Rethinking Endogenous Legal Change: How Organizations Re-Shaped Glass-Steagall*

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June 16, 2012

Abstract

This article develops a strategic and interest-based framework to describe how organizations shape the content, meaning, and effects of the laws that govern their actions. Prior work has demonstrated the endogenous nature of legal change by examining how organizational responses to ambiguous legislative mandates can become institutionalized and accepted by courts as legitimate indicators of compliance. Although these studies have generated insights about how organizations influence the law, the institutional pathways examined in this literature represent only one of many sources of legal endogeneity. This article offers a substantial reconceptualization of legal endogeneity that includes a broader set of both strategic and institutional processes. The authors identify three strategies by which organizations actively seek to alter stable legal environments and produce endogenous change. First, organizations take advantage of the flexibility inherent in any system of rules to *reinterpret the law*. Second, organizations engage in new activities not covered by existing rules, and thus *innovate around the law*. Third, organizations *engage legislatures* to change existing laws or propose new ones. We identify and explore these strategies through an analysis of the slow demise of the separation of commercial and investment banking established in the Glass-Steagall Act of 1933.

Keywords: regulation, law, legal change, finance, Glass-Steagall, Gramm-Leach-Bliley

Word Count: $\sim 21,000$, including all text, tables, figures, footnotes, and references

*Both authors contributed equally to this work. Support for this article was provided by a grant from the Rackham School of Graduate Studies at the University of Michigan. We thank Mark Mizruchi, Jason Owen-Smith, Greta Krippner, Sandy Levitsky, Sara Soderstrom, Fred Wherry, Sarah Quinn, Rob Jansen, Fabio Rojas, Chloe Thurston, Kevin Young, Lindsay Owens, Andrew Schrank, Marty Hirschman, members of the Comparative and Historical Methods and the Economic Sociology Workshops at the University of Michigan, and audiences at the American Sociological Association (Las Vegas) and Society for the Advancement of Socio-Economics (Madrid) Annual Meetings for helpful feedback on previous drafts. Max Milstein provided excellent legal research assistance. E-mail: funk@umich.edu or dandanar@umich.edu.

1 Introduction

Social scientists have long questioned the ability of formal legal institutions to bring about changes in practices and behaviors (Edelman 1992; Rosenberg 1991; Sunstein 1994; Sutton et al. 1994; Sutton and Dobbin 1996; Short and Toffel 2010). Although legislatures and courts can control the text of the law, sociological perspectives argue that the law's behavioral consequences are determined locally and informally, within communities and between individuals (Halliday and Carruthers 2009; Merry 1988; Engel 1980). Within this tradition of research, scholars have drawn on insights from institutional and organizational theory to demonstrate that private-sector organizations "mediate the impact of law on society" (Edelman 1992: 1531; Albiston 2005). Many laws act through organizations, and thus organizations' interpretations of the law are consequential for the real impact of the law on individuals (Dobbin et al. 1993; Sutton et al. 1994; Konrad and Linnehan 1995; Kelly 2003). Recent extensions of this literature have demonstrated how organizational responses to legal ambiguity not only influence the impact of laws, but also have the potential to shape the content and meaning of laws that govern those organizations. Works drawing on this legal endogeneity perspective have shown how courts adopt organizational practices and incorporate them into legal standards of compliance (Edelman et al. 1999; Talesh 2009; Edelman et al. 2011). Although existing research on legal endogeneity has proved a useful starting point for understanding subtle feedback mechanisms through which organizational actions alter the law, we argue that this research has largely overlooked organizations' overt, strategic actions aimed at shaping formal legal institutions.

For an example, consider the history of the Glass-Steagall Act of 1933. Passed in the wake of the financial crisis that precipitated the Great Depression, Glass-Steagall forced the separation of commercial and investment banking. During a series of hearings on misdoings on Wall Street, Ferdinand Pecora revealed how certain banks had misused their position as commercial banks to push individuals to invest in products sold by their investment banking arms. The Glass-Steagall Act ended those practices by forcing bankers and brokers to legally separate. In the mid-1930s, banks complied with the law by interpreting Glass-Steagall's many provisions and separating their activities accordingly.

So far, nothing in this story conflicts with the existing perspectives on law and organizations. But, more than forty years later, commercial banks began an all-out assault on Glass-Steagall. They lobbied Congress and various regulatory agencies to relax or eliminate Glass-Steagall's provisions. Simultaneously, commercial banks created new products not foreseen by Glass-Steagall that put them in direct competition with investment banks, and in doing so changed the effects of the law. After winning a series of smaller victories, commercial banks convinced investment banks and insurance companies to join together to promote the repeal of Glass-Steagall, and in 1999 Congress passed the Gramm-Leach-Bliley Act to do just that. Drawing on the case of Glass-Steagall, we argue that scholars of law and organizations need a dramatically expanded understanding of legal endogeneity to make sense of the manifold ways in which organizations strategically shape the laws governing their behavior.

We extend the concept of legal endogeneity to bring into focus the active strategies organizations use to alter their legal environments. Although prior work has looked at how organizations bring about endogenous legal change by studying organizational responses to exogenous instability in their legal environments, our focus is on the more deliberate and strategic efforts of organizations to alter the legal landscape even during times when these legal environments are otherwise relatively stable. We draw on Fligstein and McAdam's (2011) conceptualization of overlapping "strategic action fields" to theorize the conditions under which organizations would actively seek to upset a stable legal environment. Here, the end sought by organizations is not compliance and shelter from liability; rather, the ultimate goal is to change the effects of standing laws or to craft new legislation. When organizations succeed at achieving these goals, they produce endogenous legal change. Beyond the institutional feedback described in existing research, we identify three strategies by which organizations actively alter the law and its interpretation and enforcement. First, organizations take advantage of the flexibility inherent in any system of rules to *reinterpret the law*, often by lobbying regulatory agencies. Second, organizations engage in new activities not covered by existing rules, and thus *innovate around the law*. Third, organizations *engage legislatures* to change or repeal existing laws or propose entirely new legislation. We illustrate these strategies using the history of the fall of Glass-Steagall.

The remainder of the paper is organized as follows. First, we review the legal environments perspective dominant in organizational theory and highlight the absence of work on the strategies used by organizations to shape the law. We then discuss the factors that might lead an organization to upset an otherwise stable legal environment, and thus set endogenous legal change into motion. Next, we explicate the three organizational strategies discussed above, which we suggest can serve as useful heuristics for understanding the efforts of organizations to shape the law. We then turn to the history of Glass-Steagall to show how commercial banks made use of these three strategies in their struggle to end the separation of commercial and investment banking. This case is valuable not only because it represents a clear instance of endogenous legal change, but also because of the prominent role that the repeal of Glass-Steagall and financial deregulation more broadly have played in many narratives about the global financial crisis of 2008.[1] We close with a discussion of the novel implications that follow from making organizational strategies for shaping the law an analytical focus, some implications for the history of financial deregulation, and suggestions for future research.

2 Rethinking Endogenous Legal Change

2.1 Legal Environments

Existing work on legal endogeneity extends an earlier tradition of law and organizations research that emphasized the central role of private firms in interpreting and implementing new laws (Albiston 2005; Dobbin et al. 1993; Edelman 1990, 1992; Konrad and Linnehan 1995; Sutton et al. 1994). Though we acknowledge the valuable insights produced by this tradition, we suggest that contemporary work has only considered one narrow pathway to endogenous legal change, what we term "institutional feedback." Here, we begin with a brief summary of the institutional approach to legal environments. We then discuss the key findings and limitations of extant scholarship on endogenous legal change to motivate the introduction of our strategic and interest-based conceptualization of endogeneity.

[1] See Suárez and Kolodny (2011), for example. We tend to agree with the Financial Crisis Inquiry Commission (2011), which minimizes the causal role of the repeal of Glass-Steagall in creating the conditions for the recent crisis, while emphasizing other failures of financial regulation (such as the non-regulation of derivatives, discussed below).

Contemporary research demonstrates the importance of legal environments for understanding the relationship between law and organizations (Albiston 2005; Edelman 1990, 1992; Edelman et al. 2001; Heimer 1999; Sutton and Dobbin 1996; Sutton et al. 1994). Legal environments encompass formal legislation, regulative mandates, and court rulings, in addition to cultural interpretations of the law and normative expectations about the appropriate steps to compliance. These interpretations and expectations, which are collectively developed by members of a common organizational field, are often more consequential for understanding organizational behavior than the actual text of the law. When new laws are ambiguous and the proper means of compliance are unclear, organizations look to legal professionals and peer organizations in their external environments for legitimate ways to comply (Dobbin and Kelly 2007; Edelman et al. 2001; Haveman 1993; Edelman 1992). These field-wide efforts to reduce environmental uncertainty lead organizations to develop common signals of compliance—such as formal policies and procedures—even when they are not legally mandated. Legal environments have been popular explanatory tools used in an array of empirical settings involving organizational responses to legal change, including antitrust enforcement (Fligstein 1990, 1996; Dobbin and Dowd 1997, 2000), environmental regulation (Kagan et al. 2003; Short and Toffel 2010), market entry (Haveman 1993), civil rights (Edelman 1990, 1992; Dobbin and Sutton 1998; Kelly and Dobbin 1999; Hirsh 2009), employment practices (Baron et al. 1986; Edelman 1990; Sutton et al. 1994; Sutton and Dobbin 1996; Konrad and Linnehan 1995), medical decision making (Heimer 1999), and civil service reform (Tolbert and Zucker 1983).[2]

[2]Though a detailed discussion is beyond the scope of this article, we note that much like institutional approaches, ecological studies tend to focus on how organizational populations respond to exogenously formed law and regulations, as opposed to examining the role of organizations in shaping the law (Carroll and Hannan 2000). In studies of industries from finance (Barron et al. 1998; Haveman 1993), to brewing (Wade et al. 1998), to telecommunications and utilities (Barnett and Carroll 1993; Neuman 2008; Russo 2001), ecologists have found that law has a profound impact on organizational processes like diversification, competition, and product development. Though ecological studies are often concerned with large populations of small organizations, studies in other literatures have found that small firms are among the most politically active (Cook and Fox 2000; Hillman et al. 2004). These findings suggest that ecological approaches, like institutional studies, may have focused too narrowly on how legal environments shape organizational populations, rather than the other way around.

2.2 Institutional Feedback and Endogenous Change

Institutional research on legal endogeneity—the research we seek to extend—builds directly on these earlier frameworks for understanding the relationship between organizations and the law. Whereas previous work had focused on organizational responses to legal change, studies of legal endogeneity suggest that the same institutional processes that drive organizational adaptation to changes in the legal environment can also, over time, influence formal legal institutions, particularly in the form of judicial interpretations (Edelman et al. 1999; Edelman 2005, 2007; Talesh 2009; Edelman et al. 2011). In this literature, legal endogeneity is a process, through which "the content and meaning of law is determined within the social field that it is designed to regulate" (Edelman et al. 1999: 407; Edelman 2005, 2007). Through this process, "everyday organizational practices, routines, and structures subtly influence legal thinking, legal categories, and legal logic" (Edelman et al 2011: 890). We label this process institutional feedback, both to signal its theoretical underpinnings and to distinguish it from our strategic and interest-driven pathways to endogenous legal change, which we elaborate below.

Insert Figure 1 about here

Figure 1 provides a schematic illustration of how institutional feedback leads to endogenous legal change. The process begins when ambiguous legislation is enacted by legislatures for the purpose of regulating an organizational population (for example, Title VII of the 1964 Civil Rights Act left key terms, including "discrimination," undefined, which made it difficult for employers to know whether they were violating the law [Edelman 1992]). Third party compliance professionals then develop guidelines and procedures for managers to adopt in order to appear compliant with the new yet ambiguous regulation, thereby reducing the risks of lawsuits (Hwang and Powell 2005). Over time, the procedures and structures adopted by organizations in the field become taken-for-granted methods of compliance. Courts, being substantially embedded in the same organizational field as legal compliance professionals, come to see these institutionalized structures as legitimate means of adherence to the law, and defer to them in their rulings.

2.3 Redefining Endogenous Legal Change

The research on legal environments and endogenous change described in the previous section has explicated how the actions of organizations influence the meaning of the law through institutional pathways that are often subtle and indirect. However, we believe that this approach to studying legal endogeneity focuses too narrowly on these subtler pathways. We thus call for a reconceptualization of legal endogeneity that incorporates existing work with a broader set of strategic and institutional processes. Our framework, elaborated here, (1) redefines endogeneity in terms of organizational action, and therefore clearly distinguishes endogenous from exogenous change, (2) accounts for organizations' strategic and interest-driven efforts to shape their legal environments, (3) identifies multiple new pathways to legal endogeneity in a way that integrates prior work on institutional feedback, and (4) is applicable in multiple legal contexts.

