

## WHEN LAWYERS START THINKING LIKE ECONOMISTS: THE SEC IN RESPONSE TO TECHNOLOGICAL CHANGE

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**Abstract** Since its founding, the Securities and Exchange Commission (SEC) has employed a disclosure-enforcement framework, combined with a cooperative relationship with the securities industry, as the key means of ensuring market legitimacy and investor confidence. This article argues that not only is this framework deeply rooted within the SEC, but is equally ingrained in the public psyche. It is the deep belief of the public in this "prosecutorial orientation" that has sustained the SEC's disclosure-enforcement framework in the face of charges of obsolescence, inefficiency and agency capture. But as the SEC is increasingly called upon to concern itself with questions of efficiency and capital formation in the global economy, the stage may be set for a shift away from the disclosure-enforcement orientation and towards a more active, "promotional role" in the economy. In addition to external market forces, however, any qualitative shift in the SEC's regulatory mission will be affected only if there is a comparable shift in the public philosophy regarding the SEC's regulatory intent and a change in the internal orientation of the SEC. The author contends that seeds of these changes have long since been sowed.

*While the landscape of tomorrow's markets may not resemble today's, the fundamentals—quality, trust, accountability—remain timeless. Mountains may rise, rivers may change course, new roads may be created. But unless the laws of nature betray us, true north will always remain true north.<sup>1</sup>*

—SEC Chairman Arthur Levitt

If Arthur Levitt's September 23 remarks at Columbia University prove any indication, the United States securities markets are currently engaged in a period of rapid and broad transformation. The spirit of change stems both directly and indirectly from important Information Age technological developments, such as the rapid ascendancy of Electronic Communications Networks (ECN). Levitt asserted that the Securities and Exchange Commission (SEC) must match the reform of the securities markets with a reconfiguration of industry regulation.<sup>2</sup> Along these lines, Levitt opened up the possibility of merging all of the industry's Self Regulatory Organizations (SRO's) into one

overarching body, a measure supported by many important industry participants, but vigorously opposed by the New York Stock Exchange (NYSE).<sup>3</sup> While the SEC will need to readdress particular rules in order to better enable the right kind of change, Levitt did not address the possibility of radically reforming the Commission itself. Inevitably though, any qualitative transformation on the part of the securities markets will likely engender a critique of the SEC response to market changes, as well as a debate concerning the continuing relevance of the SEC, a regulatory agency firmly entrenched in the New Deal principles from which it was formed. Such a discourse may potentially indicate changes in a regulatory regime that has dominated the SEC since its birth. Levitt may indeed find that as the grounding of the SEC experiences an ideological shift, true north will not always remain true north.

### An Early History

Prior to the Securities Act of 1933, disclosure of corporate activity and protection against corporate fraud were insufficient and irregular. Already-existing state regulation did provide some protection for investors, especially against outright fraud. However, the quality of protection and the level of enforcement varied between the states, and the antifraud statutes did not cover interstate sale of securities.<sup>4</sup> Moreover, while the existing regional stock exchanges self-regulated the companies listed on their particular exchange, the regulation was directed at protecting the exchange and its members rather than the investing public.<sup>5</sup> The over-the-counter securities market, which generated more volume in dollars and total number of transactions than the stock exchanges, did not fall under the exchanges' self-regulating

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policies. This, coupled by the fact that no disciplinary structure existed for punishing wrongdoing, provided almost unlimited opportunity for unsavory behavior on the part of savvy individual brokers who dealt in the over-the-counter market.<sup>6</sup>

Corporate disclosure of financial activity was largely inconsistent, with some important companies making hardly any disclosures at all. Even with those companies that actively published reports on their financial fitness, unstandardized accounting practices and selectivity of what information was actually published made for extreme difficulty in using the information to guide informed investment decisions.<sup>7</sup> The reluctance of companies to maintain an internal policy of full, accurate disclosure is understandable even in the case of financial fitness and integrity. Many companies originated as family businesses and found the parading of financial success unseemly. At the same time, corporations were worried about giving away financial secrets that could be used by their competitors.<sup>8</sup> However, the lack of corporate disclosure afforded companies the opportunity to perpetrate fraudulent activities and mislead investors.

Federal legislation that would regulate the stock exchanges and the issuance of securities really only became possible with the stock market crash of 1929. However, even after the crash, the sweeping legislation that mandated extensive federal involvement in security trading was hardly inevitable. Herbert Hoover approved of a policy in which states and private institutions would continue governing the markets. He openly wondered whether federal interference was at all constitutional.<sup>9</sup> It was particularly the New Deal, and the change in regulatory regimes that it represented, which opened the door for extensive federal involvement.

By the time of Roosevelt's election, public opinion had ripened for federal intervention. In 1932, the Senate Banking and Currency Committee began a very public investigation of the underlying causes of the 1929 stock market crash. These hearings, orchestrated by Ferdinand Pecora, later one of the first commissioners of the SEC, embarrassed Wall Street with their revelation of widespread market manipulation and shady trading practices.<sup>10</sup>

Public opinion was not just instrumental in ensuring quick passage of securities-related legislation, but also related directly to one of the primary underlying mandates of securities regulation. At the heart of regulation of the financial markets is the need to uphold investor confidence. Certainly, regulatory reforms centered on protection of the investor with full disclosure of corporate activity and de-

fense against fraud. However, this came with a very important flip-side, namely the necessity of lending legitimacy to market activity. The same revelation of fraudulent activity that enraged the public also directly worked against the investment community by stripping away the veneer of genuineness which was crucial to encouraging investment activity. Thus, the SEC Government Performance and Results Act (GPRA) Strategic Plan attests to the fact that Congress created the Commission largely in order "to restore and maintain investor confidence."<sup>11</sup> McGraw writes that securities trading "lies at the heart of a vital but invisible paper infrastructure based on intangibles such as trust and perceived legitimacy."<sup>12</sup> As a result, securities regulation differs from other federal economic regulation aimed at controlling natural monopolies because "the regulation of securities is often best directed toward maximizing not just the efficiency of the industry, but also its legitimacy."<sup>13</sup>

Despite the controversial nature of its material, the first piece of legislation that related to securities trading passed both houses of Congress with ease and was enacted into law during the first hundred days of the Roosevelt administration. Aside from the confluence of public opinion, the quick passage of the Securities Act of 1933 was aided by a weakened Wall Street which had real difficulty generating strong opposition to the legislation.<sup>14</sup> Furthermore, any semblance of resistance to the bill was overwhelmed by the momentum of Roosevelt's New Deal agenda and his strong allies in Congress.<sup>15</sup>

