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THE SEC AT 70: TIME FOR RETIREMENT?

A.C. Pritchard*

INTRODUCTION

As one grows older, birthdays gradually shift from being celebratory events to more reflective occasions. One's fortieth birthday is commemorated rather differently from one's twenty-first, which is, in turn, celebrated quite differently from one's first. After a certain point, the individual birthdays become less important and it is the milestone years to which we pay particular attention. Sadly, for entities like the Securities and Exchange Commission (SEC), it is only the milestone years (the ones ending in five or zero, for some reason) that draw any attention at all. No one held a conference to celebrate the SEC's sixty-seventh anniversary. Clearly the SEC is not getting its fair share of chocolate cake.

Eventually, the birthdays come to be recognitions of the fact that you are still around. Survival, not moving ahead in life, becomes the notable fact. And so it is with the SEC. It has now been seventy years since Congress created the SEC in the Securities Exchange Act of 1934.1 We are still short of the gold standard for human survival—100 years—but seventy is not bad. The SEC today looks poised to outlast even the longest human life span. It has largely moved beyond the tasks that dominated much of its early agenda—the taming of the New York Stock Exchange, the reform of corporate bankruptcies and public utilities—and ensconced itself firmly as the arbiter of corporate disclosure and the primary enforcer of antifraud rules relating to the

* Professor, University of Michigan Law School. This paper was prepared for “The SEC at 70” symposium at the Notre Dame Law School, and I am grateful to participants at that conference, as well as at a Fawley Lunch at the University of Michigan, for helpful comments on an earlier version of this article. Remaining mistakes and outrageous statements are my responsibility alone. The Cook Fund of the University of Michigan Law School provided generous support for the research and writing of this article.

purchase and sale of securities.\textsuperscript{2} And the perceived importance of those latter-day functions, and thus the SEC's prospects for survival, have only increased of late, reinforced by the fin de siècle accounting scandals and corporate abuses. The list is by now familiar—Enron, Worldcom, Tyco, Adelphia, Global Crossing, etc.—and the drumbeat of scandal has made the SEC once again the fair-haired boy of the Congress and the White House. The SEC was given a raft of new enforcement tools by Congress in the Sarbanes-Oxley Act\textsuperscript{3} as politicians fell over themselves to get tough on corporate crime in the wake of the collapse of the tech bubble. The SEC—most anxious not to disappoint—has responded to this groundswell of support with a flurry of rulemaking aimed at accountants, analysts and audit committees, just to cover the "A"s.\textsuperscript{4} I have not run across any rules directed toward the "Z"s, but I am sure that is only because the agency has not gotten that far yet. So the SEC clearly shows no interest in slowing down and taking it easy as it reaches its advanced years. A more telling sign of continued vitality at the SEC is that the customary complaints about how the agency does not have nearly enough resources to adequately do its job of protecting the integrity of our financial markets\textsuperscript{5} have given way to an extraordinary situation in which the agency finds itself unable to spend all of the money allocated to it by Congress (which was in turn, more than the White House asked for).\textsuperscript{6} This is a most unusual problem for a bureaucracy to have. In sum, business is booming at the SEC.


\textsuperscript{5} See, e.g., Seligman, supra note 2, at 681 ("Neither the Clinton Administration nor Congress gave the SEC adequate new budgetary or staff support during Levitt’s Chairmanship.").

\textsuperscript{6} Abigail Rayner, SEC to Get 20% Boost to Budget, TIMES (London), Jan. 4, 2003, at 54.
How odd then, the suggestion of my title that it might be time for the SEC's retirement. Retirement can be made mandatory for persons in "high policymaking position[s]" after the age of sixty-five, and the SEC certainly qualifies as a policymaker. But no one is pushing the SEC toward retirement. Well, almost no one—I am not the first to suggest that the time has come to put the SEC out to pasture. Jon Macey suggested ten years ago at a commemoration of the bureau's sixtieth anniversary that the SEC had become "obsolete" and that it was time to kill it off.8 The efficiency of the financial markets, Macey argued, has increased "as technology has developed and as market professionals who compete to find mispriced securities have emerged in huge numbers."9 Moreover, "the opportunities for manipulation and fraud are probably fewer now than at any time in history" and "rules against fraud existed long before there was an SEC."10 Finally, the development of portfolio theory and capital asset pricing models had eliminated diversifiable risks from the investment process.11 Macey's conclusion: "[M]arket forces and exogenous technological changes . . . have obviated any public interest justification for the SEC that may have existed."12

Macey's argument was a non-starter then. The conventional wisdom held that "[t]he SEC is one important reason why the securities industry is in so much better shape than other financial service industries, and why U.S. securities markets are the best securities markets in the world."13 The causal connection between the existence of the SEC and the strength of the U.S. capital markets was difficult to pinpoint, but the conventional wisdom did not question that it did exist. And that conventional wisdom concerning the essential role of the SEC in protecting the integrity of the financial markets has only been strengthened by the aforementioned accounting scandals, although the certainty that the U.S. markets are the best in the world may have been shaken a bit.

Am I simply tilting at the same windmills as Macey? I think not. Whereas Macey seemed intent on affirmatively killing off the SEC and its essential functions, my proposal is (I think) considerably more

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9 Id. at 927.
10 Id. at 928.
11 Id. at 936.
12 Id. at 949.
modest. To return to the metaphor of my title, I think retirement would suffice; capital punishment of the kind proposed by Macey is a bit extreme. By retirement, I mean the abolition of the SEC and the transfer of its essential functions to the executive branch. Specifically, I propose transferring the SEC's regulatory function to the Treasury Department and its enforcement function to the Justice Department, while leaving largely intact the enforcement functions of the state securities authorities and the self-regulatory organizations such as the National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE) and the Public Company Accounting Oversight Board (PCAOB).

Old wine in new wineskins? Again, I think not. Separating the SEC's regulatory function from its enforcement function promises to improve the effectiveness and efficiency of both. My main point goes to accountability. Although it is traditionally argued that placing administrative responsibilities within the executive branch rather than an independent agency is desirable because it increases accountability, I think that the shift of authority I propose might diminish accountability, at least of a certain sort. The accountability that I believe should be diminished is the SEC's accountability to Congress. Because the SEC is an "independent" agency, the President's influence over the agency is limited to the ability to nominate commissioners, and even that power is subject to the Senate's confirmation authority.14 The SEC's status as an "independent" agency leaves it vulnerable to the political whims of key legislators.15 That vulnerability fuels the cyclical pattern of neglect and hysterical overreaction that typifies securities regulation emanating from both the SEC and Congress.16

14 The President may have the power to remove commissioners, either under section 4 of the Exchange Act or as a matter of inherent constitutional authority, but that is a topic for another day. It suffices to observe that commissioners are practically immune from removal because Congress would take a very dim view of any effort to remove a sitting commissioner, and any attempt to do so would be met with significant retaliation from the legislative branch.

15 See Elena Kagan, Presidential Administration, 114 Harv. L. Rev. 2245, 2271 n.93 (2001) ("As a practical matter, successful insulation of administration from the President—even if accomplished in the name of 'independence'—will tend to enhance Congress's own authority over the insulated activities."); Lawrence Lessig & Cass R. Sunstein, The President and the Administration, 94 Colum. L. Rev. 1, 115 (1994) ("Congress might make agencies independent not to create real independence, but in order to diminish presidential authority over their operations precisely in the interest of subjecting those agencies to the control of congressional committees. Independence, in short, might be a way of increasing legislative power over agencies.").

Moving securities regulation to the executive branch might help insulate the field from this destructive pattern. In addition, congressional oversight does little to help overcome the SEC's susceptibility to groupthink and confirmation bias. Moreover, moving securities regulation to the executive branch might open the field to more diverse perspectives. More executive branch involvement might also encourage securities regulators to move beyond their fixation with promulgating new disclosure requirements. Finally, disrupting the close connection between the SEC and Congress might disrupt—at the margin—the disproportionate influence that interest groups exert over securities regulation.

