

**ASSESSING THE EFFECTIVENESS OF U.S. FINANCIAL REGULATIONS: A
COMPARATIVE ANALYSIS WITH E.U. RESPONSES**

By

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Abstract

This paper assesses the effectiveness of U.S. financial regulation in carrying out its intended purpose, namely, to adequately protect investors from industry abuse, insider advantages, and fraud. Reviewing recent financial crises, the role of the S.E.C., high profile Supreme Court cases, and legislation, such findings call into question the legitimacy of the financial system as a whole and is worrying due to Americans' sheer reliance on banks and securities markets. Furthermore, this paper then compares the U.S. regulatory response with that of the E.U. as a result of the Global Financial Crisis and found that E.U. regulations are more clear, more potent, and more effective in handling and preventing financial crises. This paper uses statistical data, legislative analysis, and testimonial evidence to conclude that there are severe ways in which the U.S. regulatory regime is lacking. Particularly, through vague laws that do not take proper measures to adequately protect against a future crisis, along with the evaluation of the capacity of the S.E.C. to enforce the financial laws in question, U.S. financial regulation does not effectively carry out its intended purpose.

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1. Introduction:

Effective financial regulation is an important goal of any advanced, stable, and peaceful democracy. In fact, a functional financial system is necessary for any stable society and as our society becomes more complex, its reliance on finance increases. At the same time, so too does that society's need for effective regulation. Banking, securities markets, and mortgages all operate under the purview of financial regulation. The role of such regulations is simple: create a set of rules and guidelines that protects people from fraud, abusive tactics, and insider privilege - in other words, to make the financial system fair. For the United States in recent history, as its technology progressed and its society became more complex, its reliance on finance increased. Almost everyone in the country is affected by the financial system. Despite the increasing reliance on a functioning and healthy financial sector, the U.S. regulatory regime's increasing laxity, vagueness, and insufficiency to combat pressing issues, suggests the country's financial regulations are not fully effective at monitoring this vital network of transactions and transactors. Addressing technical gaps in regulations such as through establishing a batch process for High Frequency Trading (H.F.T.), along with the structural political challenges facing Congress, such as lobbying and Congressional operations could help strengthen the regulatory system overall. In order to create lasting change, however, the U.S. should adopt a different relationship between its businesses and regulatory bodies, similar to the E.U.'s 'bail-in' mechanism, whereby financial institutions pay a portion of their profits to fund regulatory bodies (based on their risk profile).

When breaking down the financial system into banking and securities markets, which encompass all financial assets, such as collateralized loans, it's clear that the system is indispensable to the functioning of life for the vast majority of Americans. Thus, this paper suggests that effective financial regulation is needed, yet discovers ways in which the U.S.'s

current financial regulatory regime could be strengthened to better protect and serve its citizens. Specifically, due to vague regulations that do not prevent future crises, along with the S.E.C.'s persistent lack of necessary funding to achieve its goals, and the establishment of broad ranging agencies that have lofty jurisdictions without the necessary enforcement powers or resources to properly manage them, the U.S. system is not effective enough at preventing future financial crises and leaves millions exposed to unnecessary financial, political, and health risks.

The banking system is the most obvious way that Americans, in particular, rely on the financial system. In 2021 alone, the Federal Deposit Insurance Corporation (F.D.I.C.) estimated that 81.5% of all American households, nearly 108 million individuals, were “fully banked,” meaning that they did not use non-bank transactions or non-bank credit.¹ Specifically, the F.D.I.C. defined the term “fully banked” as those who have not used, “Money orders, check cashing, or international remittances (i.e., nonbank transactions), or Rent-to-own services or payday, pawn shop, tax refund anticipation, or auto title loans (i.e., nonbank credit),” in the last twelve months.² Therefore, fully banked individuals exclusively rely on payment cards or credit for every single transaction. Although the number of those who operate entirely within the banking system seems high, it surely would have increased as a result of the COVID pandemic that necessitated social-distanced transactions and encouraged mobile and digital payment systems.

Additionally, there is a general trend showing that people are becoming more integrated into the banking system. Among those households who were fully banked, their use of mobile

¹ Mark Kutzbach, Joyce Northwood, and Jeffrey Weinstein. Susan Burhouse and Yazmin Osaki, (2021) “F.D.I.C. National Survey of Unbanked and Underbanked Households,” Federal Deposit Insurance Corporation, Executive Summary, <https://www.F.D.I.C..gov/analysis/household-survey/index.html>

² Ibid

banking increased significantly from 15.1% in 2017 to 34% just two years later.³ Similarly, the use of teller services amongst this group dropped by nearly 40% from 2017 to 2021, highlighting the decline of nonbank transactions overall. Furthermore, the use of non-bank credit also decreased during the same period.⁴ Specifically, the use of non-bank money orders dropped by 32% from 2017 to 2021 while the use of non-bank check cashing similarly decreased by 50% to just over 3% of the total population during the same period.⁵ Although there is a defined increase in the rate of integration of people into the banking system since the pandemic, there was still a clear increase in the years prior.

The trend is clear amongst the unbanked group specifically as well. The current number of those who are unbanked entirely in the U.S. stands at 4.5% of all households, representing roughly 5.9 million individuals in 2021.⁶ Unbanked households are those in which no one in the household has either a checking or a savings account at a credit union or bank.⁷ Despite the fact that millions are unbanked they are clearly integrating within the banking system over time.⁸ That is why the 4.5% figure is the lowest recorded in the history of the F.D.I.C. survey since it began in 2009.⁹ Moreover, the unbanked rate dropped by over 45% since its highest recorded level in 2011 just a decade later.¹⁰ These F.D.I.C. figures highly suggest that more Americans are integrating within the banking system over time, and that the rate of their integration was facilitated by the COVID pandemic, but still independent from it.

³ Kutzbach, Northwood, Weinstein, Burhouse, and Osaki, "F.D.I.C. National Survey of Unbanked and Underbanked Households."

⁴ Ibid

⁵ Ibid

⁶ Ibid

⁷ Ibid

⁸ Ibid

⁹ Ibid

¹⁰ Ibid

Not only are the vast majority of Americans, and an increasing number of them, dependent on banking services, but also a majority of them rely on the financial surities markets for saving for retirement and investing for a better future. According to a 2016 survey, the majority of American households (52%) have exposure to the stock market, either directly through owning specific stocks, or indirectly through retirement plans such as 401Ks.¹¹ Furthermore, a survey conducted this year by the National Bureau of Economic Research suggests that of the households that are invested in the market, 70% of their investable wealth is in the stock market.¹² Not only are there a majority of Americans currently who have a majority of their assets in the stock market, but there also seems to be a trend of increased participation and market exposure over time.¹³ For example, those who invest in the market are investing a larger share of their income today than they were prior to the year 2000. Additionally, it has been observed that each successive generation since 1970 has held more equities than previous generations.¹⁴

The securities markets represent a crucial function within our economy and so it is equally crucial to properly regulate such markets to protect individual investors. The stock market is a public exchange for the buying and selling of stocks, or fractional shares of ownership, in publicly listed (as opposed to privately held) businesses. The stock market is an amalgamated term used to refer to the multiple major exchanges in the U.S. It comprises some of the nation's largest and most economically consequential firms and industries, whose success and failures largely indicate the health of the economy as a whole. Thus U.S. securities markets

¹¹ Kim Parker and Richard Fry, "More than Half of U.S. Households Have Some Investment in the Stock Market," Pew Research Center (Pew Research Center, July 27, 2020), <https://www.pewresearch.org/fact-tank/2020/03/25/more-than-half-of-u-s-households-have-some-investment-in-the-stock-market/>. pp. 1

¹² Jonathan Parker et al., "Household Portfolios and Retirement Saving over the Life Cycle," *National Bureau of Economic Research: Working Paper Series*, 2022, pp. 2 <https://doi.org/10.3386/w29881>.

¹³ Parker et al., "Household Portfolios and Retirement Saving over the Life Cycle," 2-3

¹⁴ *Ibid*, 3

encompass every industry in the country and the vast majority of the largest companies in the world.

Securities markets serve a crucial function to the wellbeing of Americans in the operation of the U.S. economy as a whole, and specifically, in terms of economic growth and financial stability.¹⁵ Not only are the securities markets crucial for the functioning of businesses, but also for the financial well-being of the majority of American households.¹⁶ Furthermore, the data suggests that more and more people are entering the market each year and are investing a larger portion of their income in equities. The increasing exposure Americans have to the stock market warrants research into the body of U.S. governmental regulations on the matter. Specifically, increased exposure to the stock market makes it imperative to understand if Americans are adequately protected from fraud, market manipulation, and general abuse of the system by the insiders to the detriment of the average investors. The importance of both the banking system and the securities markets cannot be overstated. Banking facilitates daily transactions and serves as a vehicle for savings for the vast majority of all Americans. Yet, the financial markets are crucial to most Americans as well as a way to invest to gain a higher return on their savings and as an integral element of the retirement planning process. Not only are the majority of Americans invested, a number which is growing with time, but those households that are invested have the majority of their net worth tied in securities assets traded on public exchanges.¹⁷ Therefore, the financial system as a whole is indispensable from the transactions and expectations of U.S.

¹⁵ Olivier Blanchard, and Giovanni Dell'Ariccia. "The Macroeconomics of Asset Price Booms and Busts." IMF Working Paper, no. WP/07/259 (December 2007). International Monetary Fund. Accessed March 9, 2023. <https://www.imf.org/external/pubs/ft/wp/2007/wp07259.pdf>. Page 4

¹⁶ Kim Parker and Richard Fry, "More than Half of U.S. Households Have Some Investment in the Stock Market," Pew Research Center (Pew Research Center, July 27, 2020), <https://www.pewresearch.org/fact-tank/2020/03/25/more-than-half-of-u-s-households-have-some-investment-in-the-stock-market/>. pp. 1

¹⁷ Jonathan Parker et al., "Household Portfolios and Retirement Saving over the Life Cycle," *National Bureau of Economic Research: Working Paper Series*, 2022, pp. 2 <https://doi.org/10.3386/w29881>.

society today, which necessitates a coordinated, effective, and reasonable response from regulators for effective governance and raises the question of whether the government is doing enough to properly maintain and regulate the system for the benefit of the majority of Americans.

The Global Financial Crisis (G.F.C.) that mainly occurred from mid-2007 to early 2009, yet had lasting implications for the state of the economy for nearly a decade later in some cases showed the issues with the U.S. regulatory regime. A U.S. housing crisis caused by increased borrowing, unsound loans collateralized as Mortgage Backed Securities (M.B.S.) and sold to investors domestically and internationally, and excessive risk taking, along with regulatory failure to address the developing issues caused the most severe economic shock since the Great Depression in the 1930s.¹⁸ Millions lost their jobs, while millions more suffered from cuts to public services. Much like the Great Depression, the economic recovery was much more prolonged than other recessions.¹⁹

Not only were millions of Americans suddenly out of work, but the value of their investments had severely declined. Specifically, the Dow Jones dropped by nearly half in only a few months, taking almost five years to recover to pre-crisis prices.²⁰ This alone dissipated millions of Americans' savings forcing many close to retirement to go back into the workforce, while many others became underemployed, so even those who wished to work more hours were unable to do so.²¹ For those who could not find work at all, unemployment more than doubled in

¹⁸ Reserve Bank of Australia, "The Global Financial Crisis," <https://www.rba.gov.au/education/resources/explainers/the-global-financial-crisis.html>

¹⁹ Ibid

²⁰ "Dow Jones - DJIA - 100 Year Historical Chart," MacroTrends, 2023, <https://www.macrotrends.net/1319/dow-jones-100-year-historical-chart>.

²¹ Michael Greenstone, Adam Looney, (2011) "Unemployment and Earnings Losses: A Look at Long-Term Impacts of the Great Recession on American Workers," Brookings Institute, the Hamilton Project, <https://www.brookings.edu/articles/unemployment-and-earnings-losses-a-look-at-long-term-impacts-of-the-great-recession-on-american-workers/>

14 months and it took eight years to reach the same pre crisis levels.²² Ultimately, the crisis caused major structural disruption in the U.S. economy that took years of adjustment and reform to reinvigorated.

In Europe, the situation was even more dire. Unemployment levels rose similarly, yet the aggregate hides the depths of the crisis for many E.U. nations.²³ The E.U. decided to impose harsh austerity measures on certain nations, such as the U.K., Ireland, Greece, Portugal and Spain that further exacerbated the joblessness and asset price depression. Further millions who were now in most need, were cut off from public services, causing a severe public health crisis in at least Greece and Spain, whose health systems neared collapse.²⁴ In the E.U. as a whole, however, there were increased rates of suicide as government budgets shrank and thus public health services were unavailable to many.²⁵ Just as in the U.S. the E.U. spent years recovering. In the E.U., however, economic issues led to political upheaval as in the case of rising support for populist right wing nationalist parties in various countries including France, the U.K., Germany, Sweden, and Greece.²⁶ Thus, the effects of poor financial regulation led to direct consequences for poor quality of life, health crises, and even political upheaval.

Despite the fact that the U.S. and the E.U. have recovered from the Global Financial Crisis, the threat of the government's mismanagement of the economy looms over all its citizens. Especially since the G.F.C., since there have been subsequent crises in the U.S. that call into

²² “Databases, Tables & Calculators by Subject,” U.S. Bureau of Labor Statistics, 2023, <https://data.bls.gov/pdq/SurveyOutputServlet>

²³ Mark de Broek, (2018), “The Debt Web,” The International Monetary Fund (IMF), <https://www.imf.org/en/Publications/fandd/issues/2018/03/debroeck>

²⁴ Martin McKee, Marina Karanikolos, Paul Belcher, David Stuckler (2012) “Austerity: a failed experiment on the people of Europe,” Royal College of Physicians, doi: 10.7861/clinmedicine.12-4-346 <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4952125/>

²⁵ Martin McKee et al., “Austerity: A Failed Experiment on the People of Europe,” Clinical medicine (London, England), August 2012, <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4952125/>

²⁶ William A. Galston, “The rise of European populism and the collapse of the center-left,” Brookings, 2018 <https://www.brookings.edu/articles/the-rise-of-european-populism-and-the-collapse-of-the-center-left/>

question the viability of financial regulations. Specifically, due to new evidence surrounding manipulative market events, such as through High Frequency Trading and Payment for Order Flow, there is a reason to question whether government regulations are sufficient in protecting the majority of the wealth of average Americans. Additionally, the S.E.C.'s chronic lack of resources, in addition to its limited enforcement capabilities and curtailed judicial powers, justifies understanding the extent to which Americans are protected from financial markets. Particularly when the U.S. regulatory system is compared to that of the E.U., it becomes clear that the U.S. system lacks in clarity, capacity, and capability.

