REMUTUALIZATION

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INTRODUCTION

Lynn Stout heartily embraced heterodox economic theories for describing capital markets and a progressive zeal for reforming them. Yet when she came to formulate her policy prescriptions for financial markets, one of the most prominent progressive corporate and financial law scholars of the twentieth century could sometimes take these twin intellectual engines into surprisingly "conservative" waters. Lynn's landmark

1999 article in the *Duke Law Journal*, "Why the Law Hates Speculators" provides an example of her coming to the unexpected policy conclusions of returning to ancient solutions to the problems of modern financial markets.[1] She advocated for identifying and reducing excessive financial speculation in derivatives markets by reviving the common law doctrine of insurable interest.[2]

This Article explores how a similar intellectual move—returning to common law or traditional approaches to financial institution governance—can inform and improve a range of financial reforms. In particular, this Article seeks to revive the use of organizational form as a tool of financial regulation. Very old varietals, including partnerships and mutual companies, decanted in new bottles can promote financial stability, lower incentives for excessive risk-taking by financial intermediaries, provide mechanisms to police their market conduct, and better align their incentives with the interests of their customers and consumers.

In arguing for the use of organizational form as a regulatory tool, this Article examines a common but somewhat hidden thread running through a range of innovative, contemporary scholarship on financial regulation. In a number of works, both the contemporaries and intellectual heirs of Professor Stout have explored ways to "remutualize" ownership of financial intermediaries. For instance, Professors Claire Hill and Richard Painter argue that reintroducing elements of the old partnership structure of investment banks would curb excessive risk-taking by, and change the culture of, those important financial intermediaries.[3] Professor Saule Omarova moves from the level of the firm to the level of industry and argues for a self-regulatory legal regime in which large financial institutions would collectively bear the costs of systemically risky ac-

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1 Lynn A. Stout, *Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives*, 48 DUKE L.J. 701, 777–78 (1999).

2 *Id.* at 777–82. Under this doctrine, insurance and, in turn, derivative contracts are only legally enforceable if at least one of the parties uses the contract to transfer or hedge a preexisting risk. *Id.* at 725. If the contract involves the transfer of risks to which neither counterparty was subject before the bargain was struck, then courts would not enforce the agreement. *Id.* at 724–27. The operation of this rule can be seen in a simple example: the common law would not enforce a contract in which one person purchases fire insurance for a neighbor's house.

3 *See* CLAIRE A. HILL & RICHARD W. PAINTER, BETTER BANKERS, BETTER BANKS: PROMOTING GOOD BUSINESS THROUGH CONTRACTUAL COMMITMENT 146–48 (2015).

tivities and thus police each other's behavior.[4] Her ideas harken back to historical structures in which exchanges were mutually owned and regulated by the brokers who traded on them.[5] It also recalls how the organizational form used to operate on an industry-wide level: in the nineteenth century, large banks formed clearinghouses that provided a form of deposit insurance to one another and helped a large swath of the financial sector withstand banking panics.[6] Professor Paolo Saguato examines a different, modern version of clearinghouses: entities that facilitate the clearing and settlements of trillions of dollars of securities and derivatives trades each day.[7] Modern clearinghouses, or clearing companies, reduce risk to parties to these transactions and to the entire financial system by serving as central counterparties to trades.[8] Professor Saguato argues that the demutualization of clearinghouses results in their shareholders having incentives to increase the risk profile of these entities at the expense of both members (i.e., the financial institutions using the company to clear and settle trades) and the entire financial system.[9] He proposes various mechanisms to give control of clearing company risk-taking back to the members/users, who have the ultimate risk exposure.[10]

Still other scholars examine the way in which credit unions and other financial cooperatives tend to offer loans and other financial products with more favorable and less exploitative terms to borrowers and consumers.[11] Older works by Professor Henry Hansmann and others demonstrate that mutually owned banks and other lenders tend to make less risky invest-

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4 *See* Saule T. Omarova, *Wall Street as a Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 419–20 (2011).

5 *See, e.g.*, Roberta S. Karmel, *Turning Seats into Shares: Causes and Implications of Demutualization of Stock and Futures Exchanges*, 53 HASTINGS L.J. 367, 403–07 (2002) (tracing legislative and regulatory history of stock exchange demutualization in the United States).

6 Gary Gorton, *Clearinghouses and the Origin of Central Banking in the United States*, 45 J. ECON. HIST. 277, 282–83 (1985).

7 Paolo Saguato, *The Ownership of Clearinghouses: When "Skin in the Game" Is Not Enough, the Remutualization of Clearinghouses*, 34 YALE J. ON REG. 601, 601 (2017).

8 *Id.* at 601, 603–05.

9 *Id.* at 642–46.

10 *Id.* at 659–65.

11 *See, e.g.*, Ryan Bubb & Alex Kaufman, *Consumer Biases and Mutual Ownership*, 105 J. PUB. ECON. 39, 46 (2013) (finding that credit unions have lower purchase and default annual percentage rates and lower late and over-the-limit fees than investor-owned issuers).

ments and run a lower risk of failure.[12] In life insurance, mutual companies tend to have much more conservative financial reserve practices than their investor-owned counterparts.[13]

Common threads unite these different strands of scholarship. Each of these scholars argues that the organizational form that a financial institution takes matters intensively for one or more of the following policy concerns: the institution's risk-taking; the risk of financial failure; and consumer protection. Each of these strands of scholarship examines how an organizational form other than the investor-owned corporation may further one or more of these policy objectives. An alternative entity form may lower the risk that a financial institution would: fail and thus impose costs on investors, customers, or the financial system;[14] break laws or commit misconduct;[15] or exploit customers or consumers.[16]

Alternative entities—partnerships,[17] mutuals,[18] and cooperatives[19]—offer one or more of these policy advantages over the investor-owned corporation by changing the basic relationship between a firm's owners and its management. Some of the aforementioned scholarship focuses on changes in control rights or liability rules with respect to the entity. For example,

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12 *See, e.g.*, HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 249–50, 255–57 (2000).

13 *See id.* at 267–70.

14 By lowering the risk that a financial institution will fail, an alternative entity form may also mitigate systemic risk, i.e., lower the incidence and severity of financial crises; the failure of financial institution triggering the failure of other institutions represents one channel for systemic risk to propagate. George G. Kaufman & Kenneth E. Scott, *What Is Systemic Risk, and Do Bank Regulators Retard or Contribute to It?*, 7 INDEP. REV. 371, 372–73 (2003) (describing how systemic risk may arise from chain reaction of financial institution failures). However, even financial firms organized as partnerships or mutuals may not consider the full systemic risk implications of their failure in their decisions to take risks as some of the costs of their failure are externalized on other firms or the entire financial system.

15 *See, e.g.*, Andrew Park, *The Endless Cycle of Corporate Crime and Why It's So Hard to Stop*, DUKE LAW NEWS (Jan. 13, 2017), https://law.duke.edu/news/endless-cycle-corporate-crime-and-why-its-so-hard-stop/ [https://perma.cc/T88V-YZNK] ("In scandal after scandal . . . big corporations or their employees are found to be flouting laws, often at the expense of consumers or investors.").

16 *See, e.g.*, Luke Landes, *Mutual Vs. Public Insurance Companies*, CONSUMERISM COMMENTARY (July 31, 2019), https://www.consumerismcommentary.com/mutual-vs-public-insurance-companies/ [https://perma.cc/37FB-ZCWG] (last updated July 31, 2018).

17 *Partnership*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("A voluntary association of two or more persons who jointly own and carry on a business for profit.").

18 *Mutual Company*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("A company that is owned by its customers rather than by a separate group of stockholders.").

19 *Cooperative*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("An organization or enterprise (as a store) owned by those who use its services.").

Professors Hill and Painter write on the benefits that come with an investment bank partnership: personal liability chastens the risk-taking of partners and gives them the incentive and tools to monitor and exercise control over the actions of their co-owners.[20] However, the benefits of alternative entity forms flow from more than just the rules surrounding liability and control rights. After all, in many modern partnerships, mutuals, and cooperatives, control is delegated to a small cadre of managers[21] and the personal liability of owners in many forms such as mutuals remains limited.[22] Alternative entity forms exert a profound and often socially beneficial influence on the behavior of these managers by changing the identity of the residual claimant of the firm.[23] Even if a firm's residual claimant—–the economic actor or actors entitled to the firm's net cash flows after all debts and other claims have been paid[24]—has weak levers to control management, management has no other claimants to whom it is ultimately beholden. This can dramatically reorient management's incentives and refashion its culture. Management in an investor-owned corporation faces strong pressures to serve profit-seeking shareholders with potentially no other ties to the firm.[25] Management of a corporation may follow the norm of shareholder wealth maximization.[26] By contrast, management of partnerships, mutuals, and cooperatives are ultimately responsible to altogether different constituents: employees or producers (as is the case with investment banking partnerships) or consumers (as with mutual or cooperative banks and insurance companies).[27]

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20 *See infra* section I.A.

21 For example, Professors Hill and Painter highlight the role that executive committees played in governing the old investment banking partnerships. HILL & PAINTER, *supra* note 3, at 101.

22 For example, state statutes typically limit the liability of policyholders in a mutual insurance company to payment of premiums specified in the policy. *E.g.*, NEB. REV. STAT. § 44-218 (2019).

23 *See* Oliver E. Williamson, *Organization Form, Residual Claimants, and Corporate Control*, 26 J.L. & ECON. 351, 356–60 (1983).

24 Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 302–03 (1983).

25 Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 9–13 (2010).

26 Bernard S. Sharfman, *Shareholder Wealth Maximization and its Implementation Under Corporate Law*, 66 FLA. L. REV. 389 (2014).

27 This explanation tracks Henry Hansmann's work, which sees the identity of the residual claimant as central to the behavior of alternative entities such as mutuals and cooperatives. Hansmann explains the importance of the identity of the residual claimants compared to control rights in the following passage:

The organizational form, and particularly alternatives to investor-owned corporations, represents a potentially powerful but forgotten tool in the regulatory arsenal. Redefining who bears liability for a firm's debts in the case of its insolvency, who the firm's residual claimant is, and who exercises control and how that control is exercised, can profoundly alter a firm's risk-taking and treatment of consumers.[28] Moreover, the organizational form as a regulatory tool offers advantages over existing financial regulation. It engages firm owners, and not just government regulators, in policing risk-taking, market conduct, and legal compliance.[29] It also offers governance mechanisms that are more time-tested than many recent novel proposals that seek to expand the fiduciary duties of directors and officers, whether in terms of the duties owed, which persons owe the duties, and to whom those duties run.[30]

Deploying the set of tools offered by remutualization requires careful consideration not only of the benefits but also of the costs. Chief among those costs are the difficulties that alternative entity forms would face in raising large amounts of capital and expanding the scope and complexity of their operations.[31] However, this might prove to be a virtue. Investment banks reverting to partnership form or large lenders or insurance companies remutualizing would create checks on the size and complexity of these financial institutions. The organizational form would serve as an alternative to breaking up large financial institutions to address "Too-Big-To-Fail" and related concerns.[32] In this sense, remutualization bears a strong resemblance to Professor Stout's proposal on derivatives, as re-

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> [B]y virtue of their ownership, the patrons are assured that there is no other group of owners to whom management is responsive. It is one thing to transact with a firm whose firm whose managers are nominally your agents but are not much subject to your control; it is another to transact with a firm whose managers are actively serving owners who have an interest clearly adverse to yours.

HANSMANN, *supra* note 12, at 48.

28 *See id.* at 255–56, 269–70.

29 *See infra* section IV.C.

30 For a review and critique of corporate governance proposals to address systemic risk, particularly proposals involving modifying fiduciary duties of bank directors and officers, see Robert C. Hockett, *Are Bank Fiduciaries Special?*, 68 ALA. L. REV. 1071, 1107–10 (2017).

31 *See infra* section IV.A.3; HANSMANN, *supra* note 12, at 273–74.

32 For a primer on the "Too-Big-To-Fail" problem and an argument that the Dodd-Frank Act did not solve it, see Arthur E. Wilmarth, Jr., *The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem*, 89 OR. L. REV. 951 (2011).

quiring an "insurable interest" would curb the volume of derivatives.[33]

At the same time and by contrast, mutuals may face conflicts among residual claimants when a firm offers very different financial products.[34] Mutual companies work best for their owners, when those owners have homogenous interests. Homogeneity reduces conflict among residual claimants.[35] The potential comparative advantages of an investor-owned corporation, however, must be weighed against its costs both to customers and financial markets as described in this Article. There are also overarching risks of financial institutions conglomerating and offering products and services across multiple financial sectors.[36]

Some scholars have described the agency costs faced by owners of partnerships, mutuals, and cooperatives who have limited effective ability to control management. However, mutuals, cooperatives, and partnerships address agency costs in a subtler way beyond control rights. As explained below, changing the identity of the residual claimant of the firm ensures that management will not prioritize the interests of any other claimant above the owners, particularly those of profit-seeking investors.[37] Moreover, evidence from the insurance industry suggests the agency cost concerns associated with mutuals are muted; in many studies, mutual firms do not suffer from worse financial performance or charge higher prices than their investor-owned counterparts.[38]

Professor Hansmann provides a valuable framework for thinking about which stakeholders should optimally own a firm and toward what form of ownership firms in any given industry tend to gravitate. Financial firms, like any other firm, have

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33 After the global financial crisis, Professor Stout revisited her *Duke Law Journal* article and argued that her earlier policy proposals would reduce both the size of the mushrooming derivatives market and systemic risk. *See, e.g.*, Lynn A. Stout, *Regulate OTC Derivatives by Deregulating Them*, REGULATION, Fall 2009, at 30, 33 (suggesting a return to "common-law rule against difference contracts" to counteract "speculation [that] drives the OTC [("over the counter")] derivative markets" and increases systemic risk). In this Article, Professor Stout cited a startling statistic: at the end of 2008, when the financial crisis was peaking, the notional value of all credit default swaps, a derivative used to hedge the credit risk of bonds was $67 trillion, while "the total market value of all the underlying bonds issued by U.S. companies outstanding was only $15 trillion." *Id.*

34 *See* HANSMANN, *supra* note 12, at 263, 283–84 (stressing the "importance of homogeneity of interest among the members of a mutual company").

35 *Id.*

36 *See infra* notes 184–87 and accompanying text.

37 HANSMANN, *supra* note 12, at 48.

38 *See infra* notes 148–65 and accompanying text.

multiple "patrons," including employees/producers, capital providers, customers, suppliers, purchasers, and other counterparties. A firm could be owned by any one of these types of patrons. Owners might be:

- investors whose primary role is to supply capital and whose main interest in the firm are investment returns;
- employees or producers (as is the case with investment banks in the past and law firm partnerships up to the current day);
- customers (for example, in mutual banks or insurance companies); or
- counterparties in an industry (as with members of the old banking or modern securities/derivative clearinghouse).[39]

In Professor Hansmann's framework, any choice of entity has two sets of costs associated with it:

> *Market contracting costs:* the costs of patrons who do not have ownership rights over the firm who must contract with the firm in the marketplace; and
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> *The ownership costs* of the patrons that do have those rights.[40]

This framework comes straight from the established "theory of the firm" literature.[41] Professor Hansmann theorizes that the optimal form of entity is one that minimizes the sum of market contracting and ownership costs.[42] Over time, firms in an industry may gravitate towards the optimal form, e.g., toward investor- or mutually owned firms.

This Article explores whether modern investment banks, commercial banks, insurance companies, and firms within a financial industry sector as a collective impose too high market-contracting costs on a wide set of patrons of the firm. To the extent that customers, consumers, and counterparties of firms in a particular financial services sector cannot adequately protect their interests via contract—whether due to asymmetric information with respect to the products and services being offered, behavioral biases, or market structures—

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39 *See* HANSMANN, *supra* note 12, at 46–49.

40 *See id.* at 48 (discussing both costs of market contracting and costs of ownership).

41 *Id.* at 19–20.

42 Henry Hansmann, *Ownership of the Firm*, 4 J.L. ECON. & ORG. 267, 273 (1988) ("Efficiency will be best served if ownership is assigned [s]o that total transaction costs for all patrons are minimized. This means minimizing the sum of both the costs of market contracting for those patrons who are not owners, and the costs of ownership for the class of patrons who are assigned ownership." (footnote omitted)).

some version of partnership, mutual, or cooperative may become increasingly attractive in terms of net social benefits.[43] Furthermore, when the behavior—and notably the insolvency—of a particular type of financial firm imposes significant spillover costs on financial markets, market participants cannot protect themselves through contract or investment diversification. In this situation, systemic risk manifests.[44] One of these alternative forms may then become even more attractive as a means to mitigate this risk. A partnership, mutual, or cooperative might reduce firm size or internalize spillover costs, in either case reducing the risk profile of the firm vis-à-vis financial markets. In these scenarios, higher market contracting costs might outweigh any costs associated with ownership of these alternative organizational forms. Note that while an alternative organizational form might address systemic risk, it can never do so to perfection. Absent regulation or external constraints, no financial firm has incentive to completely internalize all the costs of its failure. The analysis in this Article is instead comparative: what net social benefits or costs does an alternative organizational form for a financial company have relative to an investor-owned counterpart?

Returning to many of these alternative organizational forms—the partnerships, mutuals, cooperatives, or clearinghouses—would rethink and reverse the wave of demutualization that swept through the financial services sector from the 1970s to the early 2000s. This wave resulted in financial services firms converting to investor-owned corporations and conducting initial public offerings (IPOs).[45] Over this period, large

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43 HANSMANN, *supra* note 12, at 21–22.

44 Kaufman & Scott, *supra* note 14, at 371–74.

45 In addition to investment banks and mutual insurance companies, other types of financial intermediaries with similar organizational structures also chose to transform into publicly traded corporations. For some of the literature on the demutualization of stock exchanges, see Reena Aggarwal, *Demutualization and Corporate Governance of Stock Exchanges*, 15 J. APPLIED CORP. FIN. 105, 107–10 (2002); Caroline Bradley, *Demutualization of Financial Exchanges: Business as Usual?*, 21 NW. J. INT'L L. & BUS. 657, 667–73 (2001); Andreas M. Fleckner, *Stock Exchanges at the Crossroads*, 74 FORDHAM L. REV. 2451, 2575–85 (2006); Karmel, *supra* note 5 at 409–13.