The Article proceeds as follows. Part I explains the pathologies of the SEC and explores the relation between those pathologies and the SEC's status as an independent agency. Part II then outlines an alternative regulatory structure primarily situated within the executive branch. I also argue that such a relocation of authority would enhance regulatory effectiveness while simultaneously reducing the cost of excessive regulation. The Article concludes with some thoughts about the viability of my proposal.

I. THE PATHOLOGIES OF THE SEC

I should begin with a caution: I do not mean to overstate my case. The SEC should certainly not be singled out as an underperformer among regulatory agencies. It enjoys the reputation as being one of the more competent of the administrative agencies and that reputation is, in my view, largely warranted. My point is a more modest one: institutions matter in regulatory policy. In the field of securities regulation, at least, the investing public is not well served by vesting authority in an independent agency. I do not believe that securities regulation in the United States has been a failure, but that does not mean that we are incapable of doing better. I argue in Part II that we might do better by placing the responsibility for the development of securities regulation and the enforcement of those rules in the executive branch.

Where has the SEC fallen short? The list should be a familiar one for most observers of securities law; I do not offer it as original. Nor is it intended to be comprehensive; others will have their own favorite examples of SEC failure. My purpose here is merely to show that the regulation came about following a large and sustained price collapse of the stock market).

SEC's interaction with Congress plays an important role in explaining a range of familiar shortcomings.

A. Regulatory Overreaction

The single most powerful influence on regulatory policy is the urge to protect defrauded investors in the wake of the bull market. To be sure, some investors are defrauded as a bull market is climbing ever higher, but the rising tide tends to obscure the shenanigans as everyone focuses on the profits that they are piling up on paper. Congressmen (at least some of them) recognize in the abstract that encouraging liquid securities markets will facilitate capital formation, and thus, economic growth. Regulation may be necessary to secure that liquidity. That interest, however, is not high on the list of legislative priorities during bull markets when investors' primary focus is counting their gains and chasing the next "sure thing." During these periods, Congress is happy to leave the day-to-day regulating to the SEC, which is, after all, the expert agency.

Bear markets, however, inevitably follow bull markets. Corporate mismanagement and corruption can be obscured by rising stock prices in a bull market, but the dirty laundry has a way of surfacing in bear markets. The bad news flushes out dissatisfied investors who clamor for government intervention. Politicians who happily ignored ever-climbing stock markets become profoundly interested in disclosure policy when the financial news migrates from the business page of the newspaper to the front page. The accounting scandal du jour provides an opportunity to fulminate, hold a series of show trials called "legislative hearings" to rake some greedy businessmen over the coals and then enact legislation to protect "investor confidence." Indeed, that is the genesis of the Exchange Act, which garnered much of its legislative momentum from the legislative proceedings orchestrated by Franklin Roosevelt's henchman, Ferdinand Pecora.18 The recent spectacle of politicians falling all over themselves to outdo each other in "getting tough on corporate crime" is only the latest chapter of political overreaction to the fallout of corruption revealed by a bear market. How quickly the winds shifted in Washington when Enron and Worldcom collapsed under the weight of their "creative" accounting. Congress and the SEC, previously inert, have responded to public outrage over corporate shenanigans by proposing a laundry list of new laws and regulations to crack down on corporate abuses. For example, after stymieing regulation of auditor independence during the

bull market, Congress quickly shifted course on the question with the Sarbanes-Oxley Act, imposing an array of restrictions on services by accounting firms to their auditor clients.  

There may be more than political opportunism at work here. The availability heuristic is also in play, as both the SEC and Congress focus too narrowly on recent and immediately available information. Regulators may also be too quick to see a pattern in a series of events that are in fact random. For example, a handful of salient accounting scandals may be construed as a corporate governance crisis. In the face of a crisis, regulatory approaches seem to make sense when they previously had no support whatsoever. Immediately prior to the Enron scandal, CEO certification of financial statements was nowhere to be found on the SEC list of policy initiatives. It was hardly news that CEOs sometimes fudge the numbers, occasionally on a grand scale. Nonetheless, CEO certification—like other aspects of the Sarbanes-Oxley Act—would not have been adopted without the external pressure to react to a supposed crisis. Similarly, before the Enron scandal broke, Capitol Hill had no interest in safeguarding the role that analysts play as gatekeepers in the securities markets. After the scandal, legislators were baying for regulatory reform, some of them—perhaps—even sincerely. It seems unlikely that this shift on the part of lawmakers could represent a rational response to new information. More likely, it is a symptom of the availability heuristic at work. Also at work is the hindsight bias, as SEC regulators and their congressional overlords place too much weight on the probability of past events that actually occurred relative to those that did not. Enron was “obvi-

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19 See 15 U.S.C.A. § 78j-1 (g) (West Supp. 2004) (forbidding auditors from providing certain non-audit services to audit clients); id. § 78j-1(j) (requiring the rotation of audit partners); id. § 78j-1(l) (prohibiting audit firms from auditing companies whose CEOs, CFOs, or controllers were employed by the audit firm and participated in the audit of the company during the prior year).


21 For an example of fraud prior to Enron, one need only look to Sunbeam Inc. and former CEO “Chainsaw Al” Dunlap, who was removed as CEO in 1998 after allegations of financial fraud. See Kelly Greene, Dunlap Agrees to Settle Suit over Sunbeam, WALL ST. J., Jan. 15, 2002, at A3.

22 The hindsight bias describes the tendency to place too great a weight on events that actually did occur in the past (rather than events that might have occurred but did not) in predicting the probability of events. See Baruch Fischhoff, Hindsight Is Not Equal to Foresight: The Effect of Outcome Knowledge on Judgment Under Uncertainty, 1 J. EXPERIMENTAL PSYCHOL.: HUM. PERCEPTION & PERFORMANCE 288, 288 (1975) (discussing evidence of the hindsight bias).
ously" a disaster waiting to happen—how odd that so few recognized it before disaster struck.

And of course these biases interact in perverse ways with the aforementioned political imperative to respond to the latest headlines. Opportunistic politicians may take advantage of the biases of the electorate, playing up recent instances of fraud to gain electoral support. Analyst independence only became a priority when the New York state Attorney General revealed incriminating internal emails from Merrill Lynch.\(^{23}\) Only after Enron and WorldCom moved accounting from the business page to the front page was auditor independence a compelling need. The SEC did nothing to discourage the notion that the small number of companies implicated in these scandals reflected a broader pattern, a statistically very dubious proposition (following the "law" of small numbers).\(^{24}\) Notwithstanding this dubious empirical foundation, once this story took hold alternative explanations were pushed aside.\(^{25}\) Just as curious as the (over)reaction to the "analyst affair" was the lack of reform effort prior to the scandal. The airing of the investment banks' dirty laundry provided no new information on the conflicts of interest that plague that business model. The SEC—and indeed, most investors—have long known that analyst ratings are skewed toward optimism and that auditors often provide non-auditing services to their clients.\(^{26}\)

Worse yet, some of the abuses that Congress has lately seen fit to regulate can be traced back not to a lack of regulation, but rather to


\(^{24}\) People tend to give too little weight to large samples and too much weight to small samples in drawing inferences on the characteristics of an overall population. See, e.g., Amos Tversky & Daniel Kahneman, Belief in the Law of Small Numbers, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 23, 24 (Daniel Kahneman et al. eds., 1982) ("[P]eople view a sample randomly drawn from a population as highly representative, that is, similar to the population in all essential characteristics. Consequently, they expect any two samples drawn from a particular population to be more similar to one another and to the population than sampling theory predicts . . . ."); Amos Tversky & Daniel Kahneman, Judgment Under Uncertainty: Heuristics and Biases, 185 Sci. 1124, 1124–31 (1974).