First, we offer a redefinition of legal endogeneity that clearly distinguishes actions that produce endogenous change from similar actions that do not. Existing work typically defines endogeneity as an institutional process through which the meaning of a law is determined within the social field it attempts to regulate (Edelman et al. 1999; Talesh 2009). Absent a clear specification of the actors that belong to the field in question, this definition cannot delineate endogenous from exogenous legal change. Institutional feedback hinges on the idea that courts defer to policies and procedures designed by organizations and their legal professionals to signal compliance. But judges, over time, find legitimacy and rationality in these policies and procedures precisely because they are substantially embedded in the same organizational (and legal) fields about which they are making decisions (Edelman et al. 2011: 901; Edelman 2007: 81-82). This raises questions about when judicial actions are endogenous or exogenous to the fields they regulate. Although organizational fields are often defined broadly to include organizational, professional, and state actors (DiMaggio and Powell 1983), or even by issues (Hoffman 1999), overly encompassing definitions lead to ambiguity in delineating endogenous from exogenous change.[3]

[3]Throughout our analysis, we use the term 'organizations' broadly to refer to non-state organizations. Although

Our framework distinguishes endogenous from exogenous change by making organizational action and interests defining features of endogenous legal change. Organizational fields are often composed of actors with interests that are too diverse to be covered by a single set of laws. Overlapping fields and multiple membership (Fligstein and McAdam 2011) further compound the problem of identifying endogenous from exogenous change at the field level. In light of these complications, we define endogenous legal change as *change that occurs when organizations, in the pursuit of their perceived interests, alter the content or meaning of the laws that govern those organizations' actions*.[4] This definition differs from prior field-based characterizations of legal endogeneity by recognizing that the boundaries of a field and the organizational population targeted by a law or regulation may not coincide. For example, under our definition, if the environmental movement secures passage of a new clean air regulation for utility companies, that would not constitute endogenous change because the law does not govern the actions of the environmental movement, who pressed for the legislation. In contrast, under a field-based definition of legal endogeneity, it would be unclear whether or not the legislation should be considered endogenous change because the environmental movement and utility companies can be classified as members of the same organizational field. Endogenous legal change, according to our definition, would occur if the utility companies were to alter the technologies they use in a way that changes the effect of the regulations by, for instance, rendering the regulations obsolete. Successfully suing the Environmental Protection Agency to prevent enforcement of the regulation or lobbying Congress to eliminate the law would also, if undertaken by the utility companies, constitute endogenous change.

Second, our account of legal endogeneity improves upon prior work by recognizing that organizations often engage in strategic and interest-driven efforts to shape their otherwise stable legal environments (Pfeffer and Salancik 1978; Lawerence 1999; Hillman and Hitt 1999; Barley 2007). We define strategies as the policies and plans used by organizations to determine

our case focuses on for-profit enterprises, we anticipate that many of the dynamics we describe are also applicable to non-profit organizations. Like for-profits, non-profit entities exist in strategic action fields, are governed by laws and regulations, and have interests that may lead them to seek legal change.

[4]We acknowledge that organizations' interests vary widely across contexts. Thus, we define endogenous legal change in terms of perceived interests to allow for that variation. For an extended discussion of the concept of interest, see Swedberg (2005).

and achieve their goals and interests (Porter 1980; Lawerence 1999). Institutional feedback—through which courts defer to the policies and procedures developed by private organizations—is an important pathway to endogenous legal change. However, institutional feedback is not itself a strategy for legal change. Rather, institutional feedback results from the pursuit of an emergent strategy for protecting other organizational interests (e.g. defending against liability). Unlike deliberate strategies, which are carefully planned and derived from an organization's broader mission, emergent strategies are largely dictated by the environment (Mintzberg and Waters 1985). By focusing on how organizations attempt to survive in their ever-changing environments, institutional studies portray organizations as things that are acted upon, and overlook the power organizations have to construct their legal environments (Perrow 1986; Hirsch and Lounsbury 1997; Mizruchi and Fein 1999; Hinings and Greenwood 2002).

We argue that by foregrounding strategies and interests, our approach provides a richer account of how organizations influence the law. Moreover, the framework has important methodological implications for research on law and organizations. For example, Edelman and coauthors have extensively documented organizational responses to Title VII of the Civil Rights Act (Edelman et al. 1992, 1999, 2011). Their analysis highlights how organizations, influenced by compliance professionals, developed grievance procedures to appear compliant following the passage of the ambiguous law. Organizations adopted grievance mechanisms after being (falsely) led to believe that these policies would shelter them from liability (Edelman et al. 1992, 1999; Dobbin and Kelly 2007). Courts then came to accept these procedures as evidence of compliance, in effect relying on organizations' interpretations of the legal ambiguities (Edelman et al. 1992, 1999). A strategic and interest-based framework differs from this institutional approach by focusing on changes in legal environments that preced organizational responses to ambiguous new laws. Specifically, the approach would investigate *why* the legislation was vague to begin with, and identify the involvement of organizations in this phase of the policy process. Furthermore, this framework also suggests that following the law's passage, larger organizations may have been able to hire the most influential lawyers and professionals, and thus ensure that practices in their interests diffused across the field. In addition to these methodological considerations, by foregrounding strategies and interests, our framework also more clearly connects research on legal endogeneity with long traditions of work in sociology, economics, political science, and management on organizational involvement in the policy making and enforcement process (Hart 2004; Hillman et al. 2004; Schaffer 1995; Mizruchi 1992; Laumann and Knoke 1987; Stigler 1971). We highlight some of these connections in greater detail in later sections.[5]

Third, we contend that a more complete approach to legal endogeneity must address multiple pathways to endogenous legal change. Institutional feedback highlights one indirect route through which the actions of a broader field of organizations influence the courts (Edelman et al. 2011). This pathway to endogenous change hinges on consensus, as evidenced by the necessary diffusion and institutionalization of compliance practices across an organizational field. Our interest and action based definition of endogenous legal change identifies an additional set of pathways by examining the competitive dynamics of fields (Fligstein and McAdam 2011). By focusing on consensus instead of competition, existing work overlooks pathways to endogenous legal change initiated by a relatively small number of firms or groups of firms whose strategies may differ substantially from the rest of the field (Porter 1980; McGee and Thomas 1986).

Finally, a robust framework for the study of endogenous legal change should also be applicable to a variety of empirical and legal contexts. Prior work on legal endogeneity has been developed almost exclusively through studies of employment law and judicial deference to organizational policies aimed at internal dispute resolution (e.g. Edelman et al. 2011; Edelman et al. 1999; for a similar critique, see Talesh [2009]).[6] The theoretical framework and empirical

[5]Our interest-based framework also has resonances with an earlier line of research in the tradition of elite theory. In contrast to institutional theorists' emphasis on the field-level diffusion of law and policy, elite theorists focus on the disproportionate political influence of a small minority of powerful individuals (Mills 1956; Domhoff 1990; Quadagno 1984). Given this dramatically different starting point, debates in the elite theory literature ask how much and under what conditions elites shape law and the political process (Crenson 1971; Salamon and Siegfried 1977; Whitt 1982; Block and Piven 2010).

[6]Talesh (2009) departs from other studies of legal endogeneity by studying how interactions between business and the legislature shape the content and meaning of the consumer protection law. Much like prior work, however, Talesh (2009) emphasizes meaning-making over strategic action, and thus fails to correct the problems in the institutional feedback literature discussed above. Also, while consumer protection law is distinct from employment law, the two share many empirical similarities, including the internalization of dispute resolution mechanisms inside private organizations.

context we develop and explore in this study moves toward this goal of broader applicability in two ways. First, although our data are limited to a single empirical context, this setting differs dramatically from the civil rights and employment law contexts of prior work. Following our analysis of Glass-Steagall, we also suggest a few other substantive cases where our action and interest framework are likely to reveal new insights. Second, we show that our framework and the organizational strategies we detail in the following section can help explain endogenous change in the law emanating from and extending across the judicial, legislative, and executive branches of government, in contrast to prior work that has focused primarily on the judiciary. In our perspective, competition leads organizations to target a broader range of authorities in their effort to create favorable legal environments.

3 The Legal Strategies of Organizations

Our approach argues that the calculated actions of private-sector organizations produce endogenous changes in the law. But what prompts organizations to engage in this behavior? Once set in motion, what strategies can organizations use? Organizational theory has long posited that organizations' primary goal is to ensure their own survival (Selznick 1949; Michels 1962). Typically, theorists assume that organizations actively promote stable environments to achieve that goal (e.g., Pfeffer and Salancik 1978). This assumption has limited attempts to understand deliberate strategic actions used by organizations that appear to disrupt otherwise orderly and predictable environments. Following more recent theoretical work by Fligstein and McAdam (2011), we challenge two assumptions in this approach in an effort to highlight the process that sets endogenous legal change into motion: (1) that the "environment" is a singular construct that can either be stable or unstable, and (2) that organizations usually act to promote stability in their environment. Rather, we conceptualize organizational environments as sets of nested, overlapping and interconnected "strategic action fields" or SAFs (Fligstein and McAdam 2011). In this conceptualization, the relevant question is no longer, "is the environment stable?" but rather, "which fields are more or less stable?" Using this approach, we ask, under what circumstances would an organization strategically attempt to unsettle a relatively stable portion of its environment? Specifically, reinterpreting the legal environment of an organization as a collection of overlapping and interconnected fields in which organizations, legislatures, courts, regulators, and interest groups interact to define the law, we ask, when and how do organization attempt to alter a stable legal environment?

As discussed above, existing work demonstrates an institutional feedback effect of organizational actions on judicial interpretations of the law. Organizational responses to legal environments alter those environments, but indirectly and not as part of a larger legal strategy. Recognizing that organizations play a deliberate role in shaping the content and interpretation of the law, we focus our analysis on three broad organizational strategies—reinterpreting the law, innovating around the law, and legislative engagement—which alter the effects of the law, and thus produce endogenous change. Organizations can pursue each strategy using a variety of specific methods or tactics.[7] Below, we focus our attention primarily on the methods used at various times by commercial and investment banks to pursue each of the three strategies in relation to Glass-Steagall, but we also, in the hope of stimulating a broader dialogue on legal endogeneity, point to methods identified in prior work that could be employed to reinterpret or innovate around the law, or engage the legislature.

We identified these three strategies in the context of our case—the long and slow demise of Glass-Steagall—after finding that institutional feedback, as describted in prior literature, failed to sufficiently explain what appeared to be a clear instance of legal endogeneity. Responding to changes in the profitability of their core business, commercial banks actively sought to disrupt their otherwise stable legal environment. We followed the legal strategies of commercial banks from their first declared attempts to end the separation of commercial and investment banking in the early 1980s through the eventual passage of Gramm-Leach-Bliley. In so doing, we identified three analytically distinct strategies for undermining Glass-Steagall. Given that these strategies were identified in the context of a single case, we emphasize that they are not an

[7]Social movement scholars have long studied the strategies and tactics used by insurgent groups to make claims on the state (and, more recently, on corporations, see King and Pearce [2010] for a review). Social movement scholars have tended to focus on "challengers," those who lack "routine, low-cost access to resources controlled by the government" (Tilly 1978: 52). We thus see our work as an analogous attempt to document the strategies of one set of powerful insiders, much as social movement scholars have exhaustively documented the strategies of challengers. For one interesting crossover, see Walker (2009) on how large organizations emulate social movements through professionalized grassroots lobbying campaigns.

exhaustive typology.

In this section, we first discuss how changes in other parts of an organizations' environment might lead an organization to push for legal change, depending on the legal opportunities available. We then examine three strategies we have identified through which organizations actively alter the law and briefly preview their role in the fall of Glass-Steagall. Though presented separately for the purposes of analytical clarity, these strategies are not mutually exclusive. The use of any given legal strategy may be contingent on the successful execution of an earlier strategy, and oftentimes organizations employ multiple strategies in combination. In the later analysis of our case, we show how the demise of Glass-Steagall was a complex, multi-causal phenomenon: commercial and investment banks used various strategies simultaneously, and the effectiveness of each approach changed over time. The strategies are summarized alongside the institutional feedback pathway in Table 1, and are displayed schematically in Figure 2.

Insert Table 1 about here

Insert Figure 2 about here

3.1 The Origins of Legal Opportunities

In agreement with classical organization theory, we argue that organizations, especially dominant incumbents, generally prefer stability over change. However, we also suggest that when environments are already unstable, organizations may be willing to promote more instability in order to produce a favorable settlement. Following Fligstein and McAdam (2011), we argue that organizational fields are typically destabilized through their links to other fields. In particular, destabilization in a nearby domain may induce a powerful actor to attempt to reorganize an otherwise stable field.

This destabilization may result from the invasion of a field by new organizations (Fligstein and McAdam 2011). In our case, for example, we argue that the entrance of foreign competitors into commercial banking, along with shifts in corporate finance, destabilized the commercial banking field in the 1970s-1990s (Davis and Mizruchi 1999; Suárez and Kolodny 2011). Facing an unstable market that looked increasingly unpromising, commercial banks sought to reorganize their legal environment in an attempt to gain access to investment banking markets. Thus, instability in one field (commercial banking) led organizations to attempt to change a second, otherwise stable, field (financial regulation) in order to enter, and thus destabilize, a third field (investment banking). The push for endogenous legal change here was inspired by disruptions in other domains. The goal, of course, was not chaos but rather a new settlement that favored the organizations that promoted this temporary instability. Here, we differ somewhat from Fligstein and McAdam who argue that "The more connected an SAF is to other SAFs, the more stable that SAF is likely to be" (2011: 17). Instead, we emphasize how the interconnections between fields may lead to cascades of changes, as instabilities propagate (Halliday and Carruthers 2009).

Legal environments are especially attractive targets for organizations seeking to make changes in neighboring fields since legal fields control the rules of the game for many neighboring fields. Like all SAFs, legal fields are composed of numerous sub-fields—courts, regulatory arenas, legislatures, and so on. These sub-fields each offer unique sets of opportunities and challenges for organizations seeking to produce legal change. For example, as many scholars have noted, the U.S. Congress is prone to stasis—it is easier to have a bill blocked than passed (Hacker and Pierson 2010). Thus, the barriers to congressional action are large. On the other hand, courts typically consider only concrete cases and thus make rulings in response to adversarial lawsuits. It is hard to lobby a court preemptively. The variations in the institutional rules governing different parts of the legal environment, as well as the sympathies and worldviews of the people in charge of different agencies, constitute a legal opportunity structure.[8]

For example, in the United States, the 1970s and 1980s witnessed a change in the outlook of regulators who began to favor loosening restrictions on corporate actions, especially in finance. At the same time, established legal doctrine privileged regulators' interpretations of ambiguous legislation over those of the courts. This combination, what some authors label cognitive regu-

[8]Here we are borrowing loosely from concepts developed in the social movements tradition to discuss opportunity structures more generally.

latory capture (Buiter 2008), allowed commercial banks an entry point to attack the separation of commercial and investment banking even as efforts to lobby for new legislation failed.[9] The next three sections discuss the strategies organizations employ to take advantage of the legal opportunities available.

