2011

Regulatory Contrarians

Brett McDonnell
University of Minnesota Law School, bhm@umn.edu

Daniel Schwarcz
University of Minnesota Law School, schwarcz@umn.edu

Recommended Citation
Brett McDonnell and Daniel Schwarcz, *Regulatory Contrarians*, 89 N.C. L. REV. 1629 (2011), *available at* https://scholarship.law.umn.edu/faculty_articles/377.

REGULATORY CONTRARIANS*

BRETT MCDONNELL & DANIEL SCHWARCZ**

This Article explores the role that "regulatory contrarians" can play in promoting more adaptive financial regulation. Such contrarians have several distinguishing features. First, they possess persuasive authority by virtue of their position, access to media and officials, or speaking engagements and reports. Second, they are affiliated with, and enjoy privileged access to, a regulatory entity but are nonetheless independent, as reflected in their budget, staffing, and/or priorities. Finally, they are tasked with studying the regulatory process, policy positions, and the regulated market and in some way reporting on deficiencies and potential improvements. The Article argues that regulatory contrarians can modestly limit the risk that regulators will fail to adapt to newly emerging and ever-shifting financial risks, by either failing to enact new rules or failing to modify or repeal old rules. Despite this potential, the Article argues that, in the domain of financial regulation, contrarians are used only in a small subset of the instances where they can provide value. Currently, financial regulatory contrarians fit into four basic categories: (1) Ombudsman Contrarians, (2) Consumer Representative Contrarians, (3) Investigative Contrarians, and (4) Research Contrarians. Whereas the first two types of contrarians are limited in their subject area to consumer protection and services, the latter two types of contrarians are limited in their methodological scope. Finally, the Article argues that the Dodd-Frank Act holds the potential to improve financial regulation by transcending historical limitations embedded in the traditional categories of financial regulatory contrarians.

** Brett McDonnell is a Professor of Law at the University of Minnesota Law School and Daniel Schwarcz is an Associate Professor of Law at the University of Minnesota Law School. We thank Dan Gifford, Kristin Hickman, Claire Hill, Alex Klass, Donald Langevoort, Hari Osofsky, Paul Rubin, David Zaring, and participants in the symposium *Adaptation and Resiliency in Legal Systems* for helpful comments. For excellent research assistance, we thank Carl Engstrom.

INTRODUCTION

Multiple, interacting forces precipitated the global financial crisis of 2008. But the failure of regulators to curb systemic risk in the shadow banking sector or to limit consumer abuses in mortgage markets are among the most troubling contributors to the crisis.[1] Financial regulators enjoyed both substantial statutory authority to address these problems and meaningful warnings from the academic community of the need to do so.[2]

---

1. For an excellent overview of the role of these two factors in the financial crisis, see generally FIN. CRISIS INQUIRY COMM'N, SHADOW BANKING AND THE FINANCIAL CRISIS (2010) [hereinafter SHADOW BANKING], *available at* http://fcic-static.law.stanford .edu/cdn_media/fcic-reports/2010-0505-Shadow-Banking.pdf; FIN. CRISIS INQUIRY COMM'N, THE MORTGAGE CRISIS (2010), *available at* http://fcic-static.law.stanford.edu/ cdn_media/fcic-reports/2010-0407-PSR_-_The_Mortgage_Crisis.pdf.

2. *See generally* Kathleen C. Engel & Pat A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255 (2002) (warning of the need to more effectively regulate the mortgage market); Gary Gorton, *Bank Regulation When "Banks" and "Banking" Are Not the Same*, 10 OXFORD REV. ECON. POL'Y 106 (1994) (explaining the need for better regulation of nonbank entities that compete with banks for greater market share); Arthur E. Wilmarth, Jr., *Transformation of the U.S. Financial Services Industry*, 2002 U. ILL. L. REV. 215 (providing a pre-crisis warning of the need to better regulate large financial conglomerates). One of the more prominent law review articles in recent times argued that federal banking agencies had the authority to protect consumers from "unsafe" credit but did not have the motivation to do so because they were primarily motivated by protecting the safety and soundness of banks. *See, e.g.*, Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 86–95 (2008). Regulatory authority prior to financial reform with respect to the shadow banking system is harder to describe, largely because the shadow banking system specifically evolved to evade regulatory restrictions on banking. *See* SHADOW BANKING, *supra* note 1, at 10–14. But it was hardly the case that regulators possessed no authority to limit the risks of shadow banking. For instance, some have argued that the SEC's failure to regulate money market accounts appropriately by requiring mark-to-market accounting contributed to the financial crisis. *See* William A. Birdthistle, *Breaking Bucks in Money Market Funds*, 2010 WIS. L. REV. 1155, 1181–

These causes of the crisis were consequently not merely a product of an inadequate statutory regime, but just as much (if not more) a product of the failure of regulators to accomplish their prescribed goals.[3]

Now that the riskiness of shadow banking and mortgage abuses have become clear, it is hardly surprising that reform efforts have sought to more effectively regulate these activities. But financial markets are constantly changing and generating new and unanticipated risks, ensuring that the next financial crisis will be different than the previous one. Indeed, much financial innovation is specifically driven by the inevitable quest of the financial sector to avoid regulation and the compliance costs that come along with it.[4] In that sense, it is not merely a possibility—but a near certainty—that new financial risks will emerge that cannot be specifically targeted in legislation. For that reason, law will only have a fighting chance to defer and moderate the next financial crisis if regulators are entrusted with broad authority to limit newly emerging, but previously unanticipated, risks.

The financial crisis of 2008 thus leaves us with apparently conflicting lessons. On one hand, regulators failed to use authority they clearly possessed to limit identified risks, but on the other hand law has no choice but to rely on such regulators to anticipate and counteract newly emerging financial risks. This diagnosis suggests deep limits in the capacity of law and regulation to prevent future financial crises. At the same time, though, it suggests that a core challenge facing financial regulation is to devise mechanisms that can mitigate the risk that regulators will not evolve as fast as the marketplaces they are regulating. Making matters yet more complicated, the regulatory implications of an evolving marketplace are not unidirectional. Whereas some forms of market evolution demand new regulations or enforcement strategies, other forms of market evolution

---

90 (arguing that the SEC's revisions to its regulations of money market funds fail to solve, and even exacerbate, this underlying problem). Another failure of financial regulators to exercise their regulatory authority pre-crisis involved the SEC's Consolidated Supervised Entity Program, which supervised investment banks on a consolidated basis. The SEC inspector general recognized serious problems in the operation of this program. *See* SEC INSPECTOR GEN., SEC'S OVERSIGHT OF BEAR STEARNS AND RELATED ENTITIES 5 (2008), *available at* http://www.sec-oig.gov/Reports/AuditsInspections/2008/446-b.pdf.

3. *See generally* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT, at xvii (2011), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf ("We conclude that the financial crisis was avoidable" and was "the result of human action and inaction, not of Mother Nature or computer models gone haywire."); *id.* at xviii ("Yet we do not accept the view that regulators lacked the power to protect the financial system. They had ample power in many arenas and they chose not to use it.").

4. *See* Howell E. Jackson, *Regulation in a Multisectored Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L.Q. 319, 321 (1999).

necessitate regulatory adaptation in the opposite direction, counseling the repeal or decreased enforcement of regulations that have gone too far or become outdated.

Various important suggestions for overcoming agency inaction in the face of financial market change have already begun to emerge. The most notable of these, which is incorporated in the Dodd-Frank Act, proposed creating an independent agency dedicated to consumer protection in the arena of credit.[5] Other proposals for promoting agency responsiveness to change include limiting the capacity of financial institutions to choose their regulators,[6] promoting competition among multiple enforcers of regulation,[7] and improving the training and resources of financial regulators.[8]

This Article describes an additional approach to taming the risk that regulators will fail to invoke their authority to address newly emerging financial risks or more generally to modify existing regulatory schemes when modification is warranted. In particular, it suggests charging an entity that is affiliated with, but independent of, a financial regulator with the task of monitoring that regulator and the regulated marketplace and publicly suggesting new initiatives or potential structural or personnel changes. Although we are the first to label such entities "regulatory contrarians," they are not uncommon in the regulatory state. Various ombudsmen have evolved to take on the role of a regulatory contrarian, such as the Taxpayer Advocate Service of the Internal Revenue Service.[9] Some regulators run

5. *See* Bar-Gill & Warren, *supra* note 2, at 98–100 (proposing the creation of a new consumer agency that would have broad rulemaking and enforcement authority to regulate consumer financial products).

6. *See, e.g.*, Dain C. Donelson & David Zaring, *Requiem for a Regulator: The Office of Thrift Supervision and the Financial Crisis*, 89 N.C. L. REV. 1777, 1779–80 (2011); Patricia A. McCoy et al., *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 493, 517–23 (2009); Daniel Schwarcz, *Regulating Insurance Sales or Selling Insurance Regulation: Against Regulatory Competition in Insurance*, 94 MINN. L. REV. 1707, 1727–28 (2009).

7. *See* Prentiss Cox, *The Importance of Deceptive Practice Enforcement in Financial Institution Regulation*, 30 PACE L. REV. 279, 306–09 (2009); Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2200–29 (2010) (discussing the use of multiple enforcers to combat underdeterrence of security fraud); John C. Coffee, Jr., *A Course of Inaction: Where Was the SEC When the Mutual Fund Scandal Happened?*, LEGAL AFF., Mar./Apr. 2004, at 46, 46, *available at* http://www.legalaffairs.org/issues/March-April-2004/review_coffee_mar apr04.msp (suggesting that regulatory competition by the New York attorney general with the SEC helped stem various abuses in the mutual fund industry).

8. Erik F. Gerding, Bubbles, Law, and Regulation 9 (May. 19, 2010) (unpublished manuscript) (draft on file with the North Carolina Law Review).

9. *See generally infra* Part III.A (discussing the means of persuasion that the Taxpayer Advocate Service employs to counter IRS inaction).

consumer participation programs that resemble regulatory contrarians.[10] For instance, the National Association of Insurance Commissioners appoints approximately twenty consumer representatives.[11] And it is quite common for agencies to have affiliated inspectors general or research programs that can also be viewed as regulatory contrarians.[12] There are also quasi-contrarian strategies that have some but not all of the elements by which we define contrarians. The Government Accountability Office—which does not qualify as a contrarian because it is not affiliated with a specific agency—is a prime example.[13]

Despite the pervasiveness of contrarians in the current regulatory state, their commonalities have not been fully appreciated in the existing literature.[14] Partially for this reason, the potential of contrarians to promote regulatory adaptation to market change has been cabined to relatively narrow domains, at least in the financial realm.[15] For instance, both

---

10. *See* Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15, 62–64 (2011) (exploring the role that public advocates can play in limiting the risk of regulatory capture).

11. *See generally infra* Part III.B (describing successful efforts of the NAIC's consumer representatives to combat regulatory inaction).

12. *See generally infra* Part III.C–D (describing the capacity of inspectors general and "research contrarians" in combating regulatory inaction).

13. *See infra* Part III.E.

14. There are two related literatures. First, there is a robust literature in the administrative law context aimed at countering regulatory inaction. Several contributions to this literature focus on empowering a single agency with countering such inaction. *See* Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260, 1277–80 (2006); Glen Staszewski, *The Federal Inaction Committee*, 59 EMORY L.J. 369, 372 (2009). These proposals, however, primarily focus on the prospect that an agency will make a *specific decision* not to act in the face of clear, existing statutory authority, a prospect reflected in the EPA's approach to regulating carbon. *See id.* at 393 ("Congress should enact a statute that creates a new, independent administrative agency to oversee, monitor, and evaluate decisions by Executive Branch agencies not to implement their existing statutory authority."). By contrast, our focus is on failure to act due to market adaptation, which typically involves failure to act coupled with failure to realize that one is failing to act. The second set of related literatures examines specific entities that we identify as contrarians. For instance, there is a substantial literature on inspectors general. *See, e.g.*, PAUL C. LIGHT, MONITORING GOVERNMENT: INSPECTORS GENERAL AND THE SEARCH FOR ACCOUNTABILITY 1–8 (1993); Michael R. Bromwich, *Running Special Investigations: The Inspector General Model*, 86 GEO. L.J. 2027, 2027–28 (1998). Similarly, there is a substantial literature on ombudsman organizations, although this literature tends to focus less on their role as a contrarian. *See, e.g.*, WENDY GINSBERG & FREDERICK M. KAISER, CONG. RESEARCH SERV., RL 34606, FEDERAL COMPLAINT-HANDLING, OMBUDSMAN, AND ADVOCACY OFFICES 1–5 (2009), *available at* http://assets.opencrs.com/rpts/RL34606_20090804.pdf. These literatures, however, typically fail to link the similar roles played by inspectors general, consumer advocates, ombudsmen, and research contrarians.

15. It may be that regulatory contrarians currently, or historically, have figured more prominently in other regulatory domains, particularly environmental regulation. For instance, the

ombudsman contrarians and consumer contrarians are typically envisioned to empower consumers and keep regulators abreast of the consumer experience.[16] Their usefulness is consequently tethered to the consumer-protection context. By contrast, the scope of investigative and research contrarians is typically constrained to domains in which they enjoy particular methodological competence: inspectors general are generally limited to investigating past instances of misconduct or waste, and research contrarians produce academic papers that only broadly and haphazardly inform day-to-day regulatory policy.[17] In sum, the capacity of existing contrarians to induce proactive financial regulation has historically been limited to specific pockets of regulatory activities.

Financial reform as outlined in the Dodd-Frank Act ("Dodd-Frank" or "the Act")[18] substantially expands the role of regulatory contrarians. In fact, one of the most distinctive structural characteristics of Dodd-Frank is its embrace of contrarian and quasi-contrarian strategies. The Act not only contains examples of all the types of contrarian and quasi-contrarian mechanisms identified in this Article, but it also dramatically expands on the historical limitations of regulatory contrarians. In particular, Dodd-Frank jettisons the subject-matter boundaries of prior financial contrarians, pushing contrarian institutions into the realm of systemic and prudential risk regulation. The Act also transcends various methodological restrictions of contrarians, directing "investigative" contrarians to be more proactive and "academic" contrarians to be more policy oriented. In sum, Congress seems to have understood both that it lacked the understanding to fully anticipate and draft all needed new rules, and also that contrarian institutions can improve the capacity of regulators to adapt to changing market conditions and structures. Of course, these strategies will certainly not eliminate the impediments to effective regulatory adaptation, but they may marginally limit them, which is still an important result.

The Article proceeds as follows. Part I begins by describing in broad brush strokes the impediments that regulators face in adapting to ever-changing financial markets. Part II offers a definition of contrarians and speculates how regulatory contrarians might counteract the difficulties reviewed in Part I. Part III describes the variants of regulatory contrarians

---

Environmental Protection Agency public liaison is authorized to investigate cases where it suspects improper agency action. *See* GINSBERG & KAISER, *supra* note 14, at 14.

16. *See infra* Part III.A–B.

17. *See generally infra* Part III.C–D (describing the functions of inspectors general and research contrarians).

18. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.A. (West Supp. 2011)).

that currently exist in financial regulation, offering a four-part typology. Finally, Part IV closes by exploring the ways in which financial reform, in Dodd-Frank and elsewhere, extends the use of contrarians to attempt to more broadly limit the risks of regulatory inaction. It also considers several preliminary lessons that the older generation of financial regulatory contrarians may offer for the new generation.

I. FINANCIAL REGULATION AND ADAPTATION

All regulators must adapt to change in order to remain effective.[19] But in many ways, adaptation is particularly important for financial regulators.[20] The markets and firms that financial regulators oversee are constantly shifting, often in ways that are difficult to observe or predict. Moreover, the increasing complexity and interconnectedness of modern financial markets means that apparently unrelated changes can have unforeseeable and synergistic impacts on the financial system as a whole.[21] For these reasons, market change can result in regulators operating under inappropriate laws or assumptions. Often, this is a product of their failure to enact new rules. But regulators' failure to evolve can also involve the continuation of rules or policies that have become ineffective or counterproductive in light of market change, or that were simply mistakes in the first place.[22]

---

19. The need for such adaptation figures particularly prominently in the academic literature on environmental regulation. *See generally* Holly Doremus, *Adaptive Management as an Information Problem*, 89 N.C. L. REV. 1455 (2011) (analyzing the "information problems" affecting adaptive management strategies). Of course, adaptation in the environmental context presents many of its own challenges, as regulators must adjust to the complexities and uncertainties of the underlying ecosystem. *See* J.B. Ruhl & James Salzman, *Climate Change, Dead Zones, and the Massive Problems in the Administrative State: A Guide for Whittling Away*, 98 CALIF. L. REV. 59, 97–98 (2010).