\(^{25}\) See Clifford R. Mynatt et al., Information Relevance, Working Memory, and the Consideration of Alternative, 46A Q.J. EXPERIMENTAL PSYCHOL. 759 (1993) (finding that subjects who had developed a plausible hypothesis were less able to recognize alternatives).

\(^{26}\) See Steven D. Jones, Heard in the Northwest: Region's Rare 'Sell' Ratings Apply to Burgers, Machinery and a Thrift, WALL ST. J. NW., Dec. 1, 1999, at 2 (noting that "of 833 opinions in place on the 135 stocks last week [of companies located in the Northwest United States], there was a 'strong sell on only one"), available at 1999 WL-WSJ 24923975.
laxity in enforcement. During the bull market, Congress had more important uses for the taxes generated from securities transactions than policing the securities markets. An understaffed SEC long ago gave up periodic review of company filings because it had other priorities. Accounting fraud ranked low on the enforcement agenda, trailing the vendetta against insider traders and the pursuit of teenagers engaged in Internet stock scams.\textsuperscript{27} Only in the late 1990s did the SEC make financial reporting a priority. Once financials were put under the microscope, the agency claimed to be shocked to find that chief financial officers were playing fast and loose with the numbers. Once the SEC started looking at the books, the number of restatements skyrocketed and we had a deluge of restatements on our hands (at least in the light of the particularly salient accounting scandals making the front pages).\textsuperscript{28}

The "deluge" now seems to have abated somewhat, but the passage of the Sarbanes-Oxley Act has been followed up by an orgy of rulemaking that shows no signs of subsiding anytime soon. The SEC, seeing a window of opportunity, looks for areas in which to expand its sphere of influence while the public still worries over the specter of massive fraud. The regulation of hedge funds looks to be the next territory to conquer.\textsuperscript{29}

Congress, however, shows certain signs of restlessness. As the echoes of those accounting shenanigans begin to fade, various members of Congress have been making threatening noises on the question of the proper accounting treatment of options. Scandal driven reform followed by political neglect has been a recurring pattern in the securities markets. Although scandals may be needed to focus dispersed lawmakers' collective will, they often result in overreaction, particularly if political entrepreneurs succeed in framing the issue in a way that resonates with the electorate.


It's hard to resist the conclusion that this entire hedge-fund exercise is little more than empire-building by the SEC staff. Having missed the mutual fund scandal, they know better than even Mr. Greenspan they have little ability to ferret out hedge-fund fraud. . . . But with more oversight comes greater job security and more Congressional cash.

\textit{Id.}
That dynamic means that demands for financial market regulation will arise in times of crisis, particularly if that crisis spills over into the real economy. Crisis, however, does not create the ideal environment for developing balanced, cost-effective policy interventions. Politicians will want to "do something," even if the proposed something may prove to be costly, ineffective or counterproductive. SEC Commissioners and division heads will be called to the carpet by legislators looking to hold someone accountable for the market decline. Commissioners and staffers tend not to enjoy such encounters. Not being paid very well (relative to their alternative employment opportunities), they expect to at least lead a quiet life, which leads them to a strong preference for conservatism in regulation. From the bureaucrat's perspective, the optimal number of regulatory failures is zero. If a rule makes an incremental contribution to the avoidance of a future crisis, government regulators may be quick to see the rule's wisdom, discounting its costs. Those costs will be borne by investors generally in the form of small reductions in their investment returns and disclosure documents that bury important information in a sea of minutiae. Those costs are sufficiently diffuse that they are unlikely to generate a groundswell for regulatory reform. Thus, the cumulative effect of regulation in response to crisis is a ratchet effect pushing toward greater, more intrusive regulation and greater deadweight costs for investors.

It may take multiple crises to push government regulations to the point where they become a serious drag on the financial markets, but having reached that point, it becomes very difficult to turn the ship of state toward less regulation. Staffers at the SEC have more important tasks to worry about than figuring out which regulations can be discarded—when is the last time anyone at the SEC sat down looking for items to cut from Regulation S-K? As the inflation rate creeps down toward zero, do investors in today's environment really need a discussion of the impact of inflation on a company's operations?30

Worse yet, once in place, legislation and regulations often take on lives of their own. It took Congress over six decades to get around to repealing the Glass-Steagall Act, for example, enacted in response to the crisis of the Great Depression.31 Legislators may accept the wisdom of prior legislation uncritically, operating under a confirmation bias.32 Interest groups that benefit from the regulatory apparatus will

31 See id. §§ 101-103, 113 Stat. at 1341-51 (repealing the Glass-Steagall Act, Pub. L. No. 73-66, 48 Stat. 162 (1933)).
32 See Joshua Klayman, Varieties of Confirmation Bias, 32 PSYCHOL. LEARNING & MOTIVATION 385 (1995) (describing different ways in which the confirmation bias can
fight hard to preserve their prerogatives. Deregulation requires a mammoth (and unusual) mustering of political will. Without any recent information of equal salience—non-scandals tend not to generate newspaper headlines—no impetus will push for removal of protective legislation.

One could argue that this regulatory approach makes sense—put out fires and “don’t fix what ain’t broken.” It may be costly to experiment with new regulations (or less regulation) without the threat of a perceived and immediate loss to investors. But this generalization cannot always be true. Sometimes rationalizing regulation, such as loosening up restrictions on forward-looking disclosure, may benefit both issuers and investors. The continued bias toward reactive reform to the securities laws represents a very dubious presumption in favor of the status quo. That presumption can only be overcome, it seems, by a spate of headlines. This political cycling between policies of benign neglect and hysterical overreaction suggests that the SEC, far from serving as a shelter against the vagaries of the political winds, acts more like a weathervane, swinging wildly with the change in the political atmosphere.

B. “Groupthink” and Confirmation Bias

I turn now from the SEC’s susceptibility to external stimuli to its internal thought processes. Few observers would suggest that there is a great deal of diversity of thought at the SEC. The SEC is known for its strong organizational culture. Often praised as hardworking and dedicated, the mission of “investor protection” is taken to heart by virtually all SEC staffers. As former SEC Chairman Arthur Levitt put it: “Investor protection is our legal mandate. Investor protection is our moral responsibility. Investor protection is my top personal prior-

affect decisions). Once regulations are on the books, regulators may feel the need to justify their worth instead of critically evaluating their effects. Evidence that does not discredit regulation unambiguously will be ignored. See Donald Langevoort, Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms), 146 U. PA. L. Rev. 101, 137 (1997) (“Ambiguous information tends to be dismissed as unmanageable.”). And the confirmation bias will be more pronounced if the evidence is more complex and subject to conflicting inferences, a fair characterization of most regulatory problems in the securities markets. Jon D. Hanson & Douglas A. Kysar, Taking Behavioralism Seriously: The Problem of Market Manipulation, 74 N.Y.U. L. Rev. 630, 648 n.60 (1999) (collecting studies). Self-justification is exacerbated when decisionmakers are held accountable in public settings. Such self-justification can obstruct any change in the status quo. See Langevoort, supra, at 142–43 (“[O]nce executives have committed to a course of action, their subsequent survey of information is strongly biased to bolster their choice—especially when their choice is public, and they can be held accountable for their decisions.”).
This ethos is no doubt reinforced by self-selection among those seeking SEC employment. The people who pursue careers as regulators and enforcement officials may be individuals with heightened senses of justice and fairness. This is not entirely a bad thing. Such traits may lead regulators to work hard for relatively low pay. Such a culture helps maintain morale and focuses SEC staffers on the task of regulating the capital markets.

Despite these benefits, the strong investor protection culture within the SEC may also lead to “groupthink.” Groupthink occurs when individuals come to identify with the organization and accept its mission uncritically due to their perceived membership in the group. Although an individual may assess a particular decision critically, members of a group defer to the consensus. Groupthink will also tend to reduce the range of hypotheses that an organization considers when faced with a problem. Homogeneous groups like the self-selected SEC staffers are particularly susceptible to the confirmation bias and are perhaps more likely to engage in self-serving inferences (to the extent that all the staffers have a homogeneous interest). Once the SEC has committed to a policy initiative through a rulemaking proposal—thereby tentatively committing the “group”—feedback on the proposal may get less weight than it would.