Therefore, this study will explore the most notable financial crises of recent history and analyze where existing regulations were insufficient and how regulators responded to the crises. It will address crises and issues that developed in the last decade, yet will especially focus on the Global Financial Crisis and the ways in which the United States and the European Union responded through new legislation. Specifically, it will explore the gaps in regulation that leave millions of Americans exposed to unnecessary risk and how lawmakers consistently fail to adequately solve the underlying causes of these financial crises. In this way, this study will assess the effectiveness of the current corpus of securities laws and regulations at achieving their desired intent of providing stability to financial markets, bolstering public trust in those markets, and facilitating equality of information and opportunity amongst investors. Thus, this paper will analyze how lawmakers have consistently failed to adequately craft and maintain securities legislation over the last few decades and identify what factors contributed to their failures.

Therefore, this paper will progress by discussing the schools of thought in financial regulation. Then it will discuss the current U.S. securities legislation process and how it leads to failures and inefficiencies, by revealing gaps in current U.S. financial securities regulation. Subsequently, it will proceed by showing the ways in which the S.E.C. is limited in terms of its

enforcement capabilities due to political reasons, resource limitations, and judiciary restrictions. Next, this paper will explore financial securities regulation in the aftermath of the G.F.C. from two new dimensions. Firstly, it will compare the U.S. response to that of the European Union generally, which will give a broad overview of the differences between the two world's two largest and most integrated economies in one of the most important economic sectors that has the potential to affect many other sectors. Secondly, it will assess banking regulations more broadly in an attempt to gain a more holistic understanding of how these separate governments navigated possibly the most critical juncture since the Great Depression. Understanding these respective governments' approach to banking regulation in addition to financial securities regulation is logical as the two fields are highly interrelated, yet it will also provide valuable insight into how the U.S. and E.U. differ in terms of their approaches to financial regulation more generally. Finally, this paper will propose solutions to these identified factors that, if applied, would institute a more effective regulatory regime in that the laws would more consistently and thoroughly promote equality and integrity of the markets amongst average investors.

2. A History of U.S. Financial Regulations - Economic and Regulatory Theories:

In its most basic form, financial security regulations are a set of rules that help monitor financial transactions and entities engaged in buying, or selling securities.²⁷ These rules were established to help maintain the integrity of the financial system, as well as protect people's property.²⁸ Scholars agree that the system of national U.S. securities regulation began in the aftermath of the Great Depression in the 1930s, which added a national layer to the sporadic

²⁷ Scott E. Hein, "Financial Regulation," in *Encyclopedia of Contemporary American Social Issues - Volume 1: Business and Economy*, ed. Michael Shally-Jensen (Santa Barbara, CA: ABC-CLIO, LLC, 2011), pp. 99

²⁸ *Ibid*, 9

various State laws that had developed since then.²⁹ As a result, the body of regulation is complex and responsibility for enforcing the regulations is unclear in some instances, due to an overlapping set of regulatory jurisdictions.³⁰ As a result, there are gaps present in the existing regulatory system that creates instances where legality is obscured as certain market actors take advantage of the uncertainty.³¹ These gaps have become increasingly apparent in recent years as technological advances sometimes make current laws obsolete.³² In addition to the shortfalls of the legislation itself, interest groups pressure Congress to reinterpret, amend, and ultimately repeal legislation that was created to stabilize the financial system and instill confidence in individual investors.³³

Despite the fact that the effectiveness of some of these laws and regulations is not clear, the origin and motivations of securities regulation are. The various authors who helped draft the Basel Committee on Banking Supervision Working Paper no. 30, such as Mathias Dewatripont and Diana Hancock, among others, noted that securities legislation was ad hoc and in response to threats or scandals that had the potential to disrupt financial markets.³⁴ This idea has been echoed by others, namely, Zingales, Biedermann, and Levine, who suggest that securities regulation is mostly enacted in response to public outcry.³⁵ The establishment of those laws in response to,

²⁹ Zingales, Luigi. "The Future of Securities Regulation." *SSRN Electronic Journal* 47, no. 2 (2009): 391–425. <https://doi.org/10.2139/ssrn.1319648>. pp. 391-392

³⁰ Douglas W. Arner, János Barberis, and Ross P. Buckley, "FinTech, RegTech, and the Reconceptualization of Financial Regulation," *Northwestern Journal of International Law and Business* 37, no. 3 (2017). 385

³¹ Arner, Barberis, and Buckley, "FinTech, RegTech, and the Reconceptualization of Financial Regulation," 385

³² Thomas M. Hoenig, "Rethinking Financial Regulation," *Economic Review, Federal Reserve Bank of Kansas City* 81, no. 2 (1996): pp. 6.

³³ Corinne Crawford, "The Repeal Of The Glass-Steagall Act And The Current Financial Crisis," *Journal of Business & Economics Research* 9, no. 1 (January 2011), pp. 128-129.

³⁴ Mathias Dewatripont and Diana Hancock, "Literature Review on Integration of Regulatory Capital and Liquidity Instruments," *Basel Committee on Banking Supervision*, no. 30 (March 2016), pp. 3

³⁵ Zingales, "The Future of Securities Regulation," pp. 391-392, 405; Zsuzsánna Biedermann, "The History of American Financial Regulation," *Public Finance Quarterly* 57, no.3, 2012, pp. 313-314; Ross Levine, "The Governance of Financial Regulation: Reform Lessons from the Recent Crisis," *International Review of Finance* 12, no. 1 (August 2011): pp. 48, <https://doi.org/10.1111/j.1468-2443.2011.01133.x>.

rather than in anticipation of, flaws in the current legislative and regulatory body inadvertently set a precedent of reactionary securities regulation that has been remarkably consistent through time.

The pattern is that public demand for regulation in the aftermath of crises leads to enhanced regulatory provisions.³⁶ Whether it was the stock market crash of 1929 that caused the Securities Act of 1933 and the Exchange Act of 1934, or the Enron accounting scandal of 2001 that led to the Sarbanes-Oxley (Public company Accounting Reform and Investor Protection Act of 2002), or the Great Recession following the crash of 2008, and the subsequent Dodd-Frank Act of 2010—regardless of the decade, or the specific causes of the crises, this pattern has remained consistent.³⁷

Just as the pattern of regulatory expansion in response to financial crises is well established, so too is the pattern between pressure from interest groups in Congress through lobbying, changes to the enforcement of financial legislation, and sometimes even its amendment and repeal. This lobbying is best illustrated by Congress' repeal of the Glass-Steagall Act, or the Banking Act of 1933 (P.L. 66-73D) by the legislation of the Gramm-Leach-Bliley Act in 1999 (P.L. 106-102).³⁸ Glass-Steagall was a cornerstone of U.S. financial regulation since its establishment in the aftermath of the 1929 Market Crash, as it separated commercial banking and investment banking functions and thus eliminated the conflicts of interest that developed when commercial banks risked depositors' savings on the stock market.³⁹ While Glass-Steagall was effective in curbing abuses by bank executives, Corinne Crawford of the Borough of Manhattan

³⁶ Zingales, "The Future of Securities Regulation," pp. 391-392, 405

³⁷ Douglas W. Arner, János Barberis, and Ross P. Buckley, "FinTech, RegTech, and the Reconceptualization of Financial Regulation," *Northwestern Journal of International Law and Business* 37, no. 3 (2017). pp. 414, 418

³⁸ Crawford, "The Repeal Of The Glass-Steagall Act And The Current Financial Crisis," pp. 130; Carter Glass and Henry Steagall, "Banking Act, 1933," Banking act, 1933 § (1933).

³⁹ Ibid

Community College, as well as Russell J. Funk and Daniel Hirschman of the University of Michigan, agreed that the commercial banks were successful in amending, reinterpreting, and ultimately repealing the Act through consistent lobbying efforts.⁴⁰

The repeal of Glass-Steagall was influenced by a confluence of factors, including the global trend of “Financialization” that began in the 1970s, the increase of foreign competition into the U.S. commercial banking space from the 1970s-1990s which decreased bank profits, and the trend of deregulation that Reagan spearheaded.⁴¹ Ultimately, however, it was the banking industry’s consistent lobbying that led to the repeal of Glass Steagall in 1999.⁴² Thus, not only are securities laws drafted and enforced to respond to crises in the financial system, but, through lobbying, third-party actors can have significant influence over the enforcement and integrity of the very laws meant to regulate them.

In order to understand the limitations placed on regulators when they attempt to enforce the law, this section will seek to contextualize the regulatory structure of U.S. securities within the available body of scholarly research on regulatory theory. Particularly, this section will focus on the major regulatory theories, such as the public interest theory associated with Arthur Pigou, the English economist instrumental to the founding of Cambridge’s School of Economics, and the capture theory associated with George Stigler, the Nobel laureate from the University of Chicago. Understanding theories will offer a more nuanced understanding of our own regulatory apparatus, as we cannot truly understand the regulatory limitations on enforcing legislation without first understanding the theoretical framework of the regulatory apparatus as a whole,

⁴⁰ Russell J. Funk and Daniel Hirschman, “Derivatives and Deregulation,” *Administrative Science Quarterly* 59, no. 4 (June 2014): <https://doi.org/10.1177/0001839214554830>. Pp. 16

⁴¹ Funk and Hirschman, “Derivatives and Deregulation,” 18

⁴² *Ibid*, 13

including Congress and interest groups, and the role of the S.E.C. specifically within this framework.

The first theory that will be discussed is the public interest theory, best attributed to Pigou. Instead of focusing on more cynical or pragmatic motivations for the application of regulations, Pigou's public interest theory assumes the benevolence of democratic governments.⁴³ Pigou's theory was developed in response to advancements in economic theories that identified the negative externalities associated with the unmonitored and unregulated free market.⁴⁴ Thus, he particularly saw his theory as a way to explain why and how the government intervenes to solve these inefficiencies, particularly those associated with monopolies and negative externalities.⁴⁵ Furthermore, the public interest theory posits that in an effort to create the most utility, or benefit the most people, the government seeks to solve those natural market inefficiencies through setting regulations that could control prices and wages, among other things.⁴⁶

In contrast to the government's benevolent approach, according to Pigou's public interest theory, capture theory sought to address the regulatory landscape from a more holistic perspective, involving private interests into the equation as opposed to simply the monolithic government and the public.⁴⁷ According to George J. Stigler's capture theory, although the government sought to regulate, it was more interested in appealing to the interests of the companies they were charged with regulating, rather than the public's interest at large. Due to constraints and practical realities facing the regulatory bodies, they are primed to be susceptible

⁴³ Andrei Schleifer, "Understanding Regulation," *European Financial Management* 11, no. 4 (2005): pp. 440

⁴⁴ Schleifer, "Understanding Regulation," 440

⁴⁵ Ibid

⁴⁶ Ibid

⁴⁷ Ibid

to third party influence and thus be ‘captured’ by the very third parties that they were tasked with monitoring.⁴⁸ Once these regulators have been captured, they are employed towards the firm’s ends, which often include using the coercive powers of the government to prevent competition.⁴⁹

Stigler discussed the ways in which, once captured, the government can be manipulated to help the business that should be regulated, and the first way is by limiting competition into the industry by controlling the entry of new companies into the marketplace.⁵⁰ Specifically, Stigler noted that “...every industry or occupation that has enough political power to utilize the state will seek to control entry.”⁵¹ Thus, Stigler addresses an important way that third parties can use their influence over regulatory bodies to benefit themselves. In this case, to the direct detriment of the consumers and in direct contrast to the regulatory interest, which would be to increase competition to lessen the negative externalities from monopolies. Secondly, Stigler noted how these third party industries with influence over regulatory bodies can more overtly use the government's power to their benefit by having the government suppress rival firms and industries.⁵² When Stigler wrote, “Crudely put, the butter producers wish to suppress margarine and encourage the production of bread,” he suggested that the butter producers would benefit from the decline of margarine production.⁵³ To carry this example further, if the butter producers had “captured” the food regulatory commissioners, then they could theoretically convince them to use the coercive powers of the government to benefit their industry. Thus, instead of a benevolent government, Stigler’s capture theory suggests that the government could be more of a

⁴⁸ George J. Stigler, “The Theory of Economic Regulation,” *The Bell Journal of Economics and Management Science* 2, no. 1 (1971), 3-4.

⁴⁹ Ibid, 4-5

⁵⁰ Ibid, 5

⁵¹ Stigler, “The Theory of Economic Regulation,” 5

⁵² Ibid

⁵³ Ibid, 6

tool controlled by business to help maintain the status quo to the potential detriment of the public.

Furthermore, Stigler described the U.S. Federal regulatory securities apparatus as one that resembles a sort of marketplace. The theory suggests that a market exists between third party actors and national political parties. Thus, Stigler states that both parties benefit in this exchange, “The industry which seeks political power must go to the appropriate seller, the political party... The industry which seeks regulation must be prepared to pay with the two things a party needs: votes and resources.”⁵⁴ Stigler believed that the democratic system itself and the structure of the regulatory body being subjected to political pressures motivated political actors and business interests to engage in an exchange of influence for treasure to the detriment of the people.

After detailing the relevant theories, this paper will now evaluate them and their applicability to the U.S. securities regulatory model. Both theories share similarities with the U.S. financial regulatory regime and shed light on its operation, however, they both fall short in some key areas. Ultimately, while the public interest theory best explains the motivations for how the securities regulations began, the capture theory best illustrates the complex interplay among competing interests present in the modern-day application of securities legislation and their enforcement.