20. For some discussions of agency inaction in the context of financial regulation, see Coffee, *supra* note 7, at 46; Donald C. Langevoort, *The SEC as a Lawmaker: Choices About Investor Protection in the Face of Uncertainty*, 84 WASH. U. L. REV. 1591, 1596–1612 (2006); Donna M. Nagy, *Regulating the Mutual Fund Industry*, 1 BROOK. J. CORP. FIN. & COM. L. 11, 17–18 (2006). For an argument that the U.S. financial regulatory system has not adequately adapted to the blurring of traditional categories of financial institutions, see Charles K. Whitehead, *Reframing Financial Regulation*, 90 B.U. L. REV. 1, 16–28 (2010).

21. *See* Steven Schwarcz & Iman Anabtawi, *Regulating Systemic Risk*, 86 NOTRE DAME L. REV. (forthcoming 2011) (manuscript at 3), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1670017 (exploring how "two otherwise independent correlations can combine to transmit localized economic shocks into broader systemic crises").

22. A prime potential candidate here might be the continuation of housing agencies such as Fannie Mae and Freddie Mac. One of us has elsewhere called for the elimination of Fannie Mae and Freddie Mac. *See* Brett H. McDonnell, *Don't Panic! Defending Cowardly Interventions During and After a Financial Crisis* 46–47 (Minn. Legal Studies, Research Paper No. 11-09, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm ?abstract_id=1753760. It is hotly

Unfortunately, financial regulators face various impediments to effectively evolving along with the markets they regulate.[23] This Part provides a broad overview of these difficulties. Section A focuses on the prospect that even properly motivated regulators may fail to appropriately adapt to change due to mistakes, ignoring some market changes while exaggerating others. Section B, by contrast, describes the limited incentives that regulators may have to evolve with regulated marketplaces. Throughout, this Part emphasizes that many of the difficulties that financial regulators face in adapting to change cut across different types of financial regulation. Whether they are seeking to protect consumers or investors on the one hand, or seeking to limit externalities by preserving firm or systemic stability on the other, many cognitive failures and incentive distortions create similar obstacles to change. But the relative importance of cognitive failures versus incentive distortions may differ for consumer protection as opposed to systemic risk, with regulatory capture being a more pronounced problem for consumer protection and cognitive errors a more pronounced problem for systemic risk.

A. Regulators and Cognitive Failures

Like all individuals, regulators are subject to various heuristics and biases that produce predictable and systematic errors.[24] Several heuristics

debated how much of a role these government-sponsored entities played in causing the financial crisis. Some argue they played at most a small role. *See, e.g.*, Paul Krugman & Robin Wells, *The Slump Goes On: Why?*, N.Y. REV. BOOKS, Sept. 30, 2010, at 57, 58, *available at* http://www.nybooks.com/articles/archives/2010/sep/30/ slump-goes-why/. Others argue that their role was significant. *See, e.g.*, Raghuram Rajan, *Reviewing Krugman*, CHI. BOOTH BLOG: FAULT LINES (Sept. 16, 2010), http://forums .chicagobooth.edu/faultlines?entry=24. The congressional panel on the causes of the crisis split by political party over the role of these entities. *See* Kevin Drawbaugh & Dave Clarke, *Flawed Report Seen from U.S. Financial Crisis Panel*, REUTERS (Jan. 12, 2011), http://in.reuters.com/article/2011/01/11/idINIndia-54087320110111. Still, even if one does not believe these entities were a major cause of the crisis, their original goal of developing a securitization market for mortgages has long-since been achieved, and private actors are now quite actively fulfilling that role. Another, less high-profile, illustration of regulators' failure to evolve by continuing ineffective or outdated policies involves insurance regulators' retention of formulaic reserve requirements for life insurers. *See* Daniel Schwarcz, *Regulating Insurance Sales or Selling Insurance Regulation?*, 94 MINN. L. REV. 1707, 1765–66 (2010).

23. There is substantial literature within the administrative law field documenting agency ossification and inaction more generally. *See generally* Mark Seidenfeld, *Why Agencies Act: A Reassessment of the Ossification Critique of Judicial Review*, 70 OHIO ST. L.J. 251, 297–307 (2009) (discussing the impact of judicial review on agency ossification).

24. The foundational work in behavioral economics is Tversky and Kahneman's initial discussion of prospect theory. *See generally* PETER A. DIAMOND ET AL., BEHAVIORAL ECONOMICS AND ITS APPLICATIONS (2007) (providing a survey of recent scholarship on behavioral economics and its applications); ANDREI SHLEIFER, INEFFICIENT MARKETS: AN INTRODUCTION TO BEHAVIORAL FINANCE (2000) (providing an introduction to the field of

and biases are particularly likely to interfere with financial regulators' adaptation to market change. First, various biases may undermine regulatory efforts by distorting regulators' perceptions of risks in the markets they regulate. It is well known that the perception of risk is impacted by the cognitive availability of the underlying risks, with individuals tending to place undue weight on relatively recent and salient events and tending to underappreciate less salient and recent risks.[25] Social amplification of risk can exacerbate this bias as media report and reflect the most extreme, recent, and "newsworthy" risks.[26]

Even though experts are generally less susceptible to these biases than lay people,[27] distortions in risk perceptions can nonetheless undermine financial regulators' adaptation to changing market conditions. This is most obvious in the context of prudential and systemic risk regulation. Financial regulation has historically been marked by a strikingly procyclical pattern of regulation in which risks are downplayed when times are good and overemphasized during periods of crisis.[28] This tendency to procyclical enforcement contrasts starkly with the countercyclical pattern that ought to

---

behavioral finance and its focus on the challenges to efficient markets based on human fallibility); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974) (discussing the "cognitive biases that stem from reliance on judgmental heuristics"). Behavioral economics has been applied to the analysis of law in the new field of behavioral law and economics. *See generally* CASS R. SUNSTEIN, BEHAVIORAL LAW AND ECONOMICS (2000) (providing a survey of recent scholarship on behavioral economics and its application to the law). Much of the initial work applying behavioral research in the legal domain emphasized that markets do not work as well as assumed by law and economics scholars, thus leaving greater room for potentially efficient regulatory interventions. *See generally* Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998) (exploring positive, prescriptive, and normative applications of behavioral economics to the law). More recent work, though, emphasizes that regulators are people, too, and hence subject to the same sorts of heuristics and biases that limit the efficiency of markets. *See* Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1, 5 (2003); Jeffrey J. Rachlinski & Cynthia R. Farina, *Cognitive Psychology and Optimal Government Design*, 87 CORNELL L. REV. 549, 553–54 (2002).

25. *See generally* THE PERCEPTION OF RISK (Paul Slovic ed., 2000) (compiling twenty-five years of research on risk perception).

26. *See generally* CASS R. SUNSTEIN, WORST-CASE SCENARIOS (2007) (providing an extensive discussion of how risk perception can affect regulation); THE SOCIAL AMPLIFICATION OF RISK (Paul Slovic et al. eds., 2003) (reviewing the ways in which mass media and social communication affect human risk perception).

27. *See* Cass Sunstein, *The Laws of Fear*, 115 HARV. L. REV. 1119, 1123–24 (2002) (book review) (arguing in favor of a technocratic view of regulation because experts are less susceptible to distortions in risk perception than lay people).

28. *See* JACK GUTTENTAG & RICHARD HERRING, DISASTER MYOPIA IN INTERNATIONAL BANKING 3–4 (1986); Gerding, *supra* note 8, at 4–5.

characterize governmental regulation of systemic risk.[29] An important explanation for this pattern is simply that financial risks are not cognitively available during the peak of a credit cycle, but are obviously both salient and immediate during times of financial crisis. Broad financial downturns also tend to result in the revelation of individual scandals, creating a perceived pattern.[30] Social amplification of risk likely exacerbates these patterns.[31]

Regulators' distorted perceptions of risk can also undermine their capacity to adapt to new consumer protection challenges. Regulators often set their consumer protection priorities based on consumer complaint patterns and recent headlines.[32] Yet many consumer protection problems develop and persist in competitive marketplaces precisely because they are neither observable to consumers nor salacious enough to generate headlines.[33] At the same time, when consumer protection issues do result in scandal, regulators may over-respond, channeling their energies into problems that do not exist and misallocating scarce resources.

A second group of biases may impede effective adaptation to change by causing financial regulators to have undue confidence in their regulatory approaches and to be overly dismissive of the need to adjust in the face of market changes. Overconfidence in one's abilities to identify problems and prescribe solutions is a persistent feature of human existence,[34] and it is particularly prevalent among "experts," such as those who tend to drive regulatory policy.[35] Confirmation bias exacerbates the problem: once regulators have put rules on the books, they will tend to interpret ambiguous evidence in a manner suggesting the effectiveness of their

---

29. *See infra* Part II (discussing how regulatory contrarians could help agencies maintain their vigilance by pointing out issues and potential problems that are not receiving enough attention by that agency).

30. *See* Amitai Aviram, *Counter-Cyclical Enforcement of Corporate Law*, 25 YALE J. ON REG. 1, 8–9 (2008).

31. *Id.* at 9.

32. *See* Daniel Schwarcz, *Redesigning Consumer Dispute Resolution: A Case Study of the British and American Approaches to Insurance Claims Conflict*, 83 TUL. L. REV. 735, 770–79 (2009). *See generally* KENNETH J. MEIER, THE POLITICAL ECONOMY OF REGULATION: THE CASE OF INSURANCE (1998) (outlining the important role that media attention, particularly in the form of headlines, has often played in setting the consumer protection agenda of insurance regulators).

33. *See* Daniel Schwarcz, *Reevaluating Standardized Insurance Policies*, 77 U. CHI. L. REV. (forthcoming Dec. 2011) (manuscript at 6 n.13), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1687909.

34. *See* Choi & Pritchard, *supra* note 24, at 28–29; Rachlinski & Farina, *supra* note 24, at 579.

35. Rachlinski & Farina, *supra* note 24, at 579.

choices.[36] So too does groupthink.[37] In most cases, the leadership of agencies will be a cohesive group, with people selected for leadership positions because of their relationship with and/or shared perspective with the agency head. In this context, regulators will tend to gravitate to shared ideas, even when the group's preexisting perspectives do not necessarily entail those ideas.[38] Once this happens, group members will tend not to challenge the accepted notions of the group. Such groupthink can interact with and intensify confirmation bias, making it very hard for an agency to escape from the mindset that led to its current regulatory choices.

This cluster of biases will systematically tend to produce excessive inaction in the face of market change.[39] The most recent and salient example of this is the Federal Reserve under chairman Alan Greenspan, which confidently endorsed limited systemic and prudential risk regulations despite dramatic increases in risk throughout the early and mid-2000s.[40] Although disentangling political ideology from cognitive bias in this context is difficult, it seems clear in retrospect that overconfidence, confirmation bias, and groupthink at least contributed to push the laissez-faire inclinations of the Federal Reserve toward excessive disregard of newly emerging systemic and prudential risks.[41] The problem may be even more severe in the consumer protection context, which is particularly susceptible to ideological precommitments that may produce confirmation bias.[42] On one hand, consumer protection agencies may attract employees who tend to see the industry with jaded eyes and extensive regulation with overly rose-colored glasses. On the other hand, those who embrace free-market ideologies may be particularly prone to interpreting all consumer

36. *See* Choi & Pritchard, *supra* note 24, at 30.

37. *See generally* IRVING L. JANIS, VICTIMS OF GROUPTHINK (1972) (reviewing the effects of groupthink on twentieth-century foreign-policy decisions).

38. *See* Mark Seidenfeld, *Cognitive Loafing, Social Conformity, and Judicial Review of Agency Rulemaking*, 87 CORNELL L. REV. 486, 541–43 (2002).

39. *See* Rachlinski & Farina, *supra* note 24, at 560–61.

40. *See generally* KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS (2011) (providing an overview of the subprime crisis and, in particular, the role of federal regulators in sanctioning risky market practices).

41. *See id.*; *see also* Geoffrey P. Miller & Gerald Rosenfeld, *Intellectual Hazard: How Conceptual Biases in Complex Organizations Contributed to the Crisis of 2008*, 33 HARV. J.L. & PUB. POL'Y 807, 825–28 (2009) (arguing that "intellectual hazard"—or the tendency of behavioral biases to interfere with accurate thought and analysis within complex organizations—contributed to the errors of the Federal Reserve in ignoring the housing bubble by promoting easy credit, relying on the self-interest of lending institutions to check risk-taking, and endorsing the idea of a "great moderation").

42. Here, too, the approach of the Federal Reserve under Greenspan to subprime mortgages constitutes an important example.

protection issues through a lens focused on consumer autonomy and healthy competition.

Bounded rationality—the cognitive limits of real individuals, as opposed to the unlimited cognitive powers of the rational actor featured in economic models[43]—can undermine regulatory adaptation even when it does not produce specific heuristics or biases.[44] Particularly in the United States, rationality is likely to be asymmetrically bounded for financial regulators as compared with financial market participants. Put more bluntly, the best and the brightest are more likely to go into the private sector than into government.[45] That's where the money and prestige are. This fact makes it particularly difficult for regulators to keep up with market change, as much financial innovation is specifically designed to exploit regulatory loopholes. Regulated financial firms constantly seek to avoid the costs of regulation through legal arbitrage, the process of characterizing and/or designing financial products or services so that they trigger the fewest regulatory costs.[46] The multisectored nature of American financial regulation makes such regulatory arbitrage a constant risk.[47]

Once again, these problems are common to the regulation of both systemic risk and consumer protection. Consumer protection regulations must constantly adjust to changing products and marketing that present new risks for consumers. And regulatory efforts to limit one-sided transactions or ensure transparency are virtually always subject to gaming by a motivated—if small—group of firms and individuals that can make money by exploiting consumer ignorance or mistakes. The same problems clearly afflict the regulation of prudential and systemic risk, where regulators must try to make sense of ever more complex financial products

43. *See generally* CASS SUNSTEIN & RICHARD THALER, NUDGE 1–17 (2008) (distinguishing between "humans" and "econs").

44. Herbert Simon, *A Behavioral Model of Rational Choice*, *in* MODELS OF MAN, SOCIAL AND RATIONAL: MATHEMATICAL ESSAYS ON RATIONAL HUMAN BEHAVIOR IN A SOCIAL SETTING 241, 241–60 (1957) (proposing a model of human rationality that is more consistent with the level of access to information and computational powers of real human beings than is found in the traditional model of "economic man"); Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449, 1449–50 (2003) (integrating psychological findings about intuitions and choice into the model of reasoning heuristics found in the author's previous work).

45. *See* Joseph Stiglitz, *Regulation and Failure*, *in* NEW PERSPECTIVES ON REGULATION 13, 20 (David Moss & John Cisternino eds., 2009). We stress that this is just a tendency. Plenty of very bright and dedicated persons enter government service because it better fits their personal identity than the private sector.

46. *See* Jackson, *supra* note 4, at 332; Gerding, *supra* note 8, at 6.

47. *See* Jackson, *supra* note 4, at 332; Whitehead, *supra* note 20, at 3–8.

and understand a vast and immensely complicated and interconnected regulatory system.

Rationality need not be asymmetrically bounded to undermine regulatory adaptation to market changes. Even deeply considered and deliberate decisions guided by the most sophisticated understandings of the economy may go badly wrong, as they did leading up to the financial crisis.[48] Systemic and prudential risk regulation are peculiarly susceptible to this problem. In recent decades, advances in the modeling of financial risk were supposed to greatly enhance our ability to understand and contain both firm-level and systemic risk.[49] That has not turned out so well.[50] One deep problem with these models appears to be that they entertained an overly tame understanding of the risk facing financial markets, either by underestimating the likelihood of extreme financial events,[51] or by purporting to assign numerical probabilities to certain types of risks that ultimately reflect truly immeasurable uncertainty.[52] Either way, the illusion of science created false confidence in economics departments, business schools, Wall Street, and ultimately financial regulators, who themselves adopted the same models used by the academics and the regulated. Regulators also increasingly turned to market participants' own risk models as the basis for regulations—Basel II capital requirements and credit rating agency ratings of asset-backed securities are key examples.[53] These models were the work of the best and the brightest engaged in trying to understand financial markets, but even the best and the brightest can get things drastically wrong.[54]

48. The Basel II capital requirements are a good example. The Basel II guidelines, adopted by the leading industrial nations, used banks' own internal models to assess their risk. Those internal models turned out to be untrustworthy. *See* Imad A. Moosa, *Basel II as a Casualty of the Global Financial Crisis*, 11 J. BANKING REG. 95, 95–96 (2010).