35 Chip Heath et al., Cognitive Repairs: How Organizational Practices Can Compensate for Individual Shortcomings, 20 RES. ORG. BEHAV. 1, 20 (1998) (“Often, organizations ensure that individuals weigh information effectively by forcing them to interact with others who might weigh the information differently.”).


37 Donald Langevoort describes self-serving inferences as follows:

Self-serving inferences arise when there is a reasonably high level of ambiguity surrounding a situation. With that kind of cognitive freedom, the mind tends to form stronger-than-justifiable inferences in the direction of a person’s self-interest. More simply, people see as correct what is more properly described as convenient. Having rationalized their inferences, people feel little guilt in acting upon them.

have if the information had been solicited before the SEC fixated upon a specific proposal.

Groupthink may also manifest itself in the SEC's single-minded focus on investor protection. When a decision can be placed on a normative scale, such as more or less investor protection, group decision dynamics will push the group toward a polar end of the scale. At the SEC, the systematic tendency will be to settle on outcomes that promise more investor protection. Many investors may be able to protect themselves, but the SEC usually focuses on the stereotypical "widows and orphans" in crafting protections. The SEC's recent initiative to regulate hedge funds—the investment haven of the ultra-rich—springs to mind.\textsuperscript{38} If hedge funds are not safe for widows and orphans, the SEC must bring them to heel. Only political pressure is likely to deter the SEC from seeking the most restrictive alternative.

The SEC's focus on "widows and orphans" also helps explain its consistently siding with the plaintiffs' bar. The plaintiffs' bar, of course, styles itself as the "investor's advocate" even more strongly than does the SEC. Private class action litigation has been an important impetus toward ever more expansive interpretations of the anti-fraud rules. With a few minor exceptions (sometimes driven by fear of congressional retribution), the SEC has sided with the plaintiffs' bar in the courts.\textsuperscript{39} As a somewhat exasperated Justice Powell noted, the "SEC usually favors \textit{all} n. I can't recall a case in which this was not so."\textsuperscript{40} The SEC has promoted this expansion despite the readily apparent weaknesses in the arguments for investor compensation.\textsuperscript{41}

Congress is of two minds on this issue. Legislators are opposed to "frivolous litigation," but they strongly favor compensating their constituents for corporate fraud, even going so far as to give up some money that would otherwise go the U.S. Treasury.\textsuperscript{42} Being of two minds is the profit maximizing strategy for members of Congress, as it allows them to extract contributions from the deep pockets on both sides of the issue.


\textsuperscript{40} Justice Powell's comment is quoted in A.C. Pritchard, \textit{Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Law}, 52 DUKE L.J. 841, 923 (2003).


The SEC's single-minded focus on investor protection may also fuel its aversion to clear rules. Regulated entities and their lawyers vastly prefer determinate rules, which allow them to structure their business dealings in predictable ways. The SEC, however, likes to afford itself leeway, promulgating mind-numbingly detailed and correspondingly impenetrable rules, but preserving discretion to pursue those who would manipulate those rules for some deceptive purpose.\textsuperscript{43} Too much clarity in the rules is deemed to provide a "roadmap to fraud." And, of course, the SEC has a very expansive notion of what constitutes fraud, one seldom bounded by common law understandings of the term. Those regulated may find the outer limits of the rules only when they are facing an enforcement action and the SEC is demanding a settlement.\textsuperscript{44} Congress is responsible for the broad rulemaking delegations that have facilitated this aversion to clear rules, and it has done nothing to rein in the SEC's open-ended interpretations of statutes.

Does congressional oversight ameliorate this tendency toward the groupthink of "investor protection"? Not likely; instead, congressional review tends to push the SEC to skew deliberation over rule proposals to make those rules easier to justify to committee chairs and their staffs. If rules are proposed to satisfy political demands, legislative oversight will induce greater justification for those rules, but it is unlikely to generate more thoughtful consideration on the part of regulators. Because the SEC staff will be aware of the preferences of important members of congressional committees, the staff will tailor regulatory rules to conform to those preferences.

The confirmation bias can be seen in the path dependence in the SEC's regulations.\textsuperscript{45} As originally enacted in the 1933 and 1934 Acts, the securities laws provided separate disclosure standards for companies making public offerings and those whose securities simply trade on the secondary markets. For several decades thereafter, commenta-


Regulators have a natural bias toward the presence (or enhancement) of complex regulation, rather than its absence (or reduction), a function of institutional and personal self-esteem as well as economic self-interest. . . . One readily sees the legal mindset of the Commission's staff, for instance, in many of the immensely arcane and open-ended rules that achieve a good deal of technical elegance, if nothing else.

\textit{Id.}

\textsuperscript{44} See generally Roberta S. Karmel, \textit{Regulation by Prosecution: The Securities and Exchange Commission vs. Corporate America} (1982).

\textsuperscript{45} See Choi & Pritchard, \textit{supra} note 17, at 32.
tors recognized the need to unify disclosure standards. Disclosures have the same relevance to investors whether they are purchasing in a public offering or on the secondary market. The SEC did not seriously consider revamping the scheme until the 1960s, ultimately adopting the present integrated disclosure system. Even that, however, falls short of a full-fledged scheme of company disclosure. Congress is nowhere to be found on this issue. Redundant disclosure is imposing a small but steady drag on the economy, but there is no political hay to be made in reducing that drag. And it certainly does not rise to the level of a scandal.

C. Fixation with Disclosure

The SEC is not known for regulatory creativity, often attempting to tackle difficult problems of corporate governance with measures invariably derived from some variant of disclosure. Bribes being paid to foreign government officials? Disclose them! CEOs being paid obscene sums? Disclose it! Disclosure traditionally has been justified as a means of exposing potentially problematic activities. Justice Louis Brandeis's oft-quoted phrase that "sunlight . . . is the best disinfectant" provides a succinct summary of the philosophy behind disclosure.

Once investors (and others) can see such activities clearly, then market participants are less likely to engage in opportunistic behavior in the first place. Managers considering a self-dealing transaction, for example, may choose not to do so if related-party transactions must be disclosed. In addition to ferreting out agency costs, disclosure may assist rational investors in allocating their investment dollars, leading to better use of capital and more accurate securities prices. So disclosure has much to recommend it as a policy lever in securities regulation.

48 Louis D. Brandeis, Other People's Money and How the Bankers Use It 92 (1913).
49 See Paul G. Mahoney, Mandatory Disclosure as a Solution to Agency Problems, 62 U. Chi. L. Rev. 1047, 1050-51 (1995) (contending that mandatory disclosure works to deter managers from engaging in opportunistic behavior at the expense of shareholders).
But disclosure is far from a panacea. Bounded search at the SEC may blind regulators to possible alternatives to disclosure regulation. In the wake of the Enron and WorldCom scandals, the SEC proposed requiring corporate chief executive officers to certify corporate financial statements annually. Congress, anxious to be seen "doing something," followed this proposal with legislation enacting the CEO certification requirement into law. What this added to the existing disclosure received by investors is unclear, but the in terrorem threat posed to CEOs and CFOs is quite clear. Huge sums are now being devoted to ensuring that this "disclosure" is accurate. If it is not, the executives fear, a flurry of lawsuits will follow, for which they face very real exposure to personal liability (or, a more remote prospect, an SEC enforcement action or, still more remote, criminal prosecution). Simply having adequate disclosures is no longer enough; company executives need to disclose about disclosure. And the informational value to investors of this certification has to be considered quite dubious.

Given these difficulties with disclosure as a regulatory tool, the SEC's continued reliance on disclosure suggests an unduly narrow search within the SEC.