Of particular importance to the Securities Act's success was the expertise with which it was drafted. McGraw points out that given "the flawed craftsmanship of other Hundred Days legislation, such as the National Industrial Recovery Act, it seems remarkable that they were able to do such a meticulous job with the Securities Act of 1933."<sup>16</sup> For example, the Securities Act, which called for full financial disclosure of corporate activity, carefully described the expected nature of mandated disclosure and included ingenious stipulations for enforcement. The legislation called for a "cooling-off period" whereby the regulating agency would be granted twenty days to review the registration statement and prospectus of new securities before allowing their sale on the market. James Landis, one of the major craftsmen of the Securities Act, felt that the feverish anticipation surrounding important new stock offerings "did not encourage wise investment decisions" and "worked to the advantage of unscrupulous promoters and... company insiders."<sup>17</sup> However, the limitation of the cooling-off period to twenty days recognized that timing is an extremely

important factor in any new issue's success and also encouraged the agency to be efficient in its review process.<sup>18</sup>

From the perspective of Roosevelt and his New Deal allies, the Securities Act of 1933 was incomplete by itself, functioning only as one portion of a much more ambitious regulatory program for the securities industry.<sup>19</sup> Roosevelt still wanted to see to the proper oversight of the securities exchanges, and discourage some of the unsavory trading activities, such as "bear-raids," which helped contribute to the 1929 market crash.<sup>20</sup> Moreover, the 1933 legislation, while covering issues of new stocks, did not address mandatory disclosure for a broad array of areas, including issues of securities already in the market.<sup>21</sup>

However, a number of converging factors helped ensure that the next piece of key securities legislation, namely the Securities Exchange Act of 1934, would prove much more difficult to pass into law than the first. The honeymoon period for the New Deal was over. Not only did Wall Street finally unify itself in stiff opposition to the new legislation, but it also pushed for amendment of the Securities Act in an attempt to water down its strict liability provisions.<sup>22</sup> Aiding Wall Street in its cries that further legislation would cripple the financial market was the fact that, aside from a brief rally in the beginning of Roosevelt's administration, the stock market really did not see any marked improvement since the enactment of the Securities Act.<sup>23</sup>

As a result, the final draft of the Securities Exchange Act of 1934 was billed largely as a compromise measure between the Wall Street forces that opposed regulation and Roosevelt and members of Congress who pushed for harsher legislative measures.<sup>24</sup> In reality though, the Securities Exchange Act gave up little of any real import in its appeasement of Wall Street.<sup>25</sup>

Abiding by Wall Street's wishes, the Securities Exchange Act was responsible for the birth of the SEC as a distinct regulatory body responsible for administering the two Securities Acts. Prior to the Securities Exchange Act, the Federal Trade Commission (FTC) was responsible for enforcing the mandates of the Securities Act of 1933. Wall Street opposed FTC supervision of the securities industry partially because it saw the FTC as a powerful agency with a diverse group of interests other than the securities industry and, therefore, harder to control. A separate, fledgling agency with only the securities industry as its major responsibility and close ties to Wall Street would be easier to manipulate into regulating with Wall Street's best interests in mind.<sup>26</sup> In practice though, most of the securities division from

the FTC was transferred directly over to the SEC, including three of five of the SEC's first commissioners.<sup>27</sup> Moreover, there was no stipulation in the creation of the agency that its commissioners had to have experience in the securities industry.<sup>28</sup>

The Securities Exchange Act included three primary components. The first one had little to do with the SEC, but related to the selling of securities nonetheless. Many key politicians felt that the buying of securities on very wide margins helped lead to the 1929 market crash. The new legislation assigned the Federal Reserve Board with the discretionary authority to set margin limits.<sup>29</sup> The second major component afforded the SEC the ability to regulate the different regional stock exchanges, using broad discretionary powers in altering their rules.<sup>30</sup> Moreover, the Securities Exchange Act significantly limited the use of questionable trading practices to artificially manipulate the rise and fall of stock prices and outlawed insider trading.<sup>31</sup> The third major component was essentially an extension of the disclosure provisions of the Securities Act of 1933 to include even issues of existing securities by companies that were listed on an existing stock exchange.<sup>32</sup> Although many later laws expanded and amended the SEC's working mandate, the basic formal infrastructure of the SEC came directly from the Securities Act of 1933 and the Securities Exchange Act of 1934.

While the SEC's working mandate left significant room for a much wider use of discretionary regulatory force, the SEC chose to take a more cooperative view in its regulation of the securities markets.<sup>33</sup> Early leaders made the conscious decision to limit the SEC's regulatory power and instead rely more heavily on the self-regulation of the institutions already in place (such as the existing stock exchanges). On the one hand, a more ambitious regulatory approach, including an extensive dismantling and external rebuilding of the self-regulating institutions, would have significantly increased the governmental regulatory costs and forced the SEC bureaucracy to grow dramatically in size.<sup>34</sup> Conversely, as Khademian points out, by giving the securities industry a role in enforcement and oversight, the SEC could overcome the limitations of its budget and, in reality, oversee a much broader regulatory effort.<sup>35</sup> However, perhaps more importantly, the SEC wanted to balance the need for reform with the need for recovery, and felt that a more heavy-handed approach in regulation would further demoralize Wall Street and jeopardize any economic recovery.<sup>36</sup> It would also undermine the very factors that led to the establishment of the SEC in the first place, namely the underlying legitimacy of the market structures and the need for investor

confidence.<sup>37</sup> Moreover, making governance of the securities markets a cooperative effort would essentially give the securities industry an important stake in realizing regulatory success.<sup>38</sup> This is particularly important when taking into account the controversial nature of the regulatory reforms and the change in institutional thinking that the securities industry needed to undergo in order to fully realize them. An important extension of this point is the fact that the SEC legislation was potentially as vulnerable to legal challenge as the other New Deal legislation, and therefore a cooperative effort made it more unlikely that the securities industry would attempt to overturn the SEC mandate in court.<sup>39</sup>

While the SEC opted for a more cooperative regulatory approach, this did not mean that the securities industry effectively “captured” the SEC.<sup>40</sup> Instead the efforts of the SEC were guided by an effort to maintain the “disclosure-enforcement framework.”<sup>41</sup> The utilization of corporate disclosure as the key means of improving market legitimacy and investor confidence and expanding the reach of this disclosure characterized much of the early securities legislation. It was with aggressive enforcement of disclosure and anti-fraud legislation that the SEC counterbalanced its cooperative stance toward the securities industry.<sup>42</sup> The vigorous enforcement of the securities laws helped the SEC maintain its integrity as a regulatory force and as an unlikely target of corporate capture.<sup>43</sup>

## Lawyers v. Economists

Roberta Karmel, a former Commissioner of the SEC, explains that agency regulatory activity can range from “promotional to prosecutorial.”<sup>44</sup> Promotional activities are “designed to benefit or foster growth that Congress has determined is in the public welfare.”<sup>45</sup> Those agencies that are created in order to address market failures, such as those caused by the existence of natural monopolies or excessive competition, are primarily promotional in nature. In essence, they function by artificially manipulating the market mechanisms at work in order to provide benefits to the industry or society as a whole. On the other hand, the SEC’s rigorous enforcement of securities laws is “prosecutorial” in nature, and rather than providing a “benefit” to the industry, is “necessarily adversarial” in its vindication of statutory norms.<sup>46</sup> In fairness, Karmel views the promotional and prosecutorial functions of an agency along a continuum, with various types of standard-setting or regulatory activities in the middle.<sup>47</sup> While Karmel acknowledges a vital role within the SEC for rulemaking and standard-setting, she stresses that the “Commission has tended to look and

think like a prosecutor” never truly executing any “pure promotional functions.”<sup>48</sup>