In the 2000s, the Mastercard and Visa payment card networks transformed from entities owned by card-issuing banks into corporations and conducted initial public offerings. Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand*, 12 HARV. NEGOT. L. REV. 137, 144–45 (2007); Eric Dash, *Big Payday for Wall St. in Visa's Public Offering*, N.Y. TIMES (Mar. 19, 2008), https://www.nytimes.com/2008/03/19/business/19visa.html [https://perma.cc/2CBL-A64E] (describing largest IPO in U.S. history to that date). Scholars have analyzed how incorporation and IPOs responded to antitrust litigation against the networks. *See, e.g.*, Scott R. Peppet, *Updating Our Understanding of the Role of Lawyers:*

investment banks abandoned the partnership form.[46] The end of the twentieth century saw a wave of demutualization among large life insurance companies.[47] Both types of firms, investment banks and insurance companies, became publicly traded corporations in an effort to raise capital, expand the scope of their operations into new financial markets, and compete globally.[48] These different categories of financial institutions also sought to compete with one another across financial services sectors, when both regulators, and Congress lowered the Glass-Steagall-era legal walls separating the businesses of banking, securities, and insurance.[49] Looking backwards, this wave of demutualization followed a much earlier transformation in the twentieth century in which mutually owned banks and savings and loan associations lost ground to their investor-owned, corporate competitors.[50] Note that the transformational shift toward investor-owned corporations continues into the current day albeit with a twist: prominent asset management firms have previously conducted IPOs and only recently began converting from partnerships to corporations.[51] At the

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Lessons from MasterCard, 12 HARV. NEGOT. L. REV. 175, 179–84 (2007) (noting that the IPO was a way for MasterCard to compete with Visa); Joshua D. Wright, *MasterCard's Single Entity Strategy*, 12 HARV. NEGOT. L. REV. 225, 229 (2007) (suggesting that MasterCard's single entity strategy could shield it from liability under Section 1 of the Sherman Act).

The benefits and costs of demutualization and remutualization in the stock exchange and payment network contexts are worth exploring but are beyond the scope of this Article.

46 *See infra* section I.A.

47 *See infra* section I.C.

48 *See infra* sections I.A and I.C.

49 For a history of the end of Glass-Steagall, see ARTHUR E. WILMARTH, JR., TAMING THE MEGABANKS—WHY WE NEED A NEW GLASS-STEAGALL ACT ch. 7–8 (forthcoming 2020), and Arthur E. Wilmarth, Jr., *The Road to Repeal of the Glass-Steagall Act*, 17 WAKE FOREST J. BUS. & INTELL. PROP. L. 441, 492–503 (2017) [hereinafter Wilmarth, *Road to Repeal*]. For a germinal analysis of how the demise of Glass-Steagall fostered the creation of financial conglomerates that spanned banking, securities, and insurance business lines, see Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 972–79 (2009) [hereinafter Wilmarth, *Dark Side of Universal Banking*]; Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215, 219–20.

50 HANSMANN, *supra* note 12, at 254–58.

51 Michael J. de la Merced, *Blackstone Will Ditch Partnership Structure to Draw More Investors*, N.Y. TIMES (Apr. 18, 2019), https://www.nytimes.com/2019/04/18/business/dealbook/blackstone-corporate-structure.html [https://perma.cc/58DR-MMM9] ("The Blackstone Group said on Thursday that it planned to convert itself into a standard corporation, becoming the latest investment firm to abandon its partnership structure . . . ."); Heather Perlberg, *Carlyle Plans to Announce Conversion to C-Corp With Earnings*, BLOOMBERG (July 9, 2019), https://www.bloomberg.com/news/articles/2019-07-09/carlyle-plans-to-an-

same time, U.S. law firms and other legal service companies have recently again flirted with the idea of following several U.K. law firms and conducting an IPO.[52] The changes that came when previous financial sector firms converted to the corporate form, including enhanced risk-taking and refocusing from the interests of clients and customers to those of shareholders, may now reach new sectors of the financial services industry. This makes revisiting the consequences of earlier demutualizations of financial institutions all the more pressing.

Many factors explain demutualization and the rise of investor-owned financial firms at the expense of mutuals. The increasing effectiveness of financial regulation represents perhaps the most surprising factor.[53] Professor Hansmann argues that the shift in the late nineteenth and early twentieth century away from mutual banks and toward investor-owned corporate banks stemmed from the fact that more effective bank regulation convinced depositors increasingly to deposit their savings with the corporate banks they previously distrusted as too unstable.[54] Similarly, effective state insurance regulation gave assurances to life insurance policy holders that they could trust corporate insurers and not just mutuals.[55] However, now, the global financial crisis has called into question the continuing effectiveness of banking and other regulations. The failure of financial institution regulation calls for a reckoning of the costs of decades of demutualization. This failure also creates an opening for reconsidering and reviving the use of partnerships, cooperatives, and mutually owned entities in financial services.[56]

Prosecutors and agencies might require remutualization of a firm that has committed severe misconduct as an alternative to shuttering the firm or imposing fines. Policymakers can pro-

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nounce-conversion-to-c-corp-with-earnings [https://perma.cc/G2F4-HAB3] ("The Washington-based firm would be the last of the private-equity giants to switch from a partnership to a corporation . . . .").

52 Roy Strom, *Why U.S. Legal Businesses Flirt with IPOs But Don't Commit*, BLOOMBERGLAW (Sept. 12, 2019), https://news.bloomberglaw.com/us-law-week/why-u-s-legal-businesses-flirt-with-ipos-but-dont-commit [https://perma.cc/D8J4-2DEV].

53 *See* HANSMANN, *supra* note 12, at 255–56.

54 *See id.* at 255.

55 *See id.* (explaining how these regulations "gave depositors some assurance that investor-owned banks would not speculate excessively with the funds entrusted to them. This form of regulation was evidently sufficiently effective to deprive the mutual banks of their decisive competitive advantage over investor-owned banks").

56 *See infra* Part IV.

mote remutualization by providing preferences in financial regulation. These preferences could lighten regulatory requirements in areas in which partnerships or the mutual form provide partial policy solutions. For example, if investment bank partnerships or mutually owned banks have incentives to make less risky investments and thus pose a lower risk of insolvency, then policymakers should require less regulatory capital or charge lower premia for deposit insurance.[57] Historically, policymakers granted these sorts of regulatory preferences to some mutually owned entities.[58] Legally, they may be required to do so under certain statutory regimes.[59] Policymakers could also foster remutualization by restoring and expanding the tax preferences that were historically given to certain mutual firms.[60]

This Article proceeds as follows: Part I takes stock of the history of demutualization across different categories of financial institutions. It sketches out the social cost of financial institutions abandoning the partnership or mutual form and reviews legal scholarship that proposes reversion to the earlier organizational forms. Part II shifts from the organizational form of individual firms to examine proposals for mutualizing risk, particularly systemic risk, across the industry. Part III discusses policy instruments that could promote remutualization. Part IV outlines the benefits and costs of using these policy instruments, including the costs of the alternative organizational forms compared to the investor-owned corporation.

I
DEMUTUALIZATION AND REMUTUALIZATION ACROSS FINANCIAL SECTORS

The introduction to this Article sketched a broad phenomenon of financial institutions "demutualizing," with successive waves of demutualization gathering strength in the last four

57 *See* HANSMANN, *supra* note 12, at 257 ("If the government had responded by charging lower premiums on deposit insurance to mutual banks than to investor-owned banks, the mutual banks might still have been able to translate their advantages as fiduciaries into a competitive advantage vis-à-vis investor-owned banks.").

58 *Id.* at 257–58.

59 For example, the Federal Deposit Insurance Corporation Improvement Act of 1991 required that a federal agency change to a "risk-based" assessment approach for charging premia for its deposit insurance. Pub. L. 102-242, 105 Stat. 2236 (Dec. 19, 1991) (codified at 12 U.S.C. § 1817(b)).

60 HANSMANN, *supra* note 12, at 275–76 (describing tax incentives for life insurance mutuals).

decades.[61] However, analyzing the reasons for, and social costs of, different financial institutions abandoning the partnership or mutual form requires close attention to institutional detail and to differences among types of institutions. To begin with, the partnerships, mutually owned companies, and cooperatives bear strong resemblance to one another but are different types of legal entities. The entity forms differ in terms of the economic agents that (1) possess the residual claims on the firm's cash flows; (2) exercise control; and (3) bear the firm's liabilities. The following chart highlights some of the key differences among the legal features of partnerships, the archetypal mutually owned financial institution, and the typical investor-owned stock corporation.

61 Aggarwal, *supra* note 45, at 105.

PARTNERSHIPS, MUTUALLY OWNED COMPANIES, AND INVESTOR-OWNED CORPORATIONS COMPARED

	Organizational Form		
Feature	**Partnership**	**Typical Mutually Owned Financial Institution**	**Investor-Owned Corporation**
Who is the firm's residual claimant? (equity owner)	Partners.[62]	Members of the mutual (*e.g.*, depositors for a mutual bank; policyholders for a mutual insurance company).[63]	Shareholders.[64]
Who exercises effective control over the firm?	Partners (or subset of partners, *e.g.*, management committee).[65]	Directors (members exercise little practical control).[66]	Directors have day-to-day control;[67] Shareholders elect directors and have voting rights on certain matters.[68]
What is the liability of the residual claimant for the obligations of the firm?	Each partner is jointly and several liable for liabilities of general partnership; No limited liability shield for partners in a general partnership.[69]	Limited liability shield for members.[70]	Limited liability shield for shareholders (shareholders generally not liable for more than value of their stock).[71]

62 The status of partners as residual claimant of the partnership can be seen most clearly in the dissolution provisions of state partnership statutes. *See*, *e.g.*, DEL. CODE ANN. tit. VI § 15-807(a) (2018) (codifying partners' liabilities to one another in cases of dissolution, settlement, and contribution).

63 *See* HANSMANN, *supra* note 12, at 247 (mutual savings banks), 252 (mutual savings and loan associations), 269–70 (mutual insurance companies).

64 *See generally* Kimble C. Cannon & Patrick J. Tangney, *Protection of Minority Shareholder Rights Under Delaware Law: Reinforcing Shareholders as Residual Claimants and Maximizing Long-term Share Value by Restricting Directorial Discretion*, 1995 COLUM. BUS. L. REV. 725 (discussing rights of shareholders as residual claimants).

65 *See, e.g.*, DEL. CODE ANN. tit. VI §§ 15-401(f), 407 (2018).

66 *See* HANSMANN, *supra* note 12, at 247, 252, 269–70.

67 *See, e.g.*, DEL. CODE ANN. tit. VIII § 141(a) (2018).

68 *See, e.g.*, DEL. CODE ANN. tit. VIII § 141(d), (k) (2018).

69 *See, e.g.*, DEL. CODE ANN. tit. VI § 15-306(a) (2018).

70 *See, e.g.*, James R. Garven, *An Exposition of the Implications of Limited Liability and Asymmetric Taxes for Property-Liability Insurance*, 59 J. RISK & INSURANCE 34, 48–49 (1992) (examining effects of limited liability on mutual property insurers).

71 For the classic empirical study of the principal exception to the limited liability enjoyed by shareholders of corporations, see Robert B. Thompson, *Piercing the Corporate Veil; An Empirical Study*, 76 CORNELL L. REV. 1036 (1991).

In addition, different categories of financial institutions have different business models, perform different economic functions, are governed by different legal regimes, suffer different kinds of market failures, and thus raise different policy concerns. All of this, as explained below, translates into demutualization causing different but broadly similar policy consequences depending on the type of financial institution. On the other hand, remutualization and the use of organizational form—whether partnership, mutual, or collective—as regulatory instrument will also yield different but broadly similar policy results for investment banks versus banks and other lenders versus insurance companies.

It is therefore important to dive into the institutional and historical detail of investment bank partnerships, mutual banks, and mutual insurance companies; the dynamics that pushed firms in these three industries to demutualize or shift toward the investor-owned corporation; and the consequences of these shifts.

A. Investment Banks

1. *The Demise of Investment Banks as Partnerships*

Before 1970, U.S. stock exchange rules prevented publicly held corporations from being exchange members. Accordingly, investment banks, which held seats on the New York Stock Exchange or other exchanges and were registered with the Securities and Exchange Commission (SEC) as broker-dealers, were organized as partnerships.[72] The partners of each of these investment banks thus had joint and several liability for the debts of the firm. As Professors Hill and Painter have described, this created a very financially conservative ethos at these securities firms.[73] Partners developed internal governance mechanisms and cultures to police each other's risk-taking and to vet individuals carefully before admitting them as partners of the firm. Many investment bankers believed that the partnership form sent a signal of the firm's prudence to their customers.[74]

The world began to experience a seismic shift in 1970 when Donaldson, Lufkin, and Jenrette challenged the stock exchange rules and embarked on a course to convert into a publicly traded corporation.[75] The SEC acquiesced. Over the next

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72 HILL & PAINTER, *supra* note 3, at 78.
73 *Id.* at 97.
74 *Id.* at 95–107.
75 *Id.* at 78–79.

three decades, other major investment banks abandoned the partnership form and became publicly traded corporations, as indicated by the following timeline of IPOs:

1970: Donaldson, Lufkin, and Jenrette

1971: Merrill Lynch

1984: Lehman Brothers (via acquisition by Shearson/American Express, which was publicly listed)

1985: Bear Stearns

1985: Morgan Stanley

1999: Goldman Sachs[76]

A number of factors drove investment banks to abandon the partnership form, become corporations, and pursue IPOs. The business of investment banking changed radically in the 1970s and 1980s. For one, a sharp rise in securities trading volume in the 1960s created the so-called "back-office crisis" of 1967–1970, in which investment banks struggled with paper processing of trades.[77] Investment banks needed capital for technology investments to process trades and keep up with competitors, such as Merrill Lynch, that had successfully computerized back-office operations.[78] Thus, as the 1960s and 1970s progressed, institutional investors came to value personal relationships with, and personalized investment advice from, investment bankers less.[79] They had in-house personnel who could conduct investment analysis and make investment decisions.

Further, other regulatory changes eroded other centers of profit for investment banks. In 1975, Congress mandated that the SEC change its rules to end fixed-brokerage commissions.[80] Afterwards, investment banks/brokers had to negotiate rates with customers, which eroded a steady stream of profits. At the same time, brokers required huge amounts of capital to make technology investments to service the needs of

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76 ALAN D. MORRISON & WILLIAM J. WILHELM, JR., INVESTMENT BANKING: INSTITUTIONS, POLITICS, AND LAW 237 (2007) [hereinafter MORRISON & WILHELM, INVESTMENT BANKING]; Alan D. Morrison & William J. Wilhelm, Jr., *The Demise of the Investment Banking Partnerships: Theory and Evidence*, 63 J. FIN. 311, 327 (2008) [hereinafter MORRISON & WILHELM, *The Demise of Investment Banking Partnerships*].

77 HILL & PAINTER, *supra* note 3, at 88.

78 MORRISON & WILHELM, INVESTMENT BANKING, *supra* note 76, at 235–38, 278.

79 Alan D. Morrison & William J. Wilhelm, Jr., *Trust, Reputation and Law: The Evolution of Commitment in Investment Banking*, 7 J. LEGAL. ANALYSIS 363, 394–97 (2015) [hereinafter Morrison & Wilhelm, *Trust, Reputation, and Law*].

80 HILL & PAINTER, *supra* note 3, at 80.

institutional investors.[81] These investors had assumed a dominant share of stock market investing and wanted speedy execution of trades, better execution, and lower commissions.[82] And in 1982, the SEC allowed large issuers to conduct "shelf registrations" of securities.[83] Issuers could thus perform much of the legal and financial preparation for a securities issuance in-house. When they wanted to make an issuance of securities (taking securities "off the shelf"), issuers could then ask a number of underwriters to make competitive bids.[84] This lessened the dependence of issuers on longstanding relationships with a particular investment banking firm and placed downward pressure on investment banking commissions. Faced with declining margins in their traditional brokerage and underwriting businesses, many investment banks turned to new business lines, such as proprietary trading, which required more capital investments and involved much more risk.[85]

The old partnership structures served to bind partners to the firm and to dampen partner risk-taking.[86] In a world in which client relationships mattered less and new riskier lines of business were prized, these structures and strictures became less important and a source of perceived competitive disadvantage. A new national emphasis on meritocracy placed further stress on the clubby world of investment bank partnerships.[87] The social connections of and among partners mattered less.[88] At the same time, investment banker norms about putting client and customer interests first also eroded as bankers sought more profitable lines of business.[89]

Investment banks faced new competition and new opportunities for expansion as financial services became increasingly globalized.[90] Moreover, the erosion of Glass-Steagall rules separating the commercial banking, investment banking/securi-

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81 *See id.* at 73, 87–89.

82 *Id.* at 73, 78–80.

83 *Id.* at 81.

84 *Id.* at 82.

85 *Id.* at 73–74, 81–83; *see* Morrison & Wilhelm, *Trust, Reputation, and Law*, *supra* note 79, at 394–97; *see also* Alan D. Morrison et al., *Investment-Banking Relationships: 1933–2007*, at 35 (Saïd Business School Working Paper No. 2014-1), https://web.northeastern.edu/kkrishnan/Wilhelm_paper.pdf [https://perma.cc/XR7L-ZUXU] (documenting declining interest among securities issuers in long-term relationships with investment banks).

86 HILL & PAINTER, *supra* note 3, at 96–97.

87 *Id.* at 89; Morrison & Wilhelm, *Trust, Reputation, and Law*, *supra* note 79, at 397.

88 HILL & PAINTER, *supra* note 3, at 72, 89–90.

89 *Id.* at 100–05.

90 *Id.* at 72.

ties, and insurance meant new competitors for investment banks.[91] Depository banks and insurance companies entered lines of the securities business traditionally reserved for investment banks.[92] The investment banking industry sued the regulators of commercial banks in unsuccessful attempts to block these new entrants into the securities business.[93]

Alan Morrison and William Wilhelm describe the tipping point in an investment bank's calculus of whether to switch from partnership to publicly traded corporation when new technologies generated sufficient economies of scale to the investment banking business that individual partners no longer had incentives to mentor junior colleagues.[94] Economies of scale at some point dwarfed any reputational loss to a firm from declining mentorship and monitoring of junior employees. Meanwhile, the advent of personal computing together with the rise of financial engineering and quantitative approaches to investing meant that investment banks needed more capital for technology.[95] At the same time, these dynamics also diminished the importance of tacit knowledge and relationships. Morrison and Wilhelm argue that the order in which investment banks went public illustrates these forces at work. The first firms to abandon the partnership form and conduct IPOs were firms active in securities markets, while the last partnership holdouts were firms like Goldman Sachs that relied on advisory businesses.[96]

The Goldman IPO marked the end of a contentious fight among old and new guard partners at that firm about the firm's culture, the reputational value for clients of Goldman being organized as a partnership, and the risk-taking and business model of the firm. After the IPO, the investment bank moved toward businesses such as proprietary trading that were less client-centered compared to traditional business lines (such as securities underwriting) and involved a higher degree of risk to the firm and its customers. The Goldman IPO also marked the

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91 *Id.* at 84–85.