Disclosure is the tool of choice largely because that is what Congress has given the SEC. The SEC's regulatory strategy reflects the broad grants of authority to the agency to mandate corporate disclosures under the 1933 and 1934 Acts. Alternatives to disclosure generally would require the SEC to seek statutory authorization from Congress. To get that authority, however, would almost certainly require the SEC to make an empirical showing to justify the need for a new regulatory tool. The Sarbanes-Oxley Act provides the SEC with a handful of additional tools, but disclosure remains the central theme. Even though it relies on disclosure as the cure-all for the maladies of securities markets, the SEC has done surprisingly little to investigate the impact that disclosure has on those markets. The agency instead prefers to remain above the grubbiness of empirical data, preferring

50 See Heath et al., supra note 35, at 9-10 (discussing the tendency of individuals to unduly constrict search for solutions to problems).
51 See Sarbanes-Oxley Act of 2002 § 302(a), 15 U.S.C.A. § 7241(a) (West Supp. 2004) (imposing "Corporate responsibility for financial reports"). The Sarbanes-Oxley Act also requires a similar certification from corporate CFOs. See id. Both the CEO and the CFO must attest to the appropriateness of the "financial statements and [disclosures] in the report" and that those financial statements and disclosures "fairly present in all material respects the financial condition . . . of the issuer." Id.
52 See Choi & Pritchard, supra note 17, at 22-23.
to ground its policy prescriptions in "investor confidence." The SEC avoids any meaningful definition of investor confidence, thereby avoiding the possibility of empirical contradiction. But it also avoids making a persuasive case to Congress for more creative tools to use against corporate malfeasance. Congress is unlikely to be creative in this arena on its own, given its generally reactive approach to securities regulation.

D. Regulatory Capture

Why do Congress and the SEC lay such heavy burdens on disclosure as the regulatory workhorse? The answer to that question takes us to our last shortcoming, regulatory capture. The SEC tirelessly promotes the myth that individual investors can be successful in choosing their own stocks, if only they devote sufficient energy to the voluminous disclosures made available to them as a result of the wise regulations promulgated by the SEC.\(^5^4\) Congress happily endorses the populist notion that every Joe or Jane Investor can compete with the big boys in picking stocks. Call it the myth of investor autonomy. Moreover, well-informed shareholders will hold directors to account, and those directors will in turn keep greedy managers in check. Call this one the myth of investor sovereignty. The empirical evidence contradicting both of these notions is overwhelming.\(^5^5\)

Why do Congress and the SEC perpetuate these myths? Because the financial services industry requires these myths for its very existence. If investors were to switch en masse to index funds and other forms of passive investment, the Wall Street-industrial complex would crumble. The SEC would lose its reason for being.\(^5^6\) And members of Congress fortunate enough to serve on the Senate Banking Committee and the House Financial Services Committee would lose the steady stream of contributions that help them maintain their tenure in office. So the myths of investor autonomy and investor sovereignty must be maintained.

percentage of investors read or understand these documents, or what influence the fundamental analysis-oriented disclosure has on their investment decisions.

\(^5^4\) See generally Henry Hu, Faith and Magic: Investor Beliefs and Government Neutrality, 78 Tex. L. Rev. 777 (2000) (arguing that the SEC promotes the belief among ordinary investors that a favorable return is virtually guaranteed).


\(^5^6\) Langevoort, supra note 43, at 535 ("Securities regulation as we know it is built on the very assumption of the presence of a large number of individual investors; a wholly institutionalized market would mean far less meaningful a role (and substantially less political power) for the SEC.").
It would be a mistake to overstate the regulatory capture story. Industry players fare well in the battle over the content of securities regulation when they are enjoying the frothy rise of a bull market. They are no match, however, for the populist appeal of protecting defrauded small investors during a bear market, as discussed above. Overall, there is little evidence to show that the SEC’s status as an independent agency has freed it from the influence of industry capture.\(^{57}\) As an agency with a specialized mission, it should come as no surprise that the subjects of that regulatory attention have an interest in influencing the agency. This would come as no surprise to the Congress that created the SEC—enhancing the susceptibility of the regulators to capture was an important goal behind the creation of the SEC. Enforcement of the securities law was originally entrusted to the Federal Trade Commission, which proved less vulnerable to the influence of the securities industry than the broker-dealer community desired.\(^ {58}\) The SEC was created as part of the ‘34 Act as a more industry-specific regulator that would be more amenable to the financial services industry.

Although that wish may have been frustrated in the short run, in the long run the narrower focus of the SEC relative to the FTC has made it more vulnerable to capture. The securities industry has spent considerable lobbying resources to influence the appointment of commissioners and, of even greater significance, chairmen. Moreover, the financial services industry has considerable influence over the information that the SEC receives as it undertakes its rulemaking responsibilities. The result has been a system of securities regulation that largely benefits the big players in the securities industry. The SEC’s protection of fixed commissions in the brokerage industry from the debilitating effects of competition for nearly half a century is by now a hackneyed example.\(^ {59}\) And the SEC has dragged its heels in implementing the National Market System that Congress intended to replace the old cartel system.\(^ {60}\) The agency continues to struggle to find a place for proprietary trading systems as the NYSE and Nasdaq resist this incursion into their comfortable sinecures. It has also been

\( \textit{\textsuperscript{57}} \text{See, e.g., SUSAN M. PHILLIPS & RICHARD M. ZECHER, THE SEC AND THE PUBLIC INTEREST (1981).} \)

\( \textit{\textsuperscript{58}} \text{SELMAN, supra note 2, at 95.} \)


\( \textit{\textsuperscript{60}} \text{See DALE ARTHUR OESTERLE, SECURITIES MARKETS REGULATION: TIME TO MOVE TO A MARKET-BASED APPROACH 11–14 (Cato Institute, Policy Analysis No. 374, 2000); Jonathan R. Macey & David D. Haddock, Shirking at the SEC: The Failure of the National Market System, 1985 U. ILL. L. REV. 315, 315–16.} \)
argued that other aspects of the SEC's regulatory agenda benefit primarily the brokerage industry, including much of the detailed disclosure required of public companies, as well as the contours of insider trading law.

Industry influence has been reinforced by the narrow focus of the relevant oversight committees in Congress: the Senate Banking Committee and the House Financial Services Committee. As Elena Kagan explains, "[w]hen Congress acts in [the sphere of administration], it does so through committees and subcommittees highly unrepresentative of the larger institution (let alone the nation) and significantly associated with particularized interests." As of the writing of this article, nine of the fifty-one members of the House subcommittee for securities came from New York, New Jersey or Connecticut, and three out of the fifteen members of the Senate subcommittee came from these same three states. This concentration of legislators from the New York metropolitan area is evidence of the fact that "the one thing the shadow executive system of the congressional standing committees can guarantee us is that the most affected regional interests will try to kidnap the federal law execution processes that most affect them." The remaining legislators on these subcommittees, coming from states lacking in constituents directly interested in this sector of the economy, may be less acutely interested in the welfare of Wall Street. Nonetheless, service on one of these subcommittees is a cash cow for these legislators, guaranteed to produce a steady stream of campaign contributions. Wall Street makes huge investments in influencing the contours of its regulatory environment.

61 PHILLIPS & ZECHER, supra note 57, at 22-23 (arguing that the SEC's disclosure policies favor market professionals).


66 This provides a powerful incentive for Congress to organize itself into committees. See Frank H. Easterbrook, The State of Madison's Vision of the State: A Public Choice Perspective, 107 HARV. L. REV. 1328, 1335 (1994) ("Interest groups can monitor the behavior of a few committee members much more closely than they can track all members of Congress. The small size of committees also permits the concentration of rewards, whether campaign contributions or other forms of political support.").
The financial services industry is not the only affected party that gives special attention to these legislative oversight committees. The accounting firms and the high-tech sector are also intensely interested. This influence was felt during the 1990s on the questions of expensing stock options and auditor independence; the SEC backed down in both cases in the face of congressional opposition. For example, corporations poured millions of dollars into the campaign war chests of strategically placed congressmen to head off the Financial Accounting Standards Board's (FASB) efforts to require that options grants be accounted for as an expense. Congress then bullied the supposedly independent FASB into submission; the SEC aided and abetted the effort.