3.2 Reinterpret the Law

While the legislature writes and passes laws, the executive branch must determine how they are implemented. Different regulatory agencies are charged with turning legislative language in to practical rules for enforcement. Yet the language of the law, like all language, requires interpretation, and thus allows for some level of interpretative flexibility (Wittgenstein 1958; Sunstein 1989; Pedriana and Stryker 2004). One important way that organizations can shape the law then, is by attempting to exploit the difficulty and ambiguity inherent in such interpretation by pushing regulators for particular readings.

Beyond the fundamental interpretative flexibility inherent in all language, we suggest several additional factors can heighten ambiguity of the law and thus make the efforts of organizations to push for reinterpretations of the law particularly successful. First, legislatures may leave certain dimensions of a given law ambiguous, either due to the simple inability to foresee contingencies (Williamson 1981) or due to a deliberate desire to push difficult political choices onto a different branch of government (Krippner 2011). Ambiguity in a given law may thus be an unintended 'bug' or a necessary 'feature' in part of the political bargain that made the legislation possible (Baier et al. 1986). Second, as time passes, it may become increasingly difficult to identify or understand the intentions of the individuals who drafted and passed the legislation.[10] In either case, understandings of how a given law should be interpreted and im-

[9]Cognitive regulatory capture involves an alignment of the interests of regulators and regulated industries through subtle shifts in theories and ideologies of regulation. We do not consider cognitive capture to be a strategy that would directly result in endogenous legal change. Rather, cognitive regulatory capture changes the legal opportunity structure—the more regulators hold similar beliefs to the industries they regulate, the more easily organizations should be able pursue strategies that result in new interpretations of existing rules, offer favorable interpretations of new rules, or have existing rules repealed entirely.

[10]Though not a factor in the history of Glass-Steagall, we note that similar processes may also play out when a law is *first* interpreted, in which case the use of various delaying tactics can be particularly effective. See, for example, reports of interest group efforts to stall and subsequently weaken the rollout of provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Greene 2011; Indiviglio 2011).

plemented are open for adjustment.

Organizations have a variety of tactics at their disposal for garnering favorable interpretations of the law. Regulatory capture theorists, for instance, propose that the primary beneficiaries of state regulation are the very organizations that the regulation seeks to control (Stigler 1971; Dal Bó 2006). Firms "capture" regulatory agencies by securing votes for favorable politicians, financing political campaigns, and even outright bribery (Peltzman 1976), all of which may help organizations secure advantageous readings of law and regulation. Additionally, firms may choose to settle lawsuits they are likely to lose while allowing those they are likely to win to go to full trial in order to secure favorable judicial interpretations of a law (Albiston 1999).

The top portion of Figure 2 shows a general set of steps through which a strategic effort at reinterpretation may unfold. In the context of Glass-Steagall, we show that the law had a relatively stable interpretation from the 1940s through the 1970s. In the 1980s, banks petitioned the Federal Reserve to reinterpret the meaning of the words "principally engaged" in Section 20 of the law to allow for some crossover between commercial and investment banking. In 1987, the Federal Reserve agreed with this interpretation, and thus created a new opening in the wall between commercial and investment banking.

3.3 Innovate Around the Law

The text of the law may remain fixed while the world it attempts to order changes. As a result, the same law, left unchanged, can have dramatically different impacts over time. A small but growing literature in political science has begun to study one aspect of this phenomenon, called "policy drift" (Mahoney and Thelen 2009; Hacker and Pierson 2010), or "changes in the operation or effect of policies that occur without significant changes in those policies' structure" (Hacker 2004: 246). Drift is often intentionally produced—as is the case when politically powerful actors prevent such updates from reaching the policy agenda (Crenson 1971; Hacker 2004). Viewed in this light, drift can be a powerful strategy, because it is largely unnoticed—non-actions are more difficult to observe than overt political acts. Policy drift may also come about inadvertently, when laws are left on the books but not updated.

The nascent literature in political science on drift has tended to focus on overtly political methods like the suppressing of agenda items. However, we suggest that seemingly apolitical organizational actions may also produce policy drift. By innovating around the law and developing new practices, organizations can change the state of the world that a given law attempts to regulate, thereby setting policy drift into motion. Although organizational innovation is not a necessary condition for policy drift, innovations often provide opportunities for drift to occur.

We note that innovation around the law can have either accidental or deliberate origins. In the accidental scenario, organizations engage in some new activity and only later realize is not covered by an existing law or regulation, in which case accelerated development of the practice may follow after recognizing the circumvention. Alternatively, innovation around the law can be deliberate, in which case organizations actively attempt to devise new practices that obviate a given regulation or law.

The right-hand side of Figure 2 presents a simplified illustration of how innovation around the law may lead to endogenous legal change. In the case of Glass-Steagall, we show how during the 1970s and 1980s, commercial and investment banks experimented with new derivative products like exchange- and interest-rate swaps. Although creating and dealing in these derivatives is considered investment banking in the dominant understanding of the term, Glass-Steagall did not prohibit commercial banks from entering this market, and banks fought hard to prevent new regulations from being imposed. Thus, organizational innovation enabled commercial banks to enter into direct competition with investment banks, which ultimately undermined Glass-Steagall's separation of commercial and investment banking.

3.4 Legislative Engagement

While the institutional perspective generally assumes that formal legal changes are exogenous, an extensive scholarly tradition in political science and sociology has noted the intense efforts organizations make to influence legislators (e.g., Mizruchi 1992; Baumgartner et al. 2009). Organizations, acting on their own or through collective representatives like the Business Roundtable and Chamber of Commerce, spend millions of dollars lobbying legislators, advertising for or against laws, and mobilizing voters through grassroots campaigns (Hillman and Hitt 1999; Walker, forthcoming). Through such lobbying efforts, organizations are able to push for the creation of new laws, the amendment of existing laws, or the outright repeal of statutes in ways that have been shown to have direct consequences for corporate performance (Rabern 2009). But legislative changes do not necessarily involve quick and decisive breaks with old practices. As institutional theorists in political science have demonstrated, change can also be driven by subtle and incremental transformations that result from rewriting and amending portions of existing legal arrangements while leaving others intact in a process known as layering (Schickler 2001; Thelen 2003). The left hand side of Figure 2 illustrates one set of steps to endogenous legal change through strategic legislative engagement. In the case of Glass-Steagall, this lobbying campaign began as early as 1980 and persisted throughout the 1980s and 1990s. Initially, commercial banks fought for a complete repeal of Glass-Steagall while investment banks and other financial companies lobbied to maintain the law, or enact a much more partial repeal. In 1999, for reasons discussed below, the financial industry unified around the Gramm-Leach-Bliley Act whose passage ended any pretense of separation between commercial and investment banking.

4 Methods

In the following section, we flesh out each of these strategies through the case of Glass-Steagall. Our analysis draws on an exhaustive review of court decisions, congressional legislation, government publications, and articles from *The New York Times*, *Washington Post* and *American Banker*, a banking trade publication, along with secondary sources. A more comprehensive discussion of the data and analytical method is presented in Appendix A. We chose to study the repeal of Glass-Steagall because of its substantive importance as a landmark piece of financial deregulation, and because the two decade struggle to overturn the law facilitated the identification of multiple pathways of legal endogeneity within the same case. As Glass-Steagall was both high profile and highly technical, the struggle to repeal it offers rich data for exploring the legal strategies pursued by organizations.[11] We begin with a brief history of Glass-Steagall, and then proceed to focus on three episodes from the 1980s and 1990s, which illustrate the three strategies and their interdependencies.

[11]For a discussion of the limitations of the case, see section 5.2.

5 The Rise and Fall of Glass-Steagall

In 1929, the United States experienced a massive financial crisis including a stock market crash and the subsequent failure of nearly 1,000 banks (Carnell et al. 2008: 16). The crash led to declining confidence in financial institutions and bank panics were common for the next four years, leading to thousands more bank failures. In 1930, Senator Carter Glass of Virginia proposed legislation that would separate commercial and investment banking and eliminate "securities affiliates" (subsidiary organizations used by commercial banks to avoid existing restrictions on their securities activities). Securities affiliates had been a matter of concern since the 1910s, but had fallen off the regulatory agenda following the federal government's widespread use of commercial and investment banks to sell bonds during World War I (Perkins 1971; Perino 2010: 206-208). In the wake of the crash, Senator Glass returned to these earlier debates and connected the crisis to the misdeeds of commercial banks that used securities affiliates to evade restrictions on their activities. Glass successfully fought for the inclusion of a plank in the Democratic party platform in 1932, calling for "The severance of affiliated securities companies from, and the divorce of investment banking business from, commercial banks" (quoted in Perkins 1971: 518).

Glass's legislation went through two years of committee hearings before eventually passing the Senate in January 1933, two months before FDR's inauguration. While the Senate focused on the separation of commercial and investment banking, the House, led by Congressman Henry Steagall of Alabama, championed the creation of federal deposit insurance, and did not address Glass's legislation, which stalled pending Roosevelt's inauguration.

In the beginning of 1933, on behalf of the Senate Committee on Banking and Currency, Ferdinand Pecora led an investigation into the causes of the crisis and uncovered extensive abuses by banks. The investigation focused in part on the conflict of interest presented by banks that were both taking deposits and making commercial loans and underwriting and dealing in corporate securities (Perino 2010).[12] Pecora exposed extensive abuses by a prominent New

[12] Like everything else encoded into the law, "taking deposits" and "underwriting and dealing in securities" are ambiguous, contested terms. Nonetheless, it might be helpful to define the less commonly used terms "underwriting" and "dealing." Carnell et al. (2008: 130) define a dealer as a party that "engages in the business of

York bank, City Bank (precursor to the modern Citibank), and its securities affiliate, National City. The investigation uncovered how National City sold investments to everyday consumers, often contacted because they were depositors at City Bank, without disclosing to them its own assessments of the worthiness of an offering or other material facts (Perino 2010: 248). Pecora also showed that the distinction between City Bank and National City was a legal fiction—the two had the same board of directors, chairman, and other top management. Thus, when National City pushed investors to buy City Bank stock, the bank was effectively propping up its own share price. As a result of Pecora's cross-examination, Charles Mitchell, the Chairman of City Bank and National City, was forced to resign, and Senator Glass's legislation gained popular support.

In light of the Pecora Commission's findings, Congress passed the Banking Act of 1933 in June. The law merged Congressman Steagall's deposit insurance bill with Senator Glass's bill separating commercial and investment banking, and thus is commonly known as the Glass-Steagall Act of 1933. Roosevelt somewhat reluctantly signed the bill into law; he was concerned that deposit insurance was an overreach, and he had only lukewarm support for the separation of commercial and investment banking (Perkins 1971: 524). Thus, although the Glass-Steagall Act is commonly included in lists of Roosevelt's New Deal accomplishments, his own role was quite minimal: both major components of the law were proposed before he took office, and Roosevelt simply allowed them to enter into law.

Glass-Steagall mandated sweeping changes to the financial industry (Cohen 1982; Carnell et al. 2008; Carpenter and Murphy 2010). First, the Act created the Federal Depository Insurance Commission (FDIC), which insured bank deposits and had the authority to take over failing banks. Second, Glass-Steagall capped interest rates through "Regulation Q." This regulation prohibited banks from paying more than a specified rate for interest on savings accounts, and from paying any interest at all on checking accounts, with the aim of preventing ruinous competition for deposits. Third, and most important to this analysis, Glass-Steagall mandated the separation between firms that took deposits and made loans (commercial bank-

buying and selling securities for its own account" while an underwriter "sells securities for an issuer…or buys securities from the issuer with a view to distributing them to the public."

ing) and firms that underwrote and dealt in securities (investment banking). Sections 20 and 32 of Glass-Steagall prohibited firms involved in taking deposits from being affiliates (part of the same holding company) or subsidiaries of each other, and from sharing directors on their boards ("interlocks") with firms "engaged principally... in the issue, flotation, underwriting, public sale, or distribution, at wholesale, retail, or through syndicate participation" of "ineligible securities," meaning corporate debt and equity among other things (but not government debt which commercial banks were allowed to continue to trade). In response, large banks split up their commercial and investment banking divisions. For example, J.P. Morgan & Co. divided into a commercial bank, J.P. Morgan, and an investment bank, Morgan Stanley, in 1935.

The Glass-Steagall Act has come to be associated mainly with the separation of commercial and investment banking required by Sections 20 and 32. (See, for one example, the *New York Times* caption in Figure 4, showing the signing of Glass-Steagall and of the Gramm-Leach-Bliley Act.) Thus, for the rest of this discussion, we use "Glass-Steagall" to refer only to these provisions unless otherwise specified. Also, we will return to the phrase "*engaged principally*" in the quoted text of the law, as its contested meaning played an important role in the efforts of commercial banks to reinterpret the law.