92 *Id.*; MORRISON & WILHELM, INVESTMENT BANKING, *supra* note 76, at 281–84, 296–300.

93 *See, e.g.*, Sec. Indus. Ass'n v. Clarke, 885 F.2d 1034 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 1113 (1990) (suing the Comptroller of the Currency); Sec. Indus. Ass'n v. Bd. of Governors, 839 F.2d 47 (2d Cir. 1988), *cert. denied*, 486 U.S. 1059 (1988) (suing the Board of Governors of the Federal Reserve System).

94 MORRISON & WILHELM, INVESTMENT BANKING, *supra* note 76, at 276–77.

95 *Id.* at 279–80.

96 *Id.* at 276–280; Morrison & Wilhelm, *Trust, Reputation, and Law*, *supra* note 79, at 392–94, Morrison & Wilhelm, *The Demise of Investment Banking Partnerships*, *supra* note 76, at 314–15.

end of the era of major U.S. investment banks being organized as private partnerships.[97]

IPOs gave partners of investment banks enormous payouts.[98] IPOs also gave investment banks new tools for compensation.[99] They could now pay traders and other employees with stock options and restricted stock.[100] These forms of compensation dramatically altered the incentives of employees to take risks.[101] This change in investment banker pay mirrored a large movement among American corporations to use compensation to make management more responsive to shareholders and to promote shareholder value as an overarching goal.[102] Investment bank employees received a hidden boost to compensation compared to the old partnerships because personal liability was jettisoned.[103] A lack of joint and several liability also meant bankers needed to take less care in vetting new colleagues.[104]

IPOs also left investment banking firms flush with cash, which they used for acquisition sprees.[105] The investment banking and brokerage industry underwent rapid and massive consolidation. Capital also allowed investment banks to purchase other kinds of financial firms and enter other businesses as regulators lowered the Glass-Steagall-era walls separating the securities business from that of banking and insurance.[106]

2. *Consequences*

Professors Hill and Painter explain how this shift away from partnerships transformed Wall Street firms and the entire

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97 *See* STEVEN G. MANDIS, WHAT HAPPENED TO GOLDMAN SACHS: AN INSIDER'S STORY OF ORGANIZATIONAL DRIFT AND ITS UNINTENDED CONSEQUENCES 95 (2013).

98 *See* HILL & PAINTER, *supra* note 3, at 112.

99 *Id.*

100 *Id.* at 105–07.

101 *Id.* at 119.

102 *Id.* at 105–06.

103 Hill and Painter illustrate the effects on limited liability on compensation with an anecdote from an old investment banking partnership. They discuss the time when an individual was named partner at the old Salomon Brothers firm, a senior partner cautioned him to tell his spouse "that once you sign the partnership papers next week you will be personally liable for $2 billion." HILL & PAINTER, *supra* note 3, at 97 (citing Henry Kaufman, *Henry Kaufman on Civility in the Financial Sector*, CARNEGIE COUNCIL (June 20, 2011), https://www.carnegiecouncil.org/studio/multimedia/20110620-henry-kaufman-on-civility-in-the-financial-sector [https://perma.cc/DWN6-ZDAY].

104 HILL & PAINTER, *supra* note 3, at 95.

105 *Id.* at 73–74, 78–79.

106 *Id.* at 84–85.

industry.[107] They link the loss of joint and several liability at investment banks to a greater appetite for risk-taking and transactions that compromised client interests and bent financial laws and regulation.[108] Removing personal liability triggered or reinforced shifts in the culture of investment banks that prioritized profit and risk.[109] Professors Hill and Painter trace how lower individual liability and organizational dynamics led to a series of calamitous investment bank actions in the years preceding, during, and after the global financial crisis. These actions include the following:

- Creating extremely risky asset-backed securities and other financial instruments, selling them to customers, and hiding the risks;[110]
- Concealing investment banks' own risks from their creditors and investors and from regulators;[111]
- Helping clients conceal leverage and risk from governments;[112]
- Manipulating financial markets and indices such as LIBOR;[113] and
- Evading laws and regulations, including doing business with sanctioned countries and assisting clients in evading taxes.[114]

The demise of the investment bank partnership increased individual banker mobility, weakening loyalty to individual firms.[115] At the same time that investment banks became partnerships, scholars argue, investment bankers became less concerned with *firm* reputation.[116] Meanwhile, *individual* reputations assumed a greater importance as a "star culture" took hold at many investment bank firms.[117] The increasing com-

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107 *Id.* at 79–80 (noting that removing personal liability incentivizes bankers to take big risks because it is the shareholders, not the bankers, who own the banks' capital and therefore have to absorb any losses).

108 *Id.* at 90.

109 *Id.* at 72.

110 *Id.* at 22–39.

111 *Id.* at 39–49; *see also supra* note 22 and accompanying text.

112 *See* HILL & PAINTER, *supra* note 3, at 54–57 (noting that Greece's cross-currency swap with Goldman Sachs—which relied on an invented exchange rate—helped disguise Greece's true financial condition).

113 *Id.* at 49–53. For analysis of the manipulation of LIBOR and other financial benchmarks, see Gina-Gail S. Fletcher, *Benchmark Regulation*, 102 IOWA L. REV. 1929 (2017); Andrew Verstein, *Benchmark Manipulation*, 56 B.C. L. REV. 215 (2015).

114 *Id.* at 62–65.

115 MORRISON & WILHELM, INVESTMENT BANKING, *supra* note 76, at 281–84.

116 *See* Morrison & Wilhelm, *Trust, Reputation, and Law*, *supra* note 79, at 390.

117 *Id.* at 367–68, 399.

plexity of investment bank business further undermined mutual trust between banks and their clients.[118] Some scholars maintain that declining concern with investment bank firm reputation contributed to the financial crisis.[119]

3. *Policy Solutions*

To remedy the incentives that skew in favor of excessive risk taking, abuse of client trust, manipulation, and law-breaking, Professors Hill and Painter propose reintroducing personal liability for senior investment banks.[120] They formulate a "covenant banking" regime in which an investment bank would voluntarily impose a set of contractual obligations on its highly compensated bankers. This regime would subject bankers to liability for at least a portion of the firm's debts upon insolvency, as well as for regulatory fines and civil judgments.

B. Banks and Lenders

Banking experienced a transformation similar to that of the investment banking industry, albeit one that occurred much earlier. Mutual banks once enjoyed a dominant position in American banking, but lost ground to investor-owned banks for surprising reasons and with dramatic consequences.[121]

The history of mutually owned banks and banking cooperatives begins with mutual savings banks, the first of which was founded in the United States in Massachusetts in 1816.[122] By 1849, the United States had eighty-seven mutual savings banks, primarily in the Northeastern and mid-Atlantic cities. Distributed earnings for those banks were shared among depositors. However, depositors possessed no voting rights. Control was exercised by a "self-perpetuating" board of directors. These mutual banks represented a valuable means for working class individuals to deposit savings in an era in which investor-owned banks, which raised funds primarily by issuing

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118 Zhaohui Chen et al., Investment Bank Governance and Client Relationships 35–36 (Dec. 5, 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3296347 [https://perma.cc/8KHE-68J9]).

119 Morrison & Wilhelm, *Trust, Reputation, and Law*, *supra* note 79, at 368 (citing Steven Davidoff Solomon, *As Wall St. Firms Grow, Their Reputations Are Dying*, N.Y. TIMES DEALBOOK (Apr. 26, 2011), https://dealbook.nytimes.com/2011/04/26/as-wall-st-firms-grow-their-reputations-are-dying [https://perma.cc/A9PG-R82Y]).

120 HILL & PAINTER, *supra* note 3, at 146.

121 *See* HANSMANN, *supra* note 12, at 247–51, 254–56; MORRISON & WILHELM, INVESTMENT BANKING, *supra* note 76, at 121, 146–49, 155–62.

122 HANSMANN, *supra* note 12, at 246–48.

stock rather than taking deposits, catered to merchants and businesses.

In the nineteenth century, mutual savings banks thrived and enjoyed a significant share of the market.[123] According to Professor Hansmann, bank regulation played a surprising role in the ascendance of investor-owned banks taking the corporate form.[124] Where *deregulation* ushered in the end of the investment bank partnership, *regulation* catalyzed the rise of corporate banks. Over the nineteenth century, individuals deposited their savings with mutual savings banks and not investor-owned banks because they did not trust the latter.[125] Without effective bank regulation, managers of investor-owned banks had incentives to invest in risky, speculative investments because of the asymmetry between those parties who enjoyed a bank's profits *versus* those parties who bore its risks. When risky investments paid out, bank shareholders would earn handsome profits while depositor returns would remain fixed. By contrast, if investments failed, bankruptcy could wipe out not only shareholders but also depositors. Managers of investor-owned banks had an incentive to maintain only minimal net assets at the bank. This increased leverage magnified potential returns, but left depositors dangerously exposed to losses. Depositors could not realistically contract with management to protect themselves. The riskiness of investor-owned banks in the nineteenth century is reflected in their high rates of failure. For example, half of all investor-owned banks formed between 1810 and 1820 had failed by 1825, and half of all banks formed between 1830 and 1840 failed by 1845.

Unwilling to trust investor-owned banks with their savings, depositors instead chose to deposit their savings with the mutual savings banks.[126] Having depositors and customers as the residual claimants on the firm's profits rather than corporate shareholders lowered the incentives of managers to make risky loans or other investments. Even if members could not exercise significant control over management, the fact that members and no one else held the residual claims lessened the pressure on managers to generate higher profits and thus to take on more risk. This underscores a vital lesson for using the organizational form as a regulatory tool: the identity of the residual claimant affects the risk-taking of a financial institu-

123 *Id.* at 246–49.
124 *Id.* at 255.
125 *Id.* at 247–49.
126 *Id.* at 249–50.

tion even when the mechanisms by which owners can effectively control management are weak.

Mutual banks represented just one organizational form that competed with the investor-owned corporation. The landscape of American banking featured numerous other entities with different residual claimants or controlling parties. Other types of mutual and cooperative banking institutions emerged in the nineteenth and twentieth centuries and provided other options for individuals to deposit savings and even to borrow. These institutions included the following:

> *Investor-owned trust companies* developed in the nineteenth century.[127] Their compensation system for managers differed from that of investor-owned banks.[128] Trust managers were paid a percentage of total trust assets rather than profits, reducing their incentive to make risky investments and increasing their incentive to attract long term deposits.
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> *Mutual savings and loan associations* (first called "mutual building and loan associations") in the United States arose in the 1830s.[129] These true cooperatives made consumer loans at a time when investor-owned banks would not. Mutual savings and loans could make these loans because their tight-knit membership allowed them to screen borrowers. These firms could thus solve two problems often associated with lending: adverse selection and moral hazard. Adverse selection occurs if a lender cannot differentiate between loan applicants with low compared to high credit risk.[130] As in a classic "lemons" market, high credit risk borrowers may price more credit-worthy borrowers out of the market as lenders cannot distinguish the two groups and raise interest rates. Moral hazard can arise when borrowers have incentive to use loans once credit has been extended for risky projects and to default should those projects fail.[131]
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> *Credit unions* entered the American financial services stage in the early twentieth century.[132] The chartering statutes for credit unions required that these depositor cooperatives maintain a "common bond," such as employment at the same place of work. Professor Hansmann argues that this com-

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127 *Id.* at 248.
128 *Id.* at 252.
129 *Id.* at 252–53.
130 *See* Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2129–30 (2016).
131 *See* Omarova, *supra* note 4, at 469 (citing HEIDI MANDANIS SCHOONER & MICHAEL W. TAYLOR, GLOBAL BANK REGULATION 60–66 (2010)).
132 HANSMANN, *supra* note 12, at 258–60.

> mon bond works to mitigate opportunistic behavior by borrowers in the same way that mutual ownership in savings and loans addresses adverse selection and moral hazard. For example, credit unions organized around places of employment may have greater information on the creditworthiness of borrowers. Credit unions may also have additional mechanisms to secure repayment (via payroll deductions) and police borrower behavior (through social pressure of coworkers and employer sanctions).

Mutual and cooperative banks not only make less risky investment decisions, but data indicates that they also offer more consumer-friendly terms to borrowers. For example, Ryan Bubb and Alex Kaufman compared contractual terms in loans offered by mutually owned lenders compared to those offered by investor-owned firms.[133] They found that loans by mutually owned lenders imposed lower penalties on customers, such as lower penalty default interest rates. Professors Bubb and Kaufman attribute this tendency to offer more consumer-friendly terms to the difference in the identity of the residual claimant of mutually owned firms compared to investor-owned ones, as well as to the nonprofit status of these lenders.[134]

These various kinds of mutual entities not only promoted public policy goals, they also were extremely successful businesses. In the nineteenth and early twentieth centuries, mutual savings banks and mutual savings and loans enjoyed a significant market share of deposit-taking and bank lending in the United States. In 1880, mutual savings banks held 87% of time deposits in the United States and mutual savings and loan associations held an additional 1% share.[135] At that same point, investor-owned banks held only 12% of time deposits in the country. The number of mutual and savings and loans continued to grow until the early twentieth century, peaking at 12,600 firms in 1928. By contrast, credit unions continued to grow throughout the twentieth century, with growth accelerating after the Second World War.[136]

1. *Demutualization*

The dominance of mutual savings banks and savings and loans eroded throughout the twentieth century. In 1925, mu-

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133 Bubb & Kaufman, *supra* note 11, at 39–40.
134 *Id.* at 40–42.
135 HANSMANN, *supra* note 12, at 254.
136 *Id.* at 259.

tual savings banks held 32% and mutual savings and loan institutions had 16% of U.S. deposits, while deposits in investor-owned banks climbed to 52%.[137] Professor Hansmann cites several factors as contributing to this shift, including changes in the organizational structure of mutual banks and savings and loans. For example, mutual savings and loans began to enjoy a larger and more fluid set of members. This reduced the ability of members to control the institutions they owned. Looser communal bonds among members diluted an important mechanism to counteract adverse selection and moral hazard among borrowers.

However, regulation also played a role in the market shift toward investor-owned corporations. This role can be seen first when regulation was absent, in the reasons for the original success of mutual banks.[138] Professor Hansmann attributes the success of mutually owned and cooperative banks and lenders to a surprising dynamic. Professor Hansmann argues that the introduction of successful bank prudential regulations in the nineteenth century assured depositors and, in turn, investors, of the safety and soundness of corporate banks.[139] At that point, corporate banks then appeared to be a much safer place to deposit money than before. This diminished the comparative advantage of banks organized as mutual or cooperatives. In short, prudential statutes and regulations began to provide a substitute for the organizational form as a regulatory tool.

As noted above, credit unions continued to thrive even as mutual savings banks and mutual savings and loan associations declined in importance. However, the common bond requirement at the core of credit union regulation has been incrementally relaxed. Credit unions no longer need a tight common bond such as a common employer.[140] Under 2018 rule changes adopted by the National Credit Union Administration, credit unions are no longer restricted to membership under 2.5 million members; this has opened the door to "mega-credit unions" whose membership and operation are national in scope. Loosening the common bond not only allows for the creation of giant credit unions, it also weakens the mechanisms described above for addressing opportunistic behavior

137 *Id.* at 254–55.
138 *Id.* at 247–51.
139 *Id.* at 255.
140 *See* Aaron D. Klein, *Banklike Credit Unions Should Follow Bank Rules*, AM. BANKER (June 25, 2018), https://www.americanbanker.com/opinion/banklike-credit-unions-should-follow-bank-rules [https://perma.cc/KP6U-BS5G].

by borrowers. This might, in turn, translate into less favorable interest rates and terms for all the borrowers of credit unions.

2. *Consequences of the Shift Away from Mutuals*

The shift away from mutually owned and cooperative banks toward investor-owned banks and savings and loans translated into a decrease in the social benefits that came with the mutual form, namely reduced firm risk-taking, more consumer-friendly loan terms, and greater access to banking services.[141] The first consequence—greater risk-taking by investor owned firms—can be seen by comparing the rate of failures of mutually owned and cooperative banks and savings and loans versus their investor-owned counterparts. Before and during major financial crises, investor-owned banks and savings and loans failed at significantly higher rates. This pattern held in the 1920s, during the Great Depression, and during the Savings and Loan crisis of the 1980s. Furthermore, the shift to investor-owned lender can have costs in terms of consumer protection given the evidence that mutually owned and cooperative lenders, such as credit unions, tend to offer more consumer-friendly terms in loans and other financial products.

C. Insurance Companies

The mutual form has long enjoyed a significant share of insurance markets, particularly in life insurance.[142] Section I.C.2 explains the structural advantages that mutuals enjoyed, particularly those resulting from having policyholders and not profit-oriented investors as the residual claimants of the firm.

Mutual insurance firms have persisted despite theories from scholars that they would be plagued by agency costs.[143] Scholars posited a "managerial discretion hypothesis" that managers of a mutual insurer could behave opportunistically vis-à-vis policyholders in risk selection and pricing of poli-

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141 *See* HANSMANN, *supra* note 12, at 246, 256–57.

142 *Infra* section I.C.1.

143 For an overview of these theories and a survey of research into mutual insurance companies, see Antti Talonen, *Systematic Literatures Review of Research on Mutual Insurance Companies*, 4 J. CO-OPERATIVE ORG. & MGMT. 53 (2016); *see also* CNTR. FOR EXCELLENCE IN ACCOUNTING AND SECURITY ANALYSIS, COLUMBIA BUSINESS SCHOOL, ANALYSIS AND VALUATION OF INSURANCE COMPANIES, 7 (Nov. 2010), http://www.columbia.edu/~dn75/Analysis%20and%20Valuation%20of%20Insurance%20Companies%20-%20Final.pdf [https://perma.cc/G398-JTC3] (explaining hypothesis that "mutuals should be less efficient than stocks due to higher agency costs").

cies.[144] However, there is little empirical support for opportunistic behavior by managers of mutual insurers.[145] In fact, studies indicate that stock insurers take on greater risk and enter riskier business lines compared to mutual counterparts.[146] This can result in mutuals having relatively lower insolvency rates.[147] Stock insurers do have higher executive compensation[148] and experience higher management turnover in response to firm performance.[149] Some academics believe that the reduced risk of a corporate takeover allows mutuals to maintain higher surpluses and thus to offer better insurance against catastrophic risks.[150] Other scholars have found that mutual insurers maintain high surpluses[151] and high degrees of liquid assets.[152]

Scholars have also posited an "expense preference" hypothesis, which holds that weaker control mechanisms in mutual companies allow management to increase salaries and

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144 *See generally* J. David Cummins, Mary A. Weiss & Hongmin Zi, *Organizational Form and Efficiency: The Coexistence of Stock and Mutual Property-Liability Insurers*, 45 MGMT. SCI. 1254 (1999) [hereinafter Cummins et al., *Organizational Form and Efficiency*] (articulating and testing different theories explaining the organization form that insurance companies take); David Mayers & Clifford W. Smith, *Contractual Provisions, Organizational Structure, and Conflict Control in Insurance Markets*, 54 J. BUS. 407 (1981) (testing incentive problems when managers of insurance companies can exercise discretion).