The consequences of this interested oversight is that the SEC regulates in the shadow of potential retaliation from Congress. Legislators on the relevant committees have powerful tools to bring the agency to heel. If the agency strays too far from the dominant view on those subcommittees, it risks legislative overruling and, worse yet, budget cuts. The bottom line: "independent" agencies such as the SEC are not independent of politics; they are highly dependent upon the industries that they are charged with regulating. That dependency is mediated through Congress, which uses its mediating role to extract financial support from the financial services industry, accounting firms and public companies. Good work if you can get it.

II. THE EXECUTIVE BRANCH AS SECURITIES REGULATOR

In this Part, I argue that the transfer of the SEC's authority to the executive branch might ameliorate some of the shortcomings identified in Part I. I begin by briefly outlining my proposal. I then turn to why I think this shift in enforcement authority will address each of the problems identified with the SEC's approach: regulatory overreaction, groupthink and confirmation bias, fixation with disclosure, and regulatory capture. I make no claim that my proposal is a cure-all; I will be satisfied if I persuade my readers that it would lead to a marginal improvement.

My proposal is quite simple. The SEC's rulemaking authority should be turned over to the Treasury Department, to be overseen by

67 Seligman, supra note 2, at 727.
68 Id. at 716.
69 See Kagan, supra note 15, at 2258 ("The legislative sanctions backing up the system include new legislation, budget cuts, and embarrassing oversight hearings. If a fire alarm goes off, the committee can threaten and, if necessary, use one of these sanctions to bring the agency into submission.").
the same regulators who oversee other aspects of financial regulation. The SEC’s enforcement authority should be turned over to the Justice Department and combined with that agency’s existing fraud section. Civil and criminal enforcement would be consolidated within the same department.

A few administrative details would need to be worked out. The adjudications currently processed by the SEC’s administrative law judges (ALJs) could be turned over to ALJs located in Treasury, or better still, be conducted in federal district court. The SEC’s supervisory authority over the self-regulatory organizations (SROs) would also go to Treasury; SROs that failed to fulfill their enforcement obligations could be referred to Justice. The SEC’s power to review sanctions imposed by the SROs could be handed over to the district courts. The states could continue to play a role in enforcing the federal statutes and regulations devised by Treasury.

Note that I am not suggesting firing the SEC staff—the staff members could be divvied up appropriately between the two departments without creating undue confusion. Five commissioners, however, would be looking for work. I address below the justifications for the minor blip in unemployment caused by this sweeping transfer of regulatory authority.

A. Regulatory Overreaction

Could transferring regulatory authority to the executive branch dampen the rapid swings from regulatory inertia to regulatory hysteria? We have witnessed a series of largely garden-variety frauds over the past few years. Companies were making up earnings. Analysts were recommending stocks that they thought were crap. Mutual funds were providing sweetheart deals to big investors in the form of guaranteed profits through late trading. The response of the SEC and Congress to the revelation that “There is fraud in our financial markets!” has been a deluge of new statutes and regulations. Those subject to all these new rules publicly welcome them and privately pass

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70 My proposal obviously invites the question of why continue the plethora of banking regulators that we currently have. That is a topic for another day to be addressed by someone who knows something about banking regulation.

My proposal also implicates the status of the Commodity Future Trading Commission (CFTC). Also transferring the CFTC’s rulemaking authority over financial derivatives to the Treasury Department would finally bring an end to the jurisdictional squabbles between the SEC and the CFTC (although not the sparring between congressional committees that enjoy oversight over those agencies).
the costs along to investors.\textsuperscript{71} To be sure, some of the wrongdoers are now facing enforcement actions and criminal prosecution. And the companies, broker-dealers and mutual funds implicated in the sleaze have taken a serious hit in the market, which enforces its judgments much more swiftly and surely than the government ever could. But sending the bad guys to jail and hammering the stock price of their employers is never enough. We must punish the wrongdoers \textit{and} make sure this never happens again.\textsuperscript{72} I have no quarrel with punishing the wrongdoers, but I fear that the SEC and Congress will typically be fighting the last war as they continually expand the Code of Federal Regulations and the United States Code in their quest to end fraud. The fraudsters, I'm afraid, will always be with us.

Would transferring accountability from the SEC to the executive branch help dampen the tendency to regulatory overreaction? Accountability (or the lack thereof) favors the status quo in this context. Although the President remains ultimately accountable for policy choices affecting the securities markets in my model, the transfer of authority envisioned in my proposal would divide accountability between the Departments of Treasury and Justice. Unlike the commissioners of the SEC, who are responsible for both rulemaking and enforcement, the Secretary of the Treasury and the Attorney General would each exercise only a portion of the regulatory authority currently wielded by the SEC. Unlike the ultimate accountability borne by the President, these political actors would be accountable only for the regulatory authority within their respective jurisdictions. This means that each will be able to point the finger at the other in the event of regulatory “failure.” Was the scandal of the week the result of insufficiently stringent rules or a consequence of lax enforcement?

One does not ordinarily consider finger-pointing of this sort a useful mechanism for encouraging effective regulation.\textsuperscript{73} In this context, however, separating enforcement and rulemaking allows for a

\textsuperscript{71} See, e.g., Paul Schott Stevens, Editorial, \textit{Honest Funds}, \textit{Wall St. J.}, Sept. 13, 2004, at A20 (“Our legal and regulatory system is working as designed, to identify and correct misconduct, to prevent it from recurring, and to hold investors harmless.”). Stevens is the President of the Investment Company Institute. \textit{Id.}

\textsuperscript{72} See Brooke A. Masters & Ben White, \textit{SEC Wants Fixes, Not Fines}, \textit{Wash. Post}, Sept. 29, 2004, at E1 (“Rather than assessing fines and rapping knuckles after abuse is uncovered, the chairman [William Donaldson] wants the 3,800 person staff to work with and get to know Wall Street well enough to get the jump on problems before large numbers of investors lose money.”).

\textsuperscript{73} See, e.g., Calabresi, \textit{supra} note 65, at 43.

\textit{[P]}lurality in the executive defeats accountability not only because it becomes more costly to figure out who to blame when there exist two or more
healthy bit of indirection and delay. The SEC has no one else to blame when it is dragged before Congress—Congress has certainly not been grudging in affording it rulemaking authority, even if it frequently has been rather tightfisted with dollars for enforcement. But Justice and Treasury could blame each other. “The rules prohibiting this fraud are unclear, so we can’t go after the bad guys,” can be met by, “This behavior clearly violates our anti-fraud rules. Prosecutors should come down hard on these fraudsters.” This is the sort of mutual recrimination that Washington uses all the time to deflect calls for change. It is sometimes disparagingly characterized as “gridlock,” but it has an important stabilizing influence, unless one thinks that every social ill calls out for a vigorous government response. The President would be accountable for the tradeoff between rulemaking and enforcement. Congress is likely to think twice before it calls him before a subcommittee for a lecturing on regulatory priorities and the critical need to protect widows and orphans. Simply put, the President is too busy for that. By contrast, commissioners of the SEC, most assuredly, are not.

If Congress wanted to make its influence felt, it would have to go through the tedious and time-consuming process of drafting legislation, finding a majority coalition to vote for it and persuading the President to sign the resulting bill into law. The marginal cost of this effort is substantially greater than bullying the SEC. Perhaps Congress, too, would then find better things to do.

