Comments on “Weaponizing Financial Firms as Surrogate Regulators”

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Summary of the Paper (1)

- State's use of financial firms as 'surrogate regulators'
  - State’s power over the financial firms
    - Comes from heavy regulations
    - Limited by different regulatory intensity
  - Financial firms’ power over the people
    - Comes from market demand for finance
    - Limited by elasticity of demands and transaction costs
  - Empowered by these leverages, the state uses financial firms as tools for policy.

Summary of the Paper (2)

- Three models
  - Private Ordering: ex) loan covenants, D&O insurance
  - Mandatory: ex) AML, CFT
  - Voluntary Code: ex) nonbinding ESG initiative
- Proposal/Conclusion
  - Need caution against over-reliance on financial firms as regulators.
  - State must align regulatory objectives with business incentives and reduce costs to improve effectiveness.

Overall Comments (1)

- Very strong paper with:
  - Original framework (‘surrogate regulator’)
  - Neatly organized and comprehensive analysis
  - Clear three-prong model: private, mandatory, voluntary
  - Balanced and nuanced analytical tone

Overall Comments (2)

- It could further benefit from:
  - More structured jurisdictional comparison
  - More prescriptive guidance for regulators (beyond “don’t over-rely”)
  - Exploring the financial firms’ role in rule setting: they are not simply rule-takers

Additional Examples

Additional examples for using finance to achieve policy objectives:

- Targeted lending programs
  - Banks are required to provide low-interest loans to specific sectors (such as small businesses, students, rural areas)
- Restrictions on bank loan for stabilizing house price
  - LTV (loan to value limit)
  - DTI (debt to income ratio)
  - DSR (debt service ratio)
- Restrictions on consumer loans to prevent over-indebtedness

A Few Questions (1)

- Is it effective to analyze insurance companies and commercial banks under the same concept of “finance”?
- In some jurisdictions, large financial firms are not simply rule-takers and may play roles in rule-setting. Does it affect your framework of surrogate regulator?
- Are there any specific jurisdictions or sectors where this model (‘surrogate regulator’) has particularly strong explanatory power?

A Few Questions (2)

- In terms of effectiveness, are there any specific jurisdictions where this model particularly promising or problematic?
- Conflict with the financial firms' directors' fiduciary duty: do we need to distinguish listed and unlisted financial firms in analyzing this model's feasibility?