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by David G. Oedel*

On January 8, 1998, at the annual meeting of the Association of American Law Schools, a program sponsored by the Section on Financial Institutions and Consumer Financial Services was held, "What Is the Governmental Role in Finance, Anyway?" Three distinguished panelists made presentations outlining core concerns that the panelists argued should guide future governmental regulation of banking and finance. The following papers are based on the panelists' presentations at the conference and offer insights into the thinking of some of the most prominent figures in financial regulation today.

The papers are evidence of the rich mix in financial regulation of the theoretical and the practical, the historical and the futuristic, the political and the economic, the bureaucratic and the entrepreneurial—an eclectic array of forces that all line up to be counted in the legal calculus. The papers also implicitly acknowledge the general social importance of finance, as well as the sheer difficulty of any attempts to adjust the systematic character of financial regulation.

John D. Hawke, Jr., Under Secretary of the Treasury for Domestic Finance, offers some fascinating reflections on his ongoing efforts to help shape the future of financial regulation. Secretary Hawke is widely acknowledged as the point man in President Clinton's administration on

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the modernization of financial regulation. He has been credited with facilitating an ongoing political conversation into significant financial services reform, and in particular was thought by many insiders to have played a key role in shepherding the various parties unexpectedly close to financial regulation reform legislation in 1997.

It was on the heels of the stalling of financial regulation reform legislation in the closing weeks of 1997 that Secretary Hawke made the presentation to law professors that is memorialized here. In his remarks, however, Secretary Hawke remained cautiously optimistic about the prospects for enactment of legislation reforming financial regulation—and at least by this writing on May 18, 1998, Secretary Hawke's cautious optimism appears to have been well grounded. On May 14, 1998, the House of Representatives barely passed—but did finally pass—the House's primary financial regulation reform bill, H.R. 10, by a vote of 214-213.[1] Senate action is now pending, but it remains uncertain.

Ironically, the Treasury Department, which has consistently pushed financial regulation reform legislation for years, extending back even into the Bush and Reagan administrations, is at this particular juncture reportedly balking (that is, threatening to recommend a veto) because of one aspect of the pending reform legislation—consolidation of more regulatory authority in the Federal Reserve at the expense of the Treasury Department and its Comptroller of the Currency.[2] We will await what may yet prove to be just another of the labyrinthine twists in the road to financial regulation reform.

As a historical matter at least, as well as for a glimpse into the more distant future of financial regulation, Secretary Hawke's remarks at the annual meeting of law professors are worth careful study.

One insightful theme that Secretary Hawke advances and defends is the dismantling of key barriers between banking and commerce—a theme that seems unlikely to be fully achieved in the near future, but a project that Secretary Hawke warns banks to avoid at their competitive peril as commercial firms use unitary thrift holding companies to blast their way into the financial marketplace.

Another theme that Secretary Hawke explores is the political dynamic, that is, who will support what reform and why. His demonstrated sensitivity to the elaborate intertwinedment of economics and politics helps make him simultaneously a candidate for the premier American

1. Leslie Wayne, *House Passes Banking Bill By One Vote*, N.Y. TIMES, May 15, 1998, at C1, col. 5.

2. *Id.*

banking lawyer and the premier American banking regulator today. Indeed, the two fields are difficult to separate.

Secretary Hawke also offers insights into why financial regulation has not been reformed despite massive efforts by regulators, legislators, and academics (he suggests that the primary aversion to reform is based on fear of competitive encroachment), into why the tide is turning (gradual regulatory erosion of legal barriers between activities, plus consumer impatience with artificial market segmenting), and into the future for functional rather than institutional regulation (prospects for functional regulation look good but still entail answering many difficult questions of how to define functional activities).

Thomas M. Hoenig, an economist, President of the Federal Reserve Bank of Kansas City since 1991, and a member of the interest rate setting Federal Open Market Committee, provides another enlightening perspective on financial reform from the vantage point of a consummate regulatory insider.

Mr. Hoenig has been surprising banking audiences for several years with his unsentimental views of the logic of bank regulation,[3] generally arguing for narrower bank regulation as a theoretical matter of sound public policy. His present paper, however, focuses more practically on the question of how the modernization of financial regulation (especially including expansions of bank power) might affect the regulatory "safety net," and in particular, access to federal deposit insurance.

In the present context, Mr. Hoenig is less concerned with narrowing the scope of financial regulation than he is with ensuring that the safety net is not expanded along with bank powers, thereby exacerbating latent problems of moral hazard (that is, "games" in which the rule is, "Heads I win; tails you lose.").

Mr. Hoenig's pragmatic caution in the present circumstances of fast moving financial regulation reform, combined with his theoretical honesty about the limited justifiability of the safety net, make him, like Jerry Hawke, an intriguing, courageous, complex, and thoughtful leader in the world of American financial regulation.

Michael Taylor graciously flew in from England to speak on this panel, helping to illustrate and illuminate the annual meeting's over arching theme of globalization. Professor Taylor, who formerly served with the Bank of England in a regulatory capacity, is now Reader in Financial

3. *See, e.g.*, Thomas M. Hoenig, *Bank Regulation: Asking the Right Questions*, ECONOMIC REVIEW OF THE FEDERAL RESERVE BANK OF KANSAS CITY (First Quarter, 1997), at 5 (arguing for a narrow bank regulation system, primarily oriented around protection of the payments system).

Regulation at the ISMA Centre for Education and Research in Securities Markets at the University of Reading.

After emerging from his life as a regulator, Professor Taylor proposed a provocative new model of financial regulation in the United Kingdom, the so-called "Twin Peaks" model in which wholesale and retail banking matters would be regulated separately.

More recently, in the wake of the Blair administration's call for a single super-regulator, Professor Taylor has again acted with a free-thinking critique in which he questions the value of "reform" in the guise of a regulatory leviathan.[4]

In his current paper given at the annual meeting of the Association of American Law Schools, by contrast, Professor Taylor takes a very broad, less pointed, essentially comparative view of financial regulatory reform, arguing that many similarities at least exist between the ongoing evolution of all the financial regulatory systems in the developed economies.

In short, Professor Taylor makes the case that the "old" and in some ways still prevailing paradigm of financial services regulation no longer lines up with economic, political, and regulatory realities. The old objective of stability in financial matters has been overcome by the emergence of competition as an important good to be nurtured by lawmakers and regulators. Meanwhile, the traditional institutional regulatory control mechanisms have become confused as the lines between institutions and markets have become blurry. Even the tools that the regulators have traditionally used to supervise their regulatees no longer seem to work precisely or well.

Professor Taylor argues that the obsolescence of the old regulatory paradigm is attributable to essential changes in the nature of the financial services industry itself. With geographic barriers being lifted, competition now occurring between different types of institutions for similar products and customers, large scale conglomerization proceeding apace, and markets becoming integrated from the consumer's perspective at least, the traditional regulatory paradigm is simply no longer meaningful.

Professor Taylor suggests that all developed nations are now in the hunt for a new regulatory paradigm that cannot wholly be satisfied simply with greater disclosure and more self-regulation by market participants.

If indeed we are, as Professor Taylor suggests, living somewhere near the crossroads of financial regulation history, then these panelists are

4. MICHAEL TAYLOR, REGULATORY LEVIATHAN: WILL SUPER-SIB WORK? (Jonathan Wren, 1997).

very promising guides on that uncertain future course. I hope you will enjoy their provocative thoughts on financial regulation as much as those of us who were fortunate enough to attend the annual meeting of the Association of American Law Schools and this program sponsored by the Section on Financial Institutions and Consumer Financial Services.