The public interest theory is most applicable to explain the motivations behind founding securities regulations. The current system of national securities regulation began in response to the Stock Market Crash of 1929 and the Great Depression in the 1930s.⁵⁵ Thus, the first set of national securities regulatory provisions were enacted in response to, rather than in anticipation

⁵⁴ Stigler, “The Theory of Economic Regulation,” 12

⁵⁵ Zingales, Luigi. “The Future of Securities Regulation.” *SSRN Electronic Journal* 47, no. 2 (2009): 391–425. <https://doi.org/10.2139/ssrn.1319648>. pp. 391-392

of market issues. Furthermore, securities regulations generally would be reactive, as the authors Mathias Dewatripont and Diana Hancock noted, securities legislation was ad hoc and crafted after market crises.⁵⁶ The scholars Luigi Zingales, Zsuzsanna Biedermann, and Ross Levine, agree with the concept of regulatory reactivity and continue to suggest that securities regulation specifically is mostly enacted due to public political pressure.⁵⁷ Therefore, Pigou's public interest theory best explains the beginning of the U.S. securities regulation model, as the Federal government decided to nationalize securities regulation to respond to the public's plight during the Great Depression in an almost benevolent manner.

Stigler's capture theory, however, best characterizes the behavior of the current S.E.C. regulators. Although the public interest theory may explain how the national securities regulations began, Stigler's capture theory best explains the limitations placed on the regulators. The capture theory, and particularly, its addition of voter and third-party business motivations provides a more holistic interpretation of the way in which the current regulatory system operates. Furthermore, capture theory best explains the existence of enforcement limitations placed on the S.E.C. Limitations such as restricted resources, structural restrictions, and political pressures, which will be discussed in the subsequent Analysis section of this Thesis exist within the understanding of Stigler's holistic theoretical model.

Ultimately, this section of the Thesis addressed the key regulatory theories and scholars in the field and thus laid the groundwork for further analysis. Arthur Pigou's public interest theory espoused the existence of the benevolent government serving to protect the people's

⁵⁶ Mathias Dewatripont and Diana Hancock, "Literature Review on Integration of Regulatory Capital and Liquidity Instruments," *Basel Committee on Banking Supervision*, no. 30 (March 2016), pp. 3

⁵⁷ Zingales, "The Future of Securities Regulation," 391-392, 405; Zsuzsanna Biedermann, "The History of American Financial Regulation," *Public Finance Quarterly* 57, no.3, 2012, pp. 313-314; Ross Levine, "The Governance of Financial Regulation: Reform Lessons from the Recent Crisis," *International Review of Finance* 12, no. 1 (August 2011): pp. 48, <https://doi.org/10.1111/j.1468-2443.2011.01133.x>.

interests. Although not entirely realistic today, it does serve to explain the motivation for the enactment of federal securities laws and enforcement. Stigler's capture theory, however, was more cynical in its approach, as it suggested that the regulators are subject to be influenced by the very industries they are tasked with monitoring. Stigler's approach, however, did encompass the various actors that contribute to the current regulatory landscape, namely the financial industry, and political parties, and thus, best encompasses our modern securities regulatory framework. Next, this paper will discuss how the various limitations placed on the S.E.C. affect their ability to enforce securities regulation within a holistic framework with multiple actors and competing interests.

The global financial crisis caused immediate government action both in the United States and in the European Union in order to mitigate its effects. The actions in question involved quantitative easing, temporary bank nationalizations, and capital controls, which directly involved the government in private finance at a level not seen in generations. The varying degrees of government involvement spawned a new debate about the role of government in the economic crisis, which brought to the fore older schools of thought developed in the 19th century centering around economic organization. Specifically, the economists Ludwig von Mises and Friedrich Hayek emphasized the importance of the free market and urged against government intervention via decreasing interest rates or through stimulus, while the economists John Maynard Keynes and Hyman Minsky believed stimulus and interest rate cuts were important instruments of financial stabilization.

Ludwig von Mises, in his landmark 1912 work titled, *The Theory of Money and Credit*, discussed his view that considered government intervention in the credit cycles to be futile and counterproductive. Specifically, he considered government intervention into the banking sector and the financial sector generally to cause the opposite of its intended effect, when he stated:

Since the time of the Currency School, the policy adopted by the governments of Europe and America with regard to the issue of fiduciary media has been guided, on the whole, by the idea that it is necessary to impose some sort of restriction upon the banks in order to prevent them from extending the issue of fiduciary media in such a way as to cause a rise of prices that eventually culminates in an economic crisis. But the course of this policy has been continually broken by contrary aims. Endeavors have been made by means of credit policy to keep the rate of interest low; ‘cheap money’ (i.e., low interest) and ‘reasonable’ (i.e., high) prices have been aimed at.⁵⁸

Mises recognized governments’ interest in mitigating economic cycles, yet he was skeptical of the methods employed. Specifically, he stated that popular notions impose the idea that restrictions are necessary to prevent crises. Yet, when he said, “...the course of this policy has been continually broken by contrary aims,” he described these very tools of control as the arbiters of future crises. Particularly, he claimed such tools as maintaining a low interest rate, thus providing “‘cheap money’” so that individuals can continue borrowing and spending to bolster economic growth (a familiar and indispensable tool for modern national banks), actually makes the financial sector less stable. Thus, for Mises, the act of seeking to control the credit cycle through government restrictions leads to the opposite effect.

To be more precise, Mises recognized the power of lowering the interest rate, yet thought it would ultimately cause more harm than good. He posited whether extending low interest rates could work indefinitely, and ultimately explained that regardless of the policy or its duration, the “‘cheap money’” would be restrained and loans would be harder to obtain. He stated the opposing reasoning would believe, “...that if the banks would only go on reducing the rate of

⁵⁸ Ludwig von Mises, *The Theory of Money and Credit*, trans. J.E. Batson (New Haven, Ct: Yale University Press, 1953). 367

interest on loans, they could continue to postpone the collapse of the market.”⁵⁹ He directed his line of reasoning to its logical end by writing:

Certainly, the banks would be able to *postpone* the collapse; but nevertheless, as has been shown, the moment must eventually come when no further extension of the circulation of fiduciary media is possible. Then the catastrophe occurs, and its consequences are the worse and the reaction against the bull tendency of the market the stronger, the longer the period during which the rate of interest on loans has been below the natural rate of interest and the greater the extent to which roundabout processes of production that are not justified by the state of the capital market have been adopted.⁶⁰

Thus, Mises understood the power of manipulating interest rates for delaying crises, but recognized that they will eventually come despite best efforts. Not only that, but when the crisis arrives, it will be more deleterious the longer it has been delayed. For Mises, the artificial delay of crises, and thus the effort to control the credit cycle, is a flawed proposition. Its flaw lies primarily in the fact that the act of postponement will only make the eventual crisis worse, by a direct factor of the time it was delayed.

Friedrich Hayek, held similar notions of the inevitability of periods of credit expansion and contraction. He argued along similar lines of Mises, yet was more concerned with economies already in periods of contraction. Having written his seminal work, *Prices and Production and Other Works*, in the throes of the Great Depression, his writing naturally discusses how governments should approach such economic crises. All the while, he criticized what he deemed

⁵⁹ Mises, *Theory of Money and Credit*, 365

⁶⁰ *Ibid*, 365, 366

the stabilizers, which included the central banks, that sought to control the credit cycle and prolong it indefinitely, naming it a “superficial view,”⁶¹:

We must not forget that, for the last six or eight years [up to 1932] monetary policy all over the world has followed the advice of the stabilizers. It is high time that their influence, which has already done harm enough, should be overthrown.⁶²

He continued to explain the detrimental effects of the stabilizers’ role in the economy in terms of the deflation that was occurring as a result of the credit contraction worldwide:

Far from following a deflationary policy, central banks, particularly in the United States, have been making earlier and more far-reaching efforts than have ever been undertaken before to combat the depression by a policy of credit expansion—with the result that the depression has lasted longer and has become more severe than any preceding one. What we need is a readjustment of those elements in the structure of production and of prices that existed before the deflation began and which then made it unprofitable for industry to borrow⁶³

Here, Hayek clearly stated his issue with the role of the stabilizers. He claimed that credit expansion caused the depression to be worse than it otherwise would have. Thus, echoing Mises, Hayek claimed the central banks’ methods of combating the crisis simply prolonged its recovery. Furthermore, he detailed how he believed the crisis could be alleviated, when he said, “What we need is a readjustment. . .” To Hayek, the only way to recover from this artificially worsened crisis caused by a natural cycle of credit expansion and contraction present in all economies was to essentially do nothing.

⁶¹ Friedrich August von Hayek, 1931 [1967], *Prices and Production*, Augustus M. Kelley Publishers, New York, pp. 5

⁶² *Ibid*, 7

⁶³ Hayek, *Prices and Production*, 5-6

John Maynard Keynes was an economist who disagreed with the previous notions of the role of government in economic crises. His work became very famous after it was used as a basis for crisis recovery efforts since the Great Depression. His work centers around the supply and demand of not only credit but critically labor and ultimately explains why the government should serve as the primary spender during economic downturns in order to stimulate job creation and economic growth. Specifically, he calculated the direct connection between investment and consumption and built upon the multiplier effect, which considered how investment will be amplified throughout the economy. Here, he explained his contribution to the multiplier effect:

For in given circumstances a definite ratio, to be called the multiplier, can be established between income and investment and, subject to certain simplifications, between the total employment and the employment directly employed on investment (which we shall call the primary employment). This further step is an integral part of our theory of employment, since it establishes a precise relationship, given the propensity to consume, between aggregate employment and income and the rate of investment...this article depended on the fundamental notion that, if the propensity to consume in various hypothetical circumstances is (together with certain other conditions) taken as given and we conceive the monetary or other public authority to take steps to stimulate or to retard investment, the change in the amount of employment will be a function of the net change in the amount of investment; and it aimed at laying down general principles by which to estimate the actual quantitative relationship between an increment of net investment and the increment of aggregate employment which will be associated with it.⁶⁴

⁶⁴ John Maynard Keynes, "The General Theory of Employment, Interest, and Money" (1936) https://www.files.ethz.ch/isn/125515/1366_keynestheoryofemployment.pdf, 60

Thus, to Keynes, there is a definitive link between investment and consumption. Through his perspective, economic downturns are a consumption problem as Keynes argued that recessions induce caution and thus higher levels of savings, in comparison to consumption. He then continued that the decline in consumption, however, exacerbates economic crises. Thus, he urged for governments to spend through deficits in order to stimulate consumption and demand for goods. This, then is further supported through the concept of the multiplier effect which claims that every dollar invested in the economy is magnified, and thus concluded that that deficit spending is a sound investment during economic downturns.

To counteract this trend, Keynes suggests that the government should undertake deficit spending and engage in public investment projects to stimulate aggregate demand and create employment opportunities. By injecting funds into the economy and increasing investment, the government can help break the cycle of low demand and initiate a recovery.

The economist Hyman P. Minsky built upon Keynes' theory and integrated it into the more modern economy of the later twentieth century. In 1977, he published his work, *A Theory of Systemic Fragility*, which suggested governments' to engage in expansionary fiscal and monetary policies to prevent recessions.⁶⁵ Particularly, he was credited with acknowledging that financial instability can lead to further instability in the future, and that the economy has sophisticated financial institutions.⁶⁶ Furthermore, he outlined the operations of our current advanced and interlinked economy whereby credit creation and investment activity can

⁶⁵ Schnabl, Gunther; Sonnenberg, Nils (2020): Monetary policy, financial regulation and financial stability: A comparison between the Fed and the ECB, Working Paper, No. 166, Universität Leipzig, Wirtschaftswissenschaftliche Fakultät, Leipzig, <https://www.econstor.eu/bitstream/10419/215749/1/1694314863.pdf>, 7

⁶⁶ Ibid

determine economic growth.⁶⁷ Thus, to him, an unsustainable growth cycle is brought on by economic stability and optimism.⁶⁸

3. Methodology

The insights in this research paper are heavily rooted in the findings of other economists and historians. Thus, the main type of evidence will be taken from such sources as scholarly articles and books. The researchers upon whose work this paper will expand used a mix of qualitative and quantitative data, however, primarily focused upon supporting their arguments with qualitative data. Such data will be examined and used as support to explain the phenomena in question. Qualitatively, this paper will examine various laws from both the U.S. and the E.U. to determine their merits and shortfalls.

4. Flaws and Failures of U.S. Financial Regulations

U.S. national securities regulations are complex and fragmented, with varying overlapping regulatory jurisdictions, which create gaps within the supervisory structure.⁶⁹ Based on recent evidence, it seems that this complex system is truly allowing certain manipulative events to go unenforced. In addition, when laws are enacted in response to financial crises, they sometimes fail to address the root of the problem, ensuring that the specific crisis cannot recur without eliminating the threat of the underlying issue. Furthermore, the laws that are effective at

⁶⁷ Schnabl, Gunther; Sonnenberg, Nils (2020): Monetary policy, financial regulation and financial stability: A comparison between the Fed and the ECB, 7

⁶⁸ Ibid; Minsky, Hyman Philip 1977. The Financial Instability Hypothesis: An Interpretation of Keynes and an Alternative to "Standard" Theory. Nebraska Journal of Economics and Business 16, 1, 5-16. 12

⁶⁹ Arner, Barberis, and Buckley, "FinTech, RegTech, and the Reconceptualization of Financial Regulation," 385

stemming conflict of interest and providing stability to the financial system can be reinterpreted, amended, and even repealed due to lobbying by the very companies whom the laws regulate.

Despite the motivations of lawmakers when they established the current body of securities regulations, moments of market manipulation still happen. In fact, the recent events surrounding market manipulation, through High Frequency Trading, and Payment for Order Flow, has called into question the effectiveness of our current securities regulations at preventing market manipulation, providing financial stability, and bolstering public trust in the securities markets. There is sufficient evidence to support the claim that, ultimately, these laws have been largely ineffective. That is problematic, as it subjects the average American investor, and, as a result, the majority of American households, to undue market risk that these very regulations were designed to mitigate.