B. “Groupthink” and Confirmation Bias

The Secretary of the Treasury has a lot of irons in the fire. According to the department’s website, “[t]he mission of the Department of the Treasury is to promote the conditions for prosperity and stability in the United States and encourage prosperity and stability in the rest of the world.” That’s a big job. More concretely, the Treasury is responsible for:

- Managing Federal finances;
- Collecting taxes, duties and monies paid to and due to the U.S. and paying all bills of the U.S.;
- Producing postage stamps, currency and coinage;
- Managing Government accounts and the public debt;

candidates for blame, but also because the two or more candidates may very well conspire among themselves to create ambiguity about the locus of blame.

Id.

Supervising national banks and thrift institutions;
Advising on domestic and international financial, monetary, economic, trade and tax policy;
Enforcing Federal finance and tax laws;
Investigating and prosecuting tax evaders, counterfeitors, and forgers.75

This diversity of tasks encourages a diversity of perspectives among the top officials at the Treasury. Although all of the senior staff are likely to have expertise in one or more of these areas, it is unlikely that any one of these areas will predominate. Consequently, when it comes time to decide important policy matters, the Secretary will be getting advice from people with a broad range of backgrounds. For the Secretary and the rest of the Treasury staff, it is hard to have a single-minded focus on saving widows and orphans from the vipers of Wall Street when you have so many tasks that require your attention. Investor protection would continue to be an important goal for a Treasury Department charged with regulating the securities markets, but so would capital formation, diversification of the outlets for financial services to consumers, and cooperation with foreign regulators.76

To be sure, many members of the Treasury staff will specialize in the regulation of the securities markets under my proposal, but their proposals will face the scrutiny of superiors not suffused in the culture of investor protection. And promotion within the department is unlikely to be a lockstep progression—a person who shows talent in the field of banking or tax might be tapped for an important role in regulating the securities markets. Going higher up the chain, Republicans and Democrats would switch places in the politically appointed slots as power shifted in the White House. The result would be less homogeneity, broader search and more critical thinking generally.

So too, with the Justice Department. The Attorney General has at least as broad a range of concerns as the Secretary of the Treasury—locking up terrorists, fighting the war on drugs, prosecuting environmental polluters, etc. Going down to the trenches, the FBI special agent who shows talent in making a case against Medicare fraudsters may well have talent for unraveling the machinations of accounting fraudsters. Fraud is fraud, and the expertise of the SEC staff can easily be oversold. The Justice Department has many lawyers and investiga-

75 Id.
76 Cf. Geoffrey P. Miller, Independent Agencies, 1986 Sup. Ct. Rev. 41, 78 (“Agencies with highly specialized agendas will tend to focus solely on matters within their jurisdiction, thus often adopting regulatory policies with perverse consequences elsewhere in the economy.”).
tors who are proficient at prosecuting securities fraud (e.g., the fraud unit of the U.S. Attorney’s office in the Southern District of New York). There would be many more such professionals if the Justice Department took over civil enforcement of the securities laws along with the criminal authority that it already exercises. But expertise must be balanced against diversity of perspective, and it is hard to imagine any state of the world in which the SEC would surpass Justice on diversity.

More importantly, the lawyers at Justice are more likely to view the regulations promulgated by Treasury with a critical eye. Although both departments are nominally components of the executive branch, they have distinct histories and cultures. Lawyers at Justice are much less likely to buy into the work of Treasury than SEC enforcement attorneys are to buy into the work of the Divisions of Market Regulation or Corporate Finance. The lawyers in the executive branch are on the same side, but not the same team. Justice is unlikely to suffer from confirmation bias in reviewing the proposals of Treasury; it is not their work, after all. The division between the two departments also matters for those discussions of enforcement policy in slightly shabby conference rooms at Justice or the Treasury. Clear rules may be a “roadmap to fraud,” but it is much easier to show violations of them in court. The skepticism with which the Solicitor General’s office has treated some of the SEC’s more cockamamie theories affords a concrete example.77

Lawyers at the Justice Department are also more likely to be skeptical of the need for class action litigation and investor compensation. The SEC’s support for the plaintiffs’ bar helps the agency with the more populist element in Congress, but the Justice Department knows that deterrence (the specialty of prosecutors) is really the critical element in minimizing the social costs of fraud. Fraudsters need to go to jail and pay hefty fines; what happens to the money afterward is, at best, a sideshow.

C. Fixation with Disclosure

Can a transfer of authority to the executive branch stimulate more creative thinking about regulatory responses to malfeasance by corporate officers and financial services professionals? Recall my argument that the Congress and the SEC focus almost exclusively on disclosure because it reinforces the myths of investor autonomy and

77 See, e.g., Pritchard, supra note 40, at 935 (discussing conflicting positions taken by the United States and the SEC in Dirks v. SEC, 463 U.S. 646 (1983)).
sovereignty, a very lucrative myth as far as the financial services sector is concerned.

Would Treasury and the President be equally enamored of this myth of the empowered investor? To be sure, the financial services industry is a major contributor to presidential as well as congressional campaigns, so disclosure has continued appeal. But the lines of accountability for ultimate policy choices would be clarified somewhat with a transfer of authority to the executive branch. A risk averse President who wanted to avoid a political backlash from the next bull market would strongly favor a well-diversified electorate. The real stories of pain in a market decline are from the poor souls who are underdiversified. Politicians, of course, are notoriously wary of blaming even foolhardy victims for their plights (think of the Enron employees) despite the inexpensive self-help that they could have adopted. "This all could have been avoided with a bit more disclosure!" Or a bit of diversification. It is doubtful that a politician in the White House would be willing to blame the victim any more than Congress and the SEC. Policy will continue to focus on throwing the books at the wrongdoers.

But will the President follow condemnation of the bad guys with a slew of new disclosure requirements to address last year's fraud? The President has the advantage of being able to rely on the strong rhetorical message sent by actual criminal prosecutions. The SEC's civil enforcement powers look rather tame by comparison to hard time in a federal prison. Congress has only the ability to write additional rules. Congress can, of course, ratchet the jail time up another couple of notches, but most maximum penalties in the securities area are already well past the point of diminishing marginal deterrence and, worse yet, obviously so. No one is impressed anymore by another five to ten potential years of jail time for white-collar criminals after the first ten to twenty. Martha Stewart's six months in prison will be quite sufficient to deter her from lying to the government in the future. Neither Congress nor the SEC has the satisfying power of throwing the fraudsters in jail. Used aggressively, the authority to prosecute could satiate the public clamor to do something without imposing an additional burden of disclosure costs on all the businesses that did not break the law and should not be punished. This may not satisfy the hue and cry for government intervention in extreme cases, but a few well-placed "perp walks" can help deflect the demand for additional disclosure requirements.
D. Regulatory Capture

Would a transfer of authority to the executive branch make a significant dent in the extent of regulatory capture? Of the four concerns identified here, this one carries the least weight; it would be insufficient standing alone to justify transferring regulatory authority to the executive branch. The principal effect of such a transfer on the usual pattern of "inside-the-Beltway" rent-seeking would be to simply shift some of the power to extract rents from regulated industries. Members of Congress would have a bit less, and the President would have a bit more. The financial services industry already tries to curry favor with the President in order to influence the choice of commissioners and to be able to call upon the President's aid in the lawmaking process (either to instigate or veto legislation). Giving the President authority over rulemaking would enhance the President's attractiveness as recipient of lobbying largesse. By contrast, lobbying to influence the Justice Department's enforcement agenda would be very tricky business; not many White House staffers would enjoy waking up to read in the Washington Post about influence peddling related to Justice Department fraud prosecutions.78 On balance, I think the overall shift would be to make members of Congress less attractive and the President more attractive,79 but rent-seeking, like fraud, will always be with us.