Put in a different way, the choice of the SEC to favor the disclosure-enforcement framework over a more heavy-handed approach in shaping the securities industry, has favored a law orientation rather than an economic orientation in the expertise displayed by the agency.<sup>49</sup> While the different professions are certainly not necessarily mutually exclusive, this does not preclude the possibility that lawyers and economists tend to approach the world in different ways. Lawyers may view the punishment of wrongdoers or the maintenance of any given legal system as a worthwhile end in itself, as well as the source of their professional integrity. As such, they tend to focus on “fraud—specifically, the prevention of fraud through full disclosure and the prosecution of fraud through enforcement.”<sup>50</sup> Economists, on the other hand, will most likely question the purpose or design of the legal system, and weigh it against a standard of efficiency. They are probably less likely to feel that a set of regulations is important if they do not promote the increased efficiency of the market in question, regardless of the regulations’ role in encouraging a sense of fair play. For economists, “an increase in public disclosure is justified only if it enhances the quality of information related to securities, and hence the ability of investors to better separate good from bad investments.”<sup>51</sup>

Indeed, even as SEC lawyers heightened their prosecutorial zeal during the 1970’s, economists and other critics began to question the necessity of maintaining any semblance of a regulatory structure based on disclosure-enforcement principles.<sup>52</sup> Some of the critics take notice of the lawyer orientation of the agency, and in fact argue that many of the SEC’s problems stem from it. Kripke asserts that “exclusive lawyer domination of the SEC left a narrowed perspective that became moralistic, not pragmatic,” and then goes on to lament “the absence of economists where they are sorely needed.”<sup>53</sup>

However, other criticisms of the SEC view the issue of corporate disclosure solely through the lens of economic efficiency, essentially ignoring the corporate culture of the agency itself.<sup>54</sup> While these criticisms are potentially beneficial in that they reexamine securities regulation through the critical lens of economic regulatory theory, they fundamentally err in assuming that the agency recognizes their viewpoints and acts accordingly.

Economically oriented criticisms of the SEC have relied heavily on market failure theory as a means of dismissing

the potential social benefits generated by regulation. Such theory views regulation primarily as a response to "market failures," or the inability of a particular market to function efficiently in terms of pricing. As mentioned earlier, market failure can derive from the presence of natural monopolies in industries where economies of scale inhibit healthy competition. Other instances of market failure include industries that are prey to excessive competition, or industry participants that regularly take advantage of their access to public goods.

According to Phillips and Zecher, government intervention in the securities industry stemmed from an environment in which "the free market yield[ed] too much fraud, manipulation and deception."<sup>55</sup> In order for the government intervention to work, mandatory disclosure, as well as rigorous enforcement, must reduce fraud and deception, making the market more efficient in the process. Thus, conclude Phillips and Zecher, the disclosure-enforcement framework was developed in order to attain promotional rather than simply prosecutorial ends.

The promotional-oriented view of disclosure-enforcement relies heavily on what economists term the "efficient market hypothesis."<sup>56</sup> The efficient market hypothesis "posits that a market is efficient if asset prices reflect at each moment all information available."<sup>57</sup> By maintaining a stance of mandatory disclosure, the SEC theoretically improves efficiency by increasing the amount of accurate information available to the investor at the time of purchase.

Critics of the SEC use the efficient market hypothesis as a point of departure in uncovering what they feel is the great fallacy of efficient markets through disclosure-enforcement. Macey maintains that technological advancement, in addition to increased competition among market professionals in trying to find mispriced securities, has rendered mandatory disclosure obsolete. He argues that, "as markets have become more efficient, society's need to devote resources to support a statutory regime of mandatory disclosure designed and enforced by the SEC has disappeared. Any information that was supplied by the force of law now is supplied by the marketplace."<sup>58</sup>

Phillips and Zecher, while not going so far as to completely dismiss the benefit of mandatory disclosure, do strongly question whether the efficiency generated by mandatory disclosure, over and above that of market-generated disclosure, justifies the overall social costs of securities regulation.<sup>59</sup> They estimate that, as of 1980, the costs of SEC-mandated disclosure probably exceed \$1

billion.<sup>60</sup> Aside from the actual cost of running the SEC bureaucracy, which is surprisingly low by federal regulatory standards, costs also include the increased burden that each firm or corporation incurs in preparing its own disclosure documents.

The picture for mandatory disclosure does not necessarily improve when one takes into account alternative theories of securities trading. The efficient market hypothesis assumes that, even when bombarded with enormous amounts of information, only a portion of it fundamental in nature, the market will reasonably sort out what information is useful, and should therefore elicit a change in price of a security, and what information is useless. Moreover, the market mechanism will effectively enable the attainment of a "correct" or objective price for each security based on the available information.<sup>61</sup> "Noise" theorists argue, on the other hand, that "pricing influences not associated with rational expectations about asset values play a far greater role than previously thought in stock market behavior."<sup>62</sup> Ironically, even though strong claims of market efficiency sometimes suggest that mandatory disclosure is unnecessary, noise theory may determine that mandatory disclosure is unhelpful and irrelevant.<sup>63</sup>

While economic theorists have not exhausted the conversation regarding the usefulness of mandatory disclosure in promoting market efficiency, their criticisms do bring to light real doubts concerning the costs and benefits of securities regulation.<sup>64</sup> The question then becomes, so what? The answer revolves around perceptions concerning the importance of market efficiency in securities regulation, both in terms of society as a whole, and in the motivations of the SEC in particular. One cannot fault the economically oriented critics for their view that market efficiency should take center stage in judging the merits of securities regulation. However, by not taking into account the law-oriented perspective of the agency, they misjudge the relative importance of market efficiency within the agency's decisionmaking processes.

The inability of market failure theory to account for the continuing necessity of regulation has prompted economists to seek out a rational theory of why regulation continues to exist even in event of its "uselessness." The resulting economic theory of regulation, or public choice theory, attempts to posit a real world explanation of bureaucratic behavior. Essentially, it assumes that each principal actor will act out its own selfish best interests. For a bureaucracy, "best interests" are defined as anything that will ultimately assure its survival, despite, and as Macey would argue, perhaps

especially in the case of, its own obsolescence.<sup>65</sup>

Why should an unnecessary agency succeed in promoting its own survival, especially in light of the costs that an industry may incur through regulation? Phillips and Zecher explain that, according to public choice theory, instead of real public interest bearing an impact on the direction of the regulatory process, "the success of a regulatory program hinges on the balancing of interests of effectively organized groups."<sup>66</sup> Regulations tend to favor small, well-organized groups with large stakes in the success of the regulations at the expense of large, poorly organized groups, for whom the effort of organizing does not outweigh the cost incurred through regulation.<sup>67</sup> Phillips and Zecher maintain that this pattern holds true in relation to the SEC.<sup>68</sup> For example, the cost of mandatory disclosure is spread out across a multitude of corporations, who in turn pass on the costs to their customers, suppliers, etc. On the other hand, financial accountants, securities lawyers and others, in addition to the SEC itself, directly benefit from ongoing regulation, and in some cases maintain their livelihood through it. These groups have a greater motivation in organizing against any attempts to do away with the regulations on which they rely.