145 HANSMANN, *supra* note 12, at 269–72, 279, 285–86.

146 Joan Lamm-Tennant & Laura Starks, *Stock Versus Mutual Ownership Structures: The Risk Implications*, 66 J. BUS. 29, 37–44 (1993) (finding stock insurers have significantly higher risk profiles compared to mutuals in property liability insurance and underwrite more policies in riskier lines and markets); Christian Laux & Alexander Muermann, *Financing Risk Transfer Under Governance Problems: Mutual Versus Stock Insurers*, 19 J. FIN. INTERMEDIATION 333, 348 (2010).

147 *See also* J. David Cummins, Scott E. Harrington & Robert Klein, *Insolvency Experience, Risk-Based Capital, and Prompt Corrective Action in Property-Liability Insurance*, 19 J. BANKING & FIN. 511, 516, 522 (1995) (finding support for previous studies showing mutual in property-liability insurance have lower insolvency rates; mutual status improves accuracy of risk-based capital regulatory formulae).

148 David Mayers & Clifford W. Smith, Jr., *Executive Compensation in the Life Insurance Industry*, 65 J. BUS. 51, 68–73 (1992) [hereinafter Mayers & Smith, *Executive Compensation*].

149 Enya He & David W. Sommer, *CEO Turnover and Ownership Structure: Evidence from the U.S. Property–Liability Insurance Industry*, 78 J. RISK & INS. 673, 689–98 (2011).

150 Dwight M. Jaffee & Thomas Russell, *Catastrophe Insurance, Capital Markets, and Uninsurable Risks*, 64 J. RISK & INS. 205, 214 (1997).

151 Howard E. Winklevoss & Robert A. Zelten, *An Empirical Analysis of Mutual Life Insurance Company Surplus*, 40 J. RISK & INS. 403, 421–25 (1973).

152 *See generally* Yung-Ming Shiu, *Corporate Liquidity: Evidence from the United Kingdom Life Insurance Industry*, 13 APPLIED ECON. LETTERS 111 (2006) (testing when and which types of insurance companies hold more liquid assets).

other costs.[153] Although one cross-country comparative study supports this hypothesis,[154] multiple other studies failed to do so.[155] One study showed mutual insurance companies are not less cost-efficient than their investor-owned stock counterparts.[156] Again, mutuals have lower levels of executive compensation.[157] Other studies show that an insurance company's expense levels do not fall after demutualization,[158] and that expense levels do not appear to explain the decision to demutualize.[159] Historical studies of British insurers show lower cost levels for mutual companies.[160]

Scholars note that mutuals use several strategies or have certain features to address agency costs. For example, several studies note that mutual boards have more outside directors than their stock counterparts.[161] As noted below, Professor Hansmann argues that having policyholders as an insurer's residual claimant dampens agency costs as management has no other constituency, such as investors, to whom it must respond.[162] Evidence shows mutuals offer lower priced policies

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153 Cummins et al., *Organizational Form and Efficiency*, *supra* note 144, at 1255, 1268–69.

154 *Id.*

155 *E.g.*, J. David Cummins, Maria Rubio-Misas & Hongmin Zi, *The Effect of Organizational Structure on Efficiency: Evidence from the Spanish Insurance Industry*, 28 J. BANKING & FIN. 3113, 3136–39, 3143–49 (2004) (finding evidence for hypothesis only with respect to largest Spanish mutual).

156 Christian Biener & Martin Eling, *Organization and Efficiency in the International Insurance Industry: A Cross-Frontier Analysis*, 221 EUR. J. OPERATIONAL RES. 454, 460, 467 (2012).

157 Mayers & Smith, *Executive Compensation*, *supra* note 148.

158 Michael J. McNamara & S. Ghon Rhee, *Ownership Structure and Performance: The Demutualization of Life Insurers*, 59 J. RISK & INS. 221, 229, 236 (1992).

159 James M. Carson, Mark D. Forster & Michael J. McNamara, *Changes in Ownership Structure: Theory and Evidence from Life Insurer Demutualizations*, 21 J. INS. ISSUES 1, 12–14 (1998).

160 *See generally* Christopher O'Brien & Paul Fenn, *Mutual Life Insurers: Origins and Performance in Pre-1900 Britain*, 54 BUS. HIST. 325 (2012) (explaining evolution of mutual life insurance companies in Britain including their lower costs compared to proprietary firms); Robin Pearson, *Mutuality Tested: The Rise and Fall of Mutual Fire Insurance Offices in Eighteenth-Century London*, 44 BUS. HIST. 1 (2002) (examining factors leading to rise of fire insurance companies taking the mutual form).

161 David Mayers, Anil Shivdasani & Clifford W. Smith, Jr., *Board Composition and Corporate Control: Evidence from the Insurance Industry*, 70 J. BUS. 33, 34–35, 43–44, 56–57 (1997).

162 *Infra* section I.C.2. Hansmann's arguments build off work by other scholars working in the theory of the firm literature. Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327 (1983); Eugene F. Fama & Michael C. Jensen, *Organizational Form and Investment Decisions*, 14 J. FIN. ECON. 101 (1985).

compared to stock companies.[163] This meshes with another scholarly finding: a study shows U.K. mutual life insurers offer higher payouts for policy holders, lower cost ratios, and higher growth rates than stock counterparts.[164]

1. *The Emergence and Dominance of Mutuals in Life Insurance*

In the mid-1990s, mutual insurance companies enjoyed a share of approximately 50% of the life insurance market and 25% of the property and liability insurance market.[165] At that time, one life insurance mutual, Prudential, had assets exceeding those of any U.S. industrial corporation. Mutual life insurance companies first appeared in the United States in the 1840s. The first seven mutual companies formed in that decade remained in existence until the end of the twentieth century and were then counted among the largest mutuals. In their first decades in existence, mutual life insurance companies largely drove investor-owned corporate life insurers out of the market by writing the first long-term life insurance policies.

2. *Life-Insurance Policyholder Protection: The Importance of the Residual Claimant*

Professor Hansmann attributes the business success of mutual life insurance companies and their ability to offer these longer term contracts to the mutual form itself.[166] He explains that long term life insurance policies create a large degree of uncertainty for consumers who worry that insurance companies may not survive long enough to pay their future claims. Policyholders may die sooner than expected, the actuarial forecasts on which insurers depend may miscalculate life expectancy, and an insurance company's investments may not earn sufficient returns to pay claims. As a result, the policyholder may worry that the insurer may not retain adequate reserves to cover its expected policy payouts. If shareholders are the residual claimant of the insurance company, they may push

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163 Alexander Braun, Hato Schmeiser & Przemyslaw Rymaszewski, *Stock vs. Mutual Insurers: Who Should and Who Does Charge More?*, 242 EUR. J. OPERATIONAL RES. 875, 888 (2015).

164 *See generally* Seth Armitage & Peter Kirk, *The Performance of Proprietary Compared with Mutual Life Offices*, 14 SERVICE INDUSTRIES J. 238 (1994) (comparing proprietary mutual life insurance companies and finding mutuals perform better in average payouts on endowment policies, average cost ratios, and average growth rates).

165 HANSMANN, *supra* note 12, at 265–66.

166 *See id.* at 266–68.

management to make riskier investments to earn greater returns. This runs contrary to the interest of policyholders for conservative reserves.[167]

This under-reserving problem is addressed in the mutual form because policyholders are the residual claimant. Even if policyholders cannot realistically exercise control over management of the company, the fact that no other patron of the firm is the residual claimant reduces incentives of management to make risky investments and to under-reserve.[168] Other researchers have found that mutuals enjoy a competitive advantage in life insurance and other insurance lines with long horizon policies; longer time periods increase the risk of exploitation of policyholders by insurers.[169] The mutual form reduces the incentive to exploit policyholders who are also the residual claimants. Many mutual insurance companies advertise their mutual status and lack of shareholders as making them behave more in the interest of policyholders.[170] This logic emphasizing the importance of the residual claimant meshes with the explanation of why mutual banks and credit unions offer more consumer friendly terms to their customers.[171] When customers are the residual claimant, the firm's incentives to behave opportunistically are greatly reduced.

The status of policyholders as residual claimants explains other ways in which mutual life insurers offer policy-holders more consumer-friendly contracts. Professor Hansmann explains that life insurers face a particular adverse selection problem with writing long term policies.[172] A policyholder may stop making payments later in the term of the policy when her or his expected benefits under the policy no longer clearly exceed the premiums she or he must pay.[173] Healthy policyholders are more likely to stop paying premia and drop their policies, but less healthy customers who are more likely to trigger policy payouts will remain in the insurance company's risk pool. Corporate life insurers often respond to this risk by front-loading the premia that policyholders must pay. But

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167 *See id.*; Henry Hansmann, *The Organization of Insurance Companies: Mutual Versus Stock*, 1 J.L. ECON. & ORG. 125, 129–34 (1985) [hereinafter Hansmann, *The Organization of Insurance Companies*].

168 HANSMANN, *supra* note 12, at 269–70; Hansmann, *The Organization of Insurance Companies*, *supra* note 167, at 129–31.

169 HANSMANN, *supra* note 12; Cummins et al., *Organizational Form and Efficiency*, *supra* note 144, at 1255.

170 *E.g.*, Landes, *supra* note 16.

171 *Supra* notes 9–10 and accompanying text.

172 *See* HANSMANN, *supra* note 12, at 266–69.

173 *Id.* at 269.

locking policyholders into longer term contracts has a perverse consequence: policyholders are less likely to exit even when the insurer is behaving opportunistically toward them. Front-loading premia addresses the adverse selection problem at the cost of dulling a mechanism to discipline insurers. Mutuals, by contrast, can mitigate the adverse selection problem in an altogether different way, namely by making the policyholder the residual claimant and thus changing her or his incentives.[174] Other theoretical and empirical research attributes the success of mutual insurers to addressing adverse selection problems among policyholders.[175]

The mutual form also helped life insurers manage an additional risk—inflation risk—with long term contracts and avoid passing on this risk to policyholders in the form of higher premia. Long term insurance contracts place tremendous pressure on the business model of life insurers.[176] If the average mortality rate, the real rate of return on investments, or the rate of inflation differ from forecasts, the insurer can suffer significant losses. The inflation rate poses particular problems. If inflation rises over the term of the policy, the insurer wins but the policyholder loses as higher price levels in the economy reduce the real value of the payout. If inflation rises at a lower than expected rate, the results reverse: the policyholder receives, and the insurer makes, a higher real payout. By placing the policyholder on both sides of the transaction, a mutual insurance company obviates the need for inflation risk to be priced into the contract.

This same logic explains how mutual life insurance companies could deal with other zero-sum risks from long term contracts. Mutual life insurance companies do not need to price these risks into the contract or include hard-to-understand contractual provisions to account for these risks. Any loss to the customer as residual claimant of the firm is offset by her or

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174 *See id.* at 268–70.

175 Bruce D. Smith & Michael J. Stutzer, *Adverse Selection, Aggregate Uncertainty, and the Role for Mutual Insurance Contracts*, 63 J. BUS. 493, 504, 507–09 (1990); James A. Ligon & Paul D. Thistle, *The Formation of Mutual Insurers in Markets with Adverse Selection*, 78 J. BUS. 529, 552–53 (2005). Historical studies of insurance markets in other countries also attribute the emergence and early market share enjoyed by mutual insurers to the advantages of their organizational form in addressing adverse selection problems and unpredictability of average losses among insured parties. Mike Adams et al., *Mutuality as a Control for Information Asymmetry: A Historical Analysis of the Claims Experience of Mutual and Stock Fire Insurance Companies in Sweden, 1889 to 1939*, 53 BUS. HIST. 1074, 1075–77 (2011): Pearson, *supra* note 160;.

176 *See id.* at 270–71.

his benefit as policyholder.[177] The mutual form also addresses the severe asymmetries of information suffered by consumers in the insurance context.[178]

3. *Regulation as a Substitute for the Mutual Form*

Just as banking regulation gave assurances to depositors that banks organized as stock corporations were stable enough to be entrusted with deposits, so too did the introduction of state insurance regimes give greater assurance to policyholders that investor-owned insurance companies would not under-reserve or behave opportunistically.[179] This reduced some of the comparative advantage that the mutual form enjoyed in life insurance. Professor Hansmann traces the introduction of state insurance statutes in the 1850s and 1860s to the decline in the ratio of mutual life insurers to their corporate counterparts.

4. *Why the Mutual Form Works in Life Insurance: Costs to the Mutual Form*

Professor Hansmann attributes the success of the mutual form in life insurance to several additional factors. *First*, life insurers historically required relatively little startup capital.[180] However, the mutual form limited the ability of these firms to raise additional capital beyond attracting new policyholders or retaining earnings. As described below, the search for additional capital drove a wave of life insurers to demutualize at the turn of the twenty-first century.[181]

Second, the mutual form in life insurance benefitted from the fact that policyholders were buying relatively homogenous products. This meant the interests of the firm's residual claimants were largely aligned.[182] Although the mutual form imposes high potential agency costs—a large number of dispersed owners may be unable to effectively organize to discipline management—empirical evidence does not show a difference in average costs between stock and mutual life insurers. This may be due to the fact that shareholders of life insurance corporations also face agency costs. However, more importantly, changing the residual claimant to policyholders also ensures

177 *See id.*
178 Hansmann, *The Organization of Insurance Companies*, *supra* note 167, at 132.
179 *See* HANSMANN, *supra* note 12, at 271–72.
180 *See id.* at 273.
181 *Infra* section I.C.5.
182 *See* HANSMANN, *supra* note 12, at 273.

that management is not responsive to the demands of any other claimant. Management thus has less incentive to behave opportunistically vis-à-vis policyholders.

The benefits of the policyholder as residual claimant, however, diminish if the insurer seeks to offer multiple products, particularly products outside life insurance.[183] Less homogenous products would translate into potential greater conflicts among the interests of policyholders. The desire to offer multiple products may provide a supplementary theoretical explanation for the wave of demutualization of life insurers explained below.

5. *Demutualization Wave Among Life Insurers at the Turn of the Twenty-First Century*

At the turn of the twenty-first century, the life insurance industry experienced a wave of demutualization, with some of the largest insurers choosing to become corporations and conduct IPOs. These companies included the following:[184]

Insurance Company	**Year of Demutualization**
John Hancock	1999
Manufacturers	1999
Mutual of New York	1998
MetLife	2000
Principal	1998
Prudential	2001

Scholars attribute this wave to a number of factors, including the following:

> (1) a decline in consumer interest in life insurance products compared to growing insurance company revenue from wealth management and annuity products;
>
> (2) the ending of Glass-Steagall's prohibitions against insurance, banking, and securities businesses within the same conglomerate;
>
> (3) changes in the Internal Revenue Code that ended tax advantages for mutual insurance companies; and
>
> (4) the prospect of foreign insurance companies entering the U.S. market.[185]

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183 Hansmann, *The Organization of Insurance Companies*, *supra* note 167, at 135.

184 Lal C. Chugh & Joseph W. Meador, *Demutualization in the Life Insurance Industry: A Study of Effectiveness*, 27 REV. BUS. 10, 16 (2006).

185 *Id.* at 10.

Studies have shown that access to capital is the primary reason for insurance company demutualization.[186] This does not mean that mutuals do not have any advantages with respect to capital raising; in fact, they may have additional opportunities to raise capital during financial crises by raising premia from policyholders.[187] Other scholars found that a mix of motivations—operational efficiency, access to capital and tax advantages—drove demutualizations generally.[188] One study, however, found no efficiency gains for insurers that demutualized.[189]

6. *Size and Systemic Risk Concerns*

In addition to losing the consumer/policyholder protection benefits of the mutual form outlined above, this demutualization wave created significant systemic risk concerns. Demutualization allowed large insurance conglomerates to grow in sheer size, connectedness to other financial institutions, and importance to broader financial markets. It also may have made them more fragile and susceptible to volatility in capital markets, including via losses on the asset side of their balance sheets and dependence on short term financing on the liability side.[190]

Demutualization allowed life insurance companies to grow their size and the scope of their operations.[191] Several expanded heavily into capital markets activities, including the following:

- derivatives transactions;
- lending via repurchase agreements (repos);
- financing themselves through asset-backed securitization vehicles; and

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186 Krupa S. Viswanathan & J. David Cummins, *Ownership Structure Changes in the Insurance Industry: An Analysis of Demutualization*, 70 J. RISK & INS. 401, 412–16 (2003); Otgontsetseg Erhemjamts & Richard D. Phillips, *Form Over Matter: Differences in the Incentives to Convert Using Full Versus Partial Demutualization in the U.S. Life Insurance Industry*, 79 J. RISK & INS. 305, 307, 330–31 (2012).

187 Laux & Muermann, *supra* note 146.

188 Otgontsetseg Erhemjamts & J. Tyler Leverty, *The Demise of the Mutual Organizational Form: An Investigation of the U.S. Life Insurance Industry*, 42 J. MONEY, CREDIT & BANKING 1011 (2010).

189 Vivian Jeng, Gene C. Lai & Michael J. McNamara, *Efficiency and Demutualization: Evidence From the U.S. Life Insurance Industry in the 1980s and 1990s*, 74 J. RISK & INS. 683, 704–09 (2007).

190 For an analysis of the systemic risk posed by insurance companies, see Daniel Schwarcz & Steven L. Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHI. L. REV. 1569 (2014).

191 *Id.* at 12 (citing McNamara & Rhee, *supra* note 158, at 221–31).

- engaging in securities lending.[192]

One can see examples of the growth of these activities by comparing the annual reports of the Prudential and MetLife five years after their IPOs with the registration statements for their IPOs. The annual reports five years later include more extensive disclosure on capital market activities, including products offered to customers, investments in capital markets, and new sources of financing for the company.[193]

Prudential[194] and MetLife[195] were two of the four nonbank companies that the Financial Stability Oversight Council (FSOC) designated as "Systemically Important Financial Institutions" pursuant to its authority under the Dodd-Frank Act.[196] The FSOC cited the capital markets activities of these insurance companies in its determinations that these firms

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192 *E.g.*, FIN. STABILITY OVERSIGHT COUNCIL, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING PRUDENTIAL FINANCIAL, INC., (Sept. 19, 2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Prudential%20Financial%20Inc.pdf [https://perma.cc/CLT2-PH65] [hereinafter FSOC PRUDENTIAL DESIGNATION] (detailing risk from Prudential's derivatives, repo, and securities lending businesses among others); FIN. STABILITY OVERSIGHT COUNCIL, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING METLIFE, INC. (Dec. 18, 2014), https://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf [https://perma.cc/6USN-K6LE] [hereinafter FSOC METLIFE DESIGNATION] (detailing risks of MetLife's sponsoring and obtaining financing via securitization vehicles and securities lending).