49. *See* SCOTT D. PATTERSON, THE QUANTS: HOW A NEW BREED OF MATH WHIZZES CONQUERED WALL STREET AND NEARLY DESTROYED IT 27–46 (2010).

50. *See id.* at 262–91.

51. BENOIT MANDELBROT & RICHARD L. HUDSON, THE (MIS)BEHAVIOR OF MARKETS: A FRACTAL VIEW OF RISK, RUIN, AND REWARD 230–44 (2004). *See generally* NASSIM NICHOLAS TALEB, THE BLACK SWAN: THE IMPACT OF THE HIGHLY IMPROBABLE (2007) (exploring limitations in our knowledge of the world and the consequent challenges of trying to predict the future).

52. *See generally* Claire A. Hill, *Justification Norms Under Uncertainty: A Preliminary Inquiry*, 17 CONN. INS. L.J. (forthcoming Apr. 2011) (discussing the need to justify decisions even though probabilities cannot be assigned); TALEB, *supra* note 51 (explaining how to cope with uncertainty).

53. Kimberly D. Krawiec, *The Return of the Rogue*, 51 ARIZ. L. REV. 127, 128–30 (2009).

54. This indeed was the case for the book that popularized the phrase "the best and the brightest." *See generally* DAVID HALBERSTAM, THE BEST AND THE BRIGHTEST (1972) (exploring the decision making that plunged the United States into the Vietnam War).

Adaptation in the consumer protection context is also complicated by deep and fundamental limits to human understanding. Many will agree that consumers and investors should be protected from exploitation but free to make informed and fully considered financial decisions. Nonetheless, potential consumer protection issues often generate inaction because it is inherently difficult to know when consumers and investors are being exploited and when they are making genuine choices.[55] Whereas some commentators invoke the power of the market to argue that regulation can best promote consumer welfare by increasing transparency, others argue that markets can promote exploitation in ways that are susceptible to aggressive legal remedies.[56] Who is right depends largely on what precisely is meant by consumer autonomy and welfare—issues that do indeed stretch the limits of human knowledge, albeit in philosophical rather than mathematical dimensions.

B. Incentive Failures

An entire field of political science examines how the private incentives of regulators and other government actors may conflict with their pursuit of general social welfare.[57] This section briefly considers two prominent critiques that are particularly likely to distort adaptation in financial regulation. First, public choice theory suggests that a small number of people or corporations with similar interests and a relatively large stake in regulatory outcomes will enjoy comparative success organizing into effective lobbying groups.[58] Such groups are better able to overcome the free-rider problem than groups that have large numbers of

---

55. *See generally* Daniel Schwarcz, *Regulating Consumer Demand in Insurance Markets*, 3 ERASMUS L. REV. 23 (2010) (exploring the extent to which various observed "anomalies" in consumers' insurance decisions reflect genuine preferences or mistakes and arguing that it is incredibly difficult to make this assessment in many cases).

56. This tension is captured well in an excellent exchange between Richard Epstein and Oren Bar-Gill. *See* Oren Bar-Gill, *Exchange: The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 801–02 (2007) (arguing that "welfare-enhancing regulation is feasible" but that "[r]egulation should only be considered where such specific evidence proves the existence, in the specific market, of a behavioral market failure that generates significant welfare costs"); Richard A. Epstein, *Exchange: The Neoclassical Economics of Consumer Contracts*, 92 MINN. L. REV. 803, 803–04 (2007) (discussing concerns about legal interventions in consumer contracts and how regulation that responds to consumer mistakes is more harmful than beneficial).

57. *See generally* JEFFREY S. BANKS & ERIC A. HANUSHEK, MODERN POLITICAL ECONOMY (1995) (exploring the interactions between economic markets and politics).

58. *See* George J. Stigler, *The Theory of Economic Regulation*, 3 BELL J. ECON. & MGMT. SCI. 3, 7 (1971).

persons each of whom has a small stake in the matter.[59] This phenomenon can result in special interests capturing regulators in the sense that they unduly influence regulatory outcomes.[60] As the financial sector has become larger, more profitable, and more concentrated, regulatory capture has become a growing concern, although suspicion of the influence of bankers goes back to the Founding Fathers.[61]

The agency capture problem is both exemplified and exacerbated by the revolving door. High-level financial regulators will frequently be recruited from the ranks of industry and/or will go from their government jobs into industry.[62] Consider two of the most influential treasury secretaries of recent decades, Robert Rubin and Henry Paulson, both former leaders of Goldman Sachs. Even in the absence of explicit corruption, regulators with such deep industry ties may have a mindset that unduly favors the industry.[63] They will tend to think that what is good for the banks is good for the country, which is sometimes true, but not always.

Regulatory capture will often blunt regulators' incentives to adapt to newly emerging financial risks, as risk tends to generate short-term profitability in the financial sphere.[64] This is particularly true in the context of consumer protection, where regulated entities have quite strong interests in deregulation, and consumers, the beneficiaries of regulation, are a large, dispersed group of individuals, each with a limited stake in regulatory outcomes.[65] But, as the recent financial crisis suggests, regulatory capture

---

59. *See* MANCUR OLSON JR., THE LOGIC OF COLLECTIVE ACTION 53 (1965); *see also* JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY 33–36 (1958) (discussing an individual's rational decision-making process when placed in a collective group).

60. *See* Stigler, *supra* note 58, at 11–12.

61. SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 14 (2010).

62. *See generally* Toni Makkai & John Braithwaite, *In and Out of the Revolving Door: Making Sense of Regulatory Capture*, 12 J. PUB. POL'Y 61, 62 (1992) (noting that "[t]he empirical fact of the revolving door is beyond dispute," but arguing that it may not lead to the type of regulatory capture that many claim).

63. Recently, this phenomenon has been termed "cognitive capture." *See* Gerald P. O'Driscoll Jr., Op-Ed., *An Economy of Liars*, WALL ST. J., Apr. 20, 2010, at A21 (describing " 'cognitive capture,' by which regulators become incapable of thinking in terms other than that of the industry").

64. Of course, some newly emerging risks may jeopardize industry interests, in which case regulatory capture can have the opposite effect of prompting overly aggressive regulatory intervention in response to these changes.

65. *See* Barkow, *supra* note 10, at 64–65 (describing consumer protection as "a prototypical example of asymmetrical interest group pressure opposing the general public interest" because the industries that consumer protection regulators "are charged with regulating are typically far more powerful and well financed than the consumers whose interests they are charged with protecting").

can also undermine adaptive systemic risk regulation, as regulated industries have an insufficient stake in systemic stability. Whereas individual firms can often capture the benefits of risk taking, the costs can be externalized to the economy as a whole, particularly in light of the prospect of governmental bailouts.[66] This form of regulatory capture is a much larger problem at the peak of the credit cycle, when the public is usually rationally ignorant of financial regulation. By contrast, during times of financial crisis the power of lobbying groups can be offset by the concentrated, if short-lived, attention of the public.

A second prominent critique of regulators' incentives—which straightforwardly cuts across all forms of financial regulation—is simply that principal-agent problems tend to result in limited bureaucratic motivation to adapt to change.[67] Regulators are agents who are supposed to act in the interests of their principal, the public. Like all agents, though, they may be tempted to pursue their own selfish interests by not working hard to accomplish this. Figuring out what form financial regulation should take is hard work. In a sense, the task is infinite, and regulators inevitably must draw a line at how far they go in exploring options before acting. This is of course the bounded rationality point discussed above. But regulators may not choose to explore as far as they could and should, or as they would if they really gave the public interest the weight it deserves. After all, one of the attractions of lower-paying government jobs is that the hours are a lot better than investment banking. At the same time, the principal-agent problem may also take the form of regulators advancing rules that increase their own power and prestige.[68] It is possible that this agency cost may actually produce excessive responsiveness to market change.

II. A POTENTIAL ROLE FOR CONTRARIANS

We define a regulatory contrarian as an individual or entity possessing three distinctive features. First, a regulatory contrarian must be at least partially affiliated with a particular regulatory body but simultaneously enjoy meaningful independence from that agency.[69] That independence can

66. *See generally* Steven Schwarcz, *Keynote Address: Understanding the "Subprime" Financial Crisis*, 60 S.C. L. REV. 549, 558 (2009) (describing the moral hazard created by any bailout plan).

67. *See generally* WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (1971) (developing a theory of bureaucratic behavior).

68. *See id.* at 38, 114.

69. Compare this to the proposals offered by Staszewski and by Bagley and Revesz, which both suggest that independent entities such as the Congressional Budget Office, Office of Information and Regulatory Affairs ("OIRA"), and GAO combat regulatory inaction. *See supra*

result from the contrarian's budget, staffing, appointment and removal process, or even institutional culture. Second, a regulatory contrarian must possess persuasive influence over its affiliated agency by virtue of its position, access to media and officials, or speaking engagements and reports. At the same time, regulatory contrarians must have limited, if any, actual regulatory authority. Finally, regulatory contrarians must be tasked with studying and identifying deficiencies and potential improvements in the regulatory process, regulatory policy, and/or the regulated market. Their focus should be entirely on regulatory policy and the internal processes that produce that policy, whether they are rulemaking or patterns of adjudication.[70] Entities or regulatory strategies that meet only some of these conditions can be thought of as "quasi-contrarian."

The key (but not only) job of contrarians is to counteract agency inaction or ossification in the face of changing market risks.[71] While numerous mechanisms promote accountability with respect to affirmative agency action (though contrarians can help here, too), few tools combat the risk of excessive agency inaction.[72] For instance, judicial review of agency decision making is much more robust than judicial review of agency inaction.[73] Notice and comment rulemaking is only required when rules are actually proposed. Legislative oversight is most likely to be an effective check against affirmative agency proposals or public and salient regulatory failures, rather than the gradual failure to adapt to changing markets.[74] To the extent that super-agencies such as the Office of Information and

---

note 14 and accompanying text. Within our framework, these entities would be considered "quasi-contrarians" because they are not affiliated with any particular regulatory entity.

70. Some literature suggests that agencies tend to make policy through adjudication rather than rulemaking because the former is subject to less robust judicial review. *See* JERRY L. MASHAW & DAVID L. HARFST, THE STRUGGLE FOR AUTO SAFETY 24–25 (1990).

71. This is a broader role than that envisioned by Staszewski as well as commentators who promote more robust judicial review of agency inaction. *See, e.g.*, Staszewski, *supra* note 14, at 393. Those commentators are focused on an agency's *specific decision* not to act. *Id.* ("Congress should enact a statute that creates a new, independent administrative agency to oversee, monitor, and evaluate decisions by Executive Branch agencies not to implement their existing statutory authority.").

72. *See id.*

73. "Although agency inaction is sometimes grounds for legal challenge, in practice it is extremely difficult to drag an agency into court to defend its policymaking reticence." Jacob E. Gersen & Anne Joseph O'Connell, *Hiding in Plain Sight? Timing and Transparency in the Administrative State*, 76 U. CHI. L. REV. 1157, 1188 (2009); *see also* Lisa Schultz Bressman, *Judicial Review of Agency Inaction: An Arbitrariness Approach*, 79 N.Y.U. L. REV. 1657, 1667–69 (2004) (explaining how the Court "insulate[d]" agency inaction from judicial review through its decision in *Heckler*). For an illustrative case, see Norton v. S. Utah Wilderness Alliance, 542 U.S. 55 (2003).

74. *See* Mark Seidenfeld, *A Big Picture Approach to Presidential Influence on Agency Policy-Making*, 80 IOWA L. REV. 1, 11 (1994).

Regulatory Affairs ("OIRA") address agency inaction, that focus is heavily tilted toward identifying existing regulations that should be relaxed rather than identifying new areas that require regulation.[75] And agency self-regulation usually takes the form of limiting agency discretion.[76] Not only do most existing regulatory oversight mechanisms fail to address the problem of regulatory inaction, but they in many ways exacerbate it by increasing the costs of change.[77]

Unlike existing accountability tools, regulatory contrarians may be able to promote affirmative agency adaptation and action.[78] Although regulatory contrarians may well resist agency actions or initiatives, they will tend to have less reason to focus on these issues precisely because of the robust set of accountability tools that affirmative regulatory actions already trigger. Contrarians—who will themselves no doubt be influenced by political incentives—will have less to gain by merely contributing to the cacophony of public comments to a proposed rule. By contrast, their unique access to information coupled with their persuasive authority should give them a comparative advantage in emphasizing regulatory shortcomings and inaction. Contrarians can be further encouraged to focus on agency adaptation to market change by developing metrics that track how often affirmative policy prescriptions originating from contrarians, rather than their affiliated agencies, are adopted, although such metrics may themselves cause problems.[79]

Contrarians can promote adaptation by pointing out, and advocating on behalf of, arguments and alternatives that are not currently being

75. *See* Daniel A. Farber, *Rethinking the Role of Cost-Benefit Analysis*, 76 U. CHI. L. REV. 1355, 1399–1402 (2009). For further discussion of OIRA as a quasi-contrarian, see *infra* Part III.E.

76. Indeed, Magill defines self-regulation in this way. *See* Elizabeth Magill, *Agency Self-Regulation*, 77 GEO. WASH. L. REV. 859, 860 (2009) (arguing that agencies take numerous measures to limit their own discretion even when they are not required to do so by some source of authority).

77. Kathleen Bawn, *Political Control Versus Expertise: Congressional Choices About Administrative Procedures*, 89 AM. POL. SCI. REV. 62, 62–73 (1995); *see also* Susan Rose-Ackerman, *Introduction* to ECONOMICS OF ADMINISTRATIVE LAW, at xiii, xvii (Susan Rose-Ackerman ed., 2009) (discussing how "[p]rocedures that limit the ability of an agency to drift away from the aims of Congress may also mean that the agency is unresponsive to technical innovations and new data").

78. Erik Gerding alludes to the same point. *See* Gerding, *supra* note 8, at 21–22 ("Unlike the traditional checks and balances of political theory, which are designed to curb political action (in order to prevent excessive concentration of power), however, the checks described below also address the problem of policy *inaction*.").

79. *See infra* Part IV.B (developing this theme in further detail).

considered within an agency or not receiving adequate attention.[80] Contrarians should be constantly looking out for persons who are speaking out against the prevailing received wisdom. These arguments need not always involve substantive regulatory decisions—just as often, regulatory contrarians may focus on procedural deficiencies in how a particular viewpoint or position has evolved within the regulatory apparatus. In all cases, these perspectives should be informed by the contrarian's privileged access to, and understanding of, the information, practices, and culture of its affiliated regulator and market conditions. Moreover, contrarians should build on their relationship with their affiliated agencies to cultivate understanding and appreciation of alternative viewpoints.[81]

Regulatory contrarians that raise awareness of alternative arguments and issues may help to counteract the various cognitive biases identified in Part I. Although there is clearly no single magic bullet, an ever-growing literature suggests that various procedural mechanisms can help to debias individuals.[82] To date, the literature suggests that some of the most effective debiasing techniques involve forcing decision makers to (1) take an outsider perspective on their work, (2) consider the opposite outcome to which they are inclined to take, (3) interact during the decision-making process with persons with differing backgrounds and biases, and (4) publicly defend their positions.[83] Not coincidentally, regulatory contrarians

80. To limit intellectual hazard in financial institutions, Miller and Rosenfeld advocate for policies that "introduce greater skepticism and independent judgment into the processes by which firms in the financial sector evaluate information and make policies related to risk." Miller & Rosenfeld, *supra* note 41, at 836. We suggest that extending this effort to regulators themselves would be advisable.

81. As Rachlinski and Farina note, "*self-generated* agency use of external and internal strategies for multiplying professional perspectives is highly desirable" because such mechanisms "minimize[] defensiveness—thereby increasing policymakers' willingness to take steps to improve their own decisional processes." Rachlinski & Farina, *supra* note 24, at 600. Similarly, some have argued that the liberalization of the rules governing standing to sue was intended to prevent the "decisional perspective from which the agency in question approached its problem [from becoming] too narrow" and ensure that "its decisional frame . . . be broadened, [by] exposure not only to additional information . . . but new decisional referents." Daniel J. Gifford, *Decisions, Decisional Referents, and Administrative Justice*, 37 LAW & CONTEMP. PROB. 3, 42–43 (1972).