At times, an agency's weighing of potential allies for assuring its survival will lead to a protection of the industry that it was created to regulate. This occurrence, referred to by public choice theorists as agency "capture," has been posited in relation to SEC behavior.<sup>69</sup> Not all of the economically oriented critics of the SEC feel that the agency is a victim of industry capture. Kripke, for instance, argues that the examples offered as support for capture theory are more likely evidence of agency ineptitude.<sup>70</sup>

Langevoort adds a bureaucratic motive for agency promotion of outdated regulation. He explains that those in the agency who question its direction have no motivation to speak up about it. This is partially due to the fact that "agency staffs rarely are rewarded for successes such as the anticipation and prevention of a problem... but [are] inevitably blamed for publicly observed failures within their jurisdiction."<sup>71</sup> He calls this "risk aversion in the face of bounded rationality."<sup>72</sup> Khademian hints that risk aversion may also underlie Congress's hesitancy to tinker with the regulatory status quo in ways that would threaten the SEC's working mandate.<sup>73</sup> What about the public? Kripke says that the public tolerates excessive regulatory costs out of pure apathy. After all, he says, "you can't fight city hall."<sup>74</sup>

This cynicism comes out even more clearly in Macey's

description of the behavior of an agency facing bureaucratic obsolescence. According to Macey, an obsolete agency will utilize any available tactic in an attempt to assure its survival. Thus an obsolete agency will consistently exhibit "(1) agency imperialism in the form of 'turf-grabbing', (2) agency 'capture' by special interests groups, (3) distortion of information flow to the public [in order to hide its obsolescence], and (4) manufactured or fabricated crises [in order to maintain the illusion of a need for the agency]."<sup>75</sup> An agency, once consciously aware of its obsolescence, will increase its odious conspiratorial activities as a means to further its own self-interest. Macey attempts to apply his theory of obsolescence to the SEC by arguing that the SEC, at least in more modern times, has displayed all of the behaviors described above.<sup>76</sup> He claims that "the modern history of the SEC has been the story of a regulatory agency far more interested in inventing problems that do not exist and expanding its own jurisdiction to restore its relevance...."<sup>77</sup>

In this combination of market failure and public choice theory, we find an SEC that does not serve the public interest, yet continues to thrive due to collusion with industry participants, risk aversion on the part of scared insiders as well as members of Congress, and an apathetic public that sits back even as economic injustice continues. Moreover, if we take Macey at his word, the SEC engages in conspiratorial activities at the expense of the public, simply to help ensure its survival through the expansion of its mandate. Unless we take a different tack, and explain that the SEC is simply inept, this all stems from a theory that, in the words of Langevoort, "posits hyper-rational agency action."<sup>78</sup> The SEC would have to clearly understand that it no longer serves the public interest, and in turn engage in intentional activities that assure its survival in light of that fact. Ironically, the government bureaucracy has never operated so finely-tuned a machine as is assumed in the discourse of Macey and his colleagues.

A more plausible explanation arises from simply rejecting market efficiency as a primary factor in the motivation behind securities regulation. We must remember the SEC's early history, in which the public indignation that made the New Deal legislation possible more directly reflected a will to punish the Wall Street insiders for their selfish, destructive activities than any rational desire to make the markets more efficient. Obviously a will to punish does not justify the extensive regulation that exists even today. Yet it symbolizes important ideals that deeply appeal to the American psyche, namely the concepts of fairness and justice. The dysfunctional activities of the market as evidenced by the

1929 market crash challenged the very foundations of unregulated laissez-faire economics, and not just simply because it was inefficient, but also because it was unfair to investors and to the public in general. Fraud in the market bothers us, not only due to its psychological effect of scaring away investors, although that obviously also plays an important role, but because we do not like being taken advantage of. The protection of disadvantaged investors can easily serve as an end in and of itself. Making such a protection a reality required a mechanism that could potentially equalize the playing field, a feat accomplished through the institution of mandatory disclosure. Moreover, in the creation of a government body that would oversee the self-regulation of the exchanges, an attempt was made to ensure that self-regulation would not be compromised due to the exchanges' personal self-interests.

Indeed, such an explanation coincides with lawyer domination at the SEC. We find evidence of support for this notion of the public interest in the SEC's 1997 GPRA Strategic Plan.<sup>79</sup> In the plan, the SEC identifies itself, not as a regulatory, but as a law enforcement agency. Moreover, the stated mission of the SEC within the plan is to "administer and enforce the federal securities laws in order to protect investors, and to maintain fair, honest and efficient markets." While the plan does mention market efficiency, this only follows the imperative of ensuring that investors remain protected and that the markets operate in fairness and honesty. That these factors are stated prominently within the mission statement implies that they function as the public interest in and of themselves. An alternative explanation can view the necessity of protecting investors and maintaining fair markets as a means through which to increase investor confidence, which in turn translates into increased liquidity for the securities markets. Again, while this may play a role, it is unlikely that it is the sole purpose behind promoting investor protection. Currently, we find a clear example in which investor confidence is directly at odds with investor protection. With the recent surge in online retail investing, one can hardly doubt investor confidence in the market. Yet, Arthur Levitt has found the need to discredit irresponsible online investor advertisements due to their promotion of uncritical confidence in market performance.<sup>80</sup> Certainly the SEC desires the increased liquidity brought upon by the online investing boom, but not at the expense of investor protection.

## Disclosure-Enforcement v. Capital Formation

In its attempts at regulatory reform, will the SEC ever depart from its disclosure-enforcement framework? Public choice theory, while providing an explanation for continued regulation in the instance of regulatory obsolescence, does not work well in explaining instances of deregulation and regulatory reform.<sup>81</sup> Instead, Harris and Milkis offer an explanation of deregulation that stems from qualitative changes in what they call regulatory regimes. They define the term "regulatory regime" as "a constellation of (1) new ideas justifying governmental control over business activity, (2) new institutions that structure regulatory politics, and (3) a new set of policies impinging on business."<sup>82</sup> In the development of securities regulation during the New Deal we find evidence to support the existence of all of these conditions. As mentioned earlier, securities regulation grew around the notion of the disclosure-enforcement framework as supported by public philosophy, new law, and the formal and informal institutions that developed within the SEC.<sup>83</sup> Thus the creation of securities regulation within a disclosure-enforcement framework represents the legitimate birth of a regulatory regime.

