obsession has not died down in recent years. The need to re-think the organizational structure of financial regulation can be seen as a central concern of Dodd-Frank, the CHOICE Act, and the Treasury Reports.

policy areas of all kinds. This Article's analysis also carries implications for core policymaking dilemmas at issue in the administrative law scholarship, such as how to determine the appropriate scope of agency jurisdiction and how to understand the usefulness of cost-benefit analysis procedures that agencies must perform to justify their regulatory output. The claim that legal rules sometimes intersect or interact sounds like a mundane observation or something that is self-evident on its face. But by taking the regulatory overlap concept seriously, this Article shows that beneath its surface simplicity lies a rich set of theoretical insights and practical policy lessons.