82. *See, e.g.*, Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 200–01, 236 tbl.A1 (2006) (discussing both substantive and procedural mechanisms that debias individuals); Katherine L. Milkman et al., *How Can Decision Making Be Improved?* 3–4 (Harvard Bus. Sch., Working Paper No. 08-102, 2008), *available at* http://www.hbs.edu/research/pdf/08-102.pdf (describing many strategies for debiasing which in turn, improve decision making).

83. Milkman et al., *supra* note 82, at 5–6 (describing studies finding that forcing individuals to take an outsider's view on their work and to consider the opposite outcome successfully debiased the individuals); Rachlinski & Farina, *supra* note 24, at 588 ("Cognitive psychological research indicates that one of the best mechanisms for reducing overconfident judgments is

are designed so that they induce regulators to take precisely these types of steps in their regulatory processes. Their independence and contrarian orientation can prompt regulators to consider alternative viewpoints, and their persuasive authority can lead regulators to anticipate the possibility, or reality, that they will have to publicly defend their positions. Because contrarians lack actual regulatory authority, they can focus their energy on playing the role of devil's advocate.[84] At the same time, contrarians' affiliation with a specific agency can ensure that those within that agency are consistently exposed to alternative viewpoints. Of course, contrarians may develop their own preferred viewpoints and not give adequate voice to a variety of points of view. And even if the contrarians do give voice to many viewpoints, there is no guarantee that regulators will listen to them. But effective contrarians will hopefully be able to have some real influence on at least some policies and problems.

Contrarians created by crisis legislation may be able to debias regulators in another way by producing a sort of regulatory time-shift. Legislatures are subject to many of the same political economy forces as regulators, meaning that robust financial reform tends to be possible only after large financial crises when public attention to the issue can offset regulatory capture.[85] However, legislators enacting financial reform in the midst of a crisis must typically delegate substantial responsibility to regulators for at least two reasons. First, the midst of a recession or depression following a financial crisis is not actually the best time to put stricter financial rules in place—such rules are likely to constrict the provision of credit, and at such moments we want credit to expand, not contract.[86] Second, the precise details of financial reform are often difficult to specify. However, by the time regulators can implement crisis legislation, regulatory capture and availability bias may take hold, resulting in the agency adopting an overly pro-industry stance. That is a common pattern for legislation in response to visible crises.[87] Contrarians may be able to disrupt this prospect by continually invoking the salient imagery of

---

forcing oneself to consider alternatives and carefully review arguments against one's own position.").

84. Indeed, the devil's advocate is a famous ancient example of a contrarian institution.

85. *See* Larry E. Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 92 (2003) (noting that major changes in financial regulation are particularly likely during financial crises, with the New Deal reforms being the most obvious and important example).

86. Congress recognized this point in the Dodd-Frank Act and directed agencies to enact countercyclical capital requirements. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 616, 124 Stat. 1376, 1615–16 (2010) (codified in scattered sections of 12 U.S.C.A. (West Supp. 2011)).

87. *See id.*

the crisis, thus reminding regulators of the need for reform and helping to keep them honest as they promulgate rules implementing the crisis legislation.

Contrarians may also be able to help address some of the high-level cognitive failures of regulation by serving as a sort of intermediary between regulators and academics. Although copious amounts of academic work across the disciplines bear on optimal regulatory policy, regulators often have limited resources and willingness to consider this research.[88] In part, this is attributable to some of the biases described above, including optimism and confirmatory bias. But it is also because academics and regulators often communicate to different audiences using different language in different forums.[89] Contrarians—who are specifically tasked with investigating alternative viewpoints—are an ideal mechanism for helping regulators better leverage this work.

The incentive failures described in Part I may also be mitigated by the efforts of an effective contrarian. Contrarians' access to regulators and their persuasive influence means that they are well positioned to serve as a whistle-blower and critic of regulatory capture. Of course, contrarians may themselves be subject to the threat of regulatory capture, but this is less likely than standard regulatory capture. First, unlike regulators, there is less need for contrarians to have work experience within the regulated industry. This is because the position is less all-encompassing than that of a regulator, with a contrarian able to focus his or her attention on a few specific issues of concern. Not only does this limit the risk of the revolving door into contrarian offices, but it also limits the revolving door out of these offices: to the extent that contrarians have broad-based experience and expertise, it is much easier as a practical matter to set strict limits on their ability to work in the regulated industry after their tenure. Still, there is a danger if contrarians are too disconnected from relevant experience, as they may not know enough to fully understand the industry. To alleviate the problem, contrarian offices may often want to have some role for industry insiders as well. Second, the risk of regulatory capture is limited by the fact that contrarians have no (or limited) regulatory authority and must rely on persuasion and public pressure to exert power. A paradox limits this effect: if a contrarian office develops a reputation for successful persuasion, that may make the office subject to more lobbying and regulatory capture. We do not think that contrarians can fully counter

88. *See* Mitchell Weiss, *Preface* to NEW PERSPECTIVES ON REGULATION 7, 7–8 (David Moss & John Cisternino eds., 2009) (emphasizing the disjunction between academic knowledge about regulation and the theoretical knowledge actually employed by regulators).

89. *See id.*

regulatory capture within agencies by any stretch of the imagination, but we hope they can help.

Regulatory contrarians may also make regulators work harder and more diligently. Knowing that their actions and decisions are being scrutinized and critiqued by an independent entity with privileged access to the agency and significant reputational capital can increase regulators' incentives to adapt to new circumstances.[90] Not only does this limit the risk of public shaming by the contrarian, but it also increases the prospect of praise and encouragement.[91] Contrarians need not be curmudgeons.

To be sure, regulatory contrarians may resemble some other mechanisms for promoting diverse viewpoints within agencies. In particular, contrarians resemble minority members in multimember commissions, particularly when a requirement exists that the commission be balanced between competing political parties.[92] But there are also important differences in these two institutional design features, resulting in each having their own distinctive benefits and weaknesses. Here we emphasize several benefits of contrarians relative to multimember boards in promoting effective regulatory adaptation. First, members of a commission may be less free than contrarians to focus on issues that might not otherwise be on an agency's agenda. Whereas board members must familiarize themselves with all of the key issues before the commission, contrarians are free to focus their energies on particular targeted initiatives that may not currently be priorities within the agency. Second, the dynamics among board members are likely to be different than the dynamics of contrarians and their affiliated regulators. Because they have the authority to vote on controversial issues, minority board members will often seek compromise. By contrast, contrarians are liberated from the practical necessity to compromise (although compromise may often be strategically beneficial) by virtue of the fact that they hold no actual power.

90. *See* Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 28 (1995) (exploring how OIRA review can improve regulation because regulators know that their work will be scrutinized by an expert entity with privileged access to information).

91. For one example of this, consider the award that NAIC consumer representatives give annually to a state insurance regulator in recognition of their consumer protection efforts. *See Colorado Insurance Commissioner Recognized for Consumer Advocacy*, INS. J. (Oct. 21, 2010), http://www.insurancejournal.com/news/west/2010/10/21/114247.htm.

92. *See generally* Barkow, *supra* note 10, at 37–41 (discussing that minority members act as a "built-in monitoring system" that prevents the committee from becoming too polarized). Contrarians may also replicate some of the benefits of interagency lobbying that others have described. *See* J.R. DeShazo & Jody Freeman, *Public Agencies as Lobbyists*, 105 COLUM. L. REV. 2217, 2231 (2005) (exploring how lobbying by outside agencies can be effective counterweight against industry pressure).

Third, disagreement among competing board members is often deeply political.[93] Contrarians, however, are meant to question assumptions and receive wisdom irrespective of politics. Finally, the mechanisms of dissent available to minority board members and contrarians differ. Minority board members often issue formal dissents from agency decisions, but they tend not to be oriented toward mobilizing public opinion on the issue.[94] Contrarians do not have a formal vote on regulatory policies, but, precisely for this reason, they are likely to be more adept at mobilizing public pressure through media contacts, formal speaking engagements, and regular reports. After all, persuasion is the primary tool available to contrarians to effect change.

Contrarians, of course, will often be ineffective, particularly to the extent that regulatory policy is influenced by strongly held ideological beliefs or political incentives within a particular administration or agency. Contrarians are inevitably doomed to sometimes—nay, often—play the role of Cassandra. The hope is simply that sometimes the agencies will actually heed the warnings, at least up to a point. But we do think that wise governance requires listening to those who disagree with you and at least sometimes actually acting upon their insights. Wise governance does sometimes happen, and we hope that contrarians can on occasion increase its incidence.

III. EXISTING CONTRARIAN AND QUASI-CONTRARIAN MODELS

This Part offers a typology of regulatory contrarians. It describes four different types of financial regulatory contrarians that currently exist at the federal and state levels: ombudsman contrarians, consumer representative contrarians, investigative contrarians, and research contrarians. In doing so, Part III suggests that existing contrarians can indeed promote affirmative agency adaptation as described in Part II. In particular, ombudsmen and consumer representatives can encourage regulatory initiatives by amplifying the voice of consumers, pushing back against industry capture, and overcoming confirmation bias and distortions in regulators' risk perceptions. Similarly, investigative contrarians, such as inspectors general, can counteract regulatory overconfidence and laziness while research

93. *See* Neal Devins & David E. Lewis, *Not-So Independent Agencies: Party Polarization and the Limits of Institutional Design*, 88 B.U. L. REV. 459, 461 (2008) (characterizing minority party members of commissions as "ideological partisans committed to the agenda of the opposition party").

94. *See* Barkow, *supra* note 10, at 41 (describing the ways in which minority members of boards can dissent, which can, in turn, serve as a "fire alarm" that activates the scrutiny of Congress and the public).

contrarians can bring together high-level academic theory and policymaking. Whether these programs and institutions accomplish these objectives efficiently or produce counteracting costs is a topic for another day.

At the same time that it demonstrates some of the theory of Parts I and II in action, this Part also reveals that the scope of existing contrarian models is dramatically limited in one of two ways. In particular, the first two types of contrarians—ombudsmen and consumer representative contrarians—are both currently limited to the consumer protection or service domain, despite the suggestions above that contrarians can also be useful with respect to other forms of financial regulation. By contrast, while the second two types of contrarians—investigative and research contrarians—currently serve an important role in a wide range of financial agencies, their methodological emphasis and the scale of their jurisdiction dramatically circumscribe these roles.

Finally, this Part also describes a category of "quasi-contrarians" that do not satisfy the basic definition of a contrarian, but nonetheless serve a similar function. Here, it focuses on the Government Accountability Office ("GAO"), which is not affiliated with any particular regulatory body and thus does not meet the first element of the contrarian definition. This Part shows how this feature of the GAO may limit its capacity to serve the core function of regulatory contrarians, promoting regulatory adaptation to changing market conditions.

A. Ombudsman Contrarians

Several different contrarians have evolved out of ombudsman offices. Although the term "ombudsman" is quite malleable, it typically refers to an independent entity or person that is tasked with responding to complaints concerning a specific government agency or other type of institution.[95] In many instances, of course, entities that process complaints are in a privileged position to identify systemic problems or concerns with the underlying entity. Patterns of complaints, for instance, are often indicative of a larger problem in an organization or institution.[96] Indeed, many regulators use patterns of consumer complaints about private firms to guide their regulatory energies.[97]

Given their privileged position in identifying and understanding institutional problems with the entities they are associated with,

95. *See* Schwarcz, *supra* note 32, at 738.
96. *See id.* at 801–02.
97. *See id.* at 753.

ombudsmen often take on the role of a contrarian.[98] Such ombudsmen are often described as "advocacy ombuds."[99] In some cases, ombudsmen are specifically imbued with this authority. In particular, some ombudsmen are formally authorized to (1) proactively investigate issues that are not necessarily raised by a specific complaint, (2) make specific recommendations for changes in organizational or institutional structure, and (3) suggest changes to the underlying agency's structure, organization, or authority in published reports or testimony to an overseeing entity.[100] In other instances, however, an ombudsman may act as a contrarian simply in the course of attempting to investigate and resolve specific suits.[101]

Perhaps the most well-known ombudsman contrarian is the Taxpayer Advocate Service ("TAS") within the Internal Revenue Service ("IRS").[102] Originally named the "Taxpayer Ombudsman," one of the central functions of the office is to help resolve taxpayer complaints and answer taxpayer inquiries.[103] At the same time, TAS is tasked with proposing changes in legislation and IRS administrative practices designed to improve the IRS's relationship with taxpayers.[104] TAS uses several mechanisms to promote these changes through the force of persuasion.[105] For instance, TAS issues

98. *See generally* GINSBERG & KAISER, *supra* note 14, at 2–3 (noting that the federal government has "multifarious forms of ombudsmen-like offices," some of which "examine the agency's operations" and proactively evaluate its effectiveness in the relevant communities); Jeffrey S. Lubbers, Independent Advocacy Agencies Within Agencies: A Survey of Federal Agency External Ombudsmen, Report to National Taxpayer Advocate, at iv (June 2003) (unpublished manuscript) (on file with the North Carolina Law Review).

99. *See* Am. Bar Ass'n, *Standards for the Establishment and Operation of Ombuds Offices*, 54 ADMIN. L. REV. 535, 549 (2002) (defining an advocate ombud as on ombudsman that "serves as an advocate on behalf of a population that is designated in the charter").

100. GINSBERG & KAISER, *supra* note 14, at 14.

101. *See* Lubbers, *supra* note 98, at v (finding that the national taxpayer advocate is an "advocate ombudsman" within the definition used by the ABA). For instance, even though the Financial Ombudsman Service ("FOS") in England purports not to have any regulatory authority over the entities about which it receives complaints (private financial firms), several different studies have found that, in practice, the FOS often exercises quasi-regulatory authority. *See* Schwarcz, *supra* note 32, at 738–39.

102. *See* Bryan Camp, *What Good Is the National Taxpayer Advocate?*, 126 TAX NOTES 1243, 1243 (March 8, 2010).

103. *Id.* at 1248. There are nine criteria by which the TAS can take cases, though the first seven are related to financial hardship. *See id.* They can also take cases on equity grounds (meaning fairness issues or taxpayer rights are at stake) and on public policy grounds, although the vast majority of these cases are hardship cases. In the first six months of 2009, the TAS worked 101 "equity" cases and only 25 public policy cases, compared with 134,000 hardship cases. *Id.*

104. *Id.*

105. The TAS is endowed with administrative authority in the form of Taxpayer Advocate Directives, which authorize it to grant broad relief to taxpayers, improve operation and procedure, and ensure equal treatment. 34 AM. JUR. 2D *Federal Taxation* ¶ 70014 (2011). Consistent with

an annual report to Congress containing legislative recommendations and outlining the key shortcomings of the IRS.[106] The TAS is also an active participant in the academic community, publishing its research in law reviews as well as in its own reports and participating in research colloquia and conferences.[107] Most importantly, the TAS relies on various informal, "soft" approaches to influence IRS practice. As one frequent commentator on the TAS puts it, the goal of the TAS is "to continually present the taxpayer point of view to other subcomponents within the agency as a balance, counterweight, or check to insular thinking and the enforcement mentality that often pervades inquisitorial systems."[108]

The TAS's focus on counteracting regulatory inaction is evident in its reports to Congress. For instance, the most recent report for TAS objectives for fiscal year 2011 emphasizes IRS delays in responding to taxpayers, issuing guidance, and incorporating into IRS materials relevant information from recent court decisions. It criticizes the IRS's lien-filing policies and practices, and it questions the effectiveness of IRS initiatives to compromise with taxpayers about their tax liability.[109] Similarly, TAS's 2009 annual report to Congress began by emphasizing the fact that the "IRS this year acted on two longstanding issues that [the TAS has] identified several times as most serious problems of taxpayers—identity theft and automated levies on Social Security benefits."[110] It also emphasized that the IRS had just announced "that it would study the question of regulating federal return preparers and present a report to the President and the Secretary of the Treasury before year's end," an initiative

this use of soft, persuasive power, the TAS has typically refrained from using its formal authority to issue Taxpayer Advocate Directives. Nina Olson, the long-time head of TAS, explained how the use of "taxpayer assistance orders[,] . . . the most obvious source of power[,] . . . [are] not going to be [what] changes the system." Camp, *supra* note 102, at 1254. Instead, Olson explained that change would ultimately come from her personnel acting as "persuaders" in conjunction with "the power of the advocate service's annual report." *Id.* For these reasons, Olson has "focused the TAS resources on engagement and persuasion" and embraced the notion that "the best path to change is to make the case for change." *Id.*

106. *See, e.g.*, TAXPAYER ADVOCATE SERV., 2009 ANNUAL REPORT TO CONGRESS 1–402, *available at* http://www.irs.gov/advocate/article/0,,id=217850,00.html.