Insert Figure 4 about here

Between the 1940s and the early 1970s, Glass-Steagall remained relatively unchanged. In 1956, the Bank Holding Company Act expanded Glass-Steagall's reach to corporations that owned banks, i.e., bank holding companies, to ensure that such a company could not own both commercial and investment banks. An amendment in 1970 removed an exception for companies that owned a single bank, further entrenching the separation between commercial and investment banking (Carpenter and Murphy 2010: 7).[13]

As with many aspects of U.S. social and economic history, previously stable fields were unsettled beginning with the economic turmoil of the 1970s. In the following section, we outline

[13]This brief story is a good example of the opposite of policy drift (Hacker and Pierson 2010), as here Glass-Steagall was successfully updated to maintain its effectiveness.

three broad historical trends, financialization, globalization and neoliberalism, that simultaneously threatened the profitability of traditional commercial banking while opening up new legal opportunities and markets for banks to exploit. Although commercial banks had fought for a few relaxations of Glass-Steagall in the 1950s and 1960s, these threats to profitability pushed banks to begin a struggle for outright repeal in the late 1970s (Davis 2009: 116; Suárez and Kolodny 2011). Efforts to repeal Glass-Steagall through congressional action began in this period, although they were met with resistance from competing interest groups and some congressional Democrats into the late 1990s (Johnson and Kwak 2010: 73). Meanwhile, efforts to broaden the powers of banks and bank holding companies through changes in the interpretation of existing laws proved much more successful. Our analysis follows three interwoven threads identified through our historical research (see Appendix A) as critical to the fall of Glass-Steagall. Each thread corresponds to one of the strategies laid out in section 3.

5.1 Shifting Contexts of Commercial Banking

Three trends reshaped the business environment of commercial banks in the 1980s and 1990s: financialization, globalization and neoliberalism.[14] We focus on these three currents because of their important effects on commercial banks' core business practices and legal opportunities; they are not a set of competing alternative explanations, but rather broader contexts that pushed banks to enter new markets, while simultaneously creating opportunities for destabilizing the existing legal environment. We draw on existing research to summarize these trends and then outline their consequences for commercial banks' legal and market opportunities.

Beginning in the late 1970s, the U.S. economy experienced a dramatic "turn to finance" or "financialization" (Krippner 2011; Davis 2009; Carruthers and Kim 2011). Scholars emphasize different aspects of this transformation. For example, Krippner (2011: 4) defines financialization as "the tendency for profit making in the economy to occur increasingly through financial channels rather than through productive activities." Davis (2009) instead focuses on the increasing dominance of financial markets over corporate and individual decision-making.

[14]For an exhaustive description of changes in commercial banking in the U.S., 1979-1994, see Berger et al. (1995). A complete review is beyond the scope of this article.

Despite the dramatic increase in the profitability of the financial sector as a whole, the rising dominance of financial markets presented a significant threat to both sides of commercial banks balance sheets (Davis and Mizruchi 1999; Davis 2009). Non-financial corporations began to rely more on their own internal financial expertise (Zorn 2004) and on issuing their own debt in the commercial paper market rather than turning to commercial banks for loans (Davis and Mizruchi 1999). Simultaneously, the deregulation of interest rates (Krippner 2011) and the creation of new savings vehicles like money-market mutual funds created significant competition for savings deposits, and thus forced banks to pay higher interest rates on deposits (Berger et al. 1995). In general, the "turn to the market" was a turn away from reliance on commercial banks as intermediaries between savers and borrowers. Thus, while financialization was characterized by an increase in the profitability of finance as a sector, it did not affect all financial institutions equally, and commercial banks in particular faced serious threats.

Just as the financialization of the U.S. economy presented serious threats to commercial banks, so did increasing global competition.[15] Improvements in communications technologies and especially advances in electronic credit scoring and credit records made it easier for foreign banks to compete in the United States. In 1979, foreign banks held less than a quarter of the amount of U.S. nonfarm, nonfinancial corporate debt as domestic banks; by 1994, they were roughly equal (Berger et al. 1995). Foreign banks tended to lend to the largest, safest corporations, and thus competed most directly with the biggest U.S. banks (Berger et al. 1995). At the same time, U.S. banks expanded overseas. These foreign subsidiaries faced different regulatory regimes, and made it easier for commercial banks to gain experience with investment banking innovations that might have been off-limits inside the U.S.

While globalization and financialization presented serious threats to the profitability of traditional commercial banks, neoliberalism offered new legal opportunities for destabilizing financial regulations. We use the term neoliberalism here in a broad sense to refer to the victory of both conservative political movements and an economic ideology that sacralized the market and demonized the state in the 1970s to 1990s (Mudge 2008; Somers and Block 2005).

[15] A full discussion of globalization and its myriad definitions is beyond our scope. For our purposes, we focus on increasing global competition and improvements in communication technology.

Institutionally, the 1970s-1980s saw the growth of conservative think tanks, the rise of the conservative legal movement and the electoral victory of conservative politicians, especially Reagan (for a recent review, see Gross et al. [2011]). Simultaneously, financial economics grew in prominence in the 1970s and 1980s, and came to emphasize the "efficient markets hypothesis," which argued that financial markets were efficient in the absence of regulatory intervention (MacKenzie 2006; Quiggin 2010). These academic justifications for deregulation created the conditions for cognitive regulatory capture (Buiter 2008), where technocrats believed in the project of deregulation even in the absence of direct cooptation. Together, the rise of the political right and of financial economics created new legal opportunities for regulatory reinterpretations, and began to create openings in the judiciary and legislative arenas as well, just as commercial banks' traditional business model came under increasing pressure from interest rate deregulation, foreign competition and the financialization of non-financial firms.[16]

5.2 Reinterpret the Law: Section 20 Subsidiaries

As discussed above, Glass-Steagall prohibited affiliations between commercial banks and companies that were "engaged principally" in ineligible securities transactions such as underwriting and dealing in corporate equity (Carpenter and Murphy 2010). Commercial banks were permitted to have subsidiaries which dealt in certain government securities (such as state and municipal bonds), and they competed with investment banks in these areas. In the early 1980s, three large commercial banks—Citicorp,[17] J.P. Morgan, and Bankers Trust of New York[18]—sought permission from the Federal Reserve to expand the activities of these subsidiaries to include certain "ineligible" securities like commercial paper and mortgage-backed securities. These banks argued that as long as their subsidiaries did less than half their business in such securities they would not be "engaged principally" in ineligible activities, and thus would not

[16]Note that we are not asserting that these three trends are entirely exogenous to the field of banking. Banks played a role in pushing for the deregulation of interest rates, for example. We treat these trends as context for analytical purposes because they were, in a sense, "bigger" than the more circumscribed set of events addressed in our case.

[17]"Citicorp Seeks Broad Securities Role." *New York Times*, December 28, 1984.

[18]"Bankers Trust Seeks Fed Backing for Commercial Paper Unit." *New York Times*, December 29, 1984.

be in violation of Section 20 of Glass-Steagall.

Reagan administration regulators responded favorably to this interpretation. In 1985, the Justice Department's Antitrust Division weighed in with the Federal Reserve in favor of the expansion of commercial banks into investment banking activities. Charles F. Rule, Deputy Assistant Attorney General in the Antitrust Division spoke on behalf of the Justice Department: "We believe that the proper interpretation of Glass-Steagall does not prohibit what Citicorp and Morgan want to do... And we also believe that interpretation is good public policy of free-market competitiveness."[19] In 1987, the Federal Reserve Board agreed to allow commercial bank subsidiaries to do up to 5-10% of their business in ineligible securities, as long as no single bank had more than a 5% share of the total market for any ineligible security (Federal Reserve 1987).

Just one day after the Federal Reserve Board issued its decision, the Securities Industry Association (SIA), a trade group for investment banks, petitioned to stop the decision from taking effect. The SIA argued that the phrase "engaged principally" should cover any affiliate created for the purpose of underwriting securities, no matter how small a share of its total revenue derived from such activities. Citicorp, J.P. Morgan, and Bankers Trust joined the case as cross-petitioners, and argued that the Federal Reserve's decision had been too restrictive. In their eyes, any subsidiary which received less than 50% of its gross revenue from ineligible securities activity was not "engaged principally" in prohibited activities. Additionally, the banks argued that the Federal Reserve's market share test was an attempt to create competition, not to enforce Glass-Steagall (which did not discuss market share). The case eventually went to the Court of Appeals for the 2nd Circuit, where the Court ruled against the SIA, largely upholding the Federal Reserve's decision.[20] The Court upheld the 5% gross revenue restriction as a reasonable interpretation of the statute to which the Court owed deference.[21] The Court

[19] "Citicorp, Morgan Backed on Underwriting." *New York Times*, December 31, 1985.

[20] *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 839 F.2d 47 (2nd Cir. 1988).

[21] In *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984), the Supreme Court laid out the logic of judicial deference to regulatory decisions. This logic, now known as "Chevron Deference," holds that when Congress has plausibly given an agency the authority to promulgate a regulation, the Court should treat the agency's ruling deferentially because the agency presumably has more technical expertise than the Court, and because the agency (deriving its authority from Congress) is

thus rejected the SIA's interpretation, but also rejected the commercial bank's attempted redefinition, noting that with a 50% threshold, commercial banks could affiliate with a traditional investment bank like Merrill Lynch. Lastly, the Court agreed with the commercial banks that the Federal Reserve did not have the authority to impose a market share restriction, and thus struck down this portion of the Fed's decision. The Supreme Court refused to hear the case, and so the 2nd Circuit's decision held.

In 1988, five bank holding companies petitioned the Federal Reserve to allow their securities affiliates to deal in any and all corporate debt and equity securities (up to the 5% revenue threshold). Using similar arguments, the SIA again petitioned to stop this slight expansion of commercial bank securities affiliates' powers, and the Court of Appeals for the D.C. Circuit ruled that the issue of the Federal Reserve Board's interpretation of the key passages of Glass-Steagall had already been settled, and thus would not be reheard.[22]

At the end of 1996, the Federal Reserve voted to expand the permissible amount of ineligible securities revenue to 25% and to eliminate certain firewalls separating the activities of Section 20 subsidiaries and their commercial bank parents (including the prohibition on interlocking directorates).[23] By 1996, before the 25% cap took effect, 41 commercial banks had Section 20 subsidiaries (Carpenter and Murphy 2010), and those subsidiaries underwrote approximately 20% of corporate debt offerings but only 2% of corporate equity offerings in 1996 (Gande et al. 1999). According to Gande et al. (1999: 194), the entrance of commercial banks into corporate debt underwriting had a "pro-competitive effect," reducing the profitability of underwriting and lowering the costs of capital for "smaller issuers of below-investment-grade quality" debt which, in turn, confirmed the fears of traditional investment banks who had fought to prevent the entry of commercial banks into underwriting.[24] Between 1996 and 1999, com-

more directly accountable.

[22] *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 900 F.2d 360 (D.C. Cir. 1990).

[23] "Review of Restrictions on Director, Officer and Employee Interlocks, Cross-Marketing Activities, and the Purchase and Sale of Financial Assets between a Section 20 Subsidiary and an Affiliated Bank or Thrift." 61 *Federal Register* 57,679 (1996) and "Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities." 61 *Federal Register* 68,750 (1996). An earlier decision had already raised the cap to 10%.

[24] Saunders (1999) notes that, beginning in 1997, regulatory decisions by the Federal Reserve made it easier for commercial banks to acquire securities firms, and thus concentration in the industry might increase, eliminating

mercial banks entered the equity underwriting market more forcefully through acquisitions, and by 1998 were handling over 20% of commercial equity underwriting (up from 2% in 1996) (Chaplinsky and Erwin 2009).

The rise of Section 20 subsidiaries is an excellent example of how organizations may act on multiple levels simultaneously when attempting to reshape or overturn a regulation. While efforts to enact an all-out repeal at the Congressional level faced numerous roadblocks (see below), deregulation-minded Reagan appointees were more receptive to commercial bankers' arguments for a re-reading of Glass-Steagall. Following established doctrine, the courts generally deferred to reasonable interpretations by regulators and thus convincing regulators to broaden commercial bank powers sufficed to convince the judiciary. By 1999, although Glass-Steagall remained on the books, commercial banks had become large players in the markets for underwriting and dealing in corporate debt and equity through their successful fight to reinterpret the law.

5.3 Innovate Around the Law: The Growth of Derivatives

Innovations can present serious challenges to regulatory frameworks. By creating new forms of activity that do not easily fit into existing categories, innovations may subvert or eliminate the effectiveness of regulatory barriers. Innovations may take advantage of inconsistencies or ambiguities in the law, and thus allow an organization to effectively engage in an activity previously prohibited. In this case, we examine the emergence of modern financial derivatives in the late 1970s through 1990s. These derivatives opened up a new market in which commercial and investment banks competed fiercely, even in the absence of a repeal of Glass-Steagall. In the wake of the 2008 financial crisis, financial derivatives entered the public eye, largely through discussions of mortgage-backed securities and credit default swaps. We focus on the growth of two slightly less well-known derivatives, interest rate and currency (or exchange rate) swaps, both of which became large markets in the 1980s and 1990s.

Modern derivatives remain hard to classify. On a basic level, a derivative refers to any financial contract whose value derives from a more traditional underlying asset, such as a se-

the pro-competitive effect found by Gande et al. (1999).

curity, commodity or index (Steinherr 2000: 284). This broad definition includes traditional options and futures, which have a long history.[25] Modern financial derivatives are of a much more recent vintage. These derivatives were generally tailored to specific clients, traded over-the-counter (OTC), and involved large, sophisticated counterparties (such as banks, large corporations, or government entities).[26] Such derivatives have features in common with traditional futures, with securities (bonds and stocks), with gambling, and with insurance, and regulators and courts have struggled to place them in existing categories (Gibson 1999; Hazen 2005).

