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Occupy Wall Street? Just defund it.

By Steven Pearlstein, Published: December 1

A century ago, Louis Brandeis, a distinguished Boston lawyer who would later go on to the Supreme Court, wrote a series of articles in Harper's Weekly denouncing what he called the "financial oligarchy" on Wall Street that had effectively seized control of the burgeoning industrial economy.

The investment banks at the center of this oligarchy, he argued, were not content simply trading securities, in which they took the "inconsistent" position of being buyer and seller. They also had cornered the market on "manufacturing" and "distributing" securities, earning huge fees in the process. The partners in these firms earned incomes derived not by "the rule of reason" but from the maxim "all that the traffic will bear."

Sound familiar?

In fairness, the world of finance today is more transparent, diverse and competitive, in large part because it is better regulated. Since the financial crisis of 2008, the government has been moving once again to rein the excessive power, risk-taking and compensation on Wall Street, as mandated by the Dodd-Frank financial reform act.

But while most of us have been distracted by elections and fiscal brinksmanship, the financial services industry has been waging a furious, well-funded counter-attack that has been alarmingly successful in wearing down the financial regulators. There has been hand-to-hand combat about every word in every regulation. And win or lose, every one of those regulations will be the subject of a scorched-earth legal strategy that will go all the way to the Supreme Court. Working through the Republican caucuses on Capitol Hill, the industry also has moved to trim regulators’ budgets, block nominations to regulatory posts and deny industry critics such as Elizabeth Warren seats on relevant oversight committees.

The depth and breadth of the industry campaign to gut Dodd-Frank is unlike any I have seen in Washington. I have no doubt it was a factor in Mary Schapiro’s decision last week to retire as chairman of the Securities and Exchange Commission.

These developments — in the face of an election in which the “repeal Dodd-Frank” candidates were resoundingly defeated — serve as a reminder that there is only so much that regulation can do to change the behavior and the culture of a determined and powerful industry. Wall Street will always have the ingenuity and muscle to get around whatever roadblocks well-meaning regulators put in its way.

Brandeis, however, understood that there is something else we can do to ensure that the financial system serves the economy, rather than the other way around. After all, it’s not their money they are playing with, he wrote, it’s ours. If we don’t like how Wall Street is investing it and lending it and what they are charging to do so, then all we have to do is put it elsewhere.

What Brandeis had in mind was a new set of institutions that are owned and controlled by their customers. Mutual banks and insurance companies. Cooperatives of various kinds. Credit unions. Employee-run pension funds.

We once had many more such institutions, going back to the mutual insurance company started by Ben Franklin in Philadelphia. But in the 1960s, mutual ownership became passé. To lower the cost of intermediation, financial firms thought they had to be bigger, to offer more products and to cross state lines. To do that they needed more capital, which could only be raised by issuing shares to outside investors. Customer ownership was also a barrier, and “demutualization” became all the rage.

Of course there were other motives as well.

By converting from mutuals to stock ownership, customer-owners were able to capture for themselves the capital and value that had been carefully built up by generations before them, paying themselves a hefty one-time dividend.

And executives lavished themselves with large grants of stock and stock options in the restructured demutualized businesses that would make them wealthier than they could have ever dreamt of in an enterprise run solely for the benefit of its customers.

Although the market share of mutuals, credit unions and cooperatives declined, it never disappeared. As stock companies took on ever more risk and leverage and got into an ever-wider array of products and services, the mutuals stuck to the basics. And when the crisis hit in 2008, the mutuals weathered it better and emerged stronger than ever.

Today, mutual banks and credit unions operate more efficiently than their stockholder-owned competitors. They have fewer loan losses and write-offs and have taken on less risk and less leverage. They charge lower fees for their services and lower interest rates for their loans. They loan more of their funds to households and small businesses. They have noticeably better service ratings from customers.

The comparative data on mutual insurance companies is less dramatic, if for no other reason than mutuals make up a bigger part of the insurance market and have come to operate in ways that are similar to stock companies. On average, mutuals have lower expense ratios and return more of each premium dollar to policyholders. They maintain more capital in reserve against losses and have slightly higher credit ratings. They take less risk on their investment portfolios, and as a result earn slightly less of a return. On ratings of overall financial strength, mutuals consistently win out.

The big difference comes in the area of customer service, where almost all of the top-rated insurers are mutuals. I know this firsthand, having bought my auto insurance from Amica, a mutual, for the past 35 years. The service at Amica is so good that it is almost a pleasure to be in fender bender, which is why the company routinely earns the top ranking in the JD Power survey. Its rates are highly competitive, and that's even before getting the end-of-the-year dividend check, my small share of Amica's profit.

Amica is the anti-Wall Street financial services company. Its business model is based on patient capital, prudent investment and a culture of loyalty and long-term relationships with customers and employees. When customers called Amica in the days after Hurricane Sandy, the average wait to talk to a human was nine seconds.

"I consider my job as more like that of a trustee," Amica chief executive Robert DiMuccio told me last week. "I was handed a franchise and a pool of capital that has grown steadily for 104 years, and my job is to pass it on to the next generation of customers in better shape than when I took it over."

Here's the point: If we don't like the rip-out-your-eyeball culture of Wall Street, if we're tired of the inherent conflicts of interest, if we don't want to encourage the excessive leverage and risk taking and executive compensation, we can take our money elsewhere — to companies that deliver as good or better products and services at the same or lower prices. Forget about occupying Wall Street — why not just defund it?

It would surely help such a grass-root movement get off the ground if existing mutual companies would begin to market themselves more aggressively and explicitly as the Wall Street alternative. They could also use some of their accumulated capital to band together to launch cooperatively owned pension funds, mutual funds and private-equity funds to serve themselves and their customers, in effect creating an alternative financial universe with different values and a different culture.

That would not only be beneficial to the mutuals and their owner-customers — it would be good for the entire financial system. The experience from other industries is that a shift of as little as 10 percent of market share would be enough of a competitive threat to prompt the big financial institutions to offer their own "organic" products, if you take my supermarket metaphor. After that, the process can become rather infectious, changing the way the financial services companies present themselves to the market, keep score and set strategy. Instead of a race to the bottom, like we had during the boom years, you'd get a race to the top.

Conservatives like to say there's nothing wrong with markets that can't be fixed by more open competition. When it comes to financial markets, Lord knows we've tried regulation — Glass-Steagall in the '30s, Garn-St. Germain in the '80s, Gramm-Leach-Bliley in the '90s, Sarbanes-Oxley in the '00s and now Dodd-Frank. But given the political power of Wall Street, maybe it's time to acknowledge that a regulatory-only approach can take you only so far.

Let's take a page from the Progressive era and let competitive discipline pick up from there.