The incoherence of U.S. financial regulation does not fit easily within the literature review's economic schools of thought. For example, although the period before crises when the government does not actively seek to regulate follows the philosophies of Hayek and Mises, the periods directly following crises fits with the economic interventionism that Keynes championed and Minsky furthered. Anthony Down's writings on the "Issue Attention Cycle" best accounts for the U.S.'s sporadic approach to regulation. Furthermore, Down's work integrates the U.S.'s use of these inherently opposed economic philosophies. When applying this concept to the U.S. regulatory methodology, the crisis itself can be attributed to stage 2 of Down's Cycle, whereby the public is suddenly alarmed by a series of events that leads to intense political will to amend changes.⁷⁰ After the intensity of the public wanes, regulatory capture sets in.⁷¹ Such a cycle of

⁷⁰ Anthony Downs and Maxwell E. McCombs, *Agenda Setting: Readings on Media, Public Opinion, and Policymaking*, ed. David Protess (Routledge, 1991), 28.

⁷¹ Downs, *Agenda Setting*, 29

interest and apathy could best fit to the ways in which Glass Steagall separated commercial and investment banks in the aftermath of the 1929 market crisis, yet was repealed decades later during a period of relative public disinterest. Despite the “Issue Attention Cycle,” U.S. regulators have consistently been unwilling to properly create legislation that is clear and comprehensive enough to address fundamental structural issues that reveal themselves during market crisis. The following examples will reveal the ways in which regulators failed to address the root cause of market crises and thus exposed average investors and the public at large to the whims of private, and often malign, actors.

High Frequency Trading (H.F.T.), is a very prominent feature of our current market system. H.F.T. is a practice that has evolved from the fact that computers have quickly become the dominant way that trades are executed in recent years.⁷² As a result, these computer algorithms can execute electronic trading strategies at superhuman speed, which has led to manipulative market events due to a limited regulatory understanding of the consequences of H.F.T.. Manahov described the way H.F.T. earns profit succinctly, when he wrote, “... H.F.T.rs earn profits by identifying patterns in trade and order data that actually allow them to anticipate and trade ahead of other investors' order flows.”⁷³ So, the H.F.T. algorithms are able to spot upcoming movements in the market, or trends, and place a trade and profit on them before the other traders’ orders process. Therefore, the computer trading algorithms profit off of information that the average investor cannot use. In fact, the algorithms are even able to profit off of the trades of another investor simply due to the speed with which they process information and place trades.

⁷² Viktor Manahov, “Front-Running Scalping Strategies and Market Manipulation: Why Does High-Frequency Trading Need Stricter Regulation?,” *Financial Review* 51, no. 3 (2016): pp. 364, <https://doi.org/10.1111/fire.12103>, pp. 364.

⁷³ Manahov, “Front-Running Scalping Strategies and Market Manipulation,” 364

In 2010, an event known as the “Flash Crash ” proved just how destructive the H.F.T. algorithms can be to the average investor. A fundamental element of the Securities Act of 1934 was that it stipulated market manipulation, such as the excessive buying or selling of securities to artificially alter its price by exploiting the demand and supply of the stock through the buy and sell orders placed on it. On May 6, 2010, within roughly two hours the price of the S&P 500 stock index futures (a.k.a a stock that tracks the overall gains and losses of the S&P 500, one of the largest market indices in the U.S.) rose and then declined by a total of 60%.⁷⁴ That event proved that “...large and temporary selling pressure can trigger a market crash even in the absence of a fundamental shock.”⁷⁵ After one of the algorithms began a rapid automated selling sequence, the other algorithms followed suit, and soon, with almost no direct human intervention, these H.F.T. algorithms crashed the S&P 500 leading to the erasing of billions of dollars of wealth from the accounts of average American investors. Even as the prices stabilized the next day, this event alone proves how insufficient current regulations are. Furthermore, as the effects of the H.F.T. trading compounded on each other, the price was artificially depressed, which is a clear sign of market manipulation, the foundational regulatory principle of the Securities Act of 1933.

The “Flash Crash” also exposed a current regulatory weakness in how the stock market functions. As of 2021, 29% of all trades were executed by “internalizers” or market makers who paid for the right to process the trades of larger brokers.⁷⁶ The 29% is equivalent to roughly \$41 trillion in transactions for that year.⁷⁷ The internalizers execute the trades of the brokers, mainly

⁷⁴ Andrei Kirilenko, et al., “The Flash Crash: High-Frequency Trading in an Electronic Market,” *The Journal of Finance* 72, no. 3 (2017): pp. 969, <https://doi.org/10.1111/jofi.12498>.

⁷⁵ Ibid

⁷⁶ Merritt B. Fox, Lawrence R. Glosten, and Sue Guan, “Manipulating Citadel: Strategies to Profit at the Expense of Retail Stock Traders’ Market Makers,” *SSRN Electronic Journal*, 2022, <https://doi.org/10.2139/ssrn.4230605>. 1

⁷⁷ Ibid, 2

on-line brokers, by leveraging them against the best bids made nationally on all the stock exchanges.⁷⁸ They provide a service by quickly executing and handling the operational aspect of trillions of dollars in trades, while offering a better price for each trade, and making a profit concurrently. It is a complicated business model, but best explained by the authors Fox, Glosten and Guan, when they wrote, “The internalizer promises that each sell order that it executes will be at a price some amount above the NBB, and each buy order at a price some amount below the NBO. In addition to this promised ‘price improvement,’ the internalizer also typically pays the broker a fee for each order that it executes, often referred to as ‘payment for order flow.’”⁷⁹ Therefore, individual companies will pay for the privilege of executing a brokers’ trades so that they can provide them with a better price. However, paying for order flow also allows the internalizers to profit from each trade, taking advantage of the arbitrage in the price differences of the same asset across different exchanges.

Payment for Order flow sounds harmless to overall market stability and integrity. After all, one company provides a service to another and makes profit from its business model. However, the way that the internalizers profit, exposes the market, and therefore the majority of American households, to potential manipulation on a vast scale.⁸⁰ Theoretically, a trader, knowing his trade will execute through an internalizer, could take a position in the market that moves the NBB (National Best Bid) or the NBO (National Best Offer).⁸¹ In that scenario, the trader would be able to profit at the expense of the internalizer and at the expense of the market as a whole.⁸² Thus, through the gaps present in the regulatory corpus, manipulative trading

⁷⁸ Fox, Glosten, and Guan, “Manipulating Citadel: Strategies to Profit at the Expense of Retail Stock Traders’ Market Makers,” 2

⁷⁹ Ibid

⁸⁰ Fox, Glosten, and Guan, “Manipulating Citadel: Strategies to Profit at the Expense of Retail Stock Traders’ Market Makers,” 3

⁸¹ Ibid

⁸² Ibid

practices such as H.F.T. and Payment for Order Flow consistently profit at the expense of the average investor while threatening public trust in the integrity and effectiveness of the markets for providing equal opportunity to all investors.

Given that securities regulation occurs in the aftermath of highly publicized crises, it would be safe to assume the regulators enacted reforms to help prevent another situation like the “Flash Crash” from occurring again; however, the way new measures were implemented to reform the system in response to this crisis, reveals the shortfalls of the current regulatory regime. Namely, while Congress and the Securities and Exchange Commission (S.E.C.) did pass certain regulations, they failed to address the underlying cause of the problem, which increased the likelihood that another similar event could occur.

Some measures that were enacted to address the problem were helpful but insufficient to solve the issue alone. For example, Brokerages have since been forced to monitor trading activity for high-frequency traders, in order to prevent erroneous orders or potentially damaging orders from being placed.⁸³ Erroneous trades were defined as those that were far from the public stock price in terms of standard deviation; thus, it provides investors with more confidence that the algorithmic traders will no longer have unregulated access to influence public stock prices. Finally, the most influential of the changes was the addition of circuit breakers for individual stocks. They stipulate that there will be a 5-minute trading freeze on securities that have moved more than 10% in five minutes.⁸⁴ This measure is meant to stop the momentum of algorithmic traders so that the prices cannot be easily, artificially manipulated.

⁸³ “Factbox: After the Flash Crash, Changes to U.S. Markets,” Reuters (Thomson Reuters, September 1, 2011), <https://www.reuters.com/article/us-financial-regulation-algos-factbox/factbox-after-the-flash-crash-changes-to-u-s-markets-idUSTRE7806QS20110901>.

⁸⁴ Ibid

While these measures are helpful in making the securities markets less volatile and fairer for the average investor, they are not sufficient in eliminating high-frequency trading manipulation in the future. For example, while individual stock circuit breakers were implemented, there were already index-based circuit breakers which were in place during the crash, but that actually did not help. Therefore, since overall market index circuit breakers failed to prevent the crash of the market, it is unclear how instituting even more circuit breaker regulations will solve the underlying issue of market manipulation by high frequency trading algorithms. In fact, making the index-wide, or the market wide, circuit breakers more effective was proposed, but not adopted, meaning that although the ineffectiveness of this regulatory device had been brought to the regulators' attention, nothing was done to solve the problem.

Furthermore, although circuit breakers were proposed and implemented to various degrees, the underlying issue that high frequency trading algorithms pose undue market risk to the average investor through manipulative practices was not addressed. In fact, a proposal was submitted that would help solve this problem. The proposal in question suggested that the privileges afforded to high-frequency market makers should be offset by the obligation to provide pricing options even in times of crisis.⁸⁵ Therefore, the proposal suggested to oblige these high frequency traders to offer bids for stocks despite the fact that the market prices may be falling precipitously. This proposal would thus provide an opportunity for average investors to find a buyer of their stock if they find themselves in the midst of a fast-moving stock price due to high-frequency trading practices. In essence, this proposal would deter these algorithmic traders from creating the conditions for another "Flash Crash" as any incremental gains they could achieve during crisis events would be offset by the fact that they would have to buy these stocks

⁸⁵ "Factbox: After the Flash Crash, Changes to U.S. Markets," Reuters (Thomson Reuters, September 1, 2011)

again at unfavorable prices. Thus, without implementing this proposal, or others that would shrink or eliminate incentives for creating unstable market conditions, high-frequency trading will increase market swings and their frequency over time.

The risks posed by H.F.T. is further attested to by Viktor Manahov who conducted studies on highly traded securities, such as Apple, Exxon Mobil, and Google, to determine whether H.F.T. actually poses a threat to the market. The studies confirmed that several years after the “Flash Crash” and despite the implemented regulations intended to curtail the negative impact of H.F.T. on market volatility, these algorithmic traders operated in a way that resulted in damage to market quality and confidence for long-term investors.⁸⁶ Specifically, Manahov found that H.F.T.s used their speed advantage to observe real-time data, compare it to historical millisecond data, and rapidly trade and make a profit on that information before the average investor could even interpret the findings.⁸⁷ Surprisingly, Manahov found that even if an average investor could have somehow observed the data, interpreted the findings, and placed an order to take advantage of that information at the same time as their algorithmic counterparts, the H.F.T. trade would still execute before the human trade.⁸⁸ Thus, the H.F.T. trades operate with an implicit advantage in stock market trading, and since they are almost entirely used by large investment companies and brokerage firms, these findings hold dramatic implications for the function of the stock market. Despite the best intentions of regulators and the public interest, the causes of the “Flash Crash” have not been sufficiently solved and H.F.T. traders are allowed to continue to have an advantage over the average investor, creating an environment where the algorithmic traders consistently profit at the expense of the average investor.

⁸⁶ Manahov, “Front-Running Scalping Strategies and Market Manipulation,” 387

⁸⁷ Ibid

⁸⁸ Ibid

While regulators enacted new laws to prevent the Flash Crash from recurring in the exact same way, they failed to address causes of the inherent instability and manipulateness of H.F.T. and Payment for Order Flow strategies, and, thus, encouraged similar crises to occur in the future. Similarly, in response to the Global Financial Crisis (G.F.C.)’s enactment in 2008, the Dodd-Frank Act (P.L. 111-203) brought many new stipulations that sought to stabilize financial markets through curbing incentives for excessive risk taking.⁸⁹ However, it did not solve the underlying problem, which was the inherent conflict of interest created by the combination of commercial and investment banking activities that resumed in 1999 with the repeal of the Glass-Steagall Act that helped preserve market stability since 1933.⁹⁰ Glass-Steagall (in addition to creating the Federal Deposit Insurance Corporation, F.D.I.C., that ensured deposits up to \$250,000) separated investment banking from commercial banking operations so that conflict of interests, such as risky investments with depositor savings, could not cause further banking crises.⁹¹ With the enactment of the Gramm-Leach-Bliley Act in 1999, and, thus, the repeal of Glass-Steagall, commercial banking and investment banking operations were once again allowed to be integrated and owned by the same company.

Political Constraints:

Building upon Pigou’s Public Interest and Stigler’s Regulatory Capture theories, this section of the Thesis will focus on presenting and analyzing the research findings. Specifically, this section will attempt to show the extent to which the S.E.C. is limited by its insufficient congressional funding, its reliance on court decisions, and the conflict between its own goals and

⁸⁹ “Dodd-Frank Wall Street Reform and Consumer Protection Act,” Public Law 111–203 Dodd-Frank Wall Street Reform and Consumer Protection Act § (2010).

⁹⁰ Funk and Hirschman, “Derivatives and Deregulation,” 13-14

⁹¹ Crawford, “The Repeal Of The Glass-Steagall Act And The Current Financial Crisis,” pp. 128

that of the third parties, including the branches of government, that may result in the third parties' undue influence over regulatory enforcement matters. This section will discuss the S.E.C.'s vulnerabilities to third party influence and thus consider its implications within Stigler's theoretical framework. Specifically, this section will show the extent to which the S.E.C. is influenced by politics in its capacity to bring enforcement actions and collect penalties, its ability to detect infractions, and its ability to have like-minded and independent chairs overseeing the enforcement efforts.

The S.E.C. is influenced by political forces and interests, which affect its ability to properly enforce the legislation under its charge. This is particularly apparent when considering how lobbying, as well as other factors that contribute to political influence, can significantly affect the probability that infractions are detected. Furthermore, political influence can also affect the extent to which an infraction is prosecuted. Dr. Maria Correia, Associate Professor of Accounting at the London School of Economics and Political Science, suggested that Congress generally, and key Congresspeople specifically have a distinct ability to influence S.E.C. enforcement decisions.⁹² She articulates that those who are on particular committees that more frequently interact with the S.E.C. have theoretically even more influence over the organization.⁹³ Correia compiled PAC contributions from the years 2000-2006 and found a strong significant correlation between long term political contributions and the decreased likelihood of being penalized for infractions.⁹⁴ Furthermore, Correia's data suggested that of those lobbying firms that are penalized, there is a positive correlation between the amount of

⁹² Maria M. Correia, "Political Connections and SEC Enforcement," London Business School. London, 2014, 12-13

⁹³ Ibid, 13

⁹⁴ Ibid

funds donated and lower monetary penalties.⁹⁵ This vulnerability within the securities regulatory system signals a similarity to Stigler's Capture Theory.