193 *Compare* MetLife, Inc., Annual Report (Form 10-K) (Mar. 5, 2004), https://www.sec.gov/Archives/edgar/data/1099219/000095012304002912/0000950123-04-002912-index.htm [https://perma.cc/TDA7-S7S3] (detailing MetLife's 2003 financial performance, note especially the high capital markets activity), *with* MetLife, Inc. Registration Statement (Form S-1) (Nov. 23, 1999), https://www.sec.gov/Archives/edgar/data/1099219/0000950123-99-010491-index.html [https://perma.cc/JG7K-3TYC] (detailing MetLife's pre-IPO financial situation and business model); *compare* Prudential Financial, Inc. Annual Report (Form 10-K) (Feb. 28, 2006), https://www.sec.gov/Archives/edgar/data/1137774/000119312506041378/0001193125-06-041378-index.htm [https://perma.cc/F52E-572Z] (detailing Prudential's 2005 financial performance, note especially high capital markets activity), *with* Prudential Financial, Inc. Registration Statement (Form S-1) (Apr. 9, 2001), https://www.sec.gov/Archives/edgar/data/1137774/000095013001500607/0000950130-01-500607-index.htm [https://perma.cc/UUB2-YJRG] (detailing Prudential's pre-IPO financial situation and business model).

194 FSOC Prudential Designation, *supra* note 192.

195 FSOC MetLife Designation, *supra* note 192.

196 Another of the companies designated by FSOC, American International Group (AIG), was an insurance conglomerate organized as a corporation. FIN. STABILITY OVERSIGHT COUNCIL, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING AMERICAN INTERNATIONAL GROUP, INC. (July 8, 2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20American%20International%20Group,%20Inc.pdf [https://perma.cc/59W7-J4MT]. AIG was never organized as a mutual. For the origins of the American International Group, see

merited systemic designation and regulation by the Federal Reserve.[197] Although MetLife successfully challenged its designation in federal court[198] and the FSOC later chose to rescind the designations of all other companies,[199] some scholars have criticized the reasoning behind these court and agency decisions against designation and argue that large insurance conglomerates continue to pose systemic risk concerns.[200]

7. *Mutuals in Property and Liability Insurance*

One additional example from the insurance context points to the circumstances in which the mutual form may prove successful in financial services. Professor Hansmann details how the mutual form historically enjoyed success in property and liability insurance.[201] Even though some of the comparative advantages enjoyed by mutual compared to investor-owned firms in these business lines have dissipated, his analysis reveals some critical components for the market success of the mutual form. Mutuals enjoyed an advantage in providing property and liability insurance to businesses in a time in which insurance companies could not easily distinguish between the risks posed by potential policyholders. At the historical height of the mutual form in these business lines, actuarial

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RON SHELP & AL EHRBAR, FALLEN GIANT: THE AMAZING STORY OF HANK GREENBERG AND THE HISTORY OF AIG 35–39 (2nd ed. 2009).

197 FSOC Prudential Designation, *supra* note 192, at 2.

198 MetLife, Inc. v. Financial Stability Oversight Council, 177 F. Supp. 3d 219, 230–36 (D.D.C. 2016).

199 *E.g.*, FIN. STABILITY OVERSIGHT COUNCIL, NOTICE AND EXPLANATION OF THE BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING PRUDENTIAL FINANCIAL, INC. (Oct. 16, 2018), https://home.treasury.gov/system/files/261/Prudential-Financial-Inc-Rescission.pdf [https://perma.cc/J4N4-Q8SC] (justifying the decision to de-designate Prudential because the company now has a sustainable business model, capital strength, and a comprehensive risk management system); *see also* FIN. STABILITY OVERSIGHT COUNCIL, LIST OF DESIGNATIONS, https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx#nonbank [https://perma.cc/BGU4-35ZZ] (listing links to FSOC decisions to designate and rescind designations of major financial companies).

200 *See* Jeremy C. Kress, *The Last SIFI: The Unwise and Illegal Deregulation of Prudential Financial*, 71 STANFORD L. REV. ONLINE 171, 171–72 (2018), (criticizing de-designation of Prudential); *see also* Jeremy C. Kress, Patricia A. McCoy & Daniel Schwarcz, *Regulating Entities and Activities: Complementary Approaches to Nonbank Systemic Risk*, 92 S. CAL. L. REV. 1455, 1458–65 (2019) (arguing that the district court opinion in the MetLife case, the FSOC de-designation decisions, and proposed FSOC changes to designation process all impose impossible standards on designation); Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem,* 84 U. CHI. L. REV. 1813, 1851–60 (2017) (discussing effects of Dodd-Frank's FSOC designation provisions on deterring large nonbanks from engaging in activities that could pose systemic risks).

201 HANSMANN, *supra* note 12, at 276–77.

data were not available or reliable.[202] The mutual form worked because policyholders possessed greater information about their own risks; they could solve the problem of asymmetric information by screening each other for risk. This success depended on policyholders being relatively homogenous in terms of the risks for which they were being insured. Similar risks meant that the residual claimants to the firm had similar interests. Homogenous policyholders who co-existed in tightly knit communities could also address the risk of moral hazard.[203]

Mutuals in property and liability insurance were particularly attractive when policyholders could not purchase insurance in competitive markets.[204] Rather than pay less than competitive rates, businesses would band together to form a mutual. This points to an insight applicable to mutuals in financial services more generally: customers facing impaired competition provides an impetus for mutual formation.[205]

D. Common Threads Among Industries

1. *Reasons for Demutualization; Industry Dynamics*

Despite differences in their organizational forms, business models, and historical evolutions, common threads tie together the demutualization of investment banks, banks, savings and loan associations, and insurance companies. When firms abandoned the partnership or mutual form and conducted an IPO, the existing owners often reaped significant payouts.[206] The new investor-owned firms could deploy capital to expand operations and acquire other companies.[207] The acquiring firms could use their own stock as consideration for these transactions.[208] Merger and acquisitions activity, in turn,

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202 *Id.* at 277–80.

203 Other researchers have found advantages in the mutual form in terms of mitigating moral hazard among policyholders. Lena Nekby, *Pure Versus Mutual Health Insurance: Evidence from Swedish Historical Data*, 71 J. RISK & INS. 115 (2004); Bruce D. Smith & Michael Stutzer, *A Theory of Mutual Formation and Moral Hazard with Evidence from the History of the Insurance Industry*, 8 REV. FIN. STUD. 545 (1995).

204 *Id.* at 278–79.

205 Hansmann, *The Organization of Insurance Companies*, *supra* note 167, at 149.

206 Chugh & Meador, *supra* note 184, at 15.

207 *See* Karl T. Muth & Andrew Leventhal, *Mutuals: An Area of Legal Climate Change*, 9 WM. & MARY BUS. L. REV. 597, 607–10, 612 (2018) (discussing the benefits of mutualization and why a company chooses to mutualize).

208 Kimble C. Cannon & Patrick J. Tangney, *Protection of Minority Shareholder Rights Under Delaware Law: Reinforcing Shareholders as Residual Claimants and Maximizing Long-Term Share Value by Restricting Directorial Discretion*, 1995

spurred industry consolidation and the growth of megafirms.[209]

The erosion of Glass-Steagall-era legal separations among banks, securities firms, and insurance companies in the 1980s and 1990s meant that these different firms could increasingly compete with one another or join together under the umbrella of a financial conglomerate.[210] Indeed, the prospects of competition across the financial sector and industry consolidation drove financial firms to seek to raise massive amounts of capital.[211] Demutualization, industry consolidation, the disintegration of Glass-Steagall, and competition that crossed financial sectors mutually reinforced one another in powerful feedback loops. At the same time, enhanced global competition and the prospect of entering foreign markets contributed to a need for even more capital and additional waves of demutualization.[212] By the turn of the twenty-first century, demutualization and these related dynamics transformed the U.S. financial services sector. It was now dominated by large internationally active financial conglomerates that offered a full range of financial services, ranging from depository banking to traditional investment banking services (underwriting and mergers and acquisitions advice) to investment funds to insurance to derivatives to trading and beyond.[213]

2. *Compensation and Incentives; Shareholders as Residual Claimants*

Against this backdrop, demutualized corporate financial institutions could also compensate employees with stock options and restricted stock.[214] This benefitted employees who enjoyed liquid assets that could appreciate dramatically in value. This dynamic could also spark compensation races among firms. It also radically altered the incentive structure of

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COLUM. BUS. L. REV. 725, 762 (describing triangular mergers, which often involve using company stock as consideration).

209 *See generally* Nu Ri Jung, *The Present and Future of the Financial Services Industry: Convergence, Consolidation, Conglomeration, and Collaboration*, 29 QUINNIPIAC L. REV. 729, 739–43 (2011) (discussing how demutualization and corresponding mergers result in convergence, consolidation, and conglomeration in the global financial services industry).

210 Wilmarth, *Road to Repeal*, *supra* note 49, at 452–55.

211 Wilmarth, *Dark Side of Universal Banking*, *supra* note 49, at 975–81.

212 *See* Chugh & Meador, *supra* note 184, at 10–11 (describing global competition as one of several reasons for increased popularity in demutualization in the life insurance market).

213 Jung, *supra* note 209, at 739–42, 789–91.

214 Chugh & Meador, *supra* note 184, at 11.

a firm's employees. Employees who could liquidate their ownership claims in public markets were less tightly tied to a firm and its financial future.[215] This raised agency costs and dulled employee incentives to mitigate the risk-taking and protect the reputation of their employers.[216]

Moreover, managers and employees of demutualized firms were now responsive to a new residual claimant—investors in public markers—rather than partners, depositors, or policyholders.[217] Lynn Stout argued extensively that corporations need not pursue a shareholder wealth maximization norm and that they could take into account the interests of other stakeholders.[218] Nevertheless, even if managers could take into account a wide set of values, various structures encouraged them to focus on stock prices.[219] Stock-based compensation, combined with the prospect of proxy fights and takeovers, meant that managers and employees of corporate financial firms placed significant focus on short term stock prices.[220] This focus can come at the expense of depositors, borrowers, policyholders, or consumers. These incentives also slant in favor of increased financial institution risk-taking, including the kind that led to failures and bailouts of financial firms during the global financial crisis.

II
MUTUALIZING RISK ACROSS THE FINANCIAL INDUSTRY: COMMUNITIES OF FATE AND CLEARINGHOUSES

Colossal financial institution failures during the global crisis and the severe costs they inflicted on taxpayers and the economy prompted Professor Saule Omarova to write her *Wall Street as Community of Fate* article. Failures of certain entities also prompted Congress to write into the Dodd-Frank Act (i) requirements that derivatives be centrally cleared; and (ii) provisions regulating the entities that conduct this central clearing

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215 Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 414–16 (2006) (describing the shareholder right of transferability and its implications).

216 *See* 2 WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2096.10 (Callaghan & Co. 1917) (explaining these agency costs as a consequence of the separation of ownership and control).

217 *See id.* §§ 837.50, 848 (describing how a corporate director's fiduciary duties flow to the shareholders and corporation and not to each other).

218 LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 2–4, 27–29 (2012).

219 *Id.* at 19–21.

220 *See generally id.* at 63–69 (describing the reasons for the overemphasizing of short-term results and stock prices).

as market utilities.[221] However, the governance structures of these modern clearing companies have changed radically in recent years. Professor Saguato explores how the demutualization of clearing companies allows profit-motivated shareholders to increase the risk-taking of these entities with potentially dramatic consequences for the financial institutions that use them and for financial markets writ large.[222] Both Professor Omarova and Professor Saguato explore how mutual entities collectively owned by financial institutions can make the financial sector more stable and reduce the incidence and severity of financial crises.[223]

A. Communities of Fate

In *Wall Street as Community of Fate*, Saule Omarova proposes creating new self-regulatory mechanisms for the financial sector that would address the increasingly complex financial products and activities of contemporary financial institutions.[224] This complexity and the globalized nature of financial institutions means government regulators constantly struggled to adapt their rules and supervision.[225] Instead of relying on regulators to compete in an arms race, Professor Omarova advocates new self-regulatory structures.[226] She describes the comparative advantage of private firms in identifying and regulating risk thus:

> Private industry actors may be in the best position to identify and understand underlying trends in the increasingly complex financial markets and to gather and analyze, in real time, information most relevant to systemic risk management. Unconstrained by matters of formal jurisdiction, private firms are also better equipped to monitor and manage their activities and risks on a global basis as an integrated economic enterprise. Leveraging this unique position of private firms to control and regulate systemic risk in global financial markets can add to ongoing efforts to strengthen the government's regulatory framework and create market-based incentives for more prudent financial conduct.[227]

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221 *See* Saguato, *supra* note 7, at 609–13 (describing Dodd-Frank provisions governing central clearing of derivatives).

222 *Id.* at 642–46.

223 *See id.* at 604, 647–48; Omarova, *supra* note 4, at 474–75.

224 Omarova, *supra* note 4, at 438–39, 474–75.

225 *Id.* at 436–37.

226 *Id.* at 490–91.

227 *Id.* at 418–19.

Professor Omarova's ideas look back to the old self-regulatory functions that U.S. stock and commodities exchanges played in capital markets before they themselves demutualized in the first decade of the twenty-first century.[228] Her proposals also recall the old function of clearinghouses, such as the New York Clearinghouse. Founded early in the nineteenth century as a central counterparty for banks to clear checks and settle financial accounts with one another, the New York Clearinghouse evolved into a kind of proto-central bank.[229] In response to a series of banking panics in the middle of that century, the Clearinghouse developed a regime by which it would make emergency loans to member banks facing a liquidity shortfall. Borrowing banks would pledge securities as collateral for the loans. The risk of the borrowing bank failing was thus mutualized among all banks that were clearinghouse members. This system gave assurances to depositors and other creditors of member banks that their loans enjoyed backup liquidity.[230] The clearinghouse pulled together member banks behind a collective veil. Creditors could not tell if individual banks faced a liquidity crisis, but did not care as the collective security provided by the clearinghouse sufficed to calm market nerves. This helped stave off or mitigate the severity of bank runs.[231]

The creators of the Federal Reserve System modeled its own "lender of last resort" function after the New York Clearinghouse.[232] The founding of the nation's central bank in 1913 rendered this function of the Clearinghouse largely obsolete. As with Professor Hansmann's theory of bank regulation undermining the competitive advantage of mutual banks,[233] public intervention in the area of emergency liquidity provision to banks also hollowed out the usefulness of a private sector organizational form as a regulatory tool.

However, flash forwarding almost a century to the global financial crisis, the Federal Reserve found its own emergency lender of last resort functions outdated. Large nonbanks that performed bank-like functions suffered their own liquidity crises. Similarly, various capital markets, including securitization, repurchase agreement (repo), asset-backed commercial

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228 *See* Karmel, *supra* note 5, at 368–70.

229 *See* Gorton, *supra* note 6, at 278–81 (describing the clearing house as "an organized market—a single location where exchange between banks occurred").

230 *Id.* at 279–82.

231 *Id.* at 277.

232 *See id.* (noting that the Federal Reserve System "was simply the nationalization of the private clearinghouse system").

233 HANSMANN, *supra* note 12, at 255.

paper, and money market mutual funds, had come to offer bank like functions; they transformed illiquid assets into theoretically highly liquid and low risk investments that institutional investors used as the equivalent of large deposit accounts. However, losses on mortgage-related investments caused investors to flee these markets and fire sales to begin. These markets—which some scholars have collectively called the "shadow banking system"—in effect suffered shadow banking runs.[234] The Federal Reserve creatively interpreted its emergency lending authority under the Federal Reserve Act to lend to non-banks and develop novel "liquidity facilities" to provide liquidity to these capital markets.[235] However, upset with "bailouts" of the financial industry, Congress curbed the ability of the Federal Reserve to take these actions in the future.[236]

Just as failures of public regulation raise the prospect of reviving the use of alternative organizational forms for individual banks and insurance companies, so too do the shortcomings of central banks as prudential regulators and liquidity providers of last resort call for reexamining a possible role for the old clearinghouses. These revived clearinghouses would differ drastically from the derivative clearinghouses created under the Dodd-Frank, which create a central intermediary for derivatives trading.[237] Instead, new financial industry clearinghouses could provide emergency liquidity to nonbanks or to capital markets that engage in liquidity transformation and are thus subject to the risk of bank run dynamics. Like the nineteenth-century clearinghouses, this type of organization would gather together financial institutions participating in these

234 *See, e.g.*, Gary Gorton & Andrew Metrick, *Securitized Banking and the Run on Repo*, 104 J. FIN. ECON. 425, 428 (2012) (noting that repo and other short-term debt experienced runs during the financial crisis); Gary Gorton, Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007, at 14 , Nat'l Bur. Econ. Res. Working Paper (May 9, 2009) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1401882 [https://perma.cc/3KKZ-JJ4L] (describing the "shadow banking system" as combining repurchase agreements "with securitization . . . to accomplish the same function for firms [as traditional banking systems]").

235 Christian A. Johnson, *Exigent and Unusual Circumstances: The Federal Reserve and the US Financial Crisis*, *in* LAW REFORM AND FINANCIAL MARKETS 269, 287 (Kern Alexander & Niamh Moloney eds. 2011).

236 *Id.* at 299–303.

237 For analyses of the roles played by the derivatives clearinghouses mandated by Dodd-Frank, see Adam J. Levitin, *The Tenuous Case for Derivatives Clearinghouses*, 101 GEO. L.J. 445, 446–47 (2013); Yesha Yadav, *The Problematic Case of Clearinghouses in Complex Markets*, 101 GEO. L.J. 387, 391–92 (2013).

markets. Each member would agree to contribute capital to a fund which could then be used for:

> (a) emergency loans to members suffering a liquidity shock;
>
> (b) guarantees to investors purchasing instruments in a frozen capital market; or
>
> (c) direct purchases of those instruments by the clearinghouse to unfreeze the market.