Harris and Milkis claim that qualitative regulatory change must confront strong inertial factors on the part of both the public philosophy as well as the bureaucracy in question.<sup>84</sup> Indeed, it seems quite unlikely that any shift will materialize except in the instance of a complete realignment of the prevailing public philosophies. When applied to the instance of securities regulation, this implies that the disclosure-enforcement framework retains remarkable staying power.

What shift in public philosophy and institutional direction could possibly undermine the disclosure-enforcement framework and catalyze the development of a new regulatory regime for securities regulation? We have already discussed the clear difference in outlook between law-oriented and economically oriented individuals concerning the nature of the public interest with regard to securities regulation. If a shift in regulatory regimes is to occur, it will most likely stem from an increased influence of economic considerations in SEC and congressional decisionmaking. Such a change would also fit well with the regulatory reform that occurred in other industries. For example, Derthick and Quirk have traced the deregulation that took place in the airlines, trucking, and telecommunications industry to academically led economic skepticism that prevailed in the early 1960's.<sup>85</sup>



As mentioned earlier, an economic perspective would entail weighing the costs and benefits of mandatory disclosure in terms of its effect on market efficiency. Moreover, the institution of new rules and regulations would follow not just a perception of market unfairness, but would also follow a careful consideration of how such rules would affect the way that the market functions. But perhaps most importantly, an economic perspective would probably evoke a change in the nature of the agency, from a prosecutorial to a promotional one. The agency may begin to see itself primarily as a promoter of efficient intra- and intermarket competition, as well as a facilitator of capital formation. Such an approach would view investor confidence as a means of boosting market legitimacy and liquidity. It would probably also signal a more heavy-handed role in the function of the self-regulatory organizations as a basis for ensuring a fragile balance of both increased competition and cooperation between markets, as opposed to simply guarding against instances of perceived unfairness.

### Setting the Stage for a Regulatory Shift

Khademian writes that the disclosure-enforcement framework continued to function, even through turmoil brought on by the Reagan administration.<sup>86</sup> However, while the events of the mid-1970's and 1980's may not have signaled a qualitative shift in regulatory regimes, they may certainly have set the stage for one. During the mid-1970's, we do find an increased activism on the part of the SEC's disclosure-enforcement framework, partially due to the agency's attempts to re-attain its reputation for integrity after two Nixon SEC political appointees were directly tied to political scandal and an attempt to cover up for members of the administration.<sup>87</sup> Yet at the same time, the 1975 amendments to the Securities Acts contained provisions that directly threatened agency concentration on disclosure-enforcement activities.

A number of important market developments led up to the 1975 amendments to the Securities Acts. The market had begun to experience an exponential growth in the importance of institutional investors, such as mutual funds, as well as a substantial increase in trading volume.<sup>88</sup> We must remember that the SEC has always taken a hands-off, cooperative stance in terms of its relationship with the exchanges as SRO's. This hands-off approach has in some cases enabled the continuation of anticompetitive practices on the part of the exchanges. Rule 390, which prescribes that NYSE member brokerages must use NYSE specialists in trading issues listed on the exchange, severely hampered

the ability of brokerages to turn to rival exchanges in finding the best price.<sup>89</sup> At the same time, the NYSE fixed-commission structure had placed an intolerable burden on institutional investors who purchased shares in much larger amounts than simple round lots.<sup>90</sup>

The SEC was not created with the notion of regulating the exchanges as natural monopolies. Until this point, the relationship between the SEC and the different exchanges was primarily punctuated by the effort of promoting a high standard of integrity and protecting against fraud. Yet in 1975, the SEC forcibly deregulated the NYSE fixed-commission rates, an action that was written into law with the 1975 amendments to the Securities Acts. Moreover, the 1975 amendments expanded the oversight power that the SEC held in relation to the SRO's.

Perhaps the most important element of the 1975 amendments, though, was the directive that the SEC should move the various exchanges in the direction of establishing a national market system. Levitt explains that before 1975:

The marketplace consisted of a number of different exchanges and dealers—some large, some small. Each operated wholly separately, attracting what order flow it could. The difficult task of determining where the best price was across these many different markets fell on brokers. While this system served our nation well, it soon became clear that a national market system would never come to fruition. Transparency of quotes would never prevail. Healthy price competition would never become part of a normal business day. So, in 1975, Congress called on the Commission to facilitate the creation of a national market system to connect these separate market centers. The motivation was clear—to develop a framework to foster greater competition.<sup>91</sup>

Originally, Congress wanted to mandate specific structural changes as part of the legislation, rather than leave development of a national market system up to industry, with SEC guidance.<sup>92</sup> The SEC explicitly opposed direct, strict intervention, and the final wording within the legislation reflected the SEC's preference for a more "gradual and cooperative approach."<sup>93</sup> While the SEC won out in its desire to allow industry to develop on its own with occasional guidance (mimicking the stress on self-regulation that has been in place since the New Deal), Congress did charge the SEC through the 1975 amendments with new roles that were



promotional, rather than prosecutorial in nature.<sup>94</sup>

Initially, the lawyer-dominated SEC was not really equipped with the capability of maintaining a promotional-oriented stance towards the securities industry. Karmel writes that in the late 1970's the "prosecutorial functions so predominated over the developmental functions given to the agency in the 1975 amendments that the agency could not engage in meaningful promotional activity."<sup>95</sup> In terms of the methodology that the SEC employed in moving along the transition to a national market system, Karmel characterizes the SEC as "indict[ing] the entire securities industry for failing to accommodate itself sufficiently and quickly to a rapidly changing economy and marketplace, and then try[ing] to punish the industry instead of assisting its passage into a new technological age."<sup>96</sup> Thus, the law orientation of the SEC exhibited itself even as the SEC tried to engage in a newer promotional direction.

However, the amendments did begin a potential shift from a pure prosecutorial disclosure-enforcement framework to one that also concerns itself with the promotional activities involved in capital formation. This added promotional element, while subservient in priority to SEC enforcement, continues to influence the SEC to the present. Even though the 1997 GPRA Strategic Plan does not include capital formation within the SEC mission statement, it is included along with protecting investors, and maintaining fair, honest, and efficient markets as one of the SEC's three primary goals.

