Knowledge Capture in Financial Regulation

Data-, Information- and Knowledge-Asymmetries in the US Financial Crisis
Table of Contents

1 Introduction .................................................................................................................. 15
  1.1 Eliminating Hobson’s Choice, Or: A Binary Model of Systemic Risk .......... 19
  1.2 The Argument in Brief ........................................................................................... 24
  1.3 Literature Overview and Current State of Research ........................................... 27
  1.4 Research Approach ............................................................................................... 30

2 Narratives of the Global Financial Crisis ..................................................................... 37
  2.1 From 1980 to 2010: Dominant Beliefs and Paradigm Shifts ......................... 41
  2.2 A Pre- and Post-Crisis Understanding of Systemic Risk .................................. 45
  2.3 Entering the Stage of 21st Century Financial Folly ........................................... 60

3 Multi-Level Complexity: The 21st Century Financial System ................................. 65
  3.1 Interconnectedness and Contagion: Complexity at the Systems Level .......... 67
  3.2 The Role and Nature of 21st Century Financial Institutions ......................... 69
  3.3 Complex Products – Financial Weapons of Mass-Destruction? ................. 81
  3.4 Innovators vs. Regulators: Science Running Amok ......................................... 84
  3.5 Can and Should Financial Complexity be Eliminated? ................................. 87

4 US Policy Responses to the Crisis ............................................................................... 93
  4.1 Stretching the Law: Case-by-Case Responses in the US ................................. 96
  4.2 TARP as a System-Wide, Medium-Term Policy Response ............................ 101
  4.3 The Regulatory Overhaul: Dodd-Frank as a System-Wide Response .......... 103
  4.4 Putting the US into Context: A Short Look at EU Policy Responses .......... 135
  4.5 Changes in Global Financial Governance: The Establishment of the FSB .. 151
  4.6 Financial Reform Revisited: Where Do We Stand Today? ............................ 156

5 Knowledge Asymmetries in Regulation ..................................................................... 161
  5.1 A Working Definition of Data, Information and Knowledge ......................... 162
  5.2 Knowledge Related Problems in Financial Regulation ............................... 165
  5.3 Boundedly Rational Financial Regulators ....................................................... 199
  5.4 Representatives vs. Experts: The Privatization of Legitimacy ....................... 203
  5.5 Keeping Pace with the Market, or: Can the OFR Enlighten Regulators? .... 206

6 Knowledge Capture: A Theoretic Framework ........................................................... 213
  6.1 Introduction to the Theory of Economic Regulation ....................................... 215
6.2 Capture Diagnoses in the Recent Financial Crisis ........................................... 220
6.3 New Perspectives on Regulation: Information and Complexity Capture ........ 222
6.4 Knowledge Capture: Experts Hijacking Regulators ..................................... 230
6.5 Solutions to Knowledge Capture Problems .................................................. 240

7 Conclusion: Policy Implications and Future Research ................................. 243
7.1 Tackling Complexity Through Regulation ................................................... 245
7.2 Future Financial Reform .............................................................................. 247
7.3 Future Research .......................................................................................... 253

References ............................................................................................................. 257