These functions mirror the Federal Reserve and Treasury Department interventions in 2008 and 2009 during the global financial crisis. They also mimic the classic government interventions to stave off any banking crisis: emergency loans from a lender of last resort, deposit insurance, and central bank open market operations.[238]

This new clearinghouse would not have the statutory jurisdictional limits faced by the Federal Reserve. This solution would put the onus for monitoring and governing the risk-taking of firms on the clearinghouse and its members. These parties enjoy an informational advantage over government regulators in terms of understanding financial products and activities, their risks, and the way these products, activities, and risks evolve over time. Moral hazard could be mitigated by the fact that each clearinghouse member would bear part of the risk of its activities. Members would also worry about reputational loss for violating clearinghouse rules. Reputational loss can be fatal in the banking industry, as confidence in a bank's credible commitment to meet short term obligations is integral to its survival.[239] Members could impose the informal sanctions of refusing to conduct business with firms that flout rules or externalize too much risk on the clearinghouse.

B. Clearinghouses and the Clearing of Securities and Derivatives

Professor Saguato examines the modern clearinghouse, which is similar but distinct from the nineteenth-century banking clearinghouses described by Gorton. Instead of mutualizing risk industrywide in the midst of a bank panic,[240] the modern clearinghouse or clearing company facilitates the

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238 ERIK F. GERDING, LAW, BUBBLES, AND FINANCIAL REGULATION 454 (2014) (describing government crisis interventions in the shadow banking system as akin to traditional government interventions in bank runs); Kathryn Judge, *The First Year: The Role of a Modern Lender of Last Resort*, 116 COLUM. L. REV. 843 (2016).

239 *See generally* Julie Andersen Hill, *Regulating Bank Reputation Risk*, 54 GA. L. REV. 523, 539 (2020) (examining bank run risk).

240 *See* Gorton, *supra* note 6, at 279–82.

clearing and settlement of securities and derivative trades.[241] By interposing itself as a central counterparty to all financial trades made on a given securities or derivatives exchange, a modern central clearing company reduces the risk that a party to any particular trade will suffer financial losses should the buyer or seller on the other side become insolvent.[242] The clearing company assumes counterparty risk. It protects itself by seeking to offset risks from multiple trades against each other and monitoring the risk of all traders that use its services (who are called "members").[243] The clearing company requires that members limit their trading risk exposure to the clearing company, post collateral to secure their settlement obligations to the clearinghouse, and contribute to a guaranty fund to protect the clearinghouse from losses when a member defaults on a trade.[244]

Professor Saguato explains how clearing companies became a centerpiece of post-crisis financial reform, including the landmark Dodd-Frank Act. He draws attention to a less understood trend: the demutualization of a large number of securities and derivatives clearinghouses.[245] He argues that this demutualization comes at significant cost. Investor-owned clearinghouses face strong pressure to take on more risk to earn greater returns for shareholders.[246] This increases the risk for clearinghouse members and ultimately for global financial markets who would suffer massive but uncertain losses should a clearinghouse fail.[247] Professor Saguato locates this risk in specific consequences of clearinghouse demutualization, namely the transfer of control rights and residual claims to shareholders and away from users/members. This transfer has perverse consequences, as it is the users/members who bear a higher degree of risk of clearinghouse failure.[248]

He outlines several potential policy responses, all of which involve remutualizing control of a clearinghouse and the risk of clearinghouse failure. These policies seek to give control rights over the clearinghouse to the parties that bear the greatest risk for a clearinghouse's losses. Professor Saguato outlines the advantages and drawbacks of multiple policy approaches in-

241 Saguato, *supra* note 7, at 604–12, 623–24.
242 *Id.* at 604–05.
243 *Id.* at 618–22.
244 *Id.* at 618–22.
245 *Id.* at 625–30.
246 Saguato, *supra* note 7, at 635.
247 *Id.* at 630–32.
248 *Id.* at 641–42.

cluding the following: requiring clearinghouses to remutualize; imposing additional liability on shareholders of an investor-owned clearinghouse; and creating hybrid governance structures to split control rights between shareholders and members.[249]

C. Mutual Insurance for a Financial Sector

Professors Omarova and Saguato consider a similar kind of problem: how to insure against widespread financial institution failure and systemic risk in important financial markets. Their proposals resemble one another in that both look to mutualize risk among firms in a crucial segment of the financial services industry. Professor Hansmann might have predicted their conclusions when he wrote about the advantage of the mutual form in insurance in bearing industrywide risks. Professor Hansmann writes:

> To the extent that the average loss level of an industry cannot be accurately predicted, an insurance company writing property or liability insurance for that industry will bear risk that it cannot reduce by writing a large number of policies. Such industrywide risk may be more efficiently borne by the firms in the industry than by an investor-owned insurance company. Although the potential variation in industrywide losses may be large as a proportion of expected earnings for a company insuring the industry, they are likely to be much smaller relative to the earnings of the industry itself. A mutual company has the advantage that it eliminates those risks that are idiosyncratic to individual firms within the industry, while it passes back, pro rata, to all firms in the industry the risk of variance in the overall loss experience of the industry as a whole.[250]

Mutualizing risk among financial firms does not necessarily obviate the need for government regulation though. Whether by mistake or intention, financial firms within a mutual could increase the overall magnitude or correlation of their collective risk-taking to a degree that would imperil financial markets and the broader economy.[251] Government oversight of industry-wide mutuals thus remains crucial.

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249 *Id.* at 659–65.
250 HANSMANN, *supra* note 12, at 280.
251 Levitin, *supra* note 237, at 451.

III
POLICY INSTRUMENTS

If alternative organizational forms can once again become powerful tools to limit excessive financial institution risk-taking, police market conduct and protect consumers, and promote access to credit and financial services, the question becomes how to promote the use of these forms. Before answering this question, it is helpful to summarize the different organizational forms discussed above. The following table lists for each organizational form, the policy values the form promotes and any related "remutualization" proposals advanced by legal scholars:

MUTUAL FIRMS, POLICY CONCERNS, AND PROPOSALS

Old Mutual Firm	**Concern Addressed**	**Contemporary Mutual Proposal**
Investment Banks as Partnerships	Excessive risk taking/systemic risk; exploiting customers; law breaking	Personal liability commitments for individual investment bankers (Painter and Hill)
Credit unions and banking cooperatives	Excessive risk-taking and insolvency; market conduct/consumer financial protection; access to credit.	
Mutual insurance companies	Market conduct; consumer financial protection; access to insurance (Hansmann)	
Bank clearinghouses	Systemic risk; insuring against bank panics	Financial industry self-regulation/ "Communities of Fate" (Omarova); Derivatives clearinghouses organized as mutuals (Saguato)

A. The Limits of Private Ordering

One approach to encouraging the use of these organizational forms and promoting remutualization would be to rely upon private ordering on the theory that firms organized as partnerships or mutuals would accrue reputational benefits.

For example, use of the partnership or mutual form might send a clear signal that the firm does not behave opportunistically with respect to its customers. Private ordering is indeed the approach advocated by some legal scholars, such as Professors Claire Hill and Richard Painter in their proposal for "covenant banking."[252] They advocate a series of off-the-rack contractual provisions that investment banks could use to impose personal liability on crucial, well-compensated employees.[253] Professors Hill and Painter believe that firms that opt into this contractual regime will benefit by sending a clear signal to their creditors, investors, and customers that the firm's most important personnel stand behind the firm's actions.[254] This credible commitment would signal that the firm can be trusted to make prudent decisions, guard its solvency, and avoid fines for opportunistic behavior vis-à-vis customers.

The evidence that private ordering alone will suffice is, however, weak. Investment banks have not opted for increased personal liability for their employees. There is scant evidence that insurance companies or banks are converting back to the mutual form. The one piece of evidence that market forces might play a small role came in the 2011 "Bank Transfer Day" and "Dump Your Bank Day" protest actions organized by consumer groups and the Occupy Wall Street movement.[255] In encouraging customers of large banks to move their deposits to smaller community banks and credit unions, these groups did enjoy a measure of success. In October 2011, 650,000 customers joined credit unions, more than the number who joined in all of 2010. That same year, Bank of America sparked consumer outrage with a new $5 debit card fee, and, in the one-month period afterwards, approximately $4.5 billion in deposits moved from large banks to U.S. credit unions. However, economists saw these developments as largely symbolic given the vast number of accounts and deposits still held by large financial conglomerates.

Private ordering alone is unlikely to trigger a shift to partnership and mutual forms for several reasons. First, reputa-

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252 HILL & PAINTER, *supra* note 3, at 8.

253 *See generally id.* at 149–64 (describing the features of different specific covenant forms).

254 *See id.* at 164–65 (arguing that "many private actors who have a stake in and interact with banks should benefit from a covenant banking regime.").

255 Gloria Goodale, *Bank Transfer Day: How Much Impact Did It Have?*, CHRISTIAN SCI. MONITOR (Nov. 7, 2011), https://www.csmonitor.com/USA/Politics/2011/1107/Bank-Transfer-Day-How-much-impact-did-it-have [https://perma.cc/MF9P-EWCA].

tion may not adequately discipline large financial conglomerates because these firms operate in markets that are far from competitive. For example, the high degree of market concentration, particularly in underwriting and advisory services, derivatives, trading, and other specialized investment banking businesses, dulls the negative competitive impact on an investment bank from scandals, including those involving allegations that the bank acted opportunistically against customer interests.[256]

Second, private ordering alone is unlikely to yield the optimal use of partnership and mutual organizational forms for the same reasons that markets fail to produce optimal levels of systemic risk, consumer protection, and consumer access to financial services in the first place. Market failures pervade financial services. For example, systemic risk arises when the failure of one of more banks or other financial institutions has severe negative spillover effects on other firms, entire financial markets, or the larger economy.[257] The parties impacted cannot adequately protect themselves via contract or investment diversification. Banks and other financial firms thus do not bear the full cost of their risky investments and their financial failure. It is unlikely that market forces alone will push these firms toward an organizational form that internalizes and reduces this systemic risk.

Similarly, market forces may not produce an optimal level of consumer protection given that consumers suffer from asymmetric information[258] and behavioral biases.[259] These dynamics impede consumers from choosing products that offer the lowest overall cost and highest benefits and leave them prone to hidden fees and other costs.[260] Given the limits to consumer financial decision-making, financial firms that chose

256 *See, e.g.*, Emilie R. Feldman, *A Basic Quantification of the Competitive Implications of the Demise of Arthur Andersen*, 29 REV. INDUS. ORG. 193, 208–09 (2006) (concluding that the Department of Justice punishment of Enron's Arthur Andersen only "maintain[ed] competition . . . in the already-concentrated accounting industry").

257 Kaufman & Scott, *supra* note 14, at 371–72.

258 HANSMANN, *supra* note 12, at 276–77.

259 Bubb & Kaufman, *supra* note 11, at 39.

260 *See, e.g.*, *id.* (describing how firms can take advantage of biased consumers with contracts offering incentives, but also generating greater payments); HANSMANN, *supra* note 12, at 228 (noting that, as a result of asymmetric information, customers may be "in a peculiarly poor position to determine, with reasonable cost or effort, the quality or the quantity of the services they receive from a firm").

mutual forms to attract customers may not enjoy socially optimal results.

B. Tax Subsidies

Tax policy provides one vehicle to subsidize mutual companies providing this access. In addition, tax preferences for investment banks organized as partnerships and banks and insurance companies organized as mutuals can promote the use of these organizational forms. Tax preferences can subsidize not only wider consumer access but also the other policy benefits offered by these types of organizations: reducing systemic risk and promoting consumer protection. Although tax scholars routinely object to the use of taxation as an instrument for new policy objectives,[261] remutualization is closely connected to traditional tax policy concerns for two reasons.

First, many mutual banks and lenders historically enjoyed tax breaks because they were organized as nonprofit or quasi-non-profit entities.[262] Likewise, historically, the Internal Revenue Code contained tax preferences for mutual insurance companies.[263] These tax preferences for life insurers were reduced in 1959,[264] and their elimination at the end of the twentieth century provided an impetus for the wave of demutualization described above.[265] Restoring these tax advantages would be justified by the benefits that mutual banks and insurance companies provide in terms of more consumer-friendly financial products and greater consumer access. In many respects, these benefits make these mutual entities more like nonprofit entities than their for-profit/investor-owned counterparts.

Second, the reduction in systemic risk that comes with the partnership and mutual form also argues for tax preferences. Reductions in the systemic risk caused by financial firms that are organized as partnerships or mutual companies translates into lower spillover costs imposed on financial markets and the macroeconomy.[266] It also means a lower impact on the public

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261 *See, e.g.*, *Hearing on "Tax: Fundamentals in Advance of Reform" Before the S. Comm. On Finance*, 110th Cong. 9–10 (2008) (statement of Jason Furman, Senior Fellow and Director of the Hamilton Project, The Brookings Institute) (asserting that the concept of tax neutrality, the notion that taxes should be levied without regard for policy goals, is widely accepted in principle).

262 HANSMANN, *supra* note 12, at 244.

263 *Id.* at 275.

264 *Id.* at 275–76.

265 HANSMANN, *supra* note 12 and accompanying text.

266 *See generally* Kaufman & Scott, *supra* note 14, at 373 (noting that a firm may reduce loss by examining the risk that other similarly situated market participants face).

fisc. This results not only from the reduced need for government interventions to rescue failing firms and frozen financial markets, but also from avoiding the losses to government revenue during financial crises. Reduced impacts on the government fisc justifies lower tax rates for investment banks organized as partnerships and banks and insurance companies organized as mutuals compared to their respective counterparts that are organized as corporations.

C. Regulatory Preferences

Policymakers can also grant regulatory preferences to partnerships and mutually owned financial companies to lower the regulatory "tax rate" on these firms. Of course, a lower regulatory tax on these firms operates as a regulatory tax premium on firms organized as corporations. Regulatory preferences might offer the most desirable policy approach for encouraging remutualization.

Regulatory preferences should ideally come in the policy area in which the partnership or mutual company outperforms their corporate counterparts. For example, to the extent that investment bank partnerships pose less systemic risk than corporate firms, they can and should be subject to lighter prudential regulations such as lower regulatory capital requirements and lower leverage requirements. Activities restrictions, such as the Volcker Rule prohibition on proprietary trading,[267] could also be relaxed for these investment banks. Investment bank partnerships would face internal rather than external disincentives to take excessive risks.

One of the advantages of using the organizational form as a regulatory tool is that it may offer greater social benefits or reduced social costs compared to traditional financial regulations. As noted in Part IV below, by creating structures for liability and control and by redefining the residual claimant, the organizational form transforms the incentives of the firm's owners, management, and employees. These changed incentives require less government-imposed process-based compliance rules. Historically, this logic prompted financial

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267 Jeff Merkley & Carl Levin, *The Dodd-Frank Act Restrictions on Proprietary Trading and Conflicts of Interest: New Tools to Address Evolving Threats*, 48 HARV. J. LEGIS. 515, 515 (2011) (offering rationale for Volcker Rule provisions of the Dodd-Frank Act).

regulators to grant more favorable regulatory treatment to mutually owned companies.[268]

In several circumstances, policymakers not only should grant regulatory preferences to partnerships or mutual companies, but they may be under a statutory mandate to do so. For example, the Federal Deposit Insurance Company Improvement Act requires that the Federal Deposit Insurance Company base the premia it charges for deposit insurance on the specific risk level of a bank failing.[269] If depositor-owned banks pose less of a risk of failure,[270] then they should pay less for deposit insurance.

Regulatory preferences do pose a measurement challenge. Policymakers must determine the level of reduced systemic risk, enhanced consumer protection, or wider consumer access that a particular organizational form offers compared to corporate entities. However, this measurement challenge is by no means insurmountable, and it already permeates all of financial regulation. Moreover, empirical data on the policy benefits offered by particular organizational forms, such as reduced failure rates by mutual banks and savings and loan associations compared to investor-owned counterparts,[271] provides a starting point for analysis.

D. Deferred Prosecution Agreements and Civil Settlements by Regulators

Policymakers can use more direct means to encourage remutualization. In the last two decades, deferred prosecution agreements in criminal cases[272] and settlement agreements in civil lawsuits brought by regulators[273] have become important

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268 *See* Hansmann, *supra* note 42, at 135–38 (exploring the historical record of the mutual form).

269 *See supra* note 59 and accompanying text.

270 *See supra* note 10 and accompanying text.

271 *See id.*

272 *See generally* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 38–68, 228 (Anthony S. Barkow & Rachel E. Barkow eds., 2011) (describing the positive shift in government use of deferred prosecution agreements (DPA) as a means of incentivizing structural change toward compliance amongst corporations); *see also* Rachel E. Barkow, *The New Policing of Business Crime*, 37 SEATTLE U. L. REV. 435, 457–60 (2014) (noting that DPAs have become a pillar of white-collar criminal enforcement in recent decades).

273 The 2003 settlement among regulators (including the New York State Attorney General and the SEC) and ten investment banks imposing new rules on stock analyst practices at those firms represented a landmark in using civil settlements by regulators to impose new rules on the financial firms. For a description of the settlement, see Stephen Labaton, *Wall Street Settlement: The Overview; 10 Wall Street Firms Reach Settlement in Analyst Inquiry*, N.Y. TIMES (Apr. 29, 2003),

regulatory tools. Prosecutors and regulatory agencies have used these agreements to impose new legal requirements on financial institutions albeit via contract rather than by statute or rulemaking.[274] Prosecutors or agencies might use this power to require a financial institution accused of breaking the law to convert to an alternative organizational form.

There is a certain symmetry to this use of prosecutorial or civil regulatory power. For example, an investment bank facing serious accusations of defrauding customers might be required to convert to a partnership on the theory that that organizational form better aligns the firm's incentives with those of customers. Similarly, a large bank accused of widespread abuses of depositors or borrowers might be required to mutualize given evidence that that organizational form better protects consumers.

Requiring conversion or mutualization is a drastic remedy, but much financial institutions malfeasance is drastic. Fines, even when they total billions of dollars, might simply represent the cost of doing business for large financial conglomerates.[275] Using the organizational form to restructure a firm's incentives would save prosecutors or regulators from having to monitor compliance compared to settlements that impose new governance processes or procedures. The public would have greater assurance that the settlement would fundamentally alter a firm's incentives rather than represent a weak and ephemeral compromise.[276] This type of condition could constitute a sig-

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https://www.nytimes.com/2003/04/29/business/wall-street-settlement-overview-10-wall-st-firms-reach-settlement-analyst.html [https://perma.cc/4AYQ-48CV].

Detailed mandates for compliance programs have now become a routine and central part of civil settlements between regulators and financial firms (as well as nonfinancial firms). *See* Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2086–91 (2016). The history of civil settlements mandating compliance programs dates to well before the global financial crisis or the Enron scandal. *Cf.* F. Joseph Warin & Jason S. Schwartz, *Corporate Compliance Programs as a Component of Plea Agreements and Civil and Administration Settlements*, 24 J. CORP. L. 71, 73–83 (1998) (exploring historical case examples of civil settlements leading to compliance programs).