The stage for the erosion of the disclosure-enforcement framework was further set in the 1980's with Reagan's appointment of Chairman John Shad. The appointment of Shad broke with a long-standing policy of appointing apolitical candidates to the position based on purely professional credentials.<sup>97</sup> Shad vigorously endorsed Reagan's anti-regulatory agenda. In terms of the SEC, this meant shifting the agency away from zealous enforcement and mandatory disclosure toward playing a more cooperative role with the industry in promoting capital formation.<sup>98</sup> Shad felt that the SEC's rigorous oversight and ponderous disclosure rules hampered the industry's competitiveness and worked against its vigorous health.<sup>99</sup>

A noteworthy change that Shad introduced, aside from the stripping away of unnecessary disclosure rules and cutting back of enforcement activity, was the creation of the Office of the Chief Economist as a subdivision of the chairman's office. While Chairman Roderick Hills had already created the Directorate of Economic and Policy Research in 1975, Shad was unsatisfied with the level of

economic consideration in SEC regulation. He felt that the creation of a new office under the chairman's guidance, with more direct integration into the decisionmaking process, would remedy the situation.<sup>100</sup>

Shad's activities as chairman directly threatened the disclosure-enforcement framework, potentially replacing it with a more economically oriented task of capital formation. While Shad did succeed in temporarily destabilizing the disclosure-enforcement framework, it appears doubtful that Shad seriously undermined it in the midterm.<sup>101</sup> For example, in terms of the creation of an Office of the Chief Economist, "though attorneys and economists jostled over policy, the latter made room for themselves in a decisionmaking hierarchy still very much dominated by attorneys. Economic analysis contributed to agency decisionmaking, but still in a support and advisory capacity."<sup>102</sup> Yet, at the same time, Shad's activities, while not replacing the disclosure-enforcement framework, did succeed in elevating economic considerations to a more formal status within the administrative hierarchy of the SEC. This elevated, yet secondary role, continues to play itself out within the regulation of the SEC, and under the right circumstances may indeed emerge to eventually overtake the disclosure-enforcement framework as the primary means of doing business for the SEC.

## Current Developments

Obviously, the deep entrenchment of the disclosure-enforcement framework within the identity of the SEC works against any ultimate change in regulatory regimes. Moreover, the political relationships that characterize the securities subgovernment are surprisingly stable, even in light of more general subgovernment instability.<sup>103</sup> Yet, in the 1975 amendments to the Securities Acts, as well Chairman Shad's institutional changes, we have seen that although the disclosure-enforcement structure remains firm, economic considerations have indeed gradually infiltrated the agency. It seems clear that any further qualitative movement away from the disclosure-enforcement framework will likely stem, at least in part, from the watershed technological and ideological shifts that currently face the market. Technological advancements will work in both directions, however, sometimes stressing the need for new regulatory direction, but also sometimes only further entrenching the traditional disclosure-enforcement framework. Whether or not rapid technological changes will lead to the dismantling of a regulatory regime built on disclosure-enforcement will partially depend on which of the emerging issues will capture the attention of the public, Congress, and the SEC itself.

Many of the recent changes in the securities markets relate directly to the advent of the Internet as a powerful trading force. Chairman Levitt points out that "in the next few years the number of online brokerage accounts will roughly equal the metropolitan populations of Seattle, San Francisco, Boston, Dallas, Denver, Miami, Atlanta and Chicago, combined."<sup>104</sup> The current bull market environment, in addition to the ease and low costs of trading online, has seduced a large number of relatively inexperienced individual investors to try their hand in the securities markets. One can even argue that a powerful social culture has emerged around securities trading, with many Americans discussing their latest trading conquests in investment clubs, brokerage lounges, and chat rooms.

It is not surprising that the SEC has chosen to react to these market changes through the lens of a disclosure-enforcement orientation. Chairman Levitt views the rise of the retail investor as primarily an investor protection challenge. Levitt expresses concern about "the great influx of new and relatively inexperienced investors who may be so seduced by the ease and speed of Internet trading that they may be trading in a way that does not match their specific goals and tolerance."<sup>105</sup> In other words, Levitt fears a growing financial literacy crisis in which "there is an unacceptably wide gap between financial knowledge and financial responsibilities."<sup>106</sup> It appears that within such an environment, the traditional emphasis on mandatory disclosure is no longer enough to provide adequate investor protection. While this could have motivated the agency to begin a new reassessment of mandatory disclosure, the agency has instead responded by trying to fill in the protection gaps through an increasing stress on investor education.<sup>107</sup>

In a parallel development, the SEC has vigorously responded to the threat of Internet use in perpetrating securities fraud. However, a recent General Accounting Office (GAO) report illustrates the various ways in which the Internet promises to directly challenge the limitations of SEC enforcement activities. The report characterizes the Internet as a "new and efficient medium to defraud investors of millions of dollars," and explains that "fraudulent operators find the Internet attractive because they can instantly communicate with millions of victims—via professional-looking websites that appear to offer legitimate investment information, online newsletters, or e-mail—at far lower costs than traditional means of communication, such as the telephone."<sup>108</sup> Such a dramatic characterization only serves to further entrench enforcement as the bread-and-butter of securities regulation. The SEC has established an Office of Internet En-

forcement with three full-time staff and over 125 volunteers nationwide in order to coordinate the agency's investigations of Internet securities fraud.<sup>109</sup> Yet, at the same time, the GAO report advocates the allocation of greater resources for the task, concluding that "the rapid growth in reported Internet securities frauds could ultimately place a significant burden on the regulators' limited investigative staff resources and thereby limit the agency's capacity to respond effectively to credible fraud allegations."<sup>110</sup>

However, other technologically motivated changes can potentially further increase stress on the disclosure-enforcement framework. Due in a large part to the ease with which information can now change hands, the securities market has experienced increasing globalization. Choi and Guzman explain that:

Driven by the rise in information technology and relative political and economic stability across several different nations, capital markets—from Hong Kong, Singapore and Taiwan to the United States, Switzerland and Britain—have become largely interconnected. Traders on the London Stock Exchange, for example, monitor bid-ask prices on the New York Stock Exchange and other markets when determining their own market clearing prices. Today, companies regularly go abroad either to seek new financing or to develop a liquid market for their existing securities.... Investors, similarly, often place their funds abroad either directly through the purchase of foreign securities in foreign markets or indirectly through a domestic institutional investor intermediary specializing in overseas investments.<sup>111</sup>

Moreover, the Internet provides a direct medium whereby foreign brokers or exchanges can reach out directly to individual investors. For example, former Commissioner Steven Wallman points out that "it would be very easy... for the Sydney exchange to set up a Web page giving Australian stock prices, with a button underneath that lets viewers convert the prices into US dollars. Another button could link to seventy-five bankers in Australia who would be more than happy to take US customers' business if they click on the site and provide a bank account."<sup>112</sup>

Great differences exist between United States securities regulation and that of other countries.<sup>113</sup> In terms of navigating these differences, the SEC can react by increasing the amount of cooperation between countries, trying to fur-

ther extend United States regulations to those foreign firms, corporations, and exchanges that do business with United States citizens, or by moving toward the creation of a single regulatory agency that will oversee multiple national market systems. The extent to which the SEC chooses to impose regulatory standards on foreign firms and corporations will likely correlate with the weight it gives its commitment of protecting US investors through US disclosure rules versus the need to maintain a respect for international boundaries, limiting SEC expansionism.