107. *See, e.g.*, Nina Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL'Y REV. 7, 7 (2009); *see also* TAXPAYER ADVOCATE SERV., FISCAL YEAR 2011 OBJECTIVES, at vii (2010) [hereinafter FY OBJECTIVES] (listing their many publications since 2001 addressing various issues with IRS collection efforts).

108. Camp, *supra* note 102, at 1249. Olson reinforced this when she suggested in one interview that "the taxpayer advocate service wants to be a part of all IRS initiative planning . . . including . . . compliance initiatives, examination initiatives, planning for tax courses, and working with task forces looking into specific issues and programs like offers in compromise." *Id.* at 1251.

109. *See* FY OBJECTIVES, *supra* note 107, at 2–20.

110. *See* TAXPAYER ADVOCATE SERV., *supra* note 106, at v.

that the TAS has "recommended . . . since [its] 2002 Annual Report to Congress, and reiterated and supplemented . . . in successive reports."[111] The TAS's focus on promoting IRS adaptation is also evident in its own performance metrics. For instance, it is developing a trailing five-year metric to track its legislative recommendations and the rate at which they have been enacted five years later.[112]

In sum, the TAS uses both its significant persuasive authority—as reflected in its direct line of communication with Congress—and its close relationship with the IRS to directly counteract regulatory inaction and delay. The TAS does so by putting political pressure on the IRS and by bringing an outsider perspective to the organization. However, its role as an ombudsman contrarian is limited to issues that involve the experiences of "consumers" of this regulation, that is, taxpayers.

B. Consumer Representative Contrarians

A second set of contrarians represents the public within the context of regulatory proceedings. These contrarians are intimately related to ombudsman contrarians in that they arise out of the same intellectual underpinnings, dating back to the 1960s and '70s in America, which emphasized public participation in lawmaking and the empowerment of consumers.[113] However, these contrarians are distinguishable from ombudsman contrarians in that they either do not have a complaint-handling function or only interact with individual members of the public as an adjunct to their primary role of serving the public as a class. Rather, these contrarians are empowered to represent public interests because they serve as a "lawyer" or representative for consumers.

One example of this consumer representative contrarian is the "Offices of Public Counsel" that are affiliated with several different state administrative agencies. For instance, several states—including California, Missouri, Florida, and Texas—have an Office of Public Counsel that is affiliated with their public utilities regulators.[114] Texas also has an Office of

---

111. *See id.* at iv.

112. *Id.* at 327–37.

113. *See Public Participation in Federal Agency Proceedings: Hearings on S. 2715 Before the Subcomm. on Admin. Practice and Procedure of the Comm. on the Judiciary*, 94th Cong. 1 (1976) (statement of William A. Blakey, Legislative Director, Commission on Civil Rights).

114. The Florida Office of Public Counsel "provide[s] legal representation for the people of the state in utility related matters in proceedings before the Florida Public Service Commission, and in proceedings before counties." *About the Office of Public Counsel*, FLA. OFFICE OF PUB. COUNSEL, http://floridaopc.gov/about.cfm (last visited Apr. 26, 2011). The Florida legislature created it by statute in 1974. *See* FLA. STAT. ANN. § 350.061 (West 1998). Similarly, the Missouri Office of the Public Counsel

Public Insurance Counsel ("OPIC") that was designated as an independent agency charged with representing Texas consumers as a class regarding insurance-related issues.[115] For many of these offices, the primary (if not sole) task is to represent consumer interests in administrative proceedings, particularly those involving ratemaking.[116] Unlike the TAS, they therefore tend not to fulfill the role of counteracting regulatory inaction. However, at least one public counsel, OPIC, is statutorily empowered to recommend rule changes or legislative enactments.[117] Although OPIC has used that authority sparingly, it recently waged a prolonged and ultimately successful campaign to ban discretionary clauses in life, health, and disability policies.[118]

There are at least two potential reasons why OPIC has not done more to promote regulatory adaptation. First, like the commissioner of the Texas Insurance Department, the public insurance counsel, who heads OPIC, is

---

> represents the interests of the public and utility customers in proceedings before the Missouri Public Service Commission (PSC) and in appeals in the courts. The PSC regulates the rates and services of investor-owned electric, natural gas, telephone, water, sewer and steam heat utilities. The Office of the Public Counsel is independent from the PSC and has a separate budget and staff.

MO. OFFICE OF THE PUB. COUNSEL, http://www.mo-opc.org (last visited Apr. 26, 2011). The Texas Office of Public Utility Counsel states its mission as follows:

> to provide representation to Texas residential and small commercial telephone and electric utility consumers in utility proceedings that come before the Public Utility Commission of Texas (PUC), the Federal Energy Regulatory Commission (FERC), the Federal Communications Commission (FCC), and in state and federal courts to ensure that utility services are available to these ratepayers at just and reasonable rates in an increasingly competitive environment.

About Us, TEX. OFFICE OF PUB. UTIL. COUNSEL, http://www.opc.state.tx.us/about%20us .html (last visited Apr. 26, 2011).

115. OFFICE OF PUB. INS. COUNSEL, SELF-EVALUATION REPORT 3 (2007), *available at* http://www.opic.state.tx.us/docs/487_sunset_self_evaluation.pdf. The Texas legislature created the OPIC. *See* TEX. INS. CODE ANN. § 501 (West 2009).

116. *See supra* note 114 and accompanying text. In some cases, these offices are also tasked with improving consumer information, though they usually undertake this task independently of any affiliated regulatory body. For instance, the Texas OPIC: (1) produces a consumer bill of rights for personal lines of insurance; (2) develops a report card for HMOs that is made available to the public; and (3) maintains a unique consumer information mechanism to facilitate consumer review of individual insurers' policy forms. OFFICE OF PUB. INS. COUNSEL, AGENCY STRATEGIC PLAN FOR THE FISCAL YEARS 2011–2015 PERIOD 5 (2010), *available at* http://www.opic.state.tx.us/docs/657_2010 _strategic_plan-sans_def.pdf. It performs each of these functions entirely independently of the Texas Insurance Department. *Id.*

117. *See* TEX. INS. CODE ANN. § 501.153 (West 2009) (granting the OPIC the power to appear, intervene, or initiate under certain circumstances); *id.* § 501.155 (empowering OPIC to recommend legislation).

118. *See* OFFICE OF PUB. INS. COUNSEL, *supra* note 116, at 5.

appointed by the governor.[119] As a result, these two entities are likely to have similar views regarding insurance regulation. In any event, they have strong political incentives not to criticize each other publicly. Second, and perhaps more importantly, the OPIC evaluates itself based largely on metrics that are not related to promoting regulatory adaptation. Because their primary goal is to advocate for consumers in rate hearings, rulemaking procedures, and other forums,[120] they evaluate their success by counting the percentage of rate and rulemaking hearings attended and the percentage of rates and rules changed as a result of OPIC participation.[121] They also measure their strategy results by counting not only the number of such hearings attended, but also the number of proposed rule and rate filings analyzed.[122] They finally measure their efficiency by looking at the amount spent per hearing attended.[123] Whether or not these metrics properly set priorities for OPIC, they clearly do not incentivize OPIC to focus on promoting the Texas Insurance Department's capacity to adapt to changing market conditions.

Another example of consumer representative contrarians is the Funded Consumer Liaison program of the National Association of Insurance Commissioners ("NAIC").[124] Unlike most contrarians, the NAIC Consumer Liaison program is not a single organization, but instead consists of approximately eighteen individuals who are selected from applications solicited from the general public on an annual basis.[125] Individual consumer liaisons are typically academics or employees of public interest organizations, and their tenure as consumer representatives ranges from a single year to over a decade.[126] Consumer liaisons are reimbursed for the

119. *Id.*

120. *Id.* at 10.

121. *Id.*

122. *Id.*

123. *Id.*

124. The NAIC is the organization of state insurance regulators from all fifty states, Washington, D.C., and the five U.S. territories. *See generally* Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 629–34 (1999) (discussing the NAIC's historical development).

125. *See* Press Release, Nat'l Ass'n of Ins. Comm'rs, NAIC Accepting Applications for 2011 Consumer Liaison Representatives (Sept. 7, 2010), http://www.naic.org/Releases/2010_docs/2011_consumer_representatives.htm (announcing the NAIC's soliciting applications for the 2011 program); *2011 NAIC Funded Consumer Representatives*, NAT'L ASS'N OF INS. COMM'RS, http://www.naic.org/documents/consumer_participation_funded _reps.pdf (last visited Apr. 26, 2011) (listing eighteen members).

126. *See* Press Release, Nat'l Ass'n of Ins. Comm'rs, *supra* note 125 (indicating that the consumer representatives consist of six academics, ten employees of nonprofit public interest organizations, and one unaffiliated individual).

expenses they incur in attending triannual meetings of the NAIC, are afforded free access to NAIC resources and conference calls, and are provided with formal training and materials.[127] More importantly, consumer liaisons are provided with privileged access to regulators and a designated public forum for presenting on issues of their choosing at each NAIC meeting.[128]

Because the NAIC consumer program is comprised of individuals with disparate interests and expertise, its contributions to the insurance regulatory apparatus are both more diverse and harder to characterize than most other contrarians.[129] But like the TAS, and to some extent OPIC, consumer liaisons often focus their energies on overcoming regulatory inaction, delay, or mistakes. For instance, one recent campaign of NAIC consumer representatives promoted transparency in personal lines insurance policies.[130] Regulators had not addressed this issue for several decades, in large part because it did not generate consumer complaints or headlines. Yet NAIC consumer representatives, based both on empirical research and their experiences in the marketplace, recognized that the issue was pressing: in recent years, this lack of transparency has caused several major national carriers to dramatically reduce the scope of their coverage without consumers or regulators recognizing this fact.[131] In response to sustained pressure from NAIC consumer representatives, the NAIC is now actively investigating comprehensive reform to improve insurance policy transparency.[132] Similarly, NAIC consumer representatives have devoted

127. *See Consumer Participation at NAIC*, NAT'L ASS'N OF INS. COMM'RS, http://www.naic.org/consumer_participation.htm (last visited Apr. 26, 2011).

128. *See Committees & Activities*, NAT'L ASS'N OF INS. COMM'RS, http://www.naic.org/committees_conliaison.htm (last visited Apr. 26, 2011) (stating the mission of the NAIC/Consumer Liaison Committee).

129. Consumer liaisons present on a wide range of issues at the public meetings where they control the agenda, almost all of which advocate for specific action by regulators on a new initiative or on an issue already before the NAIC. They similarly follow these issues of interest across the NAIC organization, participating in conference calls, providing testimony at hearings, supplying written testimony, and collaborating on public letters or press releases. In some cases, representatives form themselves into organized "teams" of representatives that collaborate on particular issues, whereas in other cases consumer liaisons fail to coordinate their activities or even clash with one another about substantive positions and strategic priorities. Because their participation in the consumer liaison program is not compensated and tangential to their primary employment, the time commitment of individual consumer liaisons varies dramatically.

130. Schwarcz, *supra* note 33 (manuscript at 6) (describing the formation of an "Insurance Policy Transparency Working Group" to study issues raised by personal lines insurance).

131. *See generally id.* (inspecting several types and carriers of insurance policies and discussing the lack of transparency therein).

132. *See* Mark Ruquet, *NAIC to Review Personal Lines Contract Transparency*, PROPERTYCASUALTY360° (Oct. 21, 2010), http://www.propertycasualty360.com/2010/10/21/naic-to-review-personal-lines-contract-transparency--.

substantial energy in recent years to encouraging regulators to scrutinize insurers' use of credit scores in pricing policies.[133] Although the practice is long standing, producing both confirmation bias and limited political pressures, consumer representatives emphasized the new impacts that the practice had in the midst of the financial crisis. In particular, they argued that those who received subprime loans were disproportionately seeing their credit scores decrease for reasons having little to do with their true insurance risks.[134] While it is too early to judge how these advocacy efforts will play out, they clearly have had a substantial impact in prompting affirmative scrutiny of a practice that otherwise would likely have been ignored.[135]

Ultimately, then, existing consumer representative contrarians have enjoyed some success in promoting regulatory adaptation to changing market conditions. But like ombudsman contrarians, consumer representative contrarians are limited in their subject matter to issues that directly implicate the welfare of consumers. They are a natural means of fighting regulatory capture and improving consumer protection regulation, but they do less to address other forms of bias or to improve prudential or systemic risk regulation.

C. Investigative Contrarians

The inspector general ("IG") offices that many agencies maintain represent a third brand of regulatory contrarian. At the federal level, IGs became a substantial element of public agencies with the Inspector General Act of 1978, which created IG offices in twelve federal agencies to

133. *See generally* CHI CHI WU & BIRNY BIRNBAUM, NAT'L CONSUMER LAW CTR., CREDIT SCORING AND INSURANCE: COSTING CONSUMERS BILLIONS AND PERPETUATING THE ECONOMIC RACIAL DIVIDE (2007), *available at* http://www.consumerlaw.org/reports/content/InsuranceScoring.pdf (calling for a ban on the use of credit scoring in insurance, but noting that many states permit it).

134. *See* Phil Gusman, *NAIC Presses Insurers over Credit Scoring Impact*, PROPERTYCASUALTY360° (June 15, 2009), http://www.propertycasualty360.com/2009/06/15/naic-presses-insurers-over-credit-score-impact-.

135. *See id.* Of course, these are just a limited number of examples where consumer representatives have promoted more affirmative scrutiny of regulatory practices and inaction. Another notable example is the work of several consumer representatives to more proactively study and craft readable and comprehensible disclosures. *See generally* Brenda Cude, *Insurance Disclosures: An Effective Mechanism to Increase Consumers' Market Power?*, 24 J. INS. REG. 57 (2005) (studying participants' reactions to disclosures and suggesting improvements); Brenda Cude, *Insurance Disclosures: Implications for Insurance Regulators of Recent Research*, 26 J. INS. REG. 1, 3 (2007) (reviewing briefly a few articles on the subject of improving insurance disclosures).

accompany two preexisting IG offices.[136] Since that time, IGs have spread throughout the federal bureaucracy, with sixty-nine agencies now having independent IG offices.[137] The primary purposes of IG offices are to detect and prevent fraud and abuse and to promote efficiency and effectiveness in government offices.[138] In contrast to other contrarians, IGs are not intended or designed to impact substantive agency policy. Consistent with this orientation, IGs are ostensibly objective and nonpartisan. They are supposedly appointed "without regard to political affiliation and solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations."[139] Some, however, question the independence of some IG offices,[140] and the enactment of reform in 2008 was largely intended to address concerns about the politicization of IGs' offices.[141]

Inspectors general are endowed with various tools to accomplish their prescribed goals. The most important of these tools is a broad authority to audit and investigate its associated agency.[142] IGs are also required to issue semiannual reports to Congress reviewing deficiencies in the administration of their agencies' programs and operations and recommending improvements.[143] At the same time, IGs are explicitly prohibited from interfering in the agency's "program operating

136. Inspector General Act of 1978, 5 U.S.C. app. § 2 (2006) (creating additional IG offices); *id.* § 12 (specifying the federal agencies with newly created IG offices). In 2008, the Inspector General Reform Act amended this act, creating the Counsel of the Inspectors General on Integrity and Efficiency, which serves as a central repository for information and coordination among the various IG offices. Inspector General Reform Act of 2008, Pub. L. No. 110-409, sec. 7, § 11, 122 Stat. 4302, 4305–06 (2008) (codified at 5 U.S.C.A. app. 3 § 11 (West Supp. 2010)).

137. Marcia G. Madsen et al., *Oversight—This Is Not a Commercial Relationship*, *in* GOVERNMENT CONTRACTS 2010: ENTERING INTO A BUSINESS RELATIONSHIP WITH THE U.S. 379, 384–85 (E. Sanderson Hoe & Marcia G. Madsen co-chairs, 2010).