274 PROSECUTORS IN THE BOARDROOM, *supra* note 272, at 75–76.

275 *E.g.*, Peter J. Henning, *Guilty Pleas and Heavy Fines Seem to Be Cost of Business for Wall St.*, N.Y. TIMES DEALBOOK (May 20, 2015), https://www.nytimes.com/2015/05/21/business/dealbook/guilty-pleas-and-heavy-fines-seem-to-be-cost-of-business-for-wall-st.html [https://perma.cc/NNR8-G6VT] (documenting criminal and civil settlements in which financial conglomerates are repeat offenders).

276 For a magisterial empirical analysis and critique of the effectiveness of prosecutorial settlements with financial and other corporations, see BRANDON L. GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS (2014).

nificant improvement over the successful prosecution of financial firms. As the Arthur Andersen indictment in the Enron scandal demonstrates, criminal prosecution could lead to the demise of firms, which might reduce competition in already oligopolistic industries.[277]

E. Promoting Clearinghouses

Selecting appropriate policy tools to mutualize systemic risk via clearinghouses presents particularly thorny questions. Centralizing systemic risk may exacerbate the "too-big-to-fail" problem and heighten rather than lessen reliance on the government safety net.[278] However, the systemic risk posed by shadow banking markets, sketched out in Part II above, demands to be addressed. Bank-run dynamics in repo and other wholesale funding markets, asset-backed securities markets, and any other capital markets that perform liquidity or maturity transformation remains a persistent, pervasive, and significant threat to financial stability. Policymakers and scholars have urged action to reduce reliance by banks and financial conglomerates on these markets as a source of funding.[279] This might be accomplished through a mix of regulatory restrictions and Pigouvian taxes on bank leverage or financial transaction taxes. Consistent with the regulatory preference approach outlined above, these regulations or taxes might be lightened in the case of entities and activities that are subject to a clearinghouse's support and are governed by the clearinghouse's rules.

This might be combined with explicit prohibitions on the government safety net extending to a clearinghouse (and certainly to firms and markets not covered by the clearinghouse) of the kind Congress placed in the Dodd-Frank Act. However, that sort of statutory restriction may not represent a fully credible commitment. Faced with a massive financial crisis, a future Congress might conclude it has no attractive option other

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277 *See* Elizabeth K. Ainslie, *Indicting Corporations Revisited: Lessons of the Arthur Andersen Prosecution*, 43 AM. CRIM. L. REV. 107, 107–110 (2006) (criticizing prosecution of accounting firm); Feldman, *supra* note 256, at 205–09 (estimating competitive impact of firm leaving auditor market).

278 Concerns with centralizing systemic risk have animated numerous critiques of the other form of clearinghouse—the institutions that centralize the clearing and settlement of derivatives trades. *See, e.g.*, Levitin, *supra* note 237, at 458–61, 463–65 (analyzing the comparative critique of OTC derivatives).

279 *See* Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at Ass'n of American Law Schools 6 (June 6, 2014), https://fraser.stlouisfed.org/files/docs/historical/federal%20reserve%20history/bog_members_statements/tarullo20140609a.pdf [https://perma.cc/RX9S-TNWB].

than to relax the restriction. Moreover, policymakers might search for creative workarounds. On the other hand, should the restriction effectively bind the government, it might remove any effective intervention to stave off a full-blown financial crisis. These sorts of dilemmas argue for proceeding with extreme caution with any efforts to mutualize risk in a clearinghouse.

A successful clearinghouse or any mutualization of systemic risk among financial firms would not obviate the need for government involvement and regulation. The prospect of financial firms collectively using a clearinghouse to externalize systemic risk on the government in a game of chicken means that regulators must closely oversee the internal rules the clearinghouse uses to govern the risk-taking of its members.[280] Indeed, when advocating for mutualizing systemic risk among financial conglomerates and transforming Wall Street into a "community of fate," Professor Omarova used the U.S. Securities and Exchange Commission's approach to self-regulatory organizations as a model.[281] These organizations pass and enforce rules to govern member financial firms, but their decisions are subject to review by the SEC.[282]

F. Less than Full Remutualization: Hybrid Forms

Policymakers might conclude that financial institutions should enjoy some of the benefits of investor-owned corporations, including the enhanced ability to raise large amounts of capital. Policymakers might then choose to promote financial institutions taking hybrid forms. For example, investment banks owned by investors might require key employees to hold a large collective "partnership" stake. Some investment banks, such as Goldman Sachs, did just this: they chose to retain at least some elements of partnership compensation and nomenclature even after they converted to a corporation and conducted an IPO.[283]

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280 This too has clear parallels with derivatives clearinghouses. Scholars have argued that derivatives clearinghouse can successfully reduce systemic risk only with robust rules, such as position limits and margin requirements, that limit the clearinghouse's exposure to member firms. Levitin, *supra* note 237, at 454–56, 460–64.

281 Omarova, *supra* note 4, at 483–86.

282 *Id.* at 417–18.

283 Susanne Craig, *How Goldman Makes (and Unmakes) Its Partners*, N.Y. TIMES (Sept. 12, 2010), https://dealbook.nytimes.com/2010/09/12/how-goldman-makes-and-unmakes-its-partners/ [https://perma.cc/KR7J-7VYN] ("When it was private, the partners were the owners, sharing in the profits, and in some cases having to put in money to shore up losses. To retain that team spirit as a public company, Goldman continued to name partners.").

Professors Hill and Painter criticize Goldman Sachs for breaking laws and taking advantage of clients throughout their book.[284] This underscores the messiness of hybrid forms. If policymakers pursue a hybrid approach, they should specify off-the-rack forms with carefully designed control rights, liability mechanisms, and residual claims. The potential for gamesmanship of hybrid forms and conflicts among various stakeholders reduces the attractiveness of attempts to split the baby of organizational entity choice. There is considerable value in assigning clear ultimate control rights, liability, and residual claims to a single group.

IV
CRITIQUES AND COMPARATIVE ADVANTAGES OF REMUTUALIZATION

Promoting remutualization—the shift toward investment banks as partnerships and banks and insurance companies as mutual companies—faces potential challenges and raises potential objections beyond the question of designing appropriate policy instruments. This Part IV examines several potential downsides to remutualization, but it concludes that the use of organizational form—partnerships and mutual companies—as a tool of financial regulation offers numerous comparative advantages vis-à-vis traditional financial rules.

Returning to Professor Hansmann's framework, the optimal organizational form would minimize the sum of the following: (i) market contracting costs for nonowner patrons of a firm; and (ii) ownership costs for those patrons who are the firm's residual claimants.[285] This Article has thus far largely focused on evidence of the benefits of mutual forms in terms of reducing the risk that financial institutions will:

- take excessive risk, fail, and generate spillover costs for customers, counterparties, and financial markets;
- exploit customers and consumers; or
- break laws or engage in misconduct.

If a firm's clients, customers, and counterparties or participants in broader financial markets are not owners of the firms,

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284 *See, e.g.*, HILL & PAINTER, *supra* note 3, at 100–05 ("To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money.").

285 *See* HANSMANN, *supra* note 12, at 48 (discussing both costs of market contracting and costs of ownership).

they would face difficulties in contracting with firms in the market to reduce these risks.

However, the other side of the ledger must also be considered. Subpart IV.A below considers the costs of ownership associated with partnerships, mutuals, and cooperatives. Subparts IV.B and IV.C then examine whether owners of these alternative forms could really oversee large and complex modern financial firms. Subpart IV.D outlines the comparative advantages to the organizational form as a regulatory tool relative to other traditional forms of financial regulation. Subpart IV.E briefly looks at the impact of organizational form on institutional culture within a firm. Subpart IV.F examines other potential public costs that come with economic clubs, namely anticompetitive and discriminatory behavior.

A. The Costs of Ownership for Partnerships, Mutuals, and Cooperatives (and the Comparative Benefits of Investor-Owned Corporations)

The costs of ownership of a firm include: agency costs/the costs of mitigating managerial opportunism; costs of reduced diversification for owners; and costs of raising capital. Each of these is examined below in turn.

1. *Agency Costs/Managerial Opportunism*

Demutualization in the financial services sector from the 1970s onwards coincided with a rising concern in elite academic, policymaking, and business circles about agency costs in the U.S. economy.[286] Converting partnerships and mutuals to investor-owned corporations, aligning the incentives of corporate management with shareholders, and promoting shareholder wealth maximization became dominant legal and economic policy norms.[287] Partnerships, mutuals, and cooperatives may appear at first blush to have a comparative disadvantage to investor-owned corporations in terms of mitigating management opportunism. Shareholders in corporations have

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286 The agency cost lens for analyzing business associations reached new prominence with Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); *see also* Carson et al., *supra* note 159, at 17 ("[D]emutualization may be motivated by attempts to control associated agency costs . . .").

287 *Supra* notes 135–40 and accompanying text. *See generally* HANSMANN, *supra* note 12, at 35–38, 40 (providing historical and analytical framework for changes in organizational form); HILL & PAINTER, *supra* note 3, at 105–06 (providing historical context for investment banks switching from partnerships to public corporations).

greater ability to discipline management by selling shares and exiting the firm, and corporations can pay managers in stock. Partnerships, mutuals, and cooperatives create structural obstacles to owners entering and exiting firms.[288] Owners also face daunting collective action problems in monitoring and controlling management. However, Professor Hansmann argues that agency costs concerns are partially mitigated by the identity of the residual claimant of partnerships, mutuals, and cooperatives. Management of these firms may shirk but they have less incentive to exploit owners because there is no other residual claimant—particularly no profit-motivated capital providers—to favor.[289] As noted above, evidence from mutual insurance companies does not indicate that mutual firms underperform compared to investor-owned firms in terms of prices offered to consumers or other financial metrics.[290]

2. *Diversification*

The ownership stake of partnerships, mutuals, and cooperatives represents a bundled financial interest. Partnership stakes essentially combine an investment of capital with an investment of labor (i.e., an equity ownership stake *plus* an implicit salary).[291] Owners of a bank or insurance mutual receive an ownership stake bundled together with one or more financial products (e.g., a bank deposit, access to credit and payments services, or an insurance policy).[292] Members of a mutualized financial clearinghouse possess an equity stake coupled with rights to access the clearinghouse's platform.[293] Were these interests to be decoupled, these respective stakeholders could still receive the respective financial product or service, but invest their capital in other financial assets. However, because these various interests are bundled, the owners of these different firms incur an opportunity cost, particularly a

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288 *E.g.*, UNIF. PARTNERSHIP ACT §§ 402, 701 (1997), https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=D4bd53b5-0e2a-d71e-6d84-66a26e296324&forceDialog=0 [https://perma.cc/LX32-S7Y8] (describing model law provisions governing admission and disassociation of partners). Obtaining an ownership stake a mutual insurance company requires purchasing a policy, and surrendering or cancelling that policy ends that ownership relationship. *About Mutual Insurance Companies*, NAT'L ASSOC. MUTUAL INS. COS., https://www.namic.org/about/mutuals [https://perma.cc/R8RB-FHCH] (last visited Nov. 15, 2019).

289 HANSMANN, *supra* note 12, at 273.

290 *Supra* notes 163–74 and accompanying text.

291 Hansmann, *Ownership of the Firm*, *supra* note 42, at 292–96 (describing economics of investment bank partnerships and other "worker-owned" firms).

292 *See* HANSMANN, *supra* note 12, at 269–70.

293 Saguato, *supra* note 7, at 647–48.

lost opportunity to diversify their investment portfolio.[294] This particular cost of ownership inheres with the traditional partnership, mutual, or cooperative form.

3. *Costs of Raising Capital/Capital Needs*

The more important benefits that come with an investor-owned corporation—and the costs that come with the partnership, mutual, or cooperative form—relate to the ability to raise significant amounts of capital.[295] The question then becomes for what purposes is the additional capital made possible by the corporate form actually used.

As noted above, demutualization enabled capital to be raised for investments in technology. Some of this technology benefitted the clients and customers of a demutualized firm. Some technological investment was necessary for financial firms to survive.[296] Yet scholars have asked trenchant questions regarding how much of technological innovation by financial institutions in the last four decades has yielded a net social benefit. Much investment in technology may have represented wasteful arms races that increased and camouflaged financial institution risk-taking, systemic risk generation, and consumer exploitation.[297]

Demutualized firms also used capital to compete and restore eroded profit margins. Financial institutions, such as investment banks, switched to the corporate form as regulatory changes reduced their profit margins and induced them to enter riskier business lines.[298] However, whether these changes in the business models of financial firms represented a net social gain proves debatable. Demutualization may have added unnecessary fuel to the competitive bonfire in which financial institutions pushed one another to take greater risk, at the expense of customers and taxpayers. Financial firms sought capital to compete firms in the same financial sector, in other financial sectors, or across borders. Demutualization in each of investment banking, banking, and insurance may have created a competitive spiral which drove more risk-taking and more demutualization within industries. We should be cautious about whether efforts to remutualize the industry can

294 HANSMANN, *supra* note 12, at 281–82.
295 *See* Viswanathan & Cummins, *supra* note 186, at 415–16.
296 *Supra* notes 80–85 and accompanying text.
297 For a magisterial consideration of the purposes, benefits, and costs of new technologies and innovation in financial services, see CRISTIE FORD, INNOVATION AND THE STATE: FINANCE, REGULATION, AND JUSTICE (2017).
298 *Supra* notes 86–93 and accompanying text.

completely reverse transformational changes in banking, investment banking, and insurance.[299]

These transformational changes had ostensible benefits.[300] They resulted in financial conglomerates that could cross-sell products to consumers. In addition to having the capital to acquire firms in other financial sectors, investor-owned corporations do not face a structural impediment to selling a range of financial products that mutuals do. As noted above, mutual banks and insurance companies thrive when owners have homogenized interests. A mutual that offers a range of products and services would have a heterogeneous set of residual claimants with conflicting interests.[301] Furthermore, larger investment banks, banks, and insurance companies could achieve economies of scale and diversify risk, whereas investment bank partnerships and bank and insurance mutuals face constraints on their growth.[302]

However, a dark side exists to all these benefits enjoyed by investor-owned financial firms. Financial institutions may face increased conflicts of interest when operating different business lines and selling different products to customers and clients.[303] Larger size translates into more severe systemic consequences when a firm fails. At the extreme, large financial conglomerates create "too-big-to-fail" concerns.[304] The flip side of diversification across asset classes and financial markets is the creation of transmission lines for financial contagion: losses suffered by financial firms in one market can spread to other markets.[305] Conglomerates also create opportunities for subsidiaries to improperly transfer government guaranties and

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299 For an overview of this transformation, see Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215.

300 *See id.* at 223.

301 *Supra* notes 23–25 and accompanying text.

302 HANSMANN, *supra* note 12, at 278–82.

303 Arthur E. Wilmarth Jr., *Conflicts of Interest and Corporate Governance Failures at Universal Banks During the Stock Market Boom of the 1990s: The Cases of Enron and Worldcom*, *in* CORPORATE GOVERNANCE IN BANKING: A GLOBAL PERSPECTIVE 97 (Benton E. Gup ed., 2007).

304 *E.g.*, GARY H. STERN & RON J. FELDMAN, TOO BIG TO FAIL: THE HAZARDS OF BANK BAILOUTS (2004) (discussing the nature and costs of, and solutions to, "too big to fail" concerns).

305 Erik F. Gerding, *Bank Regulation and Securitization: How the Law Improved Transmission Lines Between Real Estate and Banking Crises*, 50 GA. L. REV. 89, 124–25 (2015).

subsidies to one another, leaving taxpayers ultimately responsible for the firm's risk-taking.[306]

In sum, whether the constraints on capital raising that come with alternative entity forms represents a net social cost or a benefit is not clear cut. This calculation depends on judgments on the social costs and benefits of how financial firms have deployed the additional capital that they raised thanks to demutualization. Enhanced technology, competition in new lines of business, and conglomeration are not unalloyed goods.

B. Complexity and Information

In an investment bank partnership, changing the residual claimant alone may not be enough to curtail excessive risk-taking. A partner may conclude that her or his personal expected benefits from a risky transaction may outweigh her or his expected share of the partnership's liability from that transaction. The partnership may thus need to impose not only indemnification provisions on partners to protect itself from the actions of individual partners, but also systems for partners to monitor and control each other's behavior.

This leads to another potential concern, namely whether these systems would work in modern financial conglomerates which have a wide array of business lines that are often global in scope. It might be unrealistic to expect even sophisticated investment bankers using modern tools of risk management to monitor and understand other business lines, which might be conducted in far-flung offices in any number of jurisdictions, in detail sufficient to detect excessive risk-taking or misconduct.

This concern is mitigated by several factors. If this concern applies to investment bank insiders, it applies doubly to regulators charged with supervising and examining firms. The question is not whether the organizational form addresses market failures in an absolute sense, but rather whether it is an improvement on other policy approaches. Inside partners possess comparative advantages over outside regulators in several respects. These include better access to information on the firm, the ability to vet new hires closely, and a range of informal mechanisms to police each other's conduct based on social relationships.[307]

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306 Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C. L. REV. 1683, 1753–55 (2011).

307 HILL & PAINTER, *supra* note 3, at 96–97.

C. Regulating Size

Moreover, if the members of an investment bank partnership are uncomfortable with the risks posed by the size and complexity of a modern investment banking firm, they may elect to simplify the firm. This applies equally to mutual banks or insurance companies. Smaller firms with less opaque and complex operations may pose less of a risk for the partners as well as less systemic risk. More broadly, remutualization can address concerns with the size and complexity of financial firms, including the "too-big-to-fail" problem. If the conversion of investment banks, mutual banks, and insurance companies to publicly held corporations turbocharged the ability of these firms to raise capital, acquire other firms, and expand operations globally, then reverting to the older organizational form would throw this process into reverse. Partnerships and mutual companies will not be able to attract new equity owners as easily. Prospective partners in an investment bank may be concerned about liability exposure. Mutual companies can attract new equity only by signing new customers.

Remutualization offers several comparative advantages over other solutions to limit the size of financial institutions. It avoids thorny questions of defining the appropriate metric for measuring inappropriate size and drawing the line for what constitutes "too big." No legal rules limiting or taxing size also mean no industry gamesmanship of those rules. Remutualization also obviates the need for costly litigation to break up conglomerates.