In any case, the emergence of alternative regulatory models within the consciousness of American lawmakers and the public may instill an increasing urgency in reexamining SEC regulation and disclosure requirements in light of efficiency standards. While the current bull market and relative stability of the US markets, as opposed to foreign markets, has mitigated the need for worry over a potential flight of capital to markets with a lower regulatory burden, it seems unlikely that such a favorable prognosis will continue indefinitely. When the dominance of the US securities market as a stable investment environment begins to wane, corporations and investors may play their cards in foreign markets with lower barriers to entry, a higher degree of market efficiency, and a smaller regulatory burden. Precisely because globalization will subject the US regulatory framework for securities to intense competition, the SEC may need to grow even more sensitive to the market effects of any future regulatory initiatives.

The growing importance of electronic trading networks, however, provides the most direct threat to the disclosure-enforcement orientation of the SEC. Commissioner Laura Unger explains that the electronic trading technology changes the *dynamics* of the marketplace by removing a number of physical constraints imposed on markets. Within a traditional floor framework, those that are privileged to occupy space on the exchange floor maintain time and space advantages over those that do not. In terms of electronic trading networks, because trades take place electronically within cyberspace, time and space advantages, as well as geographic limitations, vanish. Moreover, electronic trading eliminates some of the need for a market to be a membership organization.<sup>114</sup> Perhaps most importantly though:

Electronic trading technology has blurred the distinction between broker-dealers and exchanges. Over years, broker-dealers' systems have become increasingly automated. Broker-dealers developed electronic trading systems that function very much like exchanges: bringing

customer buy and sell orders together, and providing a means for customers to interact with each others' orders. These alternative trading systems, or ATSS, as we call them, became real competitors of the traditional markets....<sup>115</sup>

The SEC responded to the emergence of electronic trading networks by changing the regulation that applies to ATSS, trying to strike a balance between not hampering the continuing development of electronic trading systems and, at the same time, assuring some basic regulatory standards.<sup>116</sup>

A number of recent developments have determined that the change is far from over. The NYSE and Nasdaq have both announced plans to go public, primarily in order to strategically position themselves to better compete with the electronic trading networks. This has provoked Levitt to question the ability of the exchanges, as SROs, to maintain a standard of regulatory integrity, even as they compete for a greater market share.<sup>117</sup> The Commission's approach, though, has thus far mimicked the precedent set during the debate over the development of the national market system and the 1975 amendments. Levitt assured that the Commission's role is "not to impose or dictate the ultimate structure of markets. Rather, it is to establish, monitor, and uphold the framework that gives competition the space and sustenance to flourish."<sup>118</sup> However, if the market naturally develops in ways that increasingly fragments the national market system, the SEC may very well have to exercise a more activist promotional stance in moving the markets along toward better efficiency.

In any case, overseeing the transformation of the markets, in addition to changing regulation so that it better addresses the new environment, calls upon the SEC to increasingly concern itself with questions of efficiency and capital formation. Levitt's remark in his speech at Columbia University that, "unless the laws of nature betray us, true north will always remain true north" refers to the continued relevance of the disclosure-enforcement framework. Perhaps Levitt feels that disclosure-enforcement, as the traditional bread-and-butter of securities regulation, will easily survive such an economically oriented diversion. However, perhaps, Levitt simply fails to realize that the Trojan Horse already sits within the city gates.

## Notes

<sup>1</sup> Arthur Levitt, "Dynamic Markets, Timeless Principles." Lecture delivered at Columbia University Law School, New York, 23 September 1999

<<http://www.sec.gov/news/speeches/spch295.htm>>.

<sup>2</sup> *Ibid.*

<sup>3</sup> Ianthe Jeanne Dugan and Sandra Sugawara, "SEC Chief To Propose One Market Regulator; Levitt Plan Faces Stiff NYSE Opposition," *The Washington Post*, 22 September 1999, sec. E01.

<sup>4</sup> Anne M. Khademian, *The SEC and Capital Market Regulation*. (Pittsburgh: University of Pittsburgh Press, 1992), 25.

<sup>5</sup> Thomas K. McCraw, *Prophets of Regulation* (Cambridge, MA: Harvard University Press, 1984)

<sup>6</sup> *Ibid.*, 165.

<sup>7</sup> *Ibid.*, 165-168.

<sup>8</sup> *Ibid.*, 166.

<sup>9</sup> Susan M. Phillips and J. Richard Zecher, *The SEC and the Public Interest* (Cambridge, MA: MIT Press, 1981), 8.

<sup>10</sup> Khademian, 27.

<sup>11</sup> "GPRA Strategic Plan." US Securities and Exchange Commission. September 1997 <<http://www.sec.gov/asec/gpral197.htm>>.

<sup>12</sup> McGraw, 160.

<sup>13</sup> *Ibid.*

<sup>14</sup> Khademian, 27.

<sup>15</sup> *Ibid.*

<sup>16</sup> McGraw, 175.

<sup>17</sup> *Ibid.*, 174.

<sup>18</sup> *Ibid.*

<sup>19</sup> Khademian, 31 and McGraw, 177.

<sup>20</sup> McGraw, 179.

<sup>21</sup> Khademian, 31.

<sup>22</sup> *Ibid.*, 32.

<sup>23</sup> McGraw, 178.

<sup>24</sup> McGraw, 181 and Khademian, 36.

<sup>25</sup> Phillips and Zecher, 10.

<sup>26</sup> Khademian, 35.

<sup>27</sup> Phillips and Zecher, 10.

<sup>28</sup> Khademian, 36.

<sup>29</sup> McGraw, 180.

<sup>30</sup> *Ibid.*, 181.

<sup>31</sup> *Ibid.*, 180.

<sup>32</sup> *Ibid.*, 181.

<sup>33</sup> Khademian, 37 and McGraw, 185-188.

<sup>34</sup> McGraw, 185-186.

<sup>35</sup> Khademian, 40.

<sup>36</sup> McGraw, 186.

<sup>37</sup> *Ibid.*

<sup>38</sup> Khademian, 39.

<sup>39</sup> McGraw, 201.

<sup>40</sup> Khademian, 38.

<sup>41</sup> *Ibid.*, 37-38.

<sup>42</sup> *Ibid.*, 38.

<sup>43</sup> *Ibid.*

<sup>44</sup> Roberta S. Karmel, *Regulation by Prosecution* (New York, NY: Simon and Schuster, 1982), 106.

<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*, 106-107.

<sup>47</sup> *Ibid.*, 106.

<sup>48</sup> *Ibid.*

<sup>49</sup> Khademian, 211.

<sup>50</sup> *Ibid.*, 212.

<sup>51</sup> *Ibid.*

<sup>52</sup> See Phillips and Zecher, and Homer Kripke, *The SEC and Corporate Disclosure: Regulation in Search of a Purpose* (New York: Harcourt Brace Jovanovich, 1979).

<sup>53</sup> Kripke, 18.

<sup>54</sup> See Phillips and Zecher, and Jonathan R. Macey, "Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty," *Cardozo Law Review*, January 1994, 15: 909-949.