138. *See generally* Margaret J. Gates & Marjorie Fine Knowles, *The Inspector General Act in the Federal Government: A New Approach to Accountability*, 36 ALA. L. REV. 473, 474 (1985) (stating the mission of IG offices); Diane M. Hartmus, *Inspection and Oversight in the Federal Courts: Creating an Office of Inspector General*, 35 CAL. W. L. REV. 243 (1999) (discussing the creation, purpose, and duties of IG offices).

139. Michael R. Bromwich, *Running Special Investigations: The Inspector General Model*, 86 GEO. L.J. 2027, 2029 (1998) (quoting relevant statutory language).

140. *See generally* William S. Fields & Thomas E. Robinson, *Legal and Functional Influences on the Objectivity of the Inspector General Audit Process*, 2 GEO. MASON INDEP. L. REV. 97 (1993) (considering factors that undermine the objectivity of certain IG offices).

141. Inspector General Reform Act of 2008, Pub. L. No. 110-409, §§ 1–2, 122 Stat. 4302, 4302 (2008) (codified at 5 U.S.C.A. app. 3 (West Supp. 2010)) ("An Act to amend the Inspector General Act of 1978 to enhance the independence of the Inspectors General[.]"); H.R. REP. NO. 110-354, at 8 (2007), *reprinted in* 2008 U.S.C.C.A.N. 1795, 1796.

142. 5 U.S.C. app. § 3(a) (2006).

143. *See id.* § 2(3).

responsibilities"[144] or investigating issues involving "regulatory compliance," as opposed to the actions of their agency, its employees, and recipients of federal funds.[145] Their primary tools of audit and investigation, along with their limited mandate, ensure that IGs' orientation is entirely retrospective, focusing on prior failings of internal operations within the agency rather than potential future problems that may not have manifested themselves.

Despite their investigative, nonpartisan, and procedural orientation, IGs are similar to other contrarians in that they counteract regulatory inaction and delay. This is because IGs' authority explicitly extends to the efficiency and effectiveness of a regulator's internal operations. One prominent example helps demonstrate the point. The inspector general of the SEC released an almost 500-page report in August 2009, detailing the agency's various missteps in failing to act on a decade's worth of credible, significant evidence it had received indicating that Bernard Madoff was operating a Ponzi scheme.[146] In large part on the basis of this report, the SEC instituted broad-ranging reforms in its operations, including, but not limited to, "[r]evitalizing the Enforcement Division, [r]evamping the handling of complaints and tips, [e]ncouraging greater cooperation by 'insiders,' [e]nhancing safeguards for investors' assets . . . [and] [i]mproving risk assessment capabilities."[147] Although the SEC would no doubt have instituted reforms in the wake of the Madoff scandal, the IG ultimately helped shape the nature and scope of those reforms by taking a critical eye to the factors that contributed to the SEC's failure. Similarly, while the threat of internal investigation clearly did not prevent the SEC from overlooking Madoff's fraud, it can be expected that the agencies such as the SEC overlook less given the risk of internal investigation ex post.

At the same time, some have argued that IGs are less effective than they could be at counteracting regulatory delay and inaction because they focus excessively on "compliance monitoring," or strict conformity with

144. *Id.* § 9(a).

145. Burlington N. R.R. v. Office of Inspector Gen., R.R. Ret. Bd., 983 F.2d 631, 641 (5th Cir. 1993); *see Inspector General Authority to Conduct Regulatory Investigations*, 13 OP. O.L.C. 54, 63 (1989); Charles H. Koch, Jr., *Inspector General Systems*, *in* 3 ADMINISTRATIVE LAW AND PRACTICE § 7:40 (3d ed. 2010).

146. *See* U.S. SEC. & EXCH. COMM'N, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME 47–50 (2009), *available at* http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/2000/2009_0831_SECMadoff.pdf (considering the causes of the SEC's failure to discover Madoff's illegal activities).

147. *The Securities and Exchange Commission Post-Madoff Reforms*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/spotlight/secpostmadoffreforms.htm (last modified Oct. 8, 2010).

specific rules and regulations.[148] Often, however, promoting effective regulation also requires establishing positive incentives for achieving desired outcomes ("performance accountability") and promoting agency technologies and expertise ("capacity building accountability").[149] These criticisms may help to explain why the IG did nothing to prevent the SEC from ignoring Madoff when intervention would have actually been useful. Others, however, question whether IGs are better situated than other types of entities to focus on these alternative forms of accountability.[150]

D. Research Contrarians

A fourth type of potential regulatory contrarian can best be labeled a "research contrarian" in that it essentially brings "in house" various academics or researchers who are afforded some degree of autonomy to study issues relevant to the regulatory body. Often, potential research contrarians do not satisfy the third element of the contrarian definition. These contrarians produce research that is merely meant to provide regulators with information relevant to their regulatory functions rather than to focus on potential problems in existing regulatory processes and/or policies.[151] For instance, the NAIC maintains a Center for Insurance Policy and Research that describes its mission as "leverag[ing] the resources of several NAIC departments and academicians to support the collection of information and analysis for use by state and federal officials, agencies, and policymakers."[152] Similarly, various Federal Reserve banks maintain entire "Economic Research Departments" that are partially intended to gather and produce information that is used by the Federal Open Market Committee and Board of Governors in forming national monetary policy.[153]

148. PAUL C. LIGHT, MONITORING GOVERNMENT: INSPECTORS GENERAL AND THE SEARCH FOR ACCOUNTABILITY 224 (1993).

149. *Id.* at 220.

150. William S. Fields, *The Enigma of Bureaucratic Accountability*, 43 CATH. U. L. REV. 505, 518–19 (1994).

151. Entities such as the Fed's Economic Research Departments may also fall short of the contrarian definition in other ways. For instance, they enjoy limited mechanisms for exerting their persuasive authority. In many ways, it seems, their primary such tool is to publish their research in academic journals and speak at academic conferences. Although individuals within these departments may have more substantial authority via their informal connections with top Fed officials, the extent of this authority is hard to gauge.

152. *About the CIPR*, NAT'L ASS'N OF INS. COMM'RS, http://www.naic.org/cipr_about .htm (last visited Apr. 26, 2011).

153. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 10 (2005), *available at* http://www.federalreserve .gov/pf/pdf/pf_1.pdf ("Boards of directors of the Reserve Banks provide the Federal Reserve System with a wealth of information on economic conditions in virtually every corner of the nation. This information is used by the FOMC and the Board of Governors in reaching major decisions about monetary

However, research contrarians can, and occasionally do, produce independent research that is specifically aimed at promoting innovation and evolution in regulation. Consider once again the Economic Research Departments of Federal Reserve banks. Economists in these departments have produced a substantial amount of research in recent years studying ways to reform systemic risk regulation. For example, one recent paper produced in such a department proposes the construction of a database that monitors fund flows and financial instruments to get a more accurate picture of systemic risk, allowing vulnerabilities to be spotted far sooner.[154] Other research originating in these departments focuses on potentially unaddressed but problematic market practices, such as whether certain commission programs offered to bank employees tended to increase default rates.[155] Yet another paper analyzes popular models used by the Federal Reserve in predicting wage and inflationary pressures and finds that the models are inaccurate because they don't incorporate the ways in which the Federal Reserve's economic and policy changes themselves impact wages and prices.[156] Thus, research contrarians within the Fed clearly do focus on promoting regulatory adaptation to changing market conditions. Much less information is available about what mechanisms exist for them to persuade Fed regulators to act upon their research findings.

The Federal Reserve Bank of Minneapolis, in particular, illustrates both the potential for research contrarians to promote agency adaptation and the difficulties of designing successful contrarian strategies. The Minneapolis Fed was one of the first regional Federal Reserve banks to

policy."); *About Economic Research*, FED. RESERVE BANK OF DALL., http://www.dallasfed.org/research/about.html (last visited Apr. 26, 2011) ("The Dallas Fed's Economic Research Department provides information and analysis to the Board of Governors, the Bank's president and the board of directors to assist them in implementing effective monetary policy. . . . Providing timely, insightful analysis of current economic conditions is the department's primary goal.").

154. Leonard Nakamura, *Durable Financial Regulation: Monitoring Financial Instruments as a Counterpart to Regulating Financial Institutions* 2 (Fed. Reserve Bank of Phila. Research Dep't, Working Paper No. 10-22, 2010), *available at* http://www .philadelphiafed.org/research-and-data/publications/working-papers/2010/wp10-22.pdf ("I here advocate a system for monitoring financial *instruments* as a complement to the regulation of financial *institutions*. If a system of financial regulation is to be durable, it must evolve with the development of new institutions and instruments. A main purpose of this paper is to begin a dialogue on an intellectual framework for the analysis of systemic risk data collection.").

155. Sumit Agarwal & Faye H. Wang, *Perverse Incentives at the Banks? Evidence from a Natural Experiment* 2 (Fed. Reserve Bank of Chi., Working Paper No. 09-08, 2009), *available at* http://ideas.repec.org/p/fip/fedhwp/wp-09-08.html.

156. Benjamin D. Keen & Evan F. Koenig, *How Robust Are Popular Models of Nominal Frictions?* 22–23 (Fed. Reserve Bank of Dall. Econ. Research Dep't, Working Paper No. 0903, 2009), *available at* http://www.dallasfed.org/research/papers/2009/wp 0903.pdf.

build a serious research department. Working with the University of Minnesota economics department, the Minneapolis Fed played a major role in developing the rational expectations approach to macroeconomics.[157] This approach contained major intellectual breakthroughs and, with its promarket tendencies, served as a useful counter to the proregulation tendencies that characterized the Keynesianism that dominated both academia and policy in the 1960s. It helped promote financial market deregulation at a time when regulation may well have gone too far. However, it continued to promote deregulation after that movement may well itself have gone too far. The strong free-market culture of the Minneapolis Fed and the Minnesota economics department was self-reinforcing and drew upon strong forces in the DNA of economics as an intellectual discipline.[158] However, when views that had once been contrarian become intellectually and politically dominant, this particular agency entity was not able to reverse course and start criticizing the very ideas that it helped nurture.[159] Thus, while research contrarians provide a promising avenue for addressing some of the forms of regulatory bias identified here, and especially for addressing problems in regulating systemic risk, they are far from a panacea.

E. Quasi-contrarians

A quasi-contrarian is simply an entity that resembles a contrarian but does not meet one of the formal elements of the definition that we lay out above. The most obvious, and most important, example of a quasi-contrarian is the GAO. The GAO describes itself as an "independent, nonpartisan agency that works for Congress" to "investigate[] how the federal government spends taxpayer dollars."[160] The GAO ensures that federal funds are being spent efficiently and effectively, investigates allegations of illegal and improper activities, reports on how well

157. *See* PRESTON J. MILLER, THE RATIONAL EXPECTATIONS REVOLUTION: READINGS FROM THE FRONT LINE, at xv (1994).

158. For an interesting online debate between the new president of the Minneapolis Federal Reserve, a "freshwater" economist who did research for the Fed for years before becoming its president, and Brad Delong, a prominent "saltwater" Keynesian economist, see Bradford DeLong, *The State of Modern Cutting Edge Macro: Narayana Kocherlakota Leaves Me Puzzled*, BRAD DELONG'S GRASPING REALITY WITH BOTH HANDS (Sept. 20, 2009, 12:13 PM), http://delong.typepad.com/sdj/2009/09/the-state-of-modern-cutting-edge-macro-narayana-kocherlakota-leaves-me-puzzled.html.

159. *See* Miller & Rosenfeld, *supra* note 41, at 827–28 (arguing that the idea of the "great moderation" became so dominant in the Fed that "it is unlikely that anyone in the Fed's research department would have taken issue with the concept").

160. *About GAO*, U.S. GOV'T ACCOUNTABILITY OFFICE, http://www.gao.gov/about/index.html (last visited Apr. 26, 2011).

government programs and policies are meeting their objectives, performs policy analyses, and outlines options for congressional consideration.[161] Although the GAO resembles a contrarian, it does not meet the definition of a contrarian because it is not affiliated with a specific regulatory entity. Rather, the GAO was put under the control of Congress in 1946.[162]

The GAO is, of course, an immensely valuable organization. But its capacity to counteract regulatory inaction and delay may be limited by its generalist orientation and formal relationship to Congress rather than a specific agency. Although it is authorized to evaluate regulatory programs on its own initiatives,[163] this proactive type of activity has gradually been supplanted in recent years by the GAO's increasing focus on responding to Congressional requests or statutory mandates.[164] This orientation may limit the GAO's capacity to identify and counteract agency inaction in the face of market change.[165]

Similar arguments can be made about OIRA, another quasi-contrarian that is not affiliated with any particular agency and that enjoys substantial regulatory authority. OIRA's broad mandate arguably limits its capacity to promote proactive regulation in specific agencies.[166] It may also undermine the subject-matter expertise of individual agencies.[167] Others have argued that the scope of OIRA's authority produces enhanced risk of regulatory

---

161. *Id.*

162. *See* Legislative Reorganization Act of 1946, Pub. L. No. 79-601, § 136, 60 Stat. 812, 832 (repealed 1979).

163. 31 U.S.C. § 717(b) (2006).

164. In fiscal year 1999, 95% of the GAO's work was the result of congressional requests (72%) or mandates (23%). Daryl J. Levinson & Richard H. Pildes, *Separation of Parties, Not Powers*, 119 HARV. L. REV. 2311, 2371 n.262 (2006). This trend has continued—in fiscal year 2009, 95% of the GAO's engagement resources were devoted to work requested or mandated by Congress. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-234SP, PERFORMANCE & ACCOUNTABILITY REPORT FISCAL YEAR 2009, at 16 (2009).

165. At the same time, though, the breadth of the requests to which the GAO responds may, in fact, allow it to counteract regulatory inaction. For example, the GAO appears to have made a number of recommendations that may have helped to avert the recent financial crisis, at least to some extent. Between 2004 and 2007, the GAO issued four different reports criticizing the overlapping authority of the four agencies regulating financial institutions and the potential this created for gaps in regulatory oversight. RICHARD J. HILLMAN, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-1049T, RECENT CRISIS REAFFIRMS THE NEED TO OVERHAUL THE U.S. REGULATORY SYSTEM 7–8 (2009), *available at* http://www.gao.gov/new.items/d091049t.pdf.

166. *See* Farber, *supra* note 75, at 1399–1402 (establishing the failure to be proactive).

167. *See* THOMAS O. MCGARITY, REINVENTING RATIONALITY: THE ROLE OF REGULATORY ANALYSIS IN THE FEDERAL BUREAUCRACY 281 (1991); Lisa Schultz Bressman & Michael P. Vandenbergh, *Inside the Administrative State: A Critical Look at the Practice of Presidential Control*, 105 MICH. L. REV. 47, 97 (2006).

capture.[168] This contrasts with the point made above that true contrarians may face more limited threat of capture precisely because they enjoy limited authority.[169]

IV. THE FUTURE OF REGULATORY CONTRARIANS AND FINANCIAL REGULATION

Parts II and III suggest that regulatory contrarians can, and occasionally do, modestly promote regulatory adaptation to market change. At the same time, they suggest that existing contrarians remain quite limited in important ways. Ombudsmen and consumer representatives are limited to the consumer protection function, while investigative and research contrarians are limited through their methodological emphases or limits on their authority. As a result, contrarians have historically had little influence on important segments of financial regulation. Perhaps most importantly, their substantive and methodological limitations mean that they have not generally operated in the domain of prudential and systemic risk.[170]

This Part transitions from the history of regulatory contrarians to their future. Dodd-Frank[171] is the largest and most comprehensive reform of the American system of financial regulation since the New Deal. The Act broadly embraces and expands upon regulatory contrarians in financial regulation. It creates a number of new contrarian institutions within many federal agencies, enhances some existing contrarian institutions, and contains various quasi-contrarian elements. These changes expand regulatory contrarians squarely into the domain of systemic and prudential risk regulation. They also broaden some of the methodological restrictions of contrarians, directing "investigative" contrarians to be more proactive and "academic" contrarians to be more policy oriented. Interestingly, at least one newly minted financial regulatory contrarian arose outside of Dodd-Frank, on the initiative of the SEC.

Not only are contrarians a pervasive feature of financial reform, but their effectiveness is critical for the success of reform writ large. As alluded

168. *See* Bagley & Revesz, *supra* note 14, at 1306–08 (arguing that OIRA is just as subject to regulatory capture as are ordinary agencies, and perhaps even more so); Barkow, *supra* note 10, at 34–37.

169. *See supra* text accompanying notes 89–90.