In 1979, Salomon Brothers organized the first currency swap, arranging for IBM and the World Bank to swap the returns from bonds denominated in different currencies, which saved IBM the trouble of issuing new bonds (Tett 2009: 11-12). In 1981 and 1982, numerous banks began arranging interest rate swaps. In an interest rate swap, the counterparties swap a floating rate asset for a fixed interest rate asset. For example, the quasi-governmental Student Loan Marketing Association (also known as "Sallie Mae") used interest rate swaps in 1982 to help raise floating-rate money to help fund its portfolio of floating-rate student loans.[27] Interest rate swaps allow a company to alter its exposure to rising or falling exchange rates, or change the maturity of its obligations without having to issue new debt, and thus in some ways directly compete with the more traditional (and prohibited to commercial banks) activities of dealing and underwriting in corporate equities and debt (Steinherr 2000). Last, but not least, credit default swaps (CDS) were pioneered in the mid-1990s by J.P. Morgan (again, a commercial bank) (Tett 2009).[28] CDS allow banks to shed the risk of an asset (such as a corporate bond) defaulting or, functionally, to buy and sell insurance on other financial assets. Because the

[25] Steinherr (2000: 7) notes that the ancient Greek philosopher Thales reportedly purchased the future right to use olive oil presses well in advance of the harvest, and then sold those rights for a profit when the olive crop was larger than usual. More germanely, see Cronon (1991) on the growth of the Chicago Board of Trade's market for agricultural commodity futures in the 1860s, and MacKenzie and Millo (2003) on the emergence of modern options markets in the 1970s.

[26] On the quite different history of mortgage-backed securities, see Quinn (2010).

[27] "Interest-Rate Swaps Catch on at Banks, Thrifts: Finance Technique Used for Own Portfolios, Arranged for Customers." *American Banker*, May 4, 1983.

[28] Tett notes that J.P. Morgan's early-1980s forays into derivatives transaction began at its investment banking subsidiary in London where there were no prohibitions on combining commercial and investment banking. In the early 1980s, J.P. Morgan brought its derivatives group to the U.S., as "managers had realized, to their utter delight, that there was no explicit provision in Glass-Steagall against trading in derivatives products" (Tett 2009: 17-18).

market for CDS remained small until the late 1990s, we restrict our attention to currency and interest rate swaps.

Although data from the 1980s are scarce, it appears that interest rate swaps were initially arranged roughly equally by commercial and investment banks. For example, *American Banker* reported that Morgan Stanley (an investment bank) and Morgan Guaranty (a commercial bank) were the most active arrangers of interest rate swaps, together accounting for about half of all swaps issued in mid-1983.[29] In a series of 1983 articles on the attempts by money-center commercial banks to enter more fully into investment banking, *American Banker* emphasized the relative strength of Citicorp,[30] Morgan Guaranty,[31] and Bankers Trust[32] in the new markets for interest rate and currency swaps. Note that these three banks were also the first to petition to form Section 20 subsidiaries. Last, note that these portrayals (and other similar trade press accounts) treat arranging interest rate and currency swaps as a form of investment banking, and thus treat commercial banks' entrance into these market as a challenge to Glass-Steagall.

By the mid-1990s, government officials and international organizations began to pay closer attention to the expanding derivatives market. A 1994 General Accounting Office (GAO) report on the growth of the derivatives market analyzed 15 major derivatives dealers' 1992 annual reports to get a sense of the size and distribution of the market. Table 2 reproduces those results. Note that the 15 major derivatives dealers covered included seven commercial banks, five investment banks and three insurance companies and that the GAO estimated these dealers accounted for most of the at least \$12.1 trillion of total derivatives outstanding (GAO 1994: 34).[33] Of these derivatives, approximately 62% were interest rate swaps and 37% were exchange rate (currency) swaps, with just 1% commodity or equity-based (GAO 1994: 35). Most important to our analysis, note the split between commercial and investment banks, with commercial banks accounting for 69.4% of the market and investment banks accounting for 27%.

[29] "Interest-Rate Swaps Catch on at Banks, Thrifts: Finance Technique Used for Own Portfolios, Arranged for Customers." *American Banker*, May 4, 1983.

[30] "Citi Strengthens Push into Investment Banking." *American Banker*, June 17, 1983.

[31] "Morgan Guaranty Takes Aim at Wall Street." *American Banker*, July 8, 1983.

[32] "Bankers Trust Strives to be Merchant Banker." *American Banker*, July 25, 1983.

[33] The notional amount of a derivative is the value of the underlying asset. The notional value is much larger than the market value of the derivative, which in turn is very difficult to calculate.

Similarly, a 1995 survey of non-financial firms' derivatives usage by the Wharton School found that of the 41% of firms reporting some derivatives usage, 89% listed commercial banks as a primary source of derivatives, while 44% listed investment banks (Bodnar et al. 1996: 122). Years before any formal legal repeal of Glass-Steagall, this large and rapidly growing market was fiercely contested by commercial and investment banks.

Insert Table 2 about here

Throughout the 1980s and 1990s, regulators vacillated in their response to the growth in OTC derivatives.[34] In 1987, the Commodity Futures Trading Commission (CFTC) advanced the possibility of regulating the OTC derivatives market,[35] and began an investigation into Chase Manhattan's derivatives dealing activities. The CFTC suggested that OTC derivatives (specifically commodity, rather than interest rate or currency, swaps) might be unauthorized futures contracts, and thus legally unenforceable under the 1936 Commodities Exchange Act, which requires that futures be sold on organized, regulated exchanges. These investigations sent derivatives dealers overseas, which in turn put pressure on the CFTC to cease its efforts to regulate derivatives lest the United States lose out on a substantial new financial market (Romano 1996: 55). In 1989, the CFTC backed down and issued a regulation exempting most swaps, under the relatively minimal conditions that the swap not be offered to the general public (but rather to large businesses, government entities, or sophisticated and wealthy investors), and that the swap be individually tailored (and thus not suitable to be traded on an exchange with a unifying market price).[36]

This 1989 policy statement did not entirely quell fears around issues of legal enforceability of swaps contracts, and a January 1991 ruling by the British House of Lords stoked these fears

[34] We focus here on the back and forth at the CFTC. In contrast, the Office of the Comptroller of the Currency (the primary regulator for some commercial banks) was much more permissive, arguing in favor of extending the allowed activities of banks to include a wide array of derivatives contracts (Omarova 2009). These extensions were relatively uncontroversial for interest-rate and currency swaps, but more controversial for equity swaps which potentially violated Glass-Steagall (Omarova 2009:1069-1072.)

[35] "CFTC Regulation of Hybrid and Related Exchange Instruments." 52 *Federal Register* 47,022 (1987).

[36] "CFTC Policy Statement Concerning Swap Transactions." 54 *Federal Register* 30,694 (1989).

much higher. The House of Lords ruled that British municipalities did not have the authority to enter into swaps transactions as part of their power to raise funds—for the House of Lords, swaps were pure speculation. Thus, the House of Lords voided swaps contracts with over 75 banks, causing losses to derivatives dealers estimated at $179 million (Lynn 1994: 308-309). Although this ruling did not directly affect transactions solely within the U.S., derivatives dealers feared that a similar analysis might someday be applied, and pushed for greater legal clarity on the status of derivatives. After some squabbling between advocates for the exchanges, who wanted to capture some of the OTC derivatives market share, and the major banks, who wanted to preserve their unregulated, OTC character, Congress passed the Futures Trading Practices Act (FTPA) which specifically authorized the CFTC to exempt swap transactions. The FTPA also retroactively exempted swaps from state "Bucket Shop" laws, under which their legal status could have been challenged as an unauthorized form of gambling, another source of legal uncertainty in the swaps market. In 1993, the CFTC followed through and issued regulations affirmatively exempting most swap transactions from regulation (Romano 1996: 56).

The derivatives market continued to expand in the mid-1990s, with heavy competition between commercial and investment banks (even as those barriers were eroding), and relatively little intervention from federal authorities. In May, 1998, the market received another scare as the head of the CFTC, Brooksley Born, issued a "concept release," asking a series of questions and suggesting that the CFTC might once again pursue the regulation of derivatives.[37] Born argued that derivatives contracts had become increasingly standardized, and thus the 1989 and 1993 exemptions from exchange-trading no longer made sense, and that market participants themselves were interested in moving to organized exchanges.[38] Additionally, Born noted that the CFTC was incapable of exercising its role in preventing fraud and misrepresentation without any record-keeping requirements.[39] This concept release brought about a swift reaction

[37]CFTC Over-the-Counter Derivatives, 63 *Federal Register* 26,114 (1998).

[38]U.S. Congress, Hearing before the Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises of the House Committee on Banking and Financial Services, "Technology and Banking," March 25, 1999.

[39]"The Warning: Interview with Brooksley Born." *PBS Frontline*, October 20, 2009.

from bankers, and from other financial regulators who were convinced that the regulation of derivatives was unnecessary. Specifically, Federal Reserve Chairman Alan Greenspan, Treasury Secretary Robert Rubin, and SEC Chairman Arthur Levitt, disagreed vocally with both the authority of the CFTC to regulate derivatives and the need for such regulation. To quell the market these regulators supported a successful Congressional effort to enact a moratorium on new regulations of the OTC derivatives market.[40] Born stepped down from the CFTC in April, 1999, and in 2000, Congress passed the Commodity Futures Modernization Act, affirmatively declaring that OTC derivatives would not be regulated as either futures or securities, and thus ending the possibility of CFTC regulation (Hazen 2005: 388-395).

Focusing on regulators, the growth of derivatives serves at first as an example of policy drift, as regulators missed the emerging market in the early 1980s and were uncertain of their response in the late 1980s, and second as as a story of cognitive regulatory capture in the 1990s, as key regulators vehemently disagreed with imposing regulations that might stem financial innovation. Even today, regulators are uncertain of how best to proceed in the face of a massive financial crisis linked to the proliferation of lightly-regulated, and lightly-monitored, derivatives. Regulatory frameworks established in the Great Depression continue to provide little guidance. Seen from the point of view of organizations, however, the story of derivatives is one of innovation around the law, and a relatively successful struggle to preserve those innovations from regulatory interference, while simultaneously achieving sufficient legitimacy to lessen the risks of contracts being deemed unenforceable. For investment banks, derivatives were another new product to offer, which could fulfill many of the tasks accomplished by existing, but more cumbersome and costly methods like the issuance of new bonds or stock. For commercial banks, however, derivatives offered an opportunity to jump into investment banking activities analogous to those prohibited by Glass-Steagall, while the effort to enact a full repeal was bogged down in Congress.

[40]"Credit Crisis Cassandra." *Washington Post*, May 26, 2009. See also Stout (1999: 706-707).

5.4 Legislative Engagement: Repealing Glass-Steagall

In addition to their attempts to weaken the barriers between commercial and investment banks through regulatory reinterpretation, lobbyists for the commercial banking industry pushed for outright repeal throughout the 1980s and 1990s.[41] Nearly a dozen repeal measures were introduced in Congress prior to 1999,[42] but each faced a different set of roadblocks. The repeal efforts proceeded in roughly three phases. First, from approximately 1980-1988, large commercial banks (working through the American Bankers Association [ABA]) lobbied for a complete repeal, while investment bankers (represented by the Securities Industries Association, SIA), along with many other industry groups, fought to maintain Glass-Steagall. Second, from 1989-1996, the balance of power shifted in response to the regulatory reinterpretations which weakened the separation between commercial and investment banks, and the SIA began lobbying for a partial repeal of Glass-Steagall. Finally, from 1997-1999, the major financial industry groups (including insurance companies) joined together to push the Gramm-Leach-Bliley Act past a few final hurdles. This section traces the shifting alliances in these three periods, and highlights the importance of commercial banks' efforts to overcome Glass-Steagall in other arenas to the eventual form of the repeal.

As early as 1981, commercial bankers organized to eliminate Glass-Steagall's restrictions entirely.[43] These repeal efforts picked up steam quickly, winning a tentative endorsement from the Reagan administration in 1982.[44] Powerful congressional Democrats opposed outright repeal, as did trade associations for investment banks, insurance agents, and community banks. In 1984, SIA president Edward I. O'Brien wrote,

> The repeal of Glass-Steagall... is neither compelling, logical, nor inevitable. The act's demise is advocated almost exclusively by a handful of large banks. Most corporate executives and, certainly, individual savers and investors couldn't care

[41] Our analysis in this section largely coincides with Suárez and Kolodny (2011), despite being completed independently and drawing on slightly different sources. Suárez and Kolodny focus more heavily on action at the committee level, and in particular, the details of the final repeal in the late 1990s. Interested readers should consult their Tables 1 and 2 (pp. 82-83) for an excellent representation of the evolution of support for a formal repeal from different parts of the financial sector over time.

[42] "Clinton Signs Legislation Overhauling Banking Laws." *New York Times*, November 13, 1999.

[43] "Bank Target: Glass-Steagall Act." *New York Times*, March 3, 1981.

[44] "Glass-Steagall Action Doubted." *American Banker*, January 21, 1983.

less about the issue, as they already have an almost bewildering choice of financial services, products, and providers to choose from. Repealing the act would be a radical and ill-conceived notion.[45]

The SIA maintained this opposition throughout the 1980s, with strong support from key legislators. For example, in late 1987, in the wake of the "Black Monday" stock market crash, the SIA argued that the barriers between securities and commercial banking had prevented the crash from rippling outward and causing a larger economic downturn. The staff of New York Republican Senator D'Amato helped distribute buttons proclaiming, "Glass-Steagall Saved U.S. Again."[46] Up through 1988, these forces prevented commercial banks from making significant congressional inroads on a repeal bill.