This connection between lobbying and enforcement decisions continues further. In fact, after controlling for possible variables, including firm size, valuation, and industry, among others, firms that act fraudulently in the securities markets, but that engage in lobbying efforts have a rate of being detected by regulators that is lower than firms that engage in fraudulent behavior and who do not lobby.⁹⁶ Specifically, firms that actively lobbied had a 38% decrease in the rate of detection when compared to the fraudulent firms that did not engage in lobbying.⁹⁷ Furthermore, not only are fraudulent firms more likely to have less severe punishment, if detected at all, but the firms that do engage in fraudulent activity are more likely to spend more. Specifically, fraudulent firms that lobby were found to spend 77% more on lobbying efforts than other firms. This relationship between firms and Congress that monitors the S.E.C., has dramatic implications for the proper running of our regulatory system. The fact that those who lobby and spend the most are statistically more likely to be doing so to help mitigate enforcement efforts reveals a vital vulnerability to the functioning of the regulatory system in effectively carrying out its political goals of maintaining market integrity.

Firms that are regulated by the S.E.C. can influence the organizations' agenda more directly than by lobbying members of Congress. In fact, regulated firms have more influence than initially understood. For instance, it has been observed how the firms that are regulated by the S.E.C. often can use their lobbying efforts and other political influence in the Executive and

⁹⁵ Correia, "Political Connections and SEC enforcement," 4, 20-25

⁹⁶ Yu, F., Yu, X., 2011. Corporate lobbying and fraud detection. *Journal of Financial and Quantitative Analysis* 46, 1865-1891 https://www.researchgate.net/profile/Fang-Yu-20/publication/259418914_Corporate_Lobbying_and_Fraud_Detection/links/5524b3cb0cf2caf11bfce0eb/Corporate-Lobbying-and-Fraud-Detection.pdf. 18

⁹⁷ *Ibid*, 20

Legislative branches in order to place industry insiders to the highest position in the S.E.C. Particularly, since the late 1990s, S.E.C. chairs have been primarily appointed from among industry insiders who have a vested interest in being more lenient toward their own firms.⁹⁸

Resource Limitations:

Apart from the S.E.C.'s political influence, its resource limitations may be one of its most significant hindrances to carrying out its ultimate goal. Although it goes without saying, the U.S. securities markets are the largest in the world and the S.E.C. is tasked with monitoring all participants, regulating all actors, and identifying all infractions of the complicated legal code within all the securities markets. For any company or organization, this would be a difficult task, however, the S.E.C. is particularly unequipped to effectively monitor the entire securities system because of its limited budget in comparison to its broad jurisdiction. Scholars James D. Cox, Randall S. Thomas, and Dina Kiku, claim that the S.E.C.'s funding limitations have been a consistent problem for some time.⁹⁹ These sentiments are echoed by S.E.C. personnel, such as former Executive Director of U.S. Securities and Exchange, James M. McConnell, who claimed that as the complexity and utilization of the markets increased, the S.E.C. was not equipped with the necessary funding to adapt to these changes.¹⁰⁰

The specific breadth of the S.E.C.'s jurisdiction stands in stark contrast to its scanty budget when comparing the figures. Particularly, these budgetary constraints and broad

⁹⁸ James D. Cox; Randall S. Thomas, *Revolving Elites: The Unexplored Risk of Capturing the SEC*, 107 *Geo. L.J.* 845 (2019) Provided by: Vanderbilt University Law School

<https://ir.vanderbilt.edu/bitstream/handle/1803/17284/Revolving%20Elites.pdf?sequence=1&isAllowed=y>, 845

⁹⁹ James D. Cox and Randall S. Thomas, "SEC Enforcement Actions for Financial Fraud and Private Litigation: An Empirical Inquiry," *SSRN Electronic Journal*, 2003, <https://doi.org/10.2139/ssrn.429140>. 737

¹⁰⁰ James M. McConnell, "Testimony Concerning Securities and Exchange Commission's Audited Financial Statements and Facilities Budgeting," SEC Testimony: Securities and Exchange Commission's Audited Financial Statements and Facilities Budgeting, 2005, <https://www.sec.gov/news/testimony/ts072705jmm.htm>.; Cox, Thomas, "SEC Enforcement Actions for Financial Fraud and Private Litigation: An Empirical Inquiry," 737

jurisdiction directly lead to severe limitations to personnel.¹⁰¹ For the 2023 Congressional Budgetary Justification, the S.E.C. clearly laid out the extent of its jurisdiction, when it claimed:

The S.E.C. is charged with overseeing approximately \$118 trillion in annual securities trading on U.S. equity markets and the activities of more than 29,000 registered entities. The agency also oversees 24 national securities exchanges, 95 alternative trading systems, 9 credit rating agencies, and 7 active registered clearing agencies, as well as the Public Company Accounting Oversight Board (PCAOB), the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation (SIPC), and the Financial Accounting Standards Board (FASB). In addition, the S.E.C. is responsible for reviewing the disclosures and financial statements of more than 7,900 reporting companies, of which approximately two-thirds are exchange-listed.¹⁰²

It is obvious from this quote, that the S.E.C. has a vast array of regulatory duties. It is responsible for regulating tens of thousands of registered entities, in addition to dozens of national securities exchanges, credit rating agencies, and clearing houses. These specific responsibilities are simply a portion of their overall workload, as they are also responsible for reviewing financial statements and maintaining fairness of these markets and institutions. In fact, the Commissions' detection and enforcement division accounts for only a fraction of their total employment.

Their difficulties in properly regulating the breadth of actors in their jurisdiction are further exacerbated by the technical difficulties and costs associated with maintaining expertise over a rapidly evolving industry. Concurrently, the Commission has been losing qualified

¹⁰¹ Fiscal year 2023 Congressional Budget Justifications Annual Performance Plan 3-25-2022
https://www.sec.gov/files/fy-2023-congressional-budget-justification-annual-performance-plan_final.pdf, 2

¹⁰² Fiscal year 2023 Congressional Budget Justifications Annual Performance Plan, 2

employees, which makes it more difficult to retain expertise in their field. The scale of the S.E.C.'s shortcomings regarding their employment resources, in the face of an evolving market, was best expressed by the Commission itself, when it claimed:

At the end of FY 2016, the SEC had 4,650 people on board. Five years later, that number had decreased by about three percent. The FY 2023 request seeks to close this gap by providing the additional resources needed to bring in new personnel with skills and expertise to address critical needs, including the wave of traditional initial public offerings (IPOs) and an unprecedented surge in non-traditional IPOs by special purpose acquisition companies (SPACs); the growing size and number of private funds, particularly private equity and venture capital funds; the significant growth in crypto-assets; the rise of financial technology and predictive data analytics; and increased regulation of security-based swaps.¹⁰³

The S.E.C.'s troubles in managing its jurisdiction is further exacerbated by its loss of roughly 3% of its workforce in only a five year period. Furthermore, that same period saw the rise in the sophistication of crypto based assets, along with a drastic increase in SPAC deals, that allow companies to effectively raise funds on public markets without going through the traditionally arduous and scrutinous traditional IPO offerings. The Commission also noted the rapid evolution of financial technology and the use of predictive data analytics as contributing to their detriment in capacity to properly enforce, which could be explained by their lack of resources to properly understand these developments, update their systems and strategies to properly account for them, and train and retain talented employees to effectively detect and bring actions against infractions in these new realities of financial regulation. Therefore, the Commission is overtly concerned of

¹⁰³ Fiscal year 2023 Congressional Budget Justifications Annual Performance Plan, 2

its lack of resources and how those resources are able to be employed to properly account for the rapidity of market developments in the financial services industry. Thus, the S.E.C. is practically severely limited in its resources, in terms of funding, technology, and employment, which detrimentally affects its capacity to carry out its intended function.

The Commission's limited resources and staffing capacity is further understood when placed within the context of its organizational structure. The S.E.C. is a wide-ranging organization with an equally wide-ranging responsibility to monitor and regulate, which means that the amount of assets that it has at its disposal is necessarily split between various departments and responsibilities. Primarily, the Commission's Division of Enforcement only represents a small fraction of its overall duties and employment assets. In fact, when taken into consideration with the entirety of the S.E.C.'s employment shortfall, as was mentioned previously, only a small portion of those needs will be deployed to staffing the Enforcement division, as is mentioned here, "...we are seeking to increase our workforce by 400 positions to address the priorities laid out above. The Division of Enforcement (ENF) requests 125 positions. The additional positions would allow the following: 44 positions for increased capacity to investigate misconduct and accelerate enforcement actions; 34 positions to strengthen our litigation support; 33 positions to bolster the capabilities of our Cyber Unit; and 14 positions to provide additional accounting and operational support."¹⁰⁴ Here, the S.E.C. claimed that it was lacking in enough human capital to properly investigate misconduct, progress litigation effectively, and to otherwise assist in bringing enforcement actions against those who may have committed infractions against the financial litigation under its charge.

¹⁰⁴ Fiscal year 2023 Congressional Budget Justifications Annual Performance Plan, 6

Additionally, the Commission claimed its Enforcement Division was understaffed by at least 125 members and detailed how an even smaller portion of the total (44/400) was going towards detecting and investigating misconduct and to accelerate enforcement actions. Although it could simply be evidence that the investigations section required less new employees, it also is evidence that the Commission is currently seriously constricted in its capacity to not only investigate the alleged infractions - meaning its ability to gather evidence to support a case against the malign actors - but also in its capacity to quickly bring those actions to bear in a federal court. These difficulties strongly suggest that the S.E.C. currently may be restricted in its ability to perform its intended function of protecting investors and maintaining fairness in the markets.

The S.E.C.'s difficulty in obtaining the necessary staff to properly investigate and bring actions against incursive parties, is further exacerbated by its capabilities to actually enforce actions once they are thoroughly investigated. Apart from the S.E.C.'s dearth of funding and staffing that prevents it from properly managing the financial system's integrity and fairness, the Commission has limited enforcement powers, generally, which prevents it from properly administering the legislation under its charge. Particularly, the Commission itself is not independently capable of bringing actions and obtaining verdicts against infractions. In fact, all of the Commission's actions that it investigates and hopes to gain remedy for, are subject to court decisions, making it a section of the Executive that is reliant on the Legislative for funding purposes and the Judiciary for all its ability to successfully bring actions against and thus monitor the financial system.

Judiciary Restrictions:

Furthermore, this simple fact forces the Commission to have a high burden of proof, which additionally strains its resource and investigative capacity. In fact, Luis A. Aguilar, the former Commissioner of the Securities and Exchange Commission, spoke of the difficulties the Commission faces in the fact that it can only seek civil monetary penalties, along with its difficulty in investigating and bringing to action cross-border infractions. Specifically, he mentioned these issues, along with the importance of the Commission's deployment of deterrence as a strategy, when he said:

Moreover, even when the SEC succeeds in obtaining remedies in federal district courts or administrative proceedings for a cross-border fraud, enforcing those judgments and orders still poses challenges. For instance, one important tool for the SEC to punish wrongdoers is its ability to seek monetary penalties. The power to impose penalties enhances the effectiveness of the Commission's enforcement program by more effectively deterring individual and corporate violators. However, the weight of legal authority in foreign jurisdictions tends to favor the denial of court judgments and administrative orders that impose fines or penalties.¹⁰⁵

Thus, here he stated the practical difficulties of maintaining a deterrence strategy in the face of the challenges associated with bringing solely civil proceedings, especially cross-border fraud, to the Judiciary. Particularly, he mentioned the importance of monetary civil penalties to the S.E.C.'s capacity to properly regulate the markets through deterrence, as opposed to managing every action of every single one of the tens of thousands of market actors.

¹⁰⁵ Aguilar, Luis A. "The SEC's Evolving Role: How a Rapidly Changing Landscape is Impacting the Agency's Ability to Fulfill Its Mission," Speech, 16 September 2014. <https://www.sec.gov/news/speech/preparing-regulatory-challenges-21st-century>

He stated the even larger challenges associated with conducting its deterrence efforts across national borders and the additional difficulties associated with the restrictions caused by the detrimental rulings of the Supreme Court. Specifically, he stated:

The impact of cross-border fraud on American investors is further exacerbated by the Supreme Court decision in *Morrison v. National Australia Bank, Ltd.* that limits the anti-fraud provision of the Exchange Act, Section 10(b),^[84] to claims that relate to frauds on an American stock exchange or that involve security transactions in the United States.^[85] The end result is that, as the internet and the growth in foreign capital markets facilitate the ability of American investors to directly deploy their money around the globe, their ability to seek redress in the United States is being limited, while their ability to be harmed is not.¹⁰⁶

Interestingly enough, although Aguilar stated that this Supreme Court decision detrimentally affected the Commissions' capabilities to conduct and investigate anti-fraud provisions of the Exchange Act, it also was decided only days after Congress amended the original Act, broadening its jurisdiction to include extraterritorial areas involved in fraud.

In fact, three days before the Supreme Court issued their decision on *Morrison v. National Australian Bank, Ltd.*, Congress passed Public Law number 111-203, otherwise known as the Dodd-Frank Wall Street Reform and Consumer Protection Act, on July 21st, 2010. The Act itself provided a broadening of the Commission's jurisdiction to include extraterritoriality as described here:

¹⁰⁶ Aguilar, "The SEC's Evolving Role: How a Rapidly Changing Landscape is Impacting the Agency's Ability to Fulfill Its Mission," 2014

EXTRATERRITORIAL JURISDICTION OF THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS.— (1) UNDER THE SECURITIES ACT OF 1933.—Section 22 of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended by adding at the end the following new subsection: “(c) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 17(a) involving— “(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or “(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”...

UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b– 14) is amended— (A) by striking “The district” and inserting the following: “(a) IN GENERAL.—The district”; and (B) by adding at the end the following new subsection: “(b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 206 involving— “(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves only foreign investors; or “(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”¹⁰⁷

¹⁰⁷ Public Law 111-203, Dodd-Frank Wall Street Reform and Consumer Protection Act, July 21, 2010 <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf>, 490-491

Clearly, the Act itself amends the previous core legislations of the S.E.C. in terms of further defining the previous board term of “the district” and adding provisions that allow it investigate and seek remedies against actions that were conducted within the United States. What is most striking about the Amendment is that although it occurred prior to the final Court’s decision, it nonetheless was not able to influence its decision, which suggests that the Judiciary’s application of federal securities legislation can detrimentally affect the enforcement capacity of the S.E.C., even when legislation is enacted to strengthen its role. Notably, Congress’ legislation may not have passed in time to affect the Court’s decision. Additionally, it is important to understand that Congress’ actions meant little in the face of Aguilar’s earlier issue which stated that despite their powers to investigate cross border actions, they are nonetheless effectively limited by the nuances of working with foreign agencies, coupled by the S.E.C.’s own limitation in resources, which are controlled by Congress.

Not only has the Court acted against the S.E.C. in this singular case, but in fact the Court’s action in this circumstance is representative of a larger pattern where, in recent history, the Court has voted against the interest of the Commission and restricted its enforcement capabilities. due to the vagueness of financial legislation. Primarily through the case of *Gabelli v. S.E.C.*, the Court used its authority to settle a dispute revolving around the power of the S.E.C. to bring enforcement actions.

The case of *Gabelli v. The S.E.C.* was enacted due to an instance of fraud committed by an investment company against average investors, and unfortunately, it set a legal precedent that further constrained the S.E.C.’s enforcement powers. The defendants were accused of using arbitrage to take advantage of the price differences between mutual funds at the end of one day

and the beginning of the next.¹⁰⁸ While arbitrage is a necessary feature in public markets, mutual funds were never intended to be bought and sold at such high frequency, which resulted in unnecessarily high fees and taxable transactions on the behalf of the clients.¹⁰⁹ These actions resulted in the investment company having, “...earned rates of return of up to 185%, while ‘the rate of return for long-term investors in GGGF was no more than negative 24.1 percent.’”¹¹⁰ Although the actions occurred from 1999 to 2002, the S.E.C. brought enforcement actions against the defendants in 2008, which is reflective of the already constrained nature of the S.E.C.’s resources.¹¹¹

The years that the S.E.C. needed to detect the infractions, investigate the events, and compile a strong case against the defendants exceeded the five year statute of limitations that existed for all civil penalties.¹¹² Ultimately, the case centered on the five year rule (28 U.S. Code § 2462), which stipulated that, “...an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued...”¹¹³ The main issue was that the S.E.C. argued that the section of the rule stating, “...unless commenced within five years...” was under the jurisdiction of the “discovery rule,” which allowed the Commission five years from the moment the infractions were detected, as opposed to when they had commenced.¹¹⁴ Specifically, the “discovery rule” claimed:

¹⁰⁸ Gabelli et al. v. Securities and Exchange Commission, No. 11–1274, Decided February 27, <https://supreme.justia.com/cases/federal/us/568/11-1274/case.pdf>, 4

¹⁰⁹ Ibid, 6

¹¹⁰ Gabelli v. SEC, 6

¹¹¹ Ibid, 2

¹¹² Ibid

¹¹³ Ibid, 4

¹¹⁴ Ibid

[u]nder the discovery rule, the statute of limitations for a particular claim does not accrue until that claim is discovered, or could have been discovered with reasonable diligence, by the plaintiff.¹¹⁵

Although the Court deemed that in this specific case the defendants were found liable, the Court In fact, the Court nonetheless set a precedent for all future penalties and disgorgement proceedings brought before them, “The court concluded that while ‘this rule does not govern the accrual of most claims,’ it does govern the claims at issue here... As the court explained, ‘for claims that sound in fraud a discovery rule is read into the relevant statute of limitation.’”¹¹⁶ Therefore, the Supreme Court used its adjudicating authority to effectively hinder future S.E.C. enforcement efforts.

Furthermore, the Court’s reasoning revealed a crucial misconception about the true enforcement capacity of the Commission. In its reasoning, the Court stated that the discovery rule applies to private plaintiffs, as opposed to government agencies for the following reasons:

There are good reasons why the fraud discovery rule has not been extended to Government enforcement actions for civil penalties. The discovery rule exists in part to preserve the claims of victims who do not know they are injured and who reasonably do not inquire as to any injury... The same conclusion does not follow for the Government in the context of enforcement actions for civil penalties. The SEC, for example, is not like an individual victim who relies on apparent injury to learn of a wrong. Rather, a central “mission” of the Commission is to “investigat[e] potential violations of the federal securities laws.” SEC, Enforcement Manual 1 (2012). Unlike the private party who has no reason to suspect fraud, the SEC’s very purpose is to root it out, and it has many legal

¹¹⁵ Gabelli v. SEC, 4

¹¹⁶ Ibid

tools at hand to aid in that pursuit. It can demand that securities brokers and dealers submit detailed trading information. *Id.*, at 44. It can require investment advisers to turn over their comprehensive books and records at any time. 15 U. S. C. §80b–4 (2006 ed. and Supp. V). And even without filing suit, it can subpoena any documents and witnesses it deems relevant or material to an investigation. See §§77s(c), 78u(b), 80a–41(b), 80b–9(b) (2006 ed.). The SEC is also authorized to pay monetary awards to whistleblowers, who provide information relating to violations of the securities laws. §78u–6 (2006 ed., Supp. V). In addition, the SEC may offer “cooperation agreements” to violators to procure information about others in exchange for more lenient treatment.¹¹⁷

Here, the Court revealed its misconception about the investigative and fraud detection capacity of the Commission in how it differentiated the private plaintiff from the government agency. Particularly, it differentiated them primarily by the fact that the government’s purpose and abilities both allow it and necessitate it to gather the necessary information to conduct investigations, as opposed to private individuals who have no reason to suspect fraud. Although this differentiation does account for the Commission's abilities to subpoena documents and witnesses, it assumed that the government had the resources and the capacity to properly investigate such claims across the tens of thousands of registered companies and individual actors stretching across markets, regulating agencies, and borders. However, the S.E.C. lacks the capacity to properly manage the markets given its limited resources, which suggests that ultimately the Court further diminished the S.E.C.’s enforcement capabilities and practically constrained its capacity due to its lack of sufficient resources to administer the legislation under its charge.

¹¹⁷ Gabelli v. SEC, 7-8

The U.S.'s Response to the G.F.C.:

Now that this paper discussed the challenges and limitations with U.S. financial regulation, it will now review how the U.S. and the E.U. responded to the crisis. Particularly, it will examine the ways in which the respective governments dealt with the immediate issues as well as the long-term solutions they devised through legislation and structural reform.

Within a few months of the crisis unfolding, the U.S. took emergency measures to stabilize the financial system. In October of 2008, Congress passed Public Law 110-343, otherwise known as the Emergency Economic Stabilization Act (E.E.S.A.). This law authorized the enactment of the Troubled Asset Relief Program (T.A.R.P.), which aimed to stabilize financial institutions by purchasing its worthless assets.¹¹⁸ Specifically, the law aimed to:

To provide authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers, to amend the Internal Revenue Code of 1986 to provide incentives for energy production and conservation, to extend certain expiring provisions, to provide individual income tax relief, and for other purposes.¹¹⁹

Therefore, the U.S. government recognized the severity of the impending crisis and took steps to make the financial system solvent.

The effects of this law were that the U.S. government injected over a trillion dollars into the financial system. More than \$800 billion was spent on stimulating the economy through

¹¹⁸ Public Law 110-343, Emergency Economic Stabilization Act of 2008, <https://www.congress.gov/110/plaws/publ343/PLAW-110publ343.htm>, 122 STAT. 3767

¹¹⁹ Ibid, 122 STAT. 3765

investments in unstable financial institutions.¹²⁰ Meanwhile, further funds were spent by the Federal Reserve through Quantitative Easing, to buy these troubled mortgage-backed securities and treasures.¹²¹ By November 2009, the Federal Reserve had spent \$1.4 trillion dollars, and by June of 2011, that number had reached \$2.4 trillion.¹²²

In addition to purchasing troubled assets, thereby giving funds to the financial institutions, the U.S. took further measures to stabilize the economy by giving funds to the American people through Public Law No. 111-5, or the American Recovery and Reinvestment Act of 2009 (A.R.R.A.). Primarily, this law sought to preserve and create jobs through investing in infrastructure, transportation, and environmental protection, while also investing in energy efficiency and scientific and health research.¹²³ Yet it also focused on providing funds to people directly through providing assistance to the unemployed.¹²⁴ Furthermore, it sought to stabilize the finances of State and local governments which could face default as a result of the crisis.¹²⁵ Ultimately, the law cost over \$800 billion to the American taxpayer.¹²⁶

In 2010, the U.S. Congress passed the Dodd Frank Wall Street Reform and Consumer Protection Act, which sought to fix the structural issues present in the financial system and to thus prevent similar crises from recurring. Specifically, the Act sought to increase transparency and accountability in the financial system, to end the need for bailouts of large financial

¹²⁰ U.S. Government Accountability Office, “The Legacy of the Recovery Act,” U.S. GAO, February 7, 2023, <https://www.gao.gov/blog/2019/02/21/the-legacy-of-the-recovery-act>.

¹²¹ Schnabl, Gunther; Sonnenberg, Nils, “Monetary policy, financial regulation and financial stability,” 10

¹²² Ibid

¹²³ Public Law 111-5. American Recovery and Reinvestment Act of 2009. February 17, 2009.

<https://www.congress.gov/bill/111th-congress/house-bill/1/text>, 123 STAT. 115;

U.S. Government Accountability Office, “The Legacy of the Recovery Act,” U.S. GAO, February 7, 2023,

<https://www.gao.gov/blog/2019/02/21/the-legacy-of-the-recovery-act>.

¹²⁴ Ibid

¹²⁵ Ibid

¹²⁶ Ibid

institutions that were critical to the functioning of the economy, and to attempt to further protect individual investors and consumers from abusive financial practices.¹²⁷

In order to achieve these aims, the law established multiple new institutions, such as the Financial Stability Oversight Council (F.S.O.C.) that would be responsible for monitoring the financial system for system risks. This Council would bear much of the responsibility for preventing future crises. Particularly, its aim was:

- (A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;
- (B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and
- (C) to respond to emerging threats to the stability of the United States financial system.

In summary this single newly formed organization would immediately be responsible for identifying risks to the economy as a whole, promoting discipline by communicating to large financial institutions that the government will not bail them out in the future, and finally, to respond to emerging threats in the market. It carries out these tasks through a vast scope of duties. These duties include collecting and analyzing financial data as requested from other government agencies, or the financial institutions themselves, as well as monitoring the financial system to identify crises and facilitate information sharing amongst various government

¹²⁷ Public Law 111-203, 124 STAT. 1376

agencies.¹²⁸ It also has legislative duties as well regarding monitoring domestic and international financial regulatory proposals to advise Congress, as well as to, “...identify gaps in regulation that could pose risks to the financial stability of the United States...”¹²⁹

Apart from establishing the F.S.O.C., Dodd-Frank also made stricter requirements for banks. Specifically, it charged them with developing resolution plans that would provide a guideline for liquidation if they became insolvent, thus providing a way to resolve their issues without the need for tax-payer bailouts.¹³⁰ Furthermore, it restricted banks from engaging in proprietary trading and increased reporting requirements. Ultimately, Dodd-Frank represented the extent of the U.S. structural market reforms intended to prevent future market crises through the establishment of the F.S.O.C. to monitor the financial system and review regulations, as well as to initiate more stringent capital and reporting requirements.

5. Limitations of U.S. Regulations in Comparison to the E.U. Responses to the G.F.C.:

In response to this momentous change in the regulatory landscape, the relative stability that the U.S. financial system enjoyed was totally eroded as the country faced its most significant financial crisis since the Great Depression.¹³¹ The Dodd-Frank Act that was crafted in response to this crisis regulated the extent to which banks could engage in risk, through the ‘Volcker Rule’, but did nothing to address the conflict of interest that incentivized banks to seek such risk in the first place.¹³² Specifically, while the Act regulates excessively risky Credit Default Swaps (C.D.S.’s), the very instruments that triggered the G.F.C., it does not address the fact that with

¹²⁸ Public Law 111-203, 124 STAT. 1395; Congressional Research Service (2018), Financial Stability Oversight Council (F.S.O.C.): Structure and Activities <https://crsreports.congress.gov/product/pdf/R/R45052>, 2

¹²⁹ Ibid

¹³⁰ Public Law 111-203, 124 STAT. 1425

¹³¹ Deniz Igan, Prachi Mishra, and Thierry Tresselt, “A Fistful of Dollars: Lobbying and the Financial Crisis,” 2011, <https://doi.org/10.3386/w17076>, pp. 1

¹³² “Dodd-Frank Wall Street Reform and Consumer Protection Act,” Public Law 111–203 (2010).

the repeal of Glass Steagall, banks continue to have the incentive to engage in risky lending practices as they can still repackage their risky investments as CDS's or other financial instruments that they can sell to unsuspecting investors.¹³³ Thus, U.S. securities reforms do not always solve the root of the problem, which prevents the exact crisis from occurring, while encouraging similar crises in the future.

Furthermore, not only do certain securities regulations fail to solve the issues that cause financial crises, but third-party actors actively seek to undermine the effectiveness of existing regulatory legislation. Chief among these methods is through lobbying. Most notably, the lobbying that occurred throughout the 1970s and 1980s by commercial banks allowed them to repeal the Glass-Steagall Act.¹³⁴ The lobbying that resulted in the repeal of Glass-Steagall is an example of how third-party actors can amend, reinterpret, and alter the regulatory framework meant to police their actions to the detriment of the average investor and the integrity of the financial system as a whole.¹³⁵ Thus, lobbying by third party actors, often the very companies being regulated, can erode the framework that helps ensure public trust, financial stability, and equality of opportunity in the securities markets; thus, any attempt to amend the regulatory framework must address the issue of detrimental lobbying by third party actors.