170. The financial crisis reveals that some forms of consumer abuse may increase systemic risk. For that reason, stronger consumer protection may address systemic risk. *See generally* Cox, *supra* note 7, at 279 (arguing that if consumer advocates' and regulators' warnings were heeded, then the subprime mortgage crisis might have been avoided).

171. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.A. (West Supp. 2011)).

to at the outset of this Article, a central goal of financial reform is to make financial regulation more adaptive to market changes impacting both systemic risk and consumer protection threats. In other words, it attempts to create a framework that does not simply address the particular causes of the past crisis, but that encourages agencies to anticipate future consumer protection and systemic risks. Because financial reform is a response to a deep financial crisis, the politics that temporarily made possible increased financial regulation are not likely to last, even though most of the details of reform will ultimately be spelled out by regulators in the coming years. Moreover, the Act tackles almost all of the major interest groups within the financial system and thus faces all the public choice problems that entails. In short, as an attempt at comprehensive reform of financial regulation in the face of the greatest financial crisis in the lifetime of most living Americans, it faces all of the obstacles we have identified (and then some).

Section A of this Part describes the various regulatory contrarian and quasi-contrarian tools that Dodd-Frank and associated financial reforms embrace in an effort to devise more adaptive financial regulation. Section B then offers some preliminary thoughts on the lessons that long-standing regulatory contrarians provide for the new generation of contrarians emerging out of financial reform.

A. Regulatory Contrarians in Financial Reform

Dodd-Frank establishes several new offices that meet our definition of a regulatory contrarian. First, the Act establishes several new contrarians that straddle the line between research contrarians and investigative contrarians. The most important of these may be the Office of Financial Research ("OFR").[172] This office, established as an independent entity within the Treasury Department, does not enjoy any rulemaking authority but is instead charged with identifying potential sources of systemic risk for the benefit of the Financial Stability Oversight Council (which is discussed more fully below).[173] The OFR thus extends contrarians' role firmly into the domain of systemic risk regulation. Like classical investigative contrarians, the OFR enjoys wide-ranging authority to collect data. It can explicitly collect data from financial companies.[174] While the Act does not give the OFR explicit authority to collect data from other agencies, it does have authority to standardize the data that they collect and report to the Financial Stability Oversight Council, which itself has clear authority to

172. § 152(a), 124 Stat. at 1413 (codified at 12 U.S.C.A. § 5342(a)).
173. § 153(c)(1), 124 Stat. at 1415 (codified at 12 U.S.C.A. § 5343(c)(1)).
174. § 154(b)(1)(B), 124 Stat. at 1416–17 (codified at 12 U.S.C.A. § 5344(b)(1)(B)).

collect information from agencies.[175] Despite this investigative power, its methodological orientation is more like classical research contrarians: it is directed to identify sources of systemic risk, promote research on systemic risk, and evaluate the health of the regulated marketplace.[176] Indeed, its creation was championed by an academic, John Liechty at Pennsylvania State University, who saw that federal financial regulators' data could be mined using modern computer and analytical techniques to identify sources of systemic risk.[177]

The new Federal Insurance Office[178] is another research contrarian that enjoys some features of an investigative contrarian. The primary role of the Federal Insurance Office is "to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system."[179] Not only does this mission further rely on contrarians to identify systemic risk, but it also creates a federal contrarian that is designed to influence the state-based regulatory system. Like the OFR, the Federal Insurance Office enjoys broad data-gathering powers traditionally associated with investigative contrarians. In particular, it is authorized to require any insurer to submit virtually any data that it determines is relevant to its mission.[180] Its regulatory functions are limited to a number of narrow domains, such as assisting the Treasury Department in administering the Terrorism Insurance Program, coordinating federal

---

175. § 153(c)(2), 124 Stat. at 1415 (codified at 12 U.S.C.A. § 5343(c)(2)); § 112(a)(2)(A), 124 Stat. at 1395 (codified at 12 U.S.C.A. § 5322(a)(2)(A)).

176. The Research and Analysis Center of the Office is charged

> (B) to monitor, investigate, and report on changes in systemwide risk levels and patterns to the Council and Congress; (C) to conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets; (D) to evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by the member agencies . . . (G) to conduct studies and provide advice on the impact of policies related to systemic risk; and (H) to promote best practices for financial risk management.

§ 154(c)(1), 124 Stat. at 1417–18 (codified at 12 U.S.C.A. § 5344(c)(1)).

177. Carrick Mollenkamp, *How a Street Watchdog Got Its Bite*, WALL ST. J., Sept. 15, 2010, at C1. Bankers at Morgan Stanley also helped push for the OFR. *Id.* For some biographical information on Liechty, see *Directory: John Liechty*, PA. STATE UNIV. SMEAL COLL. OF BUS., http://php.smeal.psu.edu/smeal/dirbio/displayBio.php?t_user_id =jcl12 (last visited Apr. 26, 2011).

178. Sec. 502(a), § 313(a), 124 Stat. at 1580 (codified at 31 U.S.C.A. § 313(a)).

179. *Id.*

180. Sec. 502(a), § 313(e)(2)(A), 124 Stat. at 1581–82 (codified at 31 U.S.C.A. § 313(e)(2)(A)).

efforts to develop international insurance policy, and determining whether state insurance measures are preempted by international agreements.[181]

The new Division of Risk, Strategy, and Financial Innovation ("Division") in the SEC is yet another new research contrarian, though it was created by the SEC itself rather than Dodd-Frank. According to the press release announcing the Division, it is designed to "provide the Commission with sophisticated analysis that integrates economic, financial, and legal disciplines" with a focus on "three broad areas: risk and economic analysis; strategic research; and financial innovation."[182] The initial director of the new Division was Henry Hu, a well-known finance professor who warned of potential risks from derivatives many years before the crisis.[183] Hu, who recently stepped down after setting up the Division, was brought in to help the SEC "really rethink risk management and help [the SEC] attract different skill sets to the agency as we try to remake the organization."[184]

The Act also extends the reach of contrarians by expanding the role of classical investigative contrarians. As noted in Part III, all of the major financial regulatory agencies already had their own IG offices. But Dodd-Frank importantly expands the role of these contrarians, creating a Council of Inspectors General on Financial Oversight composed of the inspectors general of the major financial regulatory agencies.[185] As above, this contrarian organization is charged with examining sources of systemic risk, a significant step away from the traditional focus of IG offices on fraud and inefficiency. The Council of Inspectors General will meet at least quarterly, "with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight."[186] It must report on its findings annually to Congress and to the Financial Stability Oversight Council.[187]

Dodd-Frank also expands the reach of investigative contrarians into several self-regulatory bodies. First, the Act not only established privately organized derivatives-clearing organizations that will be closely overseen by the Commodity Futures Trading Commission ("CFTC") or the SEC,[188]

181. Sec. 502(a), § 313(c)(1)(D)–(F), 124 Stat. at 1580–81 (codified at 31 U.S.C.A. § 313(c)(1)(D)–(F)).

182. Press Release, Sec. Exch. Comm'n, SEC Announces New Division of Risk, Strategy, and Financial Innovation (Sept. 16, 2009), *available at* http://www.sec.gov/news/press/2009/2009-199.htm.

183. *Id.*

184. Kara Scannell, *At SEC, Scholar Who Saw It Coming*, WALL ST. J., Jan. 25, 2010, at C1.

185. § 989E(a)(1), 124 Stat. at 1946 (codified at 5 U.S.C.A. app. 3 § 11).

186. § 989E(a)(2)(A), 124 Stat. at 1946 (codified at 5 U.S.C.A. app. 3 § 11).

187. § 989E(a)(2)(B), 124 Stat. at 1946–47 (codified at 5 U.S.C.A. app. 3 § 11).

188. Sec. 725(b), § 5b(g), 124 Stat. at 1686 (codified at 7 U.S.C.A. § 7a-1(g)).

but it requires these organizations to have chief compliance officers that operate as investigative contrarians.[189] These officers are required to review the organization's compliance with soundness principles set forth in the Act, resolve conflicts of interest, establish procedures for remediating noncompliance, and prepare annual reports to the CFTC or SEC concerning regulatory compliance.[190] Second, the Act requires credit rating agencies to have compliance officers who submit reports to the SEC on the organization's compliance with the securities laws.[191] Like classical ombudsmen, however, these investigative contrarians must handle complaints regarding the organization.

Although Dodd-Frank's central strategy for promoting consumer protection is through its establishment of the Consumer Financial Protection Bureau ("CFPB"), the Act relies on consumer representative contrarians as well. For instance, the Act establishes an Investor Advisory Committee within the SEC that is composed of the investor advocate (described below), representatives of state securities commissions, representatives of senior citizens, and ten to twenty members appointed to represent individual and institutional investors.[192] The committee is directed to advise and consult the SEC on protecting investor interests, promoting investor confidence, and ensuring the integrity of the marketplace.[193] Like consumer representative contrarians generally, the committee thus gives voice to outside representatives of investors within the agency. Similarly, the CFPB itself contains a Consumer Advisory Board composed of outside consumer interest advocates.[194] Note that these consumer representative contrarians work within agencies that are themselves created to protect certain consumers and investors. Various regulatory obstacles—particularly capture—threaten to divert the agency from that protective function, and the contrarians are intended to keep the agencies focused on their intended goals.[195]

---

189. Sec. 725(b), § 5b(i), 124 Stat. at 1686–87 (codified at 7 U.S.C.A. § 7a-1(i)).

190. Sec. 725(b), § 5b(i)(3), 124 Stat. at 1687 (codified at 7 U.S.C.A. § 7a-1(i)(3)).

191. § 932(a)(2), 124 Stat. at 1872–73 (codified at 15 U.S.C.A. § 78o-7(c)).

192. Sec. 911, § 39(b), 124 Stat. at 1822–23 (codified at 15 U.S.C.A. § 78pp(b)).

193. Sec. 911, § 39(a)(2), 124 Stat. at 1822 (codified at 15 U.S.C.A. § 78pp(a)(2)).

194. § 1014(b), 124 Stat. at 1974 (codified at 12 U.S.C.A. § 5494(b)).

195. Also worth noting in the role of consumer representative contrarians are the Offices of Minority and Women Inclusion that are created within each financial regulatory agency. § 342(a)(1)(A), 124 Stat. at 1541 (codified at 12 U.S.C.A. § 5452(a)(1)(A)). These offices shall assess how agency policies and programs affect women and minorities. § 342(b)(2), 124 Stat. at 1541 (codified at 12 U.S.C.A. § 5452(b)(2)).

Dodd-Frank also establishes some new ombudsman contrarians. First, it creates an Office of the Investor Advocate within the SEC.[196] The new office is charged with assisting investors in resolving problems they have with the SEC, identifying areas in which investors would benefit from rule changes, and analyzing the impact of proposed rules.[197] The investor advocate cannot otherwise be employed by the SEC for two years before or five years after serving in that position.[198] The investor advocate largely parallels the TAS in the IRS, another ombudsman contrarian: both charge agency employees who regularly field investor complaints to look after the interests of those investors by making recommendations without themselves setting rules. Interestingly, the SEC investor advocate will appoint a specific ombudsman who will help retail investors resolve problems with the SEC and review procedures to encourage persons to present questions to the investor advocate.[199] The Act also creates a Private Education Loan Ombudsman within the new CFPB.[200] This office will receive and attempt to resolve complaints from education loan borrowers and make recommendations to the relevant regulators.[201]

We thus see examples of all four categories of contrarians either newly created or strengthened within Dodd-Frank. Many of these contrarians blur some of the traditional contrarian categories described in Part III, and the majority of them focus on systemic risk, an area far afield from the traditional domain of contrarians.

The Act also includes several quasi-contrarian measures: protecting whistleblowers is one such measure. Insiders, both within agencies and within regulated businesses, often have crucial information that, if known to regulators, would help guide them. Encouraging them to make such information public is an important way to get more information to regulatory agencies. Dodd-Frank provides for awards to whistleblowers who provide original information concerning securities law violations.[202] The Act also forbids employers from retaliating against such whistleblowers.[203] More interestingly and originally, the Act creates a hotline for SEC employees to suggest improvements or report

196. Sec. 915, § 4(g)(1), 124 Stat. at 1830 (codified at 15 U.S.C.A. § 78d(g)(1)).
197. Sec. 915, § 4(g)(4), 124 Stat. at 1831 (codified at 15 U.S.C.A. § 78d(g)(4)).
198. Sec. 915, § 4(g)(2)(C), 124 Stat. at 1831 (codified at 15 U.S.C.A. § 78d(g)(2)(C)).
199. Sec. 919D, § 4(g)(8)(B)(ii), 124 Stat. at 1840 (codified at 15 U.S.C.A. § 78d(g)(8)(B)(ii)).
200. § 1035(a), 124 Stat. at 2009 (codified at 12 U.S.C.A. § 5535(a)).
201. § 1035(c)(1), 124 Stat. at 2010 (codified at 12 U.S.C.A. § 5535(c)(1)).
202. Sec. 922(a), § 21F(b)(1), 124 Stat. at 1843 (codified at 15 U.S.C.A. § 78u-6(b)(1)).
203. Sec. 922(a), § 21F(h)(1)(A), 124 Stat. at 1845–46 (codified at 15 U.S.C.A. § 78u-6(h)(1)(A)).

mismanagement.[204] The hotline will be maintained by an old contrarian: the SEC's inspector general.[205]

Another new quasi-contrarian institution, noted above, is the Financial Stability Oversight Council ("FSOC"). The FSOC is composed of the heads of the major federal financial regulatory agencies.[206] It includes as nonvoting members the directors of the OFR and the Federal Insurance Office.[207] The FSOC must meet at least quarterly and is charged with considering potential threats to financial stability.[208] This is not a separate contrarian body, but instead consists of the heads of regulatory agencies. It does, however, force those agency heads to meet regularly to consider possible problems with the existing regulatory system. They will be able to pool information and compare their varying perspectives. This will bring together persons with some diversity of perspective[209] in a setting where they are charged with considering threats to stability. The Act builds in several mechanisms to prod the FSOC to do this job effectively. The FSOC must report regularly to Congress.[210] The GAO will regularly audit the FSOC,[211] and the FSOC includes various contrarians as nonvoting members.[212]

In sum, the Dodd-Frank Act uses contrarian and quasi-contrarian institutions widely. We cannot think of another piece of federal legislation that uses such techniques so pervasively. The new contrarian entities can be slotted within the four existing categories identified in this Article. However, they push the existing bounds of those categories beyond their current limits. There is a much greater focus on systemic risk than seen before, with one entire entity (the OFR) focused on it and others enlisted in the fight. IG offices are given a substantive role that they have not had before. Research contrarians are given authority they have not previously enjoyed and more specific, policy-oriented missions. Quasi-contrarian strategies, such as those involving the FSOC that combine with old contrarians like the inspectors general and new contrarians like the OFR

204. Sec. 966, § 4D(a)(1), 124 Stat. at 1912 (codified at 15 U.S.C.A. § 78d-4(a)(1)).

205. *Id.*

206. § 111(b)(1), 124 Stat. at 1392–93 (codified at 12 U.S.C.A. § 5321(b)(1)).

207. § 111(b)(2), 124 Stat. at 1393 (codified at 12 U.S.C.A. § 5321(b)(2)).

208. § 111(e)(1), 124 Stat. at 1394 (codified at 12 U.S.C.A. § 5321(e)(1)); § 112(a)(1), 124 Stat. at 1394 (codified at 12 U.S.C.A. § 5322(a)(1)).

209. For instance, the director of the CFPB is likely to have a more proconsumer perspective than most other FSOC members.

210. § 112(a)(2)(N), 124 Stat. at 1396 (codified at 12 U.S.C.A. § 5322(a)(2)(N)).

211. § 122(a), 124 Stat. at 1411 (codified at 12 U.S.C.A. § 5332(a)).

212. § 111(b)(2)(A)–(B), 124 Stat. at 1393 (codified at 12 U.S.C.A. § 5321(b)(2)(A)–(B)) (listing the director of the OFR and director of the Federal Insurance Office as nonvoting members of the FSOC).

and the Federal Insurance Office, push agencies yet further. These new entities and strategies will surely not be a cure-all for the pervasive problems they address. Cognitive biases, capture, agency aggrandizement, and ossification will be widely present as the Act is implemented over time. But one hopes that the new institutions and strategies identified here will significantly reduce these problems. The next section considers various lessons that can be gleaned from past contrarians to help increase the chances of this outcome.