In 1988, the balance of power shifted substantially. As discussed in section 4.1 above, in 1987 commercial banks convinced regulators to allow bank subsidiaries to compete with investment banks in previously prohibited businesses, including underwriting corporate securities. The courts upheld these decisions in 1988, which in turn reduced pressure on commercial banks to push for an outright repeal of Glass-Steagall. As one staffer for Senator Proxmire noted, "Now that banks have gotten quite a lot through the regulatory process, it would be easy for them to kill a bill" that maintained too many restrictions on their activities.[47]

Following these regulatory and judicial decisions, in 1989, the SIA backed down from their complete opposition to Glass-Steagall repeal, and instead proposed an alternative measure that would partially repeal the separation between commercial and investment banking, but maintain certain barriers within companies between the two activities.[48] The ABA rejected the SIA's proposals as too restrictive, effectively replacing "the Berlin wall with a high-powered electrical fence."[49] From 1990-1994, the SIA, ABA and other lobbying groups fought over the specifics of a repeal bill, but made little headway, in part due to continued resistance from Democrats

[45] "Should the Glass-Steagall Act Be Repealed? Two Views." *American Banker*, March 8, 1984.
[46] "Briefing: Playing on Glass-Steagall Fears." *American Banker*, November 23, 1987.
[47] "Court Decision Changes the Landscape; New Strength for Lobby." *American Banker*, February 10, 1988. See also "New Powers Allowed by High Court; Appeal Not Heard; Fed Ruling Stands." *American Banker*, June 14 1988.
[48] "Securities Group to Give Some Ground on Opposition to Glass-Steagall Repeal." *American Banker*, November 30, 1989.
[49] "Banks Say No Deal to SIA's Proposal, Citing Imbalances." *American Banker*, December 5, 1989.

in the House of Representatives. The 1995 Republican takeover of the House cleared out several hostile committee chairmen,[50] but insurance industry lobbyists and the ABA continued to fight over barriers between banking and insurance (another part of the Glass-Steagall repeal discussions).[51] The ABA used its increased leverage from winning so many regulatory victories to kill partial repeal attempts that imposed too many restrictions on commercial banks' activities. The ABA would wait for a full repeal, and in the meantime commercial banks would take advantage of the new powers granted to them by regulators to enter into competion with investment banks.[52]

By 1997, the SIA itself was changing. Because commercial banks' securities activities had grown, and some had even purchased smaller investment banks, large commercial banks began to join the SIA. Of the SIA's 33 board members in 1997, six worked for companies owned by banks, and 5 of the 20 largest members of the SIA were owned by banks.[53] In 1998, Citicorp (a commercial bank) and Travelers Group (an insurance company that owned a major investment bank) announced a merger which would form a company that directly violated Glass-Steagall. Because Travelers Group was an insurance company, and not a bank holding company, it was able to apply to the Federal Reserve to become a bank holding company and thus be granted an automatic two year grace period to divest itself of impermissible activities—or to get the law changed (Carnell et al. 2008: 460). The Federal Reserve approved the petition, and the D.C. Circuit Court upheld the Fed's decision over the objections of the Independent Community Bankers of America.[54] It did not matter that the newly formed Citigroup had no intentions of divesting itself of its impermissible activities; the provisions of the Bank Holding Company Act gave the new company a two year grace period.

[50] "Glass-Steagall Reform Imperiled by Friends." *American Banker*, March 3, 1995. See also Suárez and Kolodny (2011).

[51] "Dismantling Glass-Steagall: Glass-Steagall Repeal: Is it in the Stars for Banks at Last?" *American Banker*, March 20, 1995.

[52] Although investment banks were less concerned with entering commercial banking than the reverse, investment banks did fight throughout this period for a repeal bill that allowed them maximum entrance into commercial banking. That is, investment banks decided that if the separation between commercial and investment banking was going to erode, they wanted to ensure complete access to other side's market.

[53] "Verbatim: Securities Industry Consensus Getting Harder to Reach." *American Banker*, November 19, 1997.

[54] *Independent Community Bankers of America v. Board of Governors of the Federal Reserve System.*, 195 F.3d 28 (D.C. Cir. 1999).

As divisions between securities firms, insurance companies, and traditional banks continued to weaken (or in the case of Citigroup, collapsed entirely) the three lobbies united behind a proposal to repeal Glass-Steagall. Reports estimated that in 1997 and 1998 alone, financial firms spent $300 million lobbying for the repeal.[55] In 1999, Congress repealed the already-weakened separation of commercial and investment banking through the Financial Services Modernization Act (or Gramm-Leach-Bliley). Although there were a few hurdles involving privacy concerns (specifically around medical records held by insurance companies)[56] and the Community Reinvestment Act,[57] once the major lobbying groups for the investment banks, commercial banks, and insurance companies signed on to the bill, its passage was relatively uncontroversial. The final vote in the Senate was 90-8; in the House, 362-57.

Technically, the Gramm-Leach-Bliley Act of 1999 did not completely repeal Glass-Steagall, but rather changed the rules by creating a new kind of company—the financial holding company—which was allowed to engage in activities previously prohibited to bank holding companies. For example, traditional investment banks were still prohibited from taking deposits unless they changed their legal form to a financial holding company (Carpenter and Murphy 2010: 15-17). Given that Gramm-Leach-Bliley created a form of organization that was allowed to do both commercial and investment banking, it is most often summarized as a repeal of Glass-Steagall (see again Figure 4). Soon after, Citigroup became one of the first financial holding companies, and the other large commercial banks followed.

5.5 Analytical Summary

Insert Figure 3 about here

In Figure 3, we present a graphical summary of the preceding sections to highlight the inter-

[55] "A New Financial Era: The Overview." *New York Times*, November 13, 1999.

[56] "In Focus: Financial Reform Bill's Latest Snag Could Put It into Intensive Care." *American Banker*, July 12, 1999.

[57] "Reform Vote Called Off as Republicans Battle CRA." *American Banker*, September 4, 1998. The Community Reinvestment Act, an anti-redlining act passed in 1977, encouraged banks to invest in low-income communities. See Krippner (n.d.) for an explanation of the CRA and its history. Republicans in Congress opposed provisions in Gramm-Leach-Bliley that linked a commercial bank's ability to enter into investment banking to its rating under the CRA.

dependencies of the three strategies. At the beginning of the 1980s, in response to changes in the external environment that threatened their profitability (especially globalization and the financialization of non-financial corporations), commercial banks began an all-out assault on the separation of commercial and investment banking. This assault had three primary components: an attempt to reinterpret existing regulations to increase the range of investment banking activities permissible to commercial banks, the innovation of new tools (e.g., derivatives) that straddled the line between commercial and investment banking,[58] and direct legislative engagement to pass a repeal of Glass-Steagall. The direct lobbying effort was stymied throughout the 1980s, in part by the resistance of investment banks who did not want increased competition. Reinterpreting the rules proved simpler given the deregulatory mindset of regulators during the Reagan administration. Section 20 subsidiaries, made possible by a 1987 Federal Reserve decision, allowed commercial banks to take as much as 25% of the market for underwriting corporate equity and debt by 1998. Additionally, new derivative products proved extremely successful, and the market for interest-rate and currency swaps grew precipitously. Throughout this period, commercial and investment banks competed fiercely, with commercial banks capturing the majority of derivatives business (about 70% in 1992). These successful invasions into investment banking weakened investment bankers' opposition to a repeal of Glass-Steagall: they had already lost their monopoly over traditional investment bank activities and faced stiff competition in new derivatives markets. In the 1990s, investment banks switched positions to support the repeal of Glass-Steagall. The 1994 Congressional elections removed a few key Democrats who opposed the repeal and, over the next 5 years, commercial banks, investment banks and insurance companies worked out their differences. The merger of Citibank and Travelers spurred the final push to pass the Gramm-Leach Bliley Act which removed the last vestiges of the separation of commercial and investment banking.

[58] It is difficult to say to what extent commercial banks conceptualized derivatives as a strategy for overturning Glass-Steagall. Drawing on Tett (2009), it seems likely that derivatives were an "emergent" strategy for vitiating Glass-Steagall's effectiveness.

6 Discussion

In this article, we developed a strategic and interest-based framework for making sense of how organizations influence the content and meaning of laws that govern their behavior. Prior work at the intersection of organizational theory and the sociology of law has emphasized the institutional processes through which organizations produce endogenous legal change by responding to instability in their legal environments. Although institutional approaches have led to important new insights, they have also limited exploration of more deliberate and strategic efforts of organizations to shape the law. Our approach incorporates this prior institutional research within a broader framework that emphasizes strategic pathways to legal endogeneity and therefore opens the field to a wider array of research questions and empirical settings. Our analysis of the demise of Glass-Steagall demonstrates the importance of organizational strategies in producing endogenous legal change by illustrating how organizations can engage in deliberate action intended to alter the meanings and effects of established laws, or create entirely new legislation.

The essence of our framework lies in four key departures from earlier work. First, we define endogeneity in terms of organizational action in order to delineate endogenous from exogenous change. Under this definition, the boundaries of a field as defined by the organizational theorist and the organizational population targeted by a given law or regulation do not need to coincide. Legal endogeneity occurs when organizations alter the content or meaning of laws or regulations that govern their actions. Second, our framework accounts for organizations' strategic and interest-driven efforts to shape their legal environments and ultimately produce endogenous legal change. While the process of institutional feedback explored in prior work on law and organizations may involve strategic organizational action, the strategies used by organizations are aimed at preventing liability and at survival in uncertain legal environments. The approach developed in this article differs by foregrounding the deliberate strategies used by organizations to destabilize their environments and ultimately alter the law. Third, it identifies multiple pathways to legal endogeneity while integrating existing empirical work. In addition to institutional feedback, we identified and explicated three broad strategies that organizations have used to produce endogenous legal change: reinterpreting the law, innovating around the law, and legislative engagement. Finally, our framework can be applied to diverse legal arenas. Efforts at reinterpretation are typically directed at courts and regulatory agencies. Innovation around the law involves less direct interaction with formal legal authorities, but to the extent that new organizational practices change the effects of existing laws, this strategy is most closely associated with legislative and regulatory domains. Legislative engagement is, of course, directed at political authorities with the power to write and pass laws. Lastly, institutional feedback, as detailed in prior work, plays out through subtle changes in understandings of acceptable compliance in the judiciary.

In this section, we first discuss three implications of our framework for future research on law and organizations and organizational theory more generally. Next, we highlight some of the novel historical insights that emerged from our analysis of the long and slow demise of Glass-Steagall. We then address some of the limitations of our analysis. Finally, we end with a discussion of directions for future research, and point to several substantive areas where our framework for understanding legal endogeneity may be useful.

6.1 Theoretical Implications

The framework and analyses developed in this article have three major theoretical implications. First, in recent years, numerous commentators have emphasized the need for greater attention to interests and agency study of organizations (Barley 2007; Hinings and Greenwood 2002; Mizruchi and Fein 1999; DiMaggio 1988). Research on institutional entrepreneurship and institutional work has taken important steps in this direction by exploring how social actors create, maintain, and disrupt the institutions that govern their organizations (Fligstein and McAdam 2011; Battilana et al. 2009; Lawrence and Suddaby 2006; Clemens and Cook 1999; DiMaggio 1988). But despite growing interest, most studies in this area focus either on the practices involved in creating new institutions or maintaining existing ones. As Lawrence and Suddaby (2006: 238) note in one recent review, "very little research has documented the practices through which actors purposively engage in the disrupting of institutions."

The strategic and interest-based approach we have developed in this article is well suited to the study of disruptive institutional change. Although scholars of law and organizations, and institutional theorists more generally, recognize that organizations may act strategically, they have tended to emphasize what some have deemed *emergent* strategies—"patterns or consistencies realized despite, or in the absence of, intentions" (Mintzberg and Waters 1985: 257; Thompson and McEwen 1958; Perrow 1961; Lawrence 1999). Examples of emergent strategies may include an organization's hiring of compliance professionals following the passage of an ambiguous new law to help limit liability, or the implementation of other procedures that emerge in response to environmental uncertainties. Institutional feedback results from organizations' pursuit of these types of emergent strategies. Our framework differs in that it draws attention to *deliberate* strategies, which are strategies devised and implemented in close accordance with core organizational goals, such as market expansion or new product development (Mintzberg and Waters 1985; Perrow 1961). Organizations are subject to the vicissitudes of their environments, which they seek to manage through emergent strategies. But, they can disrupt these environments as they strive to achieve their most fundamental objectives. In our analysis of the history of Glass-Steagall, we found that organizations acted deliberately and strategically to produce legal change, and that the execution of these strategies, by igniting a series of disruptive institutional transformations, contributed substantially to the law's ultimate demise. Exploring more nuanced deliberate strategies like the ones identified in this article may yield insights into the specific mechanisms through which organizational actions lead to changes in their broader environments.

Second, our theoretical framework and analysis of Glass-Steagall challenge the common assumption that organizations persistently strive for certainty and stability in their environments (Meyer and Rowan 1977; DiMaggio and Powell 1983; Pfeffer and Salancik 1978; Fligstein 1990; see Oliver [1991] for a more general discussion). Unstable environments are problematic for all organizations because they increase the overall risk of failure; they may also threaten incumbents' favorable positions (Carroll and Hannan 2000; Tushman and Anderson 1986). Although we acknowledge that stable environments are likely to be preferred in general, we argue that organizations may actually promote instability in order to produce a more favorable new settlement. In particular, instability in one field may impel an organization to destabilize another, relatively stable, field. For example, in the case of Glass-Steagall, commercial banks responded to instability in their core business of lending by actively promoting uncertainty in their otherwise stable legal environment in an effort to produce a new settlement that allowed them into investment banking. Research on legal endogeneity and on disruptive institutional change more generally may benefit from relaxing assumptions about preferences for stability, and from further identifying the conditions under which organizations are willing to accept temporary uncertainty in the pursuit of potentially more favorable legal or institutional environments.