<sup>55</sup> Phillips and Zecher, 18.

<sup>56</sup> *Ibid.*, 29.

<sup>57</sup> *Ibid.*

<sup>58</sup> Macey, 928.

<sup>59</sup> Phillips and Zecher, 29.

<sup>60</sup> *Ibid.*, 51.

<sup>61</sup> For a thorough discussion of the merit of both the efficient market hypothesis as well as the noise theory of securities trading see: Lawrence A. Cunningham, "From Random Walks to Chaotic Crashes: The Linear Genealogy of the Efficient Capital Market Hypothesis," *The George Washington Law Review*, April 1994, 62:546-608; Donald Langevoort, "Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited," in *University of Pennsylvania Law Review*, January 1992, 140:851-920.

<sup>62</sup> Donald Langevoort, "Theories, Assumptions, and Securities Regulation," 854.

<sup>63</sup> *Ibid.*, 881 and Cunningham, 602.

<sup>64</sup> See Lawrence Cunningham for a discussion of chaos theory in relation to the securities market. He writes that "chaos theory not only can defend existing mandatory disclosure rules but also implies a possible justification for expanded disclosure of information concerning price discovery in the market microstructure," 604.

<sup>65</sup> Macey, 913.

<sup>66</sup> Phillips and Zecher, 22.

<sup>67</sup> *Ibid.*

<sup>68</sup> *Ibid.*

<sup>69</sup> See Kripke, 32-36.

<sup>70</sup> *Ibid.*

<sup>71</sup> Donald Langevoort, "The SEC as bureaucracy: public choice, rhetoric and the process of policy formation," in *Washington and Lee Law Review*, 1990, 47:530.

<sup>72</sup> *Ibid.*

<sup>73</sup> Khademian, 113.

<sup>74</sup> Kripke, 27.

<sup>75</sup> Macey, 918.

<sup>76</sup> *Ibid.*, 936-949.

<sup>77</sup> *Ibid.*, 937. While I can not use the space in this paper to counter Macey's examples, David Ratner attempts to do just that in his response to Macey's article. See David Ratner, "Response the SEC at sixty: A reply to Professor Macey," *Cardozo Law Review*, 1995, 16: 1765-1779.

<sup>78</sup> Donald Langevoort, "The SEC as bureaucracy: public choice, rhetoric and the process of policy formation," 529.

<sup>79</sup> US Securities and Exchange Commission, "GPRA Strategic Plan."

<sup>80</sup> Arthur Levitt, "Plain Talk About On-line Investing," Lecture delivered

at the National Press Club, 4 May, 1999 <<http://www.sec.gov/news/speeches/spch274.htm>>. In the lecture, Levitt says, "Lastly I worry about how some on-line firms advertise.... I recently saw one commercial that showed two women rushing in from their jog to trade before the stock market closed. After a few clicks of the mouse, one woman proclaims, 'I just made \$1700.' The other woman sheepishly replies by admitting she invests in mutual funds. What's the implication of the message here? Has it become passé to invest for the longer-term and to diversify your risk? Now, some may argue that we shouldn't tell firms how to sell their products as long as it is lawful. I agree. But selling securities is not like selling soap. Brokers have always had duties to their customers that go beyond simply 'buyer beware.'"

<sup>81</sup> Richard A. Harris and Sidney M. Milkis, *The Politics of Regulatory Change: A Tale of Two Agencies* (New York: Oxford University Press, 1996), 17-18.

<sup>82</sup> *Ibid.*, 25.

<sup>83</sup> Khademian, 36-38.

<sup>84</sup> Harris and Milkis, 35, 45-48.

<sup>85</sup> Martha Derthick and Paul J. Quirk, *The Politics of Deregulation* (Washington DC: The Brookings Institute, 1985), 35-39.

<sup>86</sup> Khademian, 184.

<sup>87</sup> *Ibid.*, 122-125.

<sup>88</sup> *Ibid.*, 68-69.

<sup>89</sup> *Ibid.*

<sup>90</sup> *Ibid.*

<sup>91</sup> Levitt, "Dynamic Markets, Timeless Principles."

<sup>92</sup> Khademian, 73.

<sup>93</sup> *Ibid.*, 74.

<sup>94</sup> Karmel, 109.

<sup>95</sup> *Ibid.*

<sup>96</sup> *Ibid.*

<sup>97</sup> Khademian, 153, 157.

<sup>98</sup> *Ibid.*, 158.

<sup>99</sup> *Ibid.*

<sup>100</sup> *Ibid.*, 160, 164.

<sup>101</sup> *Ibid.*, 183-184.

<sup>102</sup> *Ibid.*, 184.

<sup>103</sup> Billy Ray Hall Jr., *A Legal Solution to Government Gridlock: The Enforcement Strategy of the Securities and Exchange Commission* (New York: Garland Publishing, 1998), 150. For a thorough discussion of the political relation-

ships that make up the securities subgovernment, and how these relationships revolve around a stress on disclosure-enforcement also see Khademian, *The SEC and Capital Market Regulation: The Politics of Expertise*.

<sup>104</sup> Levitt, "Plain Talk About On-line Investing."

<sup>105</sup> *Ibid.*

<sup>106</sup> Arthur Levitt, "Expanding the Promise of Opportunity and Security Through Saving and Investing." Lecture delivered before the Consumer Federation of America, Washington DC, 3 December, 1998 <<http://www.sec.gov/news/speeches/spch229.htm>>.

<sup>107</sup> Levitt, "Plain Talk About On-line Investing."

<sup>108</sup> General Accounting Office, *Securities Fraud: The Internet Poses Challenges to Regulators and Investors*. GAO/T-GGD-99-34. Washington DC: General Accounting Office, March 22, 1999, 1.

<sup>109</sup> *Ibid.*, 9.

<sup>110</sup> *Ibid.*, 2.

<sup>111</sup> Stephen J. Choi and Andrew T. Guzman, "National Laws, International Money: Regulation in a Global Capital Market" *Fordham Law Review*, April 1997, 65:1859.

<sup>112</sup> Ann Monroe, "Wallman's Legacy to the SEC: Rethink the Way You Regulate," in *The Investor's Dealers' Digest*, (November 24, 1997) 63, 47: 13.

<sup>113</sup> Matthew Gorra, "Note: On-Line Trading and United States Securities Policy: Evaluating the SEC's Role in International Securities Regulation" *Cornell International Law Journal*, 1998, 32:219.

<sup>114</sup> Laura S. Unger, "The Internet—Will It Be the End of the Stock Market as We Know It?" Lecture delivered at the National Press Club, Washington DC, 22 June, 1999 <<http://www.sec.gov/news/speeches/spch288.htm>>.

<sup>115</sup> *Ibid.*

<sup>116</sup> *Ibid.*, and Levitt, "Dynamic Markets, Timeless Principles."

<sup>117</sup> Levitt, Dynamic Markets, Timeless Principles."

<sup>118</sup> *Ibid.*

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