Despite these caveats, I think that my proposal would achieve some limited success in diffusing the effect of lobbying expenditures. Members of the House and Senate subcommittees for securities that do not have a substantial number of constituents in the financial services industry have little to constrain them from offering their votes and influence to the highest interested bidder. The voters back home in Wyoming will have little interest in their Representative's vote on reforming the market structure for buying and selling securities. In that vacuum of electoral interest, campaign contributions (which can be used to pay for the television ads to reach all those voters spread so thinly across the state) can be very persuasive indeed.

78 At least some members of Congress apparently feel no such compunction. See SEC v. Wheeling-Pittsburgh Steel Corp., 648 F.2d 118 (3d. Cir. 1981) (en banc) (permitting discovery on the question of whether an SEC investigation was the result of political pressure from a Senator).

79 This obviously would have little appeal for the average member of Congress, suggesting that my proposal has limited prospects for legislative success. Realistically, my proposal could only be put into action by a President with an exceptionally strong mandate who was willing to use up some of his political capital on administrative reform. I won't hold my breath on this one, but the situation is not hopeless. See infra notes 84-87 and accompanying text.
The President, by contrast, has many constituencies to which he must answer and is unlikely to be able to give decisive weight to any one interest group. Simply put, it costs more to buy a President than a legislator, even a well-placed one.\textsuperscript{80} Moreover, it is harder for lobbyists to gain access to the President, given the demands on his time. To be sure, the White House staff and Treasury Department officials are likely to be more responsive, but they too will have diverse constituencies to which they need to attend on the President’s behalf.\textsuperscript{81} Congressional committee members will still have a role to play in influencing policy,\textsuperscript{82} but they carry substantially less of a threat in a conflict with the executive branch than they do with the SEC.\textsuperscript{83} The President, as a roughly coequal actor in the legislative and budgetary processes, can fight back if a department’s budget is threatened; the SEC has to grin and take it.\textsuperscript{84} A transfer to the executive branch will not eliminate concerns over regulatory capture, but it might slow

\textsuperscript{80} See Calabresi, \textit{supra} note 65, at 64 n.105 ("National factions probably work to acquire state and local congressional representation because the cost under our electoral system of gaining congressional power is considerably less than the cost of winning presidential power.").

\textsuperscript{81} \textit{Id.} at 84 n.148 ("Congress can probably reduce the likelihood of capture by creating larger cabinet departments with more generalized jurisdictions like the big four: State; Treasury; Defense; and Justice. These four flagship departments have on balance better historical reputations in part because they are harder to capture.").

\textsuperscript{82} Cf Geoffrey P. Miller, \textit{The Unitary Executive in a Unified Theory of Constitutional Law: The Problem of Interpretation}, 15 CARDOZO L. REV. 201, 205 (1993) ("Congress no doubt has substantial control over the . . . executive branch, control that flows largely from the fact that Congress need not create the powers in question in the first instance.").

\textsuperscript{83} \textit{See} Kagan, \textit{supra} note 15, at 2347.

[W]hen the President has had little to do with agency action, the prospect that he will provide strong support for the agency declines, and the likelihood that the agency will succumb to congressional pressure correspondingly increases. This logic explains empirical data indicating that Congress can dictate more successfully to commissioners of independent agencies than to secretaries of cabinet departments . . . .

\textit{Id.}

\textsuperscript{84} See Easterbrook, \textit{supra} note 66, at 1341.

A President may resist claims by factions in the way Madison envisioned: by adding other items to the agenda. But agencies devoted to single industries lack threats; they cannot promise to veto bill \(X\) if Congress takes step \(Y\). Because agencies cannot engage in logrolling, committees in Congress gain relative influence. The loser is the President (with a national constituency), and the principal beneficiaries are committee chairmen, who hold, on average, beliefs farther from the national median view of politics.

\textit{Id.}
down by a step or two the interest groups attempting to capture regulatory policy.85

More importantly, the accountability for tailoring regulations to suit interest groups would be clear. Under the current regime, Congress can bully the SEC into caving in the face of interest group pressure and no member of Congress will face any serious threat of reprisal (as with Congress's derailing of expensing for options). There is safety in numbers. If the President overrules rules proposed by the Treasury staff, the responsibility will be clear.86 If new rules are warranted, the President who nixes them would face a considerably more substantial risk of political embarrassment than would an individual Congressman.87

CONCLUSION

As the SEC marks its seventieth anniversary, the survival of securities regulation, and the federal government's role in that regulation, are no longer in doubt (if they ever were). Federal securities regulation is here to stay; proposals to do away with it are unlikely to garner much support anytime soon.

I have made a more modest proposal in this Article: transferring that authority over securities regulation to the executive branch. The main impetus behind my call for reform is that the SEC is "independent" in name only.88 The agency's dependence on Congress has some unfortunate consequences for the path of regulatory policy in the field of securities. Specifically, far from dampening the boom and bust cycle in securities regulation, the SEC—under the watchful eye of Congress—has fueled the cyclical swings in regulatory policy as a means of gaining additional authority and budgetary support. Congress and the SEC have fed off each institution's cognitive biases. Most destructively for investor welfare, both institutions have perpetu-

85 See Miller, supra note 82, at 201 ("Where the agency exercises a limited mandate that is likely to be captured or heavily influenced by particular interest groups, the argument for presidential oversight is strong.").

86 See CHARLES FRIED, ORDER AND LAW: ARGUING THE REAGAN REVOLUTION—A FIRSTHAND ACCOUNT 153 (1991) ("The lines of responsibility should be stark and clear, so that the exercise of power can be comprehensible, transparent to the gaze of the citizen subject to it.").

87 Calabresi, supra note 65, at 47 ("Accountability, resulting from the creation of a unitary executive, was seen as promoting faction control by making the executive clearly responsible to and representative of the interests of the whole of his national, electoral constituency.").

88 Cf. id. at 84 ("Anything that weakens the presidential set of incentives and controls strengthens Congress and vice versa. There is no such thing as a truly independent agency in Washington, D.C.").
ated the twin myths of investor autonomy and investor sovereignty. Finally, vesting regulatory authority in the SEC has facilitated agency capture and enhanced the ability of members of Congress to extract rents from the securities industry, the accounting profession and others affected by securities regulation.

I have argued that the executive branch might be somewhat less subject to these maladies if we were to vest authority over securities regulation in the Treasury and Justice Departments. I am far from claiming that regulatory “perfection” (whatever that would mean) would follow if my proposal were implemented. More modest improvements, however, might come about. Transferring authority might dampen the regulatory overreaction that follows in the wake of bear markets. The Treasury and Justice Departments would almost certainly bring greater diversity of perspective to addressing the problems of corporate governance and the securities markets. Those departments might view more skeptically the claim that disclosure solves everything. And my proposal might reduce the extent of agency capture at the margin (but only at the margin).

Is my proposal to transfer regulatory authority over the securities markets to the executive branch as far-fetched as Jonathan Macey’s call to end federal securities regulation altogether? It might appear so at first blush. The SEC is busier than ever, better funded than ever and has more support generally in Congress than it has enjoyed any time in recent memory. Moreover, there are powerful constituencies that have come to rely on the SEC for their professional livelihoods. Corporate lawyers, for example, would strenuously resist the abolition of the SEC. I am a natural-born pessimist, so I freely concede that my proposal is unlikely to be adopted anytime soon.

The one constant in securities regulation is that the political fortunes of the SEC generally ebb and flow with the cycles of the market. The correlation is inverse, however, so the SEC rides high when the Dow Jones Industrial Average rides low. But within that broader correlation there is some variance in the support for the SEC. When the market is first hitting the downward trend in its cycle, support for the SEC may dip along with the major indices as the agency takes its share of the blame. In one of those future dips—who can predict when it will come—may arise the opportunity for the sort of administrative reform proposed here. To be sure, the relevant committees in Congress will cling tenaciously to their “independent” agency, but sometimes the political imperative to “do something” can overcome even entrenched institutional self-interest. It would be a poor bet to try and handicap a retirement date for the SEC, but it might be almost as speculative to count on the agency’s staying on the job forever.