Finally, our analysis suggests that interactions between private sector organizations are an important but underexplored dimension of the dynamics of legal stability and change. Research in political science documents how interactions between state actors influence the evolution of the law (Baumgartner and Jones 1993; Sheingate 2006). Early institutional studies, by contrast, turn their attention to interactions between the state and private organizations by looking at how organizations respond to exogenous changes in the law introduced by legislatures (Dobbin and Dowd 1997; Sutton and Dobbin 1996; Edelman 1990). Studies of legal endogeneity, including the present article, also examine interactions between the state and private organizations, but focus on how the actions of organizations alter the law. But our discussion of Glass-Steagall also suggests that interactions between private sector organizations are consequential for understanding the dynamics of the law. Throughout the history of Glass-Steagall, commercial banks' efforts to expand their activities were consistently met with opposition by organizations that stood to lose market share if the restrictions imposed by the law were eased. In the late 1950s and early 1960s, when commercial banks sought to underwrite revenue-secured bonds for local governments, investment banks called for regulators to block the expansion. In the following decades, investment banks, mutual funds, and other financial organizations continued to fight commercial banks' expansion by pushing for the enforcement of Glass-Steagall. Even in the deregulatory climate of the 1980s, Glass-Steagall survived legislatively in part because investment banks opposed its repeal, and was only fully overturned after investment banks changed their position.

More broadly, research on legal pluralism may offer a useful starting point for understanding the causes and consequences of private sector organizations' efforts to mobilize and uphold laws against one another. Legal pluralism refers to the co-existence of two or more legal systems, typically formal or official law and more informal normative forms of community regulation (Merry 1988; Moore 1973). Within this literature, scholars have been particularly interested in understanding the conditions under which social actors make use of the formal law. Legal pluralists find that the institutions of formal law are most often used during times of rapid social change, but for purposes that may fall out of the original boundaries of the law. One result of this repurposing is that the formal law can change in subtle ways to reflect its new uses (Engel 1980). During the 1980s, when the U.S. financial sector began to change and traditional barriers separating various types of banking activities eroded, investment banks drew on the authority Glass-Steagall, but as a way of enforcing the boundaries of competition, not out of their desire to ensure the stability of the nation's financial system—the original intent of the law. Research on law and organizations could look to these insights about legal pluralism and social change to better understand of how relationships between private sector organizations alter the formal law.

Studies of how organizations enforce the law against one another could be especially helpful for the growing organizational literature on industry self-regulation (Short and Toffel 2010; Schneiberg and Bartley 2008; King and Lenox 2000). Research on industry self-regulation has endeavored to understand the institutional conditions under which organizations and industries are likely to effectively police one another, but have focused primarily on normative pressures (Gunningham and Rees 1997). Our finding of the role of investment banks in driving the enforcement of Glass-Steagall suggests that to the extent that organizations can use the law to police one another, the nature of intra-industry competition may also be and important determinant of meaningful self-regulation, at least at the industry level.

6.2 Empirical Implications and Limitations

In addition to its theoretical contributions, our analysis adds three insights to the history of recent financial deregulation. First, most existing research on the history of modern financial derivatives has not connected the growth of derivatives to the collapse of Glass-Steagall. Drawing on previously unexplored government data, we demonstrated that commercial banks and investment banks competed heavily in the early years of the interest-rate and foreign exchange derivatives markets. Thus, without any changes to the text of Glass-Steagall, the effective separation of commercial and investment banking was eroded throughout the 1980s and 1990s as they competed in this new market.

Second, given the success of commercial banks at entering investment banking in the 1980s and early 1990s through new derivatives markets and Section 20 subsidiaries, our research suggests that scholars interested in the role of financial deregulation as a cause of the 2008 financial crisis may place too much emphasis on the formal repeal of Glass-Steagall in 1999. In agreement with the Financial Crisis Inquiry Commission (2011), we find that Glass-Steagall was largely ineffective well before the passage of Gramm-Leach-Bliley. Thus, even if the combination of commercial and investment banking activities in a single business was partially responsible for the crisis (a hotly contested issue), we find that such combinations were legally possible even in the absence of Gramm-Leach-Bliley. More generally, our analysis suggests that scholars interested in financial deregulation should focus as much on regulatory decisions, court cases, and financial innovations as they do on acts of Congress.

Third, the history of Glass-Steagall adds greater depth to our understanding of the financialization of the U.S. economy in the 20th century. In the 1980s, even large financial institutions came in a variety of distinct forms: commercial banks, investment banks, insurance companies, and so on. The turn to finance in the 1970s-1990s affected these institutions differently; for example, the increasing use of commercial paper by non-financial firms threatened the profitability of commercial bank lending in contrast to the aggregate profitability of the finance sector as a whole. By the end of the 1990s, however, many of these firms grew more similar as their core businesses began to overlap, creating what Wilmarth (2009) calls the "large, complex financial institutions" that dominate modern finance. Our analysis suggests that this unification of big finance resulted, in part, from the legal strategies of commercial banks that intentionally set out to disrupt the boundaries separating different types of financial institutions. These strategies culminated in an alliance between commercial and investment banks to complete the repeal of Glass-Steagall. Thus, our research suggests that big finance has not only become more profitable since the 1970s, but it has also become more politically and economically unified.

Our focus on Glass-Steagall has helped us to derive insights about an important case of deregulation and to propose a framework for the study of endogenous legal change. However, our reliance on a single case presents a number of limitations that suggest the need for future research. The pathways to legal endogeneity we identified in our analysis, and in prior research, were all undertaken in the United States in the late 20th century. Although we believe the basic insights of our approach will be helpful in many empirical contexts, the details will likely differ in times and places far removed from the contemporary U.S., as nations differ markedly in their legislative and regulatory institutions. Additionally, our analysis focused on the actions of large businesses; small firms face different constraints and more limited resources. Small firms are thus likely to be more reliant on coordinating bodies such as trade associations, and may lack access to foreign subsidiaries in which to incubate innovations. Similarly, non-profit entities are subject to different types of regulations and are beholden to different stakeholders. Finally, our analysis focused on a relatively technical struggle that largely escaped the public eye, and thus lacked social movement pressures which might change the dynamics between regulators, courts, legislators and large organizations.

6.3 Future Directions

Despite the limitations of our case, we believe our general framework and specific strategies are broadly relevant to many contexts of interest to organizational theorists. We conclude our discussion by suggesting how the framework might be usefully applied and extended in three empirical domains that differ markedly from the present study: antitrust, copyright, and civil rights law. By applying the framework in diverse contexts, we hope that future research will be better able to identify the conditions under which different strategies are more likely to be attempted or to succeed.

The history of antitrust law is replete with examples of endogenous legal change. The Sherman Antitrust Act of 1890, for instance, sought to outlaw various monopolies, cartels and other conspiracies to restrain trade. The law was used extensively under the administration of Theodore Roosevelt to curb anti-competitive business practices ("trust busting") including certain forms of horizontal combination. Firms later attempted to expand their market share by innovating around laws that forbid acquisition of their competitors by instead vertically integrating with their buyers and suppliers (Fligstein 1990). In 1937, FDR began advocating more aggressive use of existing antitrust laws to fight monopolies and in 1950 Congress passed the Celler-Kefauver Act, which restricted vertical mergers that limited competition (Fligstein 1990: 28). Once again, firms innovated around the law, this time by acquiring unrelated businesses, the result of which was the emergence of the conglomerate form in the 1950s and 1960s.

Innovation around the law appears to have had an important, and well-documented, influence on the evolution of U.S. antitrust policy. But our framework also points to another instance of endogenous legal change in the history of antitrust that has received much less attention in the literature on law and organizations. Although the Sherman Antitrust Act was passed in 1890, the law's first uses were not attempts to limit the monopoly power of large-scale enterprises, but rather to limit the ability of labor unions to launch boycotts (Merritt 1910; Primm 1910). Businesses used the courts to push for a reinterpretation (or expanded interpretation) of the law that would view any union strike activities that restricted the flow of goods across state lines as a conspiracy to restrict trade and therefore a violation of antitrust law (Winter 1963).[59] Future research could develop a more complete understanding of the evolution of antitrust legislation and of legal endogeneity by examining these early organizational efforts at reinterpretation.

Future studies may also benefit from considering more contemporary instances of legal endogeneity. For example, the 1998 Digital Millennium Copyright Act (DMCA) criminalized the circumvention of technologies like digital watermarks and encryption that were designed to regulate access to copyrighted works (Lessig 2006). The DMCA, which was championed

[59]The application of antitrust law to union activities remains a controversial issue among legal scholars to this day. For a recent review and discussion of relevant historical court decisions, see Litwinski (2001).

by recording, software, and other copyright intensive industries, had the effect of changing copyright disputes into criminal violations of the DMCA, where defendants no longer had strong First Amendment protections (Jackson 2001). In other words, organizations in copyright intensive industries altered the set of laws that governed the use and distribution of their core products. The legal change brought about by the DMCA worked through a tight coupling of legislative engagement and technological innovation (in digital rights management) in a way that differed from the looser coupling of the strategies found in the case of Glass-Steagall. In their attempt to innovate around existing copyright law, copyright intensive industries had to arrange for the passage of DMCA while simultaneously inventing new methods of distributing copyrighted music.

Finally, given the extent to which earlier institutional work on legal endogeneity has focused on civil rights, we briefly consider how our strategic and interest-based framework could contribute to understanding the role of organizations in shaping this area of law. Prior work has documented extensively how judicial interpretations of civil rights were influenced by the policies and procedures adopted by private sector organizations in their effort to comply with ambiguous legislation (Edelman et al. 1999, 2011). Our approach would suggest that other, more deliberate efforts of organizations could have set the legal endogeneity of civil rights regulations into motion even before the enactment of ambiguous legislation. For example, Sarratt (1966: 285-97) documents instances in which the business community in southern cities including Atlanta, Dallas, Little Rock, and New Orleans, lobbied state officials to end segregation, which they argued was harming the business climate. Rosenberg (1991: 158) also shows that as the economic position of blacks improved throughout the 1940s and 1950s, businesses became increasingly concerned about the loss of income that resulted from segregation, which contributed significantly to pressures for policy change. Although additional research would be necessary to establish the nature of organizations' influence on early civil rights law, a strategic and interest-based approach suggests that dentifying the role of employers in the changing legal environment that preceded the enactment of ambiguous civil rights legislation could lead to a slightly different interpretation of some findings documented by existing work on legal endogeneity.[60] For example, to the extent that large employers were material to the final wording of the legislation, the compliance professionals hired by organizations following the passage of the Civil Rights Act may be better viewed as conveyors of legitimacy than as the guiding forces of endogenous change. At the very least, the framework suggests that some interesting and important instances of legal endogeneity in this domain of law may have been understudied.

7 Conclusion

Organizations, especially large corporations, actively participate in the constitution of their environments. In order to extend our understanding of the relationship between organizations and the law, scholars must go beyond a simple reactive model that assumes the passage of new laws and the interpretations of existing ones is largely exogenous to the organizational fields they regulate. Although existing work on legal endogeneity has taken several useful steps towards such a model, we have argued that a more substantial break with earlier work is necessary to fully grasp the variety of legal strategies employed by organizations to shape their legal environment. Specifically, we redefined endogenous legal change as change that occurs when organizations, in the pursuit of their perceived interests, alter the content or meaning of the laws that govern those organizations' actions. This definition focuses our attention on the deliberate and emergent strategies employed by organizations to disrupt their legal environments while clarifying the boundaries between endogenous and exogenous change.

Drawing on the history of Glass-Steagall, we identified three strategies used by commercial banks to progressively break down the barriers between commercial and investment banking in the 1980s and 1990s: *reinterpreting the law*, *innovating around the law*, and *legislative engagement*. Though derived from our analysis of a single case, we believe that these strategies will be useful for scholars analyzing a diverse array of empirical sites where organizations have reasons to take up arms against existing legal arrangements. Drawing on this framework, we anticipate future research will address important questions about the conditions under which

[60] Of course, social movement organizations played a major role in driving legal change in the area of civil rights. However, because these organizations were primarily targeting laws that governed the actions of employers and not their own actions, their activities do not fall under our definition of endogenous legal change.

organizations employ particular strategies, or when particular strategies are more or less effective, and thus expand our understanding of how organizations shape the world we live in.

8 Appendix A: Data and Methods

We employ process tracing (George and Bennet 2005) to produce a detailed narrative history of contention surrounding Glass-Steagall. First, we produced a minimal description of the sequence of relevant events that led to the undermining of the separation of commercial and investment banking (on minimal vs. maximal descriptions, see Reed [2011]). After producing this minimal description, we isolated three analytically distinct pathways whose combined outcome was the complete elimination of Glass-Steagall. We then generated richer theoretical descriptions of these pathways, drawing on a large and varied body of existing research in sociology, political science, and organizations. Our method does not assess which pathway was most influential, but rather illustrates their interactions and temporal dependencies. This method accords with our theoretical project of illustrating how organizations strategically mobilize to change existing laws and regulations. Our goal is to produce generalizable pathways that are likely to be evident in other cases, not to theorize the circumstances under which organizations are more likely to attempt one pathway, nor under which different pathways are more likely to succeed.