There are significant gaps in the regulatory corpus that allow certain practices that increase the risk to the market overall and expose the market to shock events. Those events and practices, such as the prevalence of High Frequency Trading through computer algorithms and Payment for Order Flow, have each directly led to either an instance of a market shock or manipulation. H.F.T. led to a 60% price fluctuation and the eventual crash of the S&P 500 within

¹³³ Frederic S Mishkin, "Over the Cliff: From the Subprime to the Global Financial Crisis," *Journal of Economic Perspectives* 25, no. 1 (January 2011): pp. 55, <https://doi.org/10.1257/jep.25.1.49>.

¹³⁴ Funk and Hirschman, "Derivatives and Deregulation," pp. 16

¹³⁵ *Ibid*, 18

only an hour, while Payment for Order Flow exposed the average American investor, and, thus, the majority of American households, to unnecessary manipulative risk. When regulators do respond to crises caused by these manipulative practices, they often fail to address the root cause or the incentives of the manipulative strategies, such as in the aftermath of the Flash Crash and with the Dodd-Frank Act. Therefore, while regulators seek to amend the laws, they do little to prevent crises from recurring. When laws are in place that provide stability to the financial system, they can be undermined, amended, and even repealed by third party actors who are often the very companies that are being regulated.

The European Union responded in a similar manner to the U.S. in terms of its immediate management of the Global Economic Crisis. Although individual European nations as a whole implemented specific measures to rescue and recapitalize struggling financial institutions, the E.U. engaged in Quantitative Easing to help stabilize the financial markets during the crisis.¹³⁶ Instead of purchasing troubled assets as described by TARP, such as asset-backed securities and commercial paper, the European Union and member states focused on purchasing government bonds and in financing major financial institutions.¹³⁷ Overall, however, in comparison to the over one trillion dollars spent by the Federal Reserve, the European equivalent, the European Central Bank (ECB) purchased EUR 60 billion.¹³⁸ However, the European Union generally spent EUR 300 billion on extending credit provisions to failing financial institutions.¹³⁹ Although the

¹³⁶ Wei Min, (2019) “The European Central Bank's Quantitative Easing: Effects and Impacts,” China Institute of International Studies,

https://www.ciis.org.cn/english/ESEARCHPROJECTS/Articles/202007/t20200715_3614.html

¹³⁷ Daniel Gros, Cinzia Alcidì, Alessandro Giovanni, (2012) “Central Banks in Times of Crisis The FED versus the ECB,” European Parliament, Directorate General for Internal Policies - Policy Department A: Economic and Scientific Policies,

<https://www.europarl.europa.eu/document/activities/cont/201207/20120702ATT48168/20120702ATT48168EN.pdf>,

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¹³⁸ Ibid

¹³⁹ Gros, Alcidì, Giovanni, “Central Banks in Times of Crisis The FED versus the ECB,” 7

E.U. as a whole spent far less on stabilization than the U.S. it is important to note that the E.U. financial regulatory system was less centralized than it became after the crisis, so individual member states also spent their own funds to this end, such as the UK purchasing 200 billion of its own bonds. Thus, the overall size of the E.U.'s expenditure on stabilization when accounting for individual states may be larger than the EUR 360 billion spent as an institution individually. In this way, it seems that the U.S. followed more closely the philosophies and works of Keynes and Minsky that advocated a rapid infusion of funds through deficit spending, as opposed to the E.U. that followed the approach of Hayek and Mises, both of which advocated for the markets essentially to equilibrate on their own.

The E.U. also took measures to strengthen their financial system in the aftermath of the crisis in order to prevent future instability. In 2011, three new supervisory bodies were added to the E.U. to supervise the financial industry. The European Banking Authority (E.B.A.) was established to supervise banking institutions, the European Securities and Markets Authority (E.S.M.A.) was established to directly supervise credit rating agencies and financial markets, while the European Insurance and Occupational Pensions Authority (E.I.O.P.A.) was established to regulate the insurance industry.¹⁴⁰ Additionally, the E.U. created the European Systemic Risk Board (E.S.R.B.) to monitor the economy as a whole for potential threats to financial stability.¹⁴¹ Thus, like the U.S. with the F.S.O.C., the E.U. created new overarching financial oversight bodies that were tasked with monitoring various aspects of the financial markets.

Furthermore, the E.U. established a different approach to preventing future crises, with its bail-in mechanism. Through this mechanism, the E.U. would no longer be able to commit to

¹⁴⁰ European Commission, (2014), "A comprehensive EU response to the financial crisis: substantial progress towards a strong financial framework for Europe and a banking union for the eurozone," Memo 14/57. https://ec.europa.eu/commission/presscorner/detail/en/MEMO_14_57.

¹⁴¹ Ibid

bail-outs that occurred during the crisis. Specifically, this mechanism outlines a strategy that stabilizes a failing financial institution so that it can continue to provide essential services.¹⁴² In practice, bail-in is similar to U.S. style bankruptcy, in the sense that the shareholders will bear the losses through write-downs of the company's assets.¹⁴³ Essentially, this law enables the sale of the financial institution's assets without needing consent from the shareholders, while thus allowing an insolvent company to be quickly sold without causing damage to the financial system.¹⁴⁴ Additionally, the law enacts a mandatory levy on the banking sector to fund a pool of money to be used in the case of such immediate recapitalization needs, and if there are not enough funds in that collected pool, the appropriate funds will be gained by taxing the banking sector directly.¹⁴⁵ Thus, the European Union through its bail-in mechanism enacted via the Bank Recovery and Resolution Directive (B.R.R.D.) sought to mitigate future crises by placing the risks of financial sector instability directly on the institutions themselves, thus alleviating the burden from taxpayers.

The U.S. and the E.U. both responded to the crisis in similar manners in the short term, as they both provided bail-outs and stabilized the markets via Quantitative Easing (Q.E.). However, while the U.S. continued to provide credit, stimulus, and bailouts in the post crisis recovery

¹⁴² European Commission, (2013), "A comprehensive EU response to the financial crisis: a strong financial framework for Europe and a banking union for the eurozone," Memo 13/679, https://ec.europa.eu/commission/presscorner/detail/de/MEMO_13_679

¹⁴³ Christos Hadjiemmanuil, (2022), "Bail-in in the European Banking Union: A Close Reading of Article 27 of the Single Resolution Mechanism Regulation," European Banking Institute, EBI Working Paper Series 2022 – no. 116, <https://deliverypdf.ssrn.com/delivery.php?ID=089119105064003123101017110065090124022046039021042055064085118096098077117111103028063033000008109016026091118027097017126091006041062046036011083026116112124103091029030021101094121019006112065111115022089026099003122102121030022018077105095069123025&EXT=pdf&INDEX=TRUE>, 10

¹⁴⁴ DIRECTIVE 2014/59/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL, (2014) Official Journal of the European Union <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0059>, 200 ch. 61, 67

¹⁴⁵ European Commission, Memo 13/679

period, the E.U., through the European Central Bank (E.C.B.) tightened monetary policy.¹⁴⁶ Specifically, while the Federal Reserve paid positive interest rates to large banking reserves after the bail-out packages, the E.U. charged negative interest rates, which meant a slower recovery for its banking sector.¹⁴⁷ The result of this policy meant that the U.S. Federal Reserve responded to the crisis more quickly, yet it paid for it dearly.¹⁴⁸ From 2014-2019, E.U. banks paid the equivalent of \$34 billion to the ECB, while during the same period, U.S. banks received \$120 billion from the Fed.¹⁴⁹

Overall, the E.U.'s approach to regulation was more influenced by the economic philosophies of Hayek and Mises, yet not entirely so. Specifically, the austere fiscal policies levied upon European debtor countries, such as Greece and Portugal, to reduce public spending and deficits were Hayekian in nature as they forced the economies to stabilize on their own. Despite the E.U.'s efforts to follow Hayek and Mises in its efforts to reduce the wildness of future economic cycles, the E.U. followed Keynes and Minsky in its approach to government intervention in the economy. Specifically, liquidation injections of emergency funds, bank bailouts, and increased regulation and legislation following the crisis is a clear Keynesian attempt to control the markets. Ultimately, however, the E.U.'s bail-in mechanism, although a Keynesian regulation, attempts to limit future government intervention and to properly make large, previously "too big to fail" financial institutions, follow the natural market forces in the future. Thus, although the E.U.'s attempts to regulate followed the learnings of Keynes, its

¹⁴⁶ Gunther Schnabl, Nils Sonnenberg, (2020), "Monetary policy, financial regulation and financial stability: A comparison between the Fed and the ECB," Working Paper, No. 166., Universität Leipzig, Wirtschaftswissenschaftliche Fakultät, Leipzig, <https://www.econstor.eu/bitstream/10419/215749/1/1694314863.pdf>, 15-16

¹⁴⁷ Ibid

¹⁴⁸ Ibid

¹⁴⁹ Ibid, 21

attempts to alter the functioning of the market such that it would not require future government intervention reveals its ultimate Hayekian intentions.

The two governments differed most significantly in their handling of the long-term effects of the crisis through the restructuring of their financial regulatory supervisory system. While the U.S. created a new regulatory body, the F.S.O.C., through Dodd-Frank, the body had broad jurisdictional powers and vague language. Furthermore, Dodd-Frank enabled stricter rules for capitalization and disclosures, it still had no provision or plan to prevent future bail-outs, thus encouraging the financial sector to repeat its mistakes.

Specifically, the F.S.O.C., despite its broad jurisdiction and duties, “...does not generally have direct regulatory authority...,” rather, it is charged with making, “...recommendations to member agencies where authority already exists or to Congress where additional authority is needed,” according to the Congressional Research Service.¹⁵⁰ The specific language in Dodd-Frank states that the F.S.O.C. does not have direct regulatory powers, rather it is tasked to, “...recommend to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies.”¹⁵¹ The legislation continued to explain the role of the F.S.O.C. as a recommending body:

(I) make recommendations to the Board of Governors concerning the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for nonbank financial companies and large, interconnected bank holding companies supervised by the Board of Governors¹⁵²

¹⁵⁰ Congressional Research Service (2018), F.S.O.C., 2

¹⁵¹ Public Law 111-203, 124 STAT. 1395

¹⁵² Ibid; Congressional Research Service, 2

Thus, the F.S.O.C. is tasked with monitoring the entire financial system, gathering data and coordinating with various government agencies and private financial institutions, and in locating gaps in regulation, it crucially has no actual authority or regulatory powers.

In contrast, to the U.S.'s F.S.O.C., the three European agencies created to monitor the financial system in the aftermath of the crisis have defined supervisory capabilities. Specifically, the aforementioned European supervisory authorities (E.S.A.s) composed of the (E.B.A.), the (E.S.M.A.), and the (E.I.O.P.A.) have the direct authority to create specific rules for national authorities and financial institutions, create binding technical standards, and to take emergency action during future crises through banning certain financial products.¹⁵³ Thus, although the U.S.'s structural reform through the creation of the F.S.O.C. had broader jurisdictional duties than the more specified E.S.A.s, the U.S.'s reforms were lacking in actual regulatory authority in comparison.

Thus, the E.U. crafted stronger preventative legislation in the aftermath of the crisis through its authoritative monitoring bodies, yet it also took direct measures to prevent future bail-outs through the bail-in mechanism, in contrast to the U.S. that was ambiguous with its regulation. While the E.U. directs measures so that bank shareholders would be liable for their own risky behavior in future scenarios, the U.S. Dodd-Frank law stated that it would "...end 'too big to fail' ..."¹⁵⁴ The differences are striking. The chief structural regulation in the U.S. since the Great Depression used colloquial terminology to imply the prevention of bail-outs without actually providing any way for that to occur. In fact, apart from the increased disclosures and capitalization requirement, the only method the U.S. took to prevent future bail-outs was by

¹⁵³ European Commission European Commission, "Press Corner," European Commission - European Commission, 2010, https://ec.europa.eu/commission/presscorner/detail/en/MEMO_10_434.

¹⁵⁴ Public Law 111-203, 124 STAT. 1376

dictating to the newly formed F.S.O.C. the duty to, “... to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure.”¹⁵⁵ So, while the E.U. took measures to create binding, authoritative, and meaningful legislation through its bail-in mechanism and its E.S.A.s to prevent future crises, the U.S. took broad, yet ill-defined steps to grant broad jurisdiction and little actual authority to its F.S.O.C., while simultaneously using vague language and “...discipline...” as its only measures to prevent future bail-outs.

6. Conclusion

Ultimately, the financial securities markets, as well as the regulations meant to regulate their actions are complex and difficult to understand. However, due to the importance of the proper and fair functioning of the securities marketplace on the American economy as a whole and American households in particular, it is necessary to understand to what extent these regulations are effective in achieving their goals. After reviewing certain crises in detail, such as the Flash Crash, and by reviewing the causes of these crises, as well as the legislation developed to prevent such crises from recurring, it is clear that the current regulatory regime fails to adequately solve the root cause of the prior crisis. Furthermore, when legislation is effective, it can still be subjected to amendment and dismemberment due to lobbying pressure by third parties, who are often the very businesses that are subjected to those regulations.

The S.E.C., although has a wide-ranging responsibility to regulate tens of thousands of actors and individual participants in order to promote market fairness, it nonetheless is not fully equipped with the capabilities needed to do so most effectively. Particularly, the S.E.C. is

¹⁵⁵ Public Law 111-203, 124 STAT. 1394-5

influenced by politics in its capacity to bring enforcement actions and collect penalties, its ability to have a sufficient budget to detect infractions, and its constrained abilities due to Congressional legislation and Judiciary decisions that effectively stifle the Commissions' capabilities to properly regulate the securities markets, encourage deterrence, and promote fairness. Politically connected firms engaging fraudulently have a statically significant chance of having their actions go undetected, when compared to firms that are not politically connected. Furthermore, the breadth of the S.E.C.'s jurisdiction of regulating \$118 trillion dollars of securities trading stands in stark contrast to its scanty budget, which forces them to operate at a deficit of 400 employees. Additionally, Judiciary decisions, particularly in the cases of *Morrison v. National Australian Bank, Ltd* and *Gabelli v. S.E.C.* effectively curtailed the S.E.C.'s capacity to enforce cross border infractions, while practically stifling its potential to bring actions to bear due to the discovery rule not applying to the five-year statute of limitations. Ultimately, these issues are wide ranging and would need comprehensive reform from Congress to effectively liberate the Commission from its limitations, however, through encouraging more self-reporting and strengthening protection for those who do come forward as whistleblowers, the Commission would be in a stronger position to use its resources more effectively to combat infractions while promoting deterrence and fairness.

