Streamlining the Regulatory Apparatus

By Kermit L. Schoenholtz

This essay discusses the missed opportunity to simplify the regulatory structure in the United States. The financial crisis of 2007-2009, the most severe since the Great Depression, provides stark evidence of a colossal failure of U.S. financial regulation and supervision. One cause of that failure was the "complex, incoherent and fragmented regulatory system" composed of multiple regulators with overlapping jurisdictions but nevertheless replete with loopholes. This byzantine apparatus made it virtually impossible for an observer—either a market participant, a financial executive, or a regulator—to view the financial system as a whole and to detect its vulnerabilities. In addition to the many federal and state regulators, the system also includes the officially authorized self-regulatory organizations, such as the Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board, along with the numerous finance and real estate industry associations that intensively lobby regulators and legislators alike. In this burdensome arrangement, no one was well placed to protect the financial system as a whole.

The Dodd-Frank Act did almost nothing to simplify the U.S. regulatory structure, eliminating just one federal regulator—the Office of Thrift Supervision (OTS)—which was arguably the most ineffective of the lot. But Dodd-Frank also created a new regulatory agency—the Consumer Financial Protection Bureau (CFPB)—and a new coordinating entity: the Federal Stability Oversight Council (FSOC).

The Financial CHOICE Act also fails utterly to simplify this regulatory framework. The only organization that it would eliminate is the tiny Office of Financial Research, the only one that seeks to assess systemic risks without a conflict of interest arising from a direct supervisory role.

Indeed, the CHOICE Act takes none of the steps that have been widely viewed as desirable simplification. For example, numerous proposals have called for combining the SEC and CFTC into one capital markets regulator. Undoubtedly, U.S. regulatory arrangements could be radically streamlined, making the system both more effective and less wasteful. The challenge of doing so is not conceptual, but political.