B. Preliminary Lessons for Future Regulatory Contrarians

Long-standing regulatory contrarians offer a broad range of potential insights for the new generation of contrarians created in the wake of financial reform. First, the experience of the Minneapolis Fed research contrarian offers some potential insights on how to structure regulatory contrarians so that they maintain a contrarian orientation in the long run. Recall that this institution seemingly adopted a contrarian orientation when it was first developed that helped to nudge federal banking policy away from excessive regulation. Unfortunately, this substantive, deregulatory position became a defining feature of the Minneapolis Fed, leading it to maintain this perspective well past the point when it was a minority viewpoint within the Fed. The contrarian thus ultimately ended up as more of a cheerleader for the deregulatory policies of the Federal Reserve under Alan Greenspan than as a skeptical, contrarian institution. This risk seems particularly grave for research contrarians because their contrarian orientation is neither tethered to a particular constituency nor inherently apolitical (as is arguably true with investigative contrarians).

Research contrarians such as the OFR; the Federal Insurance Office; and the SEC's Division of Risk, Strategy, and Financial Innovation may be able to avoid a similar fate by changing their leadership whenever the leadership of their associated regulatory entity changes. Of course, the goal would be for the new leadership of the research contrarian to have different perspectives than the new leadership of the affiliated agency, so this would only make sense if there were a way to allow the losing political party to select the contrarian leadership. Approaches such as that employed in Texas, where the governor appoints both the head of OPIC and the commissioner of the Insurance Department, should thus be avoided.[213] Replacing the leadership of research contrarians on a periodic basis, or simply infusing research contrarians with staff or visitors from divergent methodological and philosophical perspectives, are two sensible, less

213. *See* OFFICE OF PUB. INS. COUNSEL, *supra* note 116, at 5, 16.

radical plans. Alternatively, some new contrarians might follow the model of the NAIC Consumer Liaison program, soliciting applications from the public for time-bound positions that afford them substantial autonomy in pushing their own particularized contrarian perspective.[214]

A second lesson for the new generation of financial regulatory contrarians concerns the use of performance metrics. If feasible, well-designed performance metrics not only improve agency accountability, but they also shape the objectives of the organization being evaluated.[215] Developing such metrics may be difficult for contrarians, however, because while their outputs, such as audits or reports, are measurable, their progress in promoting regulatory adaptation is likely difficult to measure and controlled predominantly by their affiliated agency.[216] Some contrarians, such as OPIC,[217] consequently resort to performance metrics that are easy to track and meet, but fail to develop "measurable goals for the results or outcomes that their programs are intended to achieve."[218] Poorly designed metrics like these can create perverse incentives. The GAO faced this problem in the late 1990s, when its performance metrics were process oriented, not outcome oriented, measuring easy-to-count items such as the number of reports issued or the number of hearings attended.[219] They responded by developing several new outcome-oriented performance metrics, including the number of recommendations made, the percentage of

---

214. *See supra* notes 124–27 and accompanying text.

215. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-03-1167T, TRANSFORMATION, CHALLENGES, AND OPPORTUNITIES: STATEMENT OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE U.S. 8–9 (2003) [hereinafter WALKER], *available at* http://www.gao.gov/new.items/d031167t.pdf ("Measuring the right things is vitally important because you manage what you measure and measurements ultimately drive basic organizational and individual behaviors."); Ken S. Cavalluzzo & Christopher D. Ittner, *Implementing Performance Measurement Innovations: Evidence from Government*, 29 ACCT., ORGS. & SOC'Y 243, 259–60 (2004) (studying the statistically significant correlation between performance measurement development and the accountability of government agencies).

216. This is particularly true for ombudsman contrarians, who handle consumer complaints but depend upon their affiliated agency to address underlying causes of those complaints, and research contrarians, who lack the authority to implement any of their suggestions. *See* BERYL A. RADIN, CHALLENGING THE PERFORMANCE MOVEMENT: ACCOUNTABILITY, COMPLEXITY, AND DEMOCRATIC VALUES 42–44 (2006) (discussing the difficulties faced in designing performance metrics by agencies that either cannot measure or do not control the outcomes of their efforts).

217. *See supra* Part III.B.

218. U.S. GOV'T ACCOUNTABILITY OFFICE, GGD-99-16, MANAGING FOR RESULTS: MEASURING PROGRAM RESULTS THAT ARE UNDER LIMITED FEDERAL CONTROL 1 (1998); *see also* Sidney A. Shapiro & Rena Steinzor, *Capture, Accountability, and Regulatory Metrics*, 86 TEX. L. REV. 1741, 1760 (2008) (describing the tendency among federal agencies to design performance metrics comprised of "a set of optimistic statistics designed to reassure the agency's overseers that they are doing fine, rather than a frank discussion of the real causes of regulatory failure").

219. *See* WALKER, *supra* note 215, at 9.

reports with recommendations, and the percentage of its recommendations made four years ago that had been implemented.[220]

These metrics encourage contrarians to focus both on making realistic recommendations and on aggressively lobbying to have those recommendations implemented. This has certainly been the case for the GAO. In 1998, 69% of recommendations from 1994 had been implemented, while only 33% of written products issued in 1998 contained recommendations.[221] These numbers have steadily improved, and in 2008, 83% of recommendations from four years ago had been implemented, and 66% of new written products contained recommendations.[222] The TAS has adopted similar metrics, and it too has seemingly enjoyed substantial success in promoting IRS adaptation in recent years.[223] However, even these more sophisticated metrics could have perverse incentives. For instance, they may encourage a contrarian to make a large number of small and uncontroversial recommendations rather than recommendations that are likely to face serious resistance, but are more important and valuable. So, using performance metrics is worth considering, but only with very careful deliberation. It may be that performance metrics are more appropriate for some contrarians than others—they may work better for consumer representatives, for instance, than for research contrarians focused on complex problems surrounding systemic risk.

A third lesson for future contrarians is the importance of using a combination of formal and "soft" approaches to influence the underlying regulator. As recounted earlier, the TAS has utilized these different types of persuasive elements to great success in the recent past.[224] By involving its own personnel with daily regulatory activities, it has developed both legitimacy within the IRS as well as a deep appreciation of the difficulties facing the IRS. At the same time, the TAS has strategically used the power

---

220. *Id.* at 8–9.

221. *Id.* at 11.

222. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-234SP, PERFORMANCE & ACCOUNTABILITY REPORT: FISCAL YEAR 2009, at 23, *available at* http://www.gao.gov/new.items/d10234sp.pdf. The fact that thirty-four percent of new products did not contain recommendations demonstrates that while performance metrics can be valuable, they have limitations; regulatory contrarians should recognize where statistical achievements may undermine their core mission. "[W]e set our target [for the percentage of new products containing recommendations] again in fiscal year 2010 at 60 percent because we recognize that our products do not always include recommendations and that the Congress and agencies often find informational reports just as useful as those that contain recommendations." *Id.* at 32.

223. The TAS, an ombudsman organization, will begin in 2011 to measure the percentage on recommendations from four years ago that have been implemented. *See* FY OBJECTIVES, *supra* note 107, at VI-3.

224. *See supra* notes 105–08 and accompanying text.

of its formal reports to Congress in combination with this soft power to push otherwise difficult reforms at the IRS.

A final lesson concerns how to preserve the contrarian's independence from its affiliated agency. Because of a contrarian's role in studying, investigating, or criticizing an affiliated executive agency, independence from that agency is essential to a contrarian's proper functioning.[225] Even the appearance that a contrarian is under the influence or control of its affiliated executive agency may undermine its power to persuade and thus its effectiveness.[226] There are a number of ways a contrarian's independence can be threatened. Some of these include the appointment process for the director, the ability to remove that director, control over the contrarian's budget, lack of an independent staff or legal counsel, and a unique form of agency capture, whereby the contrarian's employees come from the ranks of the affiliated agency.[227]

Existing contrarians offer various potential lessons for how best to safeguard the independence of the new generation of contrarians. For instance, as noted earlier, one of the primary goals of the Inspector General Reform Act of 2008 was to enhance the independence of IGs. Some of the mechanisms it relies upon to accomplish this include requiring prior written explanations to Congress regarding the removal or transfer of an IG, facilitating IG access to independent legal advice, and establishing a Council of Inspectors General that itself polices the independence of IGs.[228]

225. *See, e.g.*, NAT'L TAXPAYER ADVOCATE, 2009 ANNUAL REPORT TO CONGRESS 109 (2009), *available at* http://www.irs.gov/pub/irs-utl/09_tas_arc_vol_2.pdf (explaining that "[a]n ombudsman must be free from bias or conflicts of interest . . . . At a minimum, the ombudsman should be independent from management or other administrative obligations or functions because the more an ombudsman must rely on his or her parent organization, the more difficult it is to operate impartially"); Fields & Robinson, *supra* note 140, at 108 (arguing that "independence and objectivity . . . are central to the Inspector Generals' role in that they bear directly upon the Inspector Generals' ability to produce results that are both reliable and relevant to decision makers").

226. *See* FREDERICK M. KAISER, U.S. GOV'T ACCOUNTABILITY OFFICE AND GEN. ACCOUNTING OFFICE, RL 30349, CRS REPORT FOR CONGRESS 12, 15 (2008), *available at* http://www.fas.org/sgp/crs/misc/RL30349.pdf (discussing the GAO's view that "independence from regulation by executive branch entities . . . was seen as necessary to remove even the appearance of a conflict of interest, as GAO had increased oversight of these agencies and the federal personnel system") (internal quotation marks omitted).

227. *See* NAT'L TAXPAYER ADVOCATE, *supra* note 225, at 112–14 (describing various ways that an ombudsman agency can be compromised by its affiliated agency); *see also* AM. BAR ASS'N, STANDARDS FOR THE ESTABLISHMENT AND OPERATION OF OMBUDS OFFICES 2–4 (2004), *available at* http://www.americanbar.org/content/dam/aba/migrated/leadership/2004/dj/115.authcheckdam.pdf (outlining the requirements for effective ombuds operation).

228. Inspector General Reform Act of 2008, Pub. L. No. 110-409, sec. 7(a), § 11(a), 122 Stat. 4302, 4306 (codified at 5 U.S.C.A. app. 3 § 3 (West Supp. 2010)); sec. 6(a), § 3(g), 122 Stat. at

Similarly, the TAS's independence was buttressed with the Restructuring and Reform Act of 1998, which provided that the national taxpayer advocate reports only to the IRS commissioner and cannot have worked for the IRS for two years before appointment. Under the statute, the TAS itself is to be separate from the IRS with respect to management control, facilities, and career opportunities.[229]

To be sure, some of these lessons appear to have already influenced the structure of the next generation of contrarians created by Dodd-Frank. For instance, Dodd-Frank occasionally prevents executive agencies from interfering with a contrarian by removing its director,[230] changing its duties,[231] cutting its budget,[232] reviewing its reports to Congress,[233] or controlling its hiring or firing.[234] But these protections appear to be lacking in some cases. For example, while independent budgets were provided for the OFR[235] and the CFPB,[236] there is no such provision for the Office of the Investor Advocate.[237] These limitations have already hindered the progress of contrarians, with the SEC recently announcing that it is indefinitely delaying the creation and staffing of both the Office of Investor Advocate and the Whistleblower Office due to "budget uncertainty."[238] Also concerning is the lack of protections against director removal. This could be a particular problem where the contrarian's director reports directly to the head of the affiliated agency, such as the investor advocate, who is appointed by, and reports directly to, the chairman of the SEC.[239] As the

4305 (codified at 5 U.S.C.A. app. 3 § 3); sec. 3(a), § 3(b), 122 Stat. at 4302 (codified at 5 U.S.C.A. app. 3 § 3); H.R. REP. NO. 110-354, at 8 (2007), *reprinted in* 2008 U.S.C.C.A.N. 1795, 1796.

229. *See* Camp, *supra* note 102, at 1248.

230. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 152(b)(1), 124 Stat. 1376, 1413 (codified at 12 U.S.C.A. § 5342(b)(1) (West Supp. 2011)) (stating that the director of the OFR is to be appointed by the president).

231. § 152(b)(5), 124 Stat. at 1413 (codified at 12 U.S.C.A. § 5342(b)(5)).

232. § 155, 124 Stat. at 1418–19 (codified at 12 U.S.C.A. § 5345); § 1017(a)(2), 124 Stat. at 1975–76 (codified at 12 U.S.C.A. § 5497(a)(2)).

233. Sec. 915, § 4(g)(6)(B)(iii), 124 Stat. at 1832 (codified at 12 U.S.C.A. § 78d(g)(6)(B)(iii)).

234. § 152(d), 124 Stat. at 1413–14 (codified at 12 U.S.C.A. § 5342(d)); *see, e.g.*, Lubbers, *supra* note 98 (manuscript at 61–64) (reviewing the various provisions that give the TAS a high degree of independence); KAISER, *supra* note 226, at 23 (outlining the protections afforded the comptroller general of the GAO against removal from office).

235. *See* § 155(b)(1), 124 Stat. at 1419 (codified at 12 U.S.C.A. § 5345(b)(1)).

236. *See* § 1017(a)(2)(C), 124 Stat. at 1975 (codified at 12 U.S.C.A. § 5497(a)(2)(C)).

237. *See* § 915, 124 Stat. at 1830–32 (codified at 12 U.S.C.A. § 78d).

238. *See Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act—Dates To Be Determined*, U.S. SEC. & EXCH. COMM'N (Dec. 2, 2010), http://www.sec.gov/spotlight/dodd-frank/dates_to_be_determined.shtml.

239. Sec. 915, § 4(g)(2)(A), 124 Stat. at 1830–31 (codified at 15 U.S.C.A. § 78d(g)(2)(A)).

new contrarians grow and evolve, the lessons learned from existing contrarians should be used to buttress structural independence from affiliated agencies.

CONCLUSION

Would all of these contrarians in Dodd-Frank have prevented the financial crisis from occurring? We doubt it, but that is in part because we fight the hypothetical—creating such contrarians would have gone against the very trends that led to the crisis. This financial crisis occurred after the longest period of relative financial peace in American history. The last great financial crisis in the United States was the Great Depression. The 1970s had some turbulence, but no full-blown crisis, and the '80s had the savings and loan fiasco, but that affected a much more limited part of the financial system. Such relative peace for so long is bound to eventually lead to both private actors and regulators letting down their guard.[240] Few saw the need for contrarians. Even if they had been in place, eventually they would have become Cassandras impotently decrying the excessive move to deregulation.

Now that a crisis has occurred, we are more attuned to the need for such contrarians. If we institutionalize them, there is a chance that they may delay the next crisis and help lessen its severity when it does arrive. We have seen the large number of contrarian and quasi-contrarian entities and strategies that the Dodd-Frank Act creates or strengthens. Some of these are quite narrow and focused, while others are broader. Some focus on consumer or investor protection, while others focus on systemic risk. The sheer number and variety of new entities provide many different paths for those concerned about emerging risks to make themselves heard. We think there is quite a good chance that as new financial risks emerge, someone somewhere within the various financial regulatory agencies will sound an alarm. The chances of that occurring are even greater to the extent that some of the new contrarians, especially research contrarians such as the Office of Financial Research or the Division of Risk, Strategy, and Financial Innovation (not a part of Dodd-Frank, but also a response to the crisis), adopt a model of broad academic inquiry and debate that brings in scholars and others with a wide range of views to discuss questions with the agencies and regulators.

The much harder question is whether those raising the right alarms will manage to get the appropriate regulators to listen and act on their

240. *See* HYMAN P. MINSKY, STABILIZING AN UNSTABLE ECONOMY 5, 68, 176, 219–20, 270 (1986); McDonnell, *supra* note 22, at 38.

concerns. Only time will answer that question. Surely the answer in part will be that some on-target alarms will be ignored. When the next crisis does hit, there will be stories of people within some of the contrarian entities discussed here who identified some problem that helped cause the new crisis, but who were unable to get their regulators to listen and act on their warnings. But with some luck, hard work, and wisdom, it may also be that some contrarians do identify real problems and manage to get regulators to act to address them. These probably will not generate as many stories—crises averted are less salient than crises that occur after warnings that fall on deaf ears. Cassandras ignored and vindicated will cry out, "I told you so," while Cassandras heeded will often generate people annoyed by the regulations they inspired while no one feels the benefits from a crisis averted. Even so, these contrarians, old and new, have promise to do some good in nudging regulators to better respond to changing risks as financial markets rapidly evolve.