Finally, after comparing the ways in which the U.S. and the E.U. responded to the Global Financial Crisis, it is clear that the U.S. response was less than ideal. Specifically, the vague language in Dodd-Frank used to describe "too big to fail" in efforts to prevent it failed to address the real concern of government bail-outs of the financial sector. Furthermore, the broad jurisdiction of the F.S.O.C., along with its broad jurisdictional duties created a situation in which it would be difficult for any agency to carry them out. In addition to the breadth of the F.S.O.C.'s duties, however, the Council was only granted recommendatory powers, to the extent that the

over 1000-page long law's most prominent defense against future bail-outs was the F.S.O.C. "...instill[ing] discipline..." in the financial institutions and to let them understand that a future bail-out would not occur. The E.U. in comparison, took concrete measures to restructure their financial system by creating three E.S.A.s that all had real regulatory power to impose new rules unilaterally and ban products from trading. Additionally, their bail-in mechanism ensured that future bank liquidations would be paid for by the banks themselves as opposed to the taxpayer. Thus, while the U.S. made some efforts to fix the issue, it did not take measures far enough. The E.U., on the other hand, effectively legislated strategies such that future crises would be less probable.

A clear limitation with this research is that its main focus is financial crises. Thus, through the lens of evaluating one failure after the other, the U.S. regulatory system was bound to seem incompetent in addressing fundamental structural issues. The research did not address the numerous instances where fraudsters were apprehended and money was remitted to investors, nor did it mention the probably innumerable moments when the established legislation and relevant agencies actually prevented serious economic issues from occurring. Ultimately, this research focused on the failures in order to find ways of improvement, which subjected it to a bias by not addressing many of the ways in which the current regulatory regime was effective and useful.

An interesting area for future research with this paper would be to understand the recent Silicon Valley Bank collapse. It would be interesting to compare what led to its collapse to the events leading to the G.F.C., along with how the government responded in both cases. In this way, there could be a clearer understanding of the extent to which regulations and agencies were effective in carrying out their intended purpose of ending bail-outs and monitoring the market for systemic risks. Reviewing this recent crisis would be especially interesting in the context of this

research paper, especially its section on comparing the U.S. regulations to those of the E.U. This is because when compared to the U.S., the E.U. did not suffer any comparable bank collapse similar to the liquidation of Silicon Valley Bank.¹⁵⁶ All this is despite the interconnectedness of the market and contagion of bad assets from one economy to the other, which contributed to the spread of the G.F.C. This would reveal how the U.S. financial system works on a more holistic level over the past fourteen years and perhaps reveal further ways by which the U.S. system could be strengthened to prevent similar crises from occurring in the future.

This paper puts forth a few important points about the effectiveness of current U.S. financial legislation and enforcement. It raises a few important questions as well, such as to what extent does the current regulatory regime benefit the majority of Americans and to what extent does it benefit the very for-profit business it is intended to monitor? Ultimately the answer to these questions and the points raised in the paper could theoretically have a number of policy implications in terms of strengthening legislation by making it clearer, and in properly funding and empowering the enforcement agencies. It also raises important social and ethical implications as well regarding the type of society Americans want to live in, the value of social equality, and the ethics of business. Most importantly, it questions readers to consider what they want the role of government to be in private markets and in regulating private businesses. Ultimately, these answers are different for every reader and they will hardly affect the functioning and actions of the world's largest economy. Yet they are important to think about nonetheless, as every American citizen has the right to vote and to elect officials that could take measures to make real change for the greater good.

¹⁵⁶ Hannah Brenton, (2023) "Nothing to see here: EU shrugs off Silicon Valley Bank collapse," Politico, accessed 2023, <https://www.politico.eu/article/nothing-to-see-here-eu-shrugs-off-svb-collapse/>

Recommendations:

While perfecting the entire U.S. regulatory apparatus would be impossible, this paper still proposed ways in which it could be made more effective and resistant to third party influences. The proposed solutions to the problem of legislative inefficiency followed three categories, there were technical solutions to fix prior insufficiencies, such as with the batch process proposal, there were amendments to the existing Congressional structure and mode of operations through the establishment of the joint Committee on Securities and Market Safety, and there were suggestions to curb the potentially deleterious effects of lobbying on the regulatory apparatus as a whole. Ultimately, such proposals may have the ability to help strengthen the current system, however, there are still areas of interest for future research.

So far, this paper has identified three key areas of concern in which existing securities laws and amendments have not sufficiently accounted for the underlying issue when relating to high-frequency trading and payment for order flow. Additionally, it has been established that cemented regulations can be undermined and even repealed by the very organizations whom Congress is tasked with regulating. Any proposals to help solve the issue of regulations failing to address the root of the problem must address the structure of Congress and how regulatory legislation is considered and enacted. Additionally, proposals seeking to ensure long-term stability in the financial system must focus on the issue of lobbying and its deleterious effects on the financial system.

In the aftermath of the “Flash Crash,” regulators enacted responses that they hoped would prevent another similar crisis from reoccurring. However, although they adopted some changes, such as the individual stock circuit breakers, they failed to strengthen existing regulations that were unsuccessful in mitigating crises, such as the index-wide circuit breakers. In order to help

solve the problem of high-frequency trading and payment for order flow, not only do stronger measures need to be taken to strengthen existing regulations such as the index-wide and cross-industry circuit breakers, but also to implement batch processes that will hinder the H.F.T.'s capability to use its speed advantage over other average market participants.

This batch process, which has been suggested by Manahov, among others, would ultimately prevent high-frequency trading algorithms from placing orders without restrictions. In the batch process proposal, there would be an auction that would take place every few milliseconds that would serve to slow the algorithm's process. Specifically, if regulators can slow down the speed with which H.F.T. algorithms place trades, they would help diminish their advantage over the average human investor. Furthermore, such batch processes would serve to help prevent manipulative tactics related to Payment for Order Flow, as market participants would lose crucial time to place trades to take advantage of the price differences between markets. Ultimately, such a proposal would help make the markets fairer for the average American investor.

In addition to the batch proposal that would help slow down the operations of advantaged high-frequency traders, there needs to be a committee in place to monitor the effects of new regulations and to track whether existing securities laws are carrying out their intended effect. To that end, the Congress would need to incorporate certain elements of the prior "regular order," so as to strengthen the role of the existing committees, while establishing new ones. Specifically, the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs individually hold broad jurisdiction over the entire financial services industry and the national economy generally. The House Committee on Financial Services holds jurisdiction over 10 broad domains, which happen to include everything related to finance, from "Bank and banking..." and "Money and Credit..." to "Insurance generally," and "Public and

Private Housing.”¹⁵⁷ In addition to these obligations, the Committee also has broad jurisdiction over all “Securities and Exchanges,” as well as over five other broad domains.¹⁵⁸ The Senate Committee on Banking, Housing, and Urban Affairs is the committee that is most directly related to the jurisdictions of the House Committee on Financial Services and which can monitor banking and securities. The Senate Committee on Banking, Housing, and Urban Affairs, however, has less than half the members than its House counterpart, while having 40% more tasks to monitor.¹⁵⁹ In addition to the 14 broad points of jurisdiction included in this Senate Committee’s tasks, the Committee, “...shall also study and review on a comprehensive basis, matters relating to international economic policy as it affects United States monetary affairs, credit, and financial institutions; economic growth, urban affairs, and credit, and report thereon from time to time.”¹⁶⁰ After reviewing how complex and byzantine these securities regulations are, and also after witnessing how difficult addressing complex securities issues can be, then it should be clear that these broad Committees are insufficient to address the safety of our securities markets.

To that end, this paper proposes to divide these broad organizations into more specific groups. Specifically, both the House and the Senate Committees should be amended, such that they may adequately provide the opportunity for its members to effectively evaluate whether existing securities laws are effective and holistic in providing safety to the marketplace. Therefore, they should make a separate and dedicated joint committee to monitor the financial market and oversee the S.E.C. By taking jurisdiction away from the existing committees, such as

¹⁵⁷ “Jurisdiction,” U.S. House Committee on Financial Services, accessed December 19, 2022, <https://financialservices.house.gov/about/jurisdiction.htm>.

¹⁵⁸ Ibid

¹⁵⁹ “Jurisdiction: United States Committee on Banking, Housing, and Urban Affairs,” About | United States Committee on Banking, Housing, and Urban Affairs, accessed December 19, 2022, <https://www.banking.senate.gov/about/jurisdiction>.

¹⁶⁰ Ibid

the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs, which both have broad jurisdictions, into a separate joint and dual Committee on Securities and Market Safety, there would be a greater chance that specialized expertise and experience would accumulate towards the monitoring of existing market policies and regulations. It must be noted that these committees should not form within the existing ones as subcommittees. In order for the full benefits of such a proposal to take effect, the Securities and Market Safety proposed committees must be individual committees of their own, so that they will have defined powers and can report legislation to the chamber.¹⁶¹ Thus, this proposal suggests more than simply to revive the House Subcommittee on Economic Stabilization that existed until 1988.¹⁶² Rather, it proposes to amend Congress' operations by creating a committee that has the jurisdiction, as well as the duty, to monitor the effectiveness of existing regulations, while suggesting new ones that will improve market safety.

Furthermore, in order for such a committee to be successful, there must be a strong emphasis on technological advancements. H.F.T. and Payment for Order Flow developed due to a fundamental misunderstanding of the breadth and functions of new technologies, such as high-speed algorithmic trading. Such measures would increase the likelihood that market regulations and securities laws will be more thorough and more effective at helping protect the average American from market manipulation.

In addition to amending the Committee structure, Congress could take steps to create more comprehensive and effective securities laws, by incorporating some elements of "regular order," into its current operations. It seems that the measures taken by Congress to legislate and

¹⁶¹ "The Legislative Process: Committee Consideration (Video ... - Congress," accessed December 19, 2022, <https://www.congress.gov/legislative-process/committee-consideration>.

¹⁶² Norbert Michel, "Dodd-Frank's Financial Monster Council: The F.S.O.C.," *Forbes* (Forbes Magazine, July 7, 2014), <https://www.forbes.com/sites/norbertmichel/2014/07/07/dodd-franks-financial-monster-council-the-F.S.O.C./?sh=5ae26e832f8f>.

to effectively regulate the securities industry always address the immediate crisis, but never go much farther towards actually solving the underlying problem. In reverting from the “new order” to the “regular order”, Congress will have the tools necessary to understand these regulatory issues and market crises in greater depth. A greater understanding, coupled with the responsibility and accumulated expertise in being a part of a specialized committee that will determine policy in that field, will increase the chances that effective legislation is enacted and that the underlying problem, the cause of the crisis or scandal, can be effectively addressed.

According to Drutman, in the “regular order,” Congress mostly relied on a committee system, which created space for cross-partisan coalitions to work.¹⁶³ Those committees also allowed for greater expertise of the subject area as members would stay on the same committee for years and accumulate experience. This “regular order” was established by the mid-twentieth century, and was decentralized in the sense that the dispersion of power and influence was more multipolar and concentrated among a couple dozen members in each house.¹⁶⁴ In this regime, top party leaders, such as the Speaker of the House and the Senate majority leader, largely deferred to the expertise of these Committee leaders, scheduling legislation for floor consideration, but largely being absent from setting committee agendas and crafting legislation.¹⁶⁵ This system inherently valued expertise, experience, and positive legislation rather than party politics.

The current system of Congressional operations is far from the idealized previous regime. The “new order” that developed gradually since the 1960s-1970s, encompasses the Congress’ primary operating methodology today.¹⁶⁶ In both houses, it incorporates a strict hierarchy that

¹⁶³ Drutman, Lee, 2017, “Can Our Political Institutions Handle Our Political Divisions?” (Washington, D.C: New Republic Foundation). pp. 8 <https://na-production.s3.amazonaws.com/documents/Institutions-Divided-Politics.pdf>

¹⁶⁴ Steven S. Smith, Jason M. Roberts, and Ryan J. Vander Wielen, *The American Congress 8th*, 9th ed. (Cambridge, UK: Cambridge University Press, 2015), pp. 8

¹⁶⁵ Smith, Roberts, Vander Wielen, *The American Congress 8th*, 9th ed, pp. 8

¹⁶⁶ *Ibid*, 9

focuses all decision-making authority and debate in the hands of the party leaders, the Speaker of the House and the Senate Majority Leader.¹⁶⁷ As a result, Congress members are pressured by leadership to vote on large bills with almost no time to review, let alone debate and deliberate. According to Marini, through the increased centralization of Congressional power in the hands of leadership, Congress lost its ability to effectively legislate, “It was in the ongoing process of subcommittee hearings, bill markups, floor amendments, and conference reports, that a congressional consensus could be established that all could live with even if they didn't like it.”¹⁶⁸ Marini states exactly what was lost in the “new order,” “Unfortunately, in the absence of member participation, the considerable expertise and control that came with longevity on a committee, has been nearly lost. Furthermore, when the committee and subcommittee members no longer participate, you get speedy, ill-considered legislation cobbled together by the Senate and House majority leadership staff, which is heavily influenced by interested stake-holders in the private sector.”¹⁶⁹ Without this expertise and without deliberation, it is no wonder why there remain gaps in the regulatory apparatus and why many of the central issues to the financial sector are not properly addressed. Through a return to “regular order”, Congress members can again debate and combine their expertise towards finding a bipartisan solution to these problems.

Admittedly, changing the entire mode of Congressional operations that has been in place since at least by the 1980s, is not entirely realistic. However, now that it has been established that returning to “regular order” could be beneficial to the legislative process, this paper will suggest some ideas that, while short of changing the entire structure of Congressional operations, does

¹⁶⁷ Smith, Roberts, Vander Wielen, *The American Congress 8th*, 9th ed, 9-10

¹⁶⁸ John A. Marini and Ken Masugi, “Politics and Administration,” in *Unmasking the Administrative State: The Crisis of American Politics in the Twenty-First Century* (New York: Encounter Books, 2019), pp. 19.

¹⁶⁹Marini, Masugi, “Politics and Administration,” *