D. The Comparative Advantage of Organizational Form as Regulatory Tool

This same logic explains the comparative advantages that the use of alternative organizational forms—partnerships, mutual companies, and cooperatives—enjoys over other forms of financial regulation more generally. The organizational form acts structurally, by changing incentives of firms internally rather than through external pressure. It reorders the organic relationships among different patrons or constituencies of a firm. As a regulatory tool, the organizational form does not require specifying the precise favored or disfavored conduct to be subject to a formal legal rule. It likewise requires neither specifying the desired level of conduct (e.g., the level of firm risk-taking, the cost of financial products to consumers, or the level of consumer access to financial services) nor the level of a regulatory tax. Accordingly, it is less subject to regulatory arbi-

trage than traditional forms of prudential and consumer financial regulation. Managers have less incentive to exploit loopholes because the entity form embeds changed incentives into the very structure of legal relationships within the firm. The organizational form relies on the informational advantages of equity owners or managers over government regulators in making decisions on desirable levels of risk-taking and consumer protection.

The organizational form also has advantages over compliance regimes. As a regulatory tool, alternative organizational forms do not require determining whether particular procedures will achieve a substantive policy result or monitoring whether those procedures are being followed. Instead, it creates a set of relationships among owners and managers using liability rules, control mechanisms, and residual claimants. Owners and managers can then craft more particularized governance structures and make decisions between themselves.

The use of partnerships and mutual companies also has advantages over other corporate governance-based proposals for financial reform.[308] These organizational forms do not require experiments with creating new fiduciary duties for managers of the firm or new beneficiaries of fiduciary duties. Moreover, questions in corporate law abound on the effectiveness of fiduciary duties in performing their crucial current role in mitigating agency costs in the management-shareholder relationship. These questions would only multiply should the scope of fiduciary duties be expanded to include reducing systemic risk or serving other stakeholders. Effective use of corporate fiduciary duties to address financial regulatory concerns such as systemic risk would require rethinking core corporate law doctrines, such as the business judgment rule, in fundamental ways. Corporate governance solutions might also require resolving conflicting interests of different stakeholders in an investor-owned corporation.

Professors Hill and Painter are not alone among legal scholars in proposing new liability regimes to curb financial institution risk-taking and misconduct. For example, some scholars have proposed reforms that would impose additional

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308 *See generally* David Min, *Balancing the Governance of Financial Institutions*, 40 SEATTLE U. L. REV. 743 (2017) (surveying corporate governance-based proposals to mitigate systemic risk posed by banks). For one example of a proposal that would impose new duties on management, see Steven L. Schwarcz, *Misalignment: Corporate Risk-Taking and Public Duty*, 92 NOTRE DAME L. REV. 1, 22 (2016) (advocating imposing a "public governance" duty on management of financial institutions in addition to fiduciary duties).

losses or liability on executives or shareholders in the event of a bank's insolvency.[309] The use of partnership and mutual forms, however, relies not only on control or personal liability mechanisms, but, moreover, on changing the identity of the residual claimant. The identity of the residual claimant plays a powerful but subsurface role in changing the incentives within the firm.

E. The Importance of Culture

The organizational form not only changes the incentives within the firm—the cost-benefit analysis conducted by owners, managers, and employees—it can also change the firm's culture. Indeed, this cultural dynamic lies at the core of the analysis of Professors Hill and Painter on the consequences of the shift in the investment banking industry from partnerships to publicly traded corporations. They make a compelling case that the partnership structure either created or reinforced a culture of prudent risk-taking and elevating client interests.[310] Reverting to partnerships and mutual companies, with the liability rules, control mechanisms, and different residual claimants that come with those organizational forms, could foster the restoration of these older social norms. It is important to temper expectations, however, on how dramatically or quickly a firm or industry's culture or norms can change.

F. Clubs, Competition, and Exclusion

Partnerships, mutuals, and cooperatives represent forms of economic clubs. These differ markedly from investor-owned corporations with respect to ease of entry. The price of admission to ownership of a publicly traded corporation is the price per share. By contrast, alternative entity forms may have elab-

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309 *E.g.*, Peter Conti-Brown, *Elective Shareholder Liability*, 64 STAN. L. REV. 409, 428 (2012) (proposing scheme in which bank shareholders would have option of either reducing firm leverage or assuming liability for bank failure); Richard Ridyard, *Toward a Bank Shareholder-Orientated Model: Using Double Liability to Mitigate Excessive Risk-Taking*, 2 UCL J.L. & JURIS. 141 (2013) (advocating return to earlier historical rules in which bank shareholders are liable upon bank insolvency for twice their capital contribution); James Si Zeng, *Internal and External Shareholder Liability in the Financial Industry: A Comparative Approach*, 37 REV. BANKING & FIN. L. 285 (2017) (surveying post-crisis legal rules that directly or indirectly increase shareholder liability for financial institutions).

A large number of other proposals would address systemic risk by creative changes to the forms of compensation for financial institution executives. *See, e.g.*, Wulf A. Kaal, *Contingent Capital in Executive Compensation*, 69 WASH. & LEE L. REV. 1821 (2012) (proposing paying executives in debt that would convert into equity upon trigger event linked to firm's deteriorating financial health).

310 HILL & PAINTER, *supra* note 3, at 95–101.

orate mechanisms to restrict entry of new owners.[311] This has social benefits when owners who would take excessive risks, exploit customers, or break laws are kept out of the firm. However, exclusion may also occur for anticompetitive or discriminatory reasons.[312] Alternative organizational forms, such as mutuals, flourish when members have homogenous interests.[313] Unfortunately, some alternative organizational forms have also perpetuated unacceptable kinds of homogeneity among members. Entity forms could serve as vehicles for discrimination. For example, investment bank partnerships depended upon and cultivated deep social relationships both among partners and between partners and clients. Historically, the "old boys club" of investment bank partnerships fostered exclusion based on gender, ethnicity, race, and religion.[314] Policymakers may need to monitor the practices of financial industry partnerships, mutuals, and cooperatives for troubling exclusionary practices. Of course, investor-owned corporations can also engage in anticompetitive or discriminatory behavior.[315]

G. Reinforcing Reputational Markets from the Inside Out

The decline of concern with firm reputation hastened the demise of alternative entities such as investment banking partnerships, and the switch to investor-owned corporations, in turn, further diluted the importance of firm reputation.[316] The decline of the valuation of, and investment in, firm reputation had dire systemic consequences. Jonathan Macey makes a compelling case that this decline contributed to waves of financial scandals and crises.[317] Traditional financial regulation

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311 These restrictions survive even in investment banks that have abandoned the partnership form but retain some of the vestiges of partnerships. *See, e.g.*, Craig, *supra* note 273 ("[B]ecoming a partner at Goldman Sachs is considered the equivalent of winning the lottery . . . [and c]andidates are judged on many qualities, primarily their financial contribution to the firm.").

312 Saguato, *supra* note 7, at 649 (discussing anticompetitive concerns associated with member-owned clearinghouses).

313 *Supra* notes 34, 182–83 and accompanying text.

314 HILL & PAINTER, *supra* note 3, at 77–78, 89.

315 *See, e.g.*, Caroline Hudson, *BofA Agrees to Pay $4.2M in Discrimination Probe*, CHARLOTTE BUSINESS JOURNAL (Sept. 30, 2019), https://www.bizjournals.com/charlotte/news/2019/09/30/bofa-agrees-to-pay-4-2m-in-discrimination-probe.html [https://perma.cc/433Z-6PZ2] (discussing Bank of America's decision to pay $4.2 million after the U.S. Department of Labor found the bank engaged in hiring discrimination).

316 *Supra* notes 116–36 and accompanying text.

317 JONATHAN R. MACEY, THE DEATH OF CORPORATE REPUTATION: HOW INTEGRITY HAS BEEN DESTROYED ON WALL STREET (2013).

may prove an unwieldy tool to restore the value of reputation among financial firms.[318] Organizational forms provide a tantalizing alternative. Instead of regulating reputation from the outside in, recreating older relationships among stakeholders—for example, partners in an investment bank—works from the inside out. The entity form provides a vessel that can restore the value of firm reputation. This vessel possesses the governance mechanisms and incubates the institutional culture necessary for that reputation.

CONCLUSION

Pushing investment banks back toward partnerships, banks and insurance companies back toward the mutual form, and industrywide entities toward mutualization may promote important and elusive goals of financial policy. These forms of remutualization may further objectives of reducing the following: financial firm risk-taking; the probability and severity of financial firm failure; the systemic risk and other spillover costs posed by firm failure; the exploitation of consumers, customers, and clients; and the breaking and bending of financial laws and the commission of other misconduct. In short, alternative entities can reduce the market contracting costs of important stakeholders of the firm.

It is important to highlight at the end of this Article the broader social goals that alternative entities do and do not promote. At the same time, it must be underscored how many benefits of promoting alternative entity forms can be realized even if existing financial firms do not convert. This Article ends by outlining several market, regulatory, and political dynamics that may create an opening for remutualization.

A. "Corporate" Social Responsibility

There are limits to what remutualization can accomplish. First, the benefits to remutualization outlined in this Article come only in traditional areas of concern for financial regulation. Investment banks as partnerships and banks and insurance firms as mutually owned companies serve one or more of the traditional objectives of financial regulation: mitigating systemic risk, protecting consumers, and promoting access to financial services. At first blush, it is not clear that remutualization would necessarily put business entities in ser-

318 Morrison & Wilhelm, *Trust, Reputation, and Law*, *supra* note 79, at 400–01, 412.

vice to the environmental and social goals and the wider set of stakeholders that were the focus of much of Lynn Stout's scholarship.[319] Making business entities more prosocial in these ways will need to wait for scholarship from others inspired by her work. These scholars might explore ways to make an even broader set of stakeholders residual claimants of a firm.

B. Conversion Not Required: Shifting Capital and a Diversified Ecosystem

Remutualization will not prove a panacea for traditional objectives of financial regulation; it will not address all concerns with systemic risk, market conduct and consumer protection, and consumer access. Tax and regulatory preferences will not induce all investment banks to convert to partnerships or all banks and insurance conglomerates to mutualize. Investment bank partnerships and mutually owned banks and insurance firms may still take excessive risks and exploit customers.

Even if not a panacea, remutualization would still make financial markets more stable, safer for consumers, and more accessible. Part of the value of remutualization lies in the diversification of the universe of financial institutions. Financial regulations and tax rules that favor alternative organizational forms may have value beyond causing investor-owned firms to remutualize. Indeed, the greatest benefit of these rules may come in encouraging capital and customer business to flow away from investor-owned corporations and toward financial institutions organized as partnerships, mutuals, or cooperatives. It might thus diminish the size of the herd of financial institutions taking excessive risk, exploiting consumers, or committing misconduct. A more diverse ecosystem of financial institutions would expand the choices available to consumers and the competitiveness of financial services markets. Greater market share for financial entities with alternative organizational forms might reduce the number of firms participating in future industry herding into speculative investments. This will leave a larger segment of the market high and dry when the herd reverses and financial crisis returns. Greater diversity might also reduce the number of firms seeking to bend financial laws (via regulatory arbitrage) or break them altogether and

319 *E.g.*, STOUT, *supra* note 218, at 2–4, 27–29 (outlining Stout's attack on shareholder primacy and contrasting stakeholders).

thus relieve competitive pressure on other companies to follow a race-to-the-bottom.

Diversification also allows for more experimentation and promotes a wider set of values. Scholars such as sociologist Marc Schneiberg have made a compelling case for the benefits of a diverse set of organizational forms for business, including cooperatives.[320] Schneiberg argues for promoting a resurgence of cooperatives to promote regulatory experimentation, create new markets and improve existing ones, foster competition, and promote sustainable economic development.[321] Promoting cooperatives and similar organizational forms enhances local control of financial institutions and makes these firms more responsive to consumer and community needs.[322]

C. Access

Some alternative entity forms—particularly mutuals, cooperatives, and nonprofit banks—might expand access to credit and financial services for poorer communities.[323] Over the nineteenth and twentieth centuries, various forms of mutually owned and cooperative banks also dramatically expanded access to bank savings vehicles and bank credit.[324] Indeed, expanded access was one of the primary reasons that mutual banks, savings and loans (building and loans), and credit unions were created.[325]

As mutual banks and other lenders declined, so did this access. The effects of the shift away from mutually owned banks and savings and loans on access to banking is complex. The existence of fewer mutually owned and cooperative financial institutions dedicated to providing access to lower income customers doubtless may have had a significant impact. How-

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320 *E.g.*, Marc Schneiberg, *Toward an Organizationally Diverse American Capitalism? Cooperative, Mutual, and Local, State-Owned Enterprise*, 34 SEATTLE U. L. REV. 1409, 1422–31 (2011) (making a historical argument for the value of cooperatives as an organizational form of business).

321 *Id.* at 1431–34.

322 Marc Schneiberg, *Organizational Diversity and Regulatory Strategy in Financial Markets: Possibilities for Upgrading and Reform*, 18 N.C. BANKING INST. J. 141, 160–65 (2013).

323 MEHRSA BARADARAN, HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY 64–80, 85–90, 94–101 (2015) [hereinafter BARADARAN, HOW THE OTHER HALF BANKS] (describing history of credit unions, savings and loan associations, building and loan (or thrift) banks, Morris banks, and industrial loan companies in lending to the poor).

324 HANSMANN, *supra* note 12, at 259.

325 For a history of the introduction of these different entities and how they promoted access to credit, see BARADARAN, HOW THE OTHER HALF BANKS, *supra* note 323, at 64–80, 85–90.

ever, some scholars have argued that mutually owned and cooperative lenders also deemphasized providing banking services to lower income customers in favor of pursuing the higher margins associated with a wealthier middle-class clientele.[326] Together, these dynamics contributed to crisis of the unbanked and underbanked in America lacking access to affordable savings, payments, and credit products.[327]

Enhanced consumer access to financial services may have characteristics of quasi-public goods, meaning market forces alone may underprovide this access. Consumers who are unbanked or underbanked or who lack access to credit, savings, insurance, and payments services at reasonable costs cannot fully participate in the economy and face barriers to full social and political participation as a result.[328] This can be particularly true for African American and other racial and ethnic communities that suffered de jure and de facto discrimination.[329] Indeed, scholars have documented the gradual but pronounced decades-long shift of mutual banks and credit unions away from serving low-margin, low income communities.[330] This suggests not only that private ordering is insufficient to cause an optimal number of banks and insurance companies to choose the mutual form for purposes of providing socially optimal levels of financial access, but also that mutual firms may need additional regulatory preferences or subsidies in order to provide—and have these preferences conditioned upon providing—financial services to low-income and underserved communities.

D. A Ripe Moment for Remutualization?

Four dynamics may make this a moment ripe for remutualization.

First, an anticompetitive environment in certain financial markets might induce market consumers to create their own mutuals or cooperatives. The largest financial conglomerates enjoy tremendous market power in crucial financial markets

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326 *Id.* at 90–94.

327 *Id.* For a germinal analysis of the problem of poor Americans lacking access to banking services, see Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 134–40 (2004).

328 *See* Barr, *supra* note 327, at 123–25 (describing the barriers preventing many low-income individuals from accessing the mainstream financial and the ramifications of that lack of access).

329 MEHRSA BARADARAN, THE COLOR OF MONEY: BLACK BANKS AND THE RACIAL WEALTH GAP 4–6 (2017).

330 BARADARAN, HOW THE OTHER HALF BANKS *supra* note 323, at 146.

such as derivatives dealing.[331] Many policymakers and scholars decry restricted competition among banks and other financial institutions,[332] whereas a few see it as complementary to goals of financial stability.[333] One thing is clear: impaired competition creates conditions ripe for consumer cooperatives. Faced with monopolistic or limited competition among producers, consumers have strong incentives to form cooperatives to reduce their welfare loss and create a substitute for an imperfect market.[334]

Second, regulatory failures may undermine one of the historic reasons for the rise of investor-owned corporations at the expense of mutual. Looking back in history, the first comprehensive legal and effective federal and state regimes regulating banking and insurance undermined the competitive advantage enjoyed by mutual firms in those industries. Bank depositors and insurance policyholders could then rely on regulation to ensure the solvency of those respective financial institutions and to reduce opportunism by management. The relative importance of the organizational form as a regulatory tool was thus diminished.[335] By contrast, at this historical moment, the effectiveness of regulation in constraining the risk-taking of financial institutions remains shrouded by doubt. Accordingly, the regulatory use of alternative organizational forms may be primed for a comeback.

Doubts about government regulatory regimes meshes with a *third* dynamic that creates conditions ripe for remutualization: the widespread public distrust of large banks and financial conglomerates and of corporations in general has not abated since the end of the global financial crisis. The measured success of the Bank Transfer Day/Dump Your Bank Day movements, while not enough to alter radically the market share in favor of credit unions,[336] does highlight the political

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331 Dan Awrey, *Complexity, Innovation, and the Regulation of Modern Financial Markets*, 2 HARV. BUS. L. REV. 235, 266, 277 (2012).

332 *E.g.*, Brett Christophers, *Banking and Competition in Exceptional Times*, 36 SEATTLE U. L. REV. 563, 570–72, 574–75 (2013) (linking competition concerns to the "too-big-to-fail problem").

333 Prasad Krishnamurthy, *George Stigler on His Head: The Consequences of Restrictions on Competition in (Bank) Regulation*, 35 YALE J. REG. 823, 848–52 (2018).

334 HANSMANN, *supra* note 12 at 126; RICHARD B. HEFLEBOWER, COOPERATIVES AND MUTUALS IN THE MARKET SYSTEM 10–12, 25–31 (1980); Henry Hansmann, *Cooperative Firms in Theory and Practice*, 1999 FINNISH J. BUS. ECON. 387, 389–90; Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 889–94 (1980).

335 Schneiberg *supra* note 320, at 1425–28.

336 Goodale, *supra* note 255 and accompanying text.

attractiveness of cooperatives and mutuals. This political dynamic could support efforts either to restore the old tax advantages and regulatory preferences enjoyed by financial institutions organized as mutuals or to create new ones. It could also support regulatory preferences for the older, conservative model of investment banks as partnerships. Social movements promoted earlier historical waves of mutualization in finance and other sectors.[337] Future social movements could channel public antipathy toward financial conglomerates and corporations toward support for remutualization.

Fourth, the current political climate might incubate a deep public affinity for cooperatives, mutuals, and partnerships. These organizational forms not only promote traditional goals of financial regulation, they may also reflect traditional, communitarian values in which risk is mutualized and borne by the parties that create it, governance is shared, and a greater number of institutions are ultimately owned by their employees or the customers they serve.

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337 Marc Schneiberg, Marissa King & Thomas Smith, *Social Movements and Organizational Form: Cooperative Alternatives to Corporations in the American Insurance, Dairy and Grain Industries*, 73 AM. SOC. REV. 635, 638–42 (2008); Marc Schneiberg, *Organizational Heterogeneity and the Production of New Forms: Politics, Social Movements and Mutual Companies in American Fire Insurance, 1900–1930*, *in* SOCIAL STRUCTURE AND ORGANIZATIONS REVISITED VOL: 19, 39 (Michael Lounsbury & Marc J. Ventresca eds., 2002).