Specifically, we began our research with a detailed examination of trade and general newspapers. We focused initially on *American Banker*, the trade newspaper of the banking industry, and *The New York Times* (*NYT*), the most prominent general newspaper in the United States during our period and the local newspaper of many key financial institutions. We read every article in each publication that included the term "Glass-Steagall", "Banking Act of 1933", and "Gramm-Leach-Bliley" and used these articles to identify relevant events and periods and to generate new search terms (such as "Section 20 subsidiary"). In total, we collected 4,267 *American Banker* articles and 723 *NYT* articles. We checked *NYT* coverage against a smaller sample of Washington Post articles ($N = 386$). Drawing on existing secondary research (especially Tett [2009]), we also identified the history of derivatives as an important component of the story, and broadened our search to include "swaps" and "derivatives." After establishing the general narrative in the trade and general press, we then dug deeper into key moments of contention. We analyzed court documents and rulings, regulatory publications, Congressional Research Service reports, and contemporary law review articles, among other sources. These sources allowed us to understand the shifting positions of investment and commercial banks, the dominant threats faced by each industry (as they understood them), the strategies employed by these organizations, and how regulators, courts and legislators responded. We then produced the more analytical narrative presented here.

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10 Figures and Tables

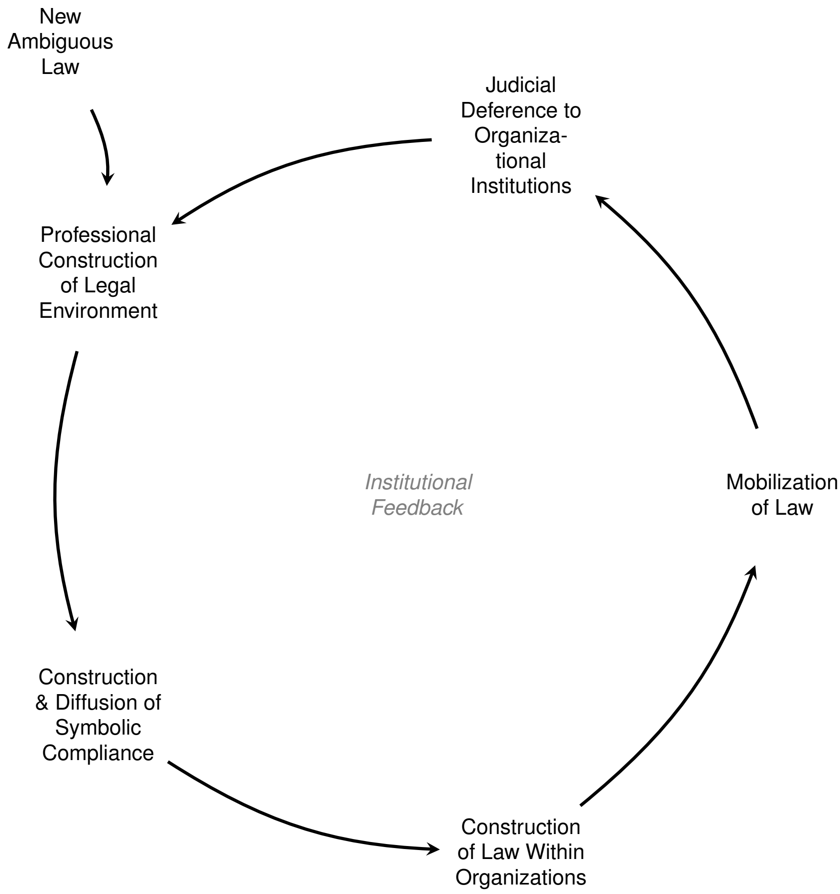

Figure 1: Legal Environments Model of Endogenous Legal Change. Adapted from Edelman (2005).

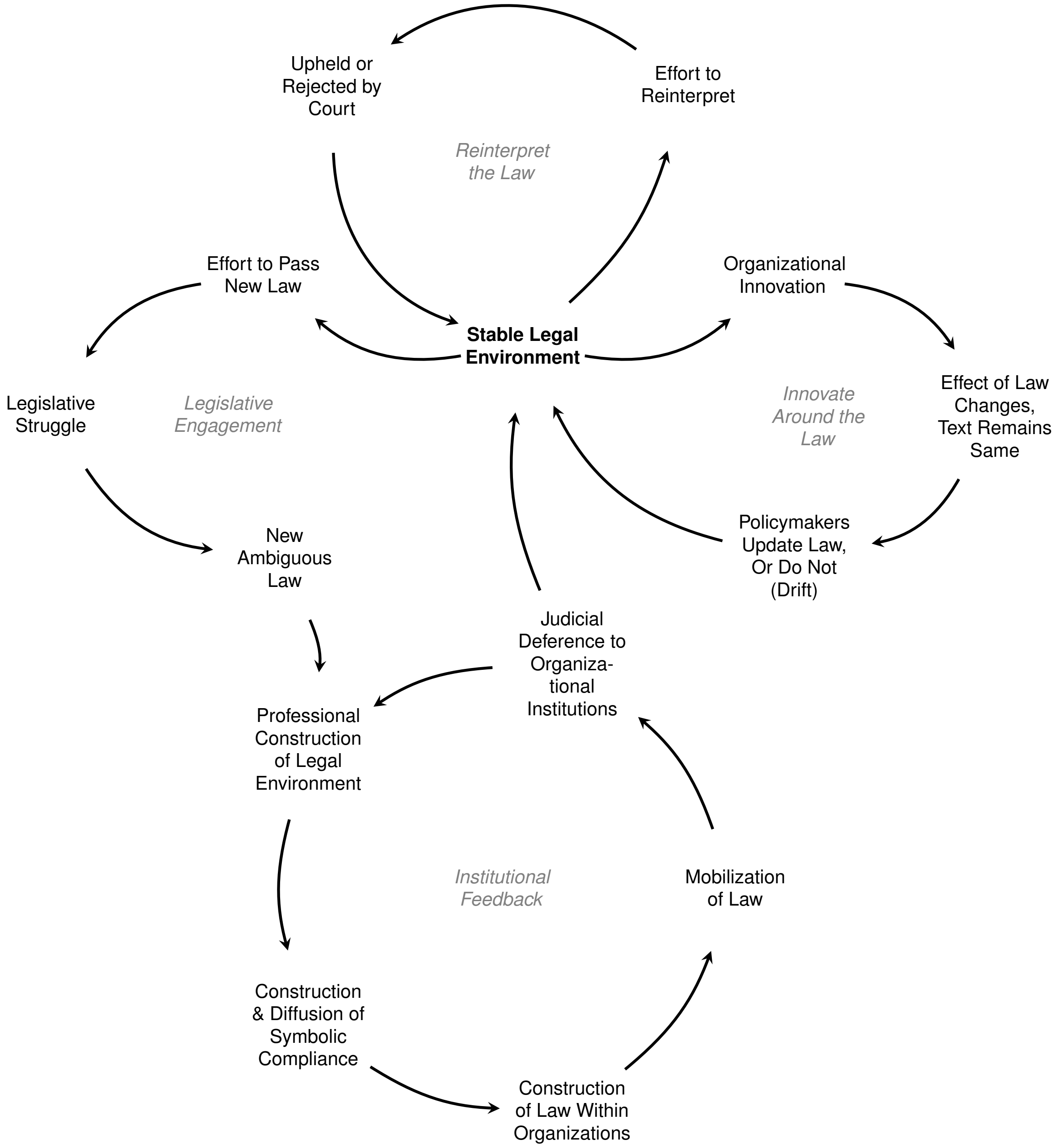

Figure 2: Four Organizational Sources of Endogenous Legal Change.

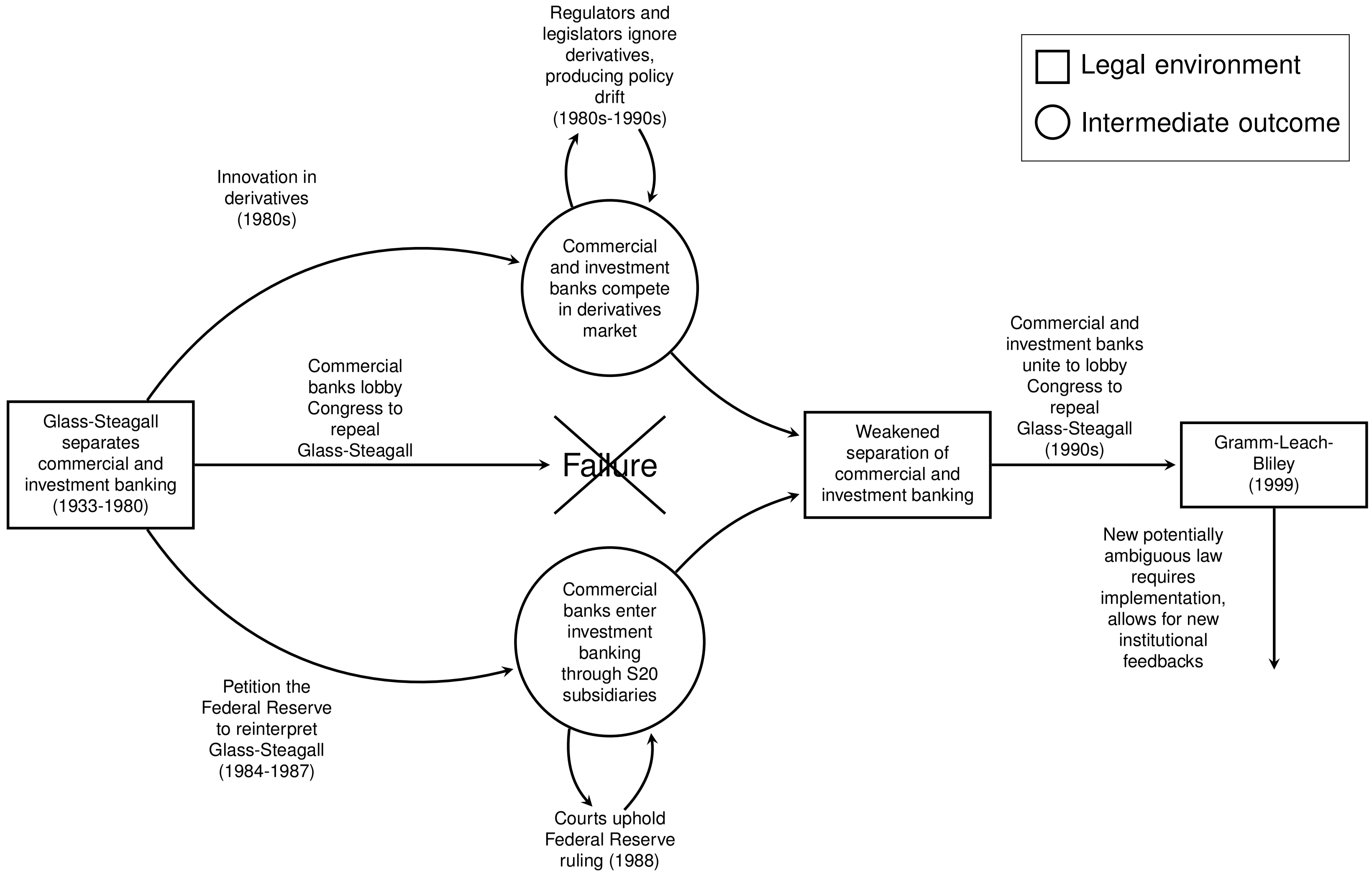

Figure 3: How Organizations Re-Shaped Glass-Steagall.

Figure 4: A picture accompanying a *New York Times* article about the financial crisis that began in 2008. The caption read “DONE AND UNDONE. . . In 1933, left, Franklin Roosevelt signed the law that separated banks from securities firms. In 1999, Bill Clinton signed the bill that undid that separation.” (“Casino America In Play,” *New York Times*, September 20, 2009)

	Source of Endogeneity	**Type of Pathway**	**Description**
1	Institutional feedback	Result of emergent strategy	Organizations adapt in response to legal change. Courts adopt interpretations of the law that correspond to procedures created by organizations.
2	Reinterpret the law	Deliberate strategy	Organizations exploit ambiguity in the wording of the law to push regulators to make favorable interpretations.
3	Innovate around the law	Deliberate or emergent strategy	Organizations develop new structures and practices, thereby setting policy drift into motion.
4	Legislative engagement	Deliberate strategy	Organizations lobby for the creation of new laws, the amendment of existing laws, or the outright repeal of statutes.

Table 1: Organizational Sources of Endogenous Legal Change.

Major OTC Derivatives Dealers	**$**	**%**
Banks		
Chemical Bank Corporation	1,620,819	14.7
Citicorp	1,521,400	13.8
J.P. Morgan & Co., Inc.	1,251,700	11.4
Bankers Trust New York Corporation	1,165,872	10.6
The Chase Manhattan Corporation	886,300	8.1
BankAmerica Corporation	787,891	7.2
First Chicago Corporation	391,400	3.6
Bank Subtotal	**7,625,382**	**69.4**
Securities Firms		
The Goldman Sachs Groups, L.P.	752,041	6.8
Salomon, Inc.	729,000	6.6
Merrill Lynch & Co., Inc.	724,000	6.6
Morgan Stanley Group, Inc.	424,937	3.9
Shearson Lehman Brothers, Inc.	337,007	3.1
Securities Firms Subtotal	**2,966,985**	**27.0**
Insurance Companies		
American International Group, Inc.	198,200	1.8
The Prudential Insurance Company of America	121,515	1.1
General Re Corporation	82,729	0.8
Insurance Companies Subtotal	**402,444**	**3.7**
Total	**10,994,811**	**100**

Table 2: 15 Major OTC Derivatives Dealers and Their Notional Derivatives Holdings in 1992.

Dollar amounts in millions. Percents are of the 15 firm total, not of all OTC derivatives issued. The seven commercial banks accounted for 90% of OTC derivatives issued by commercial banks in 1992, while the five securities firms accounted for 87% of OTC derivatives issued by securities firms. Source: 1992 Annual Reports, compiled by GAO (1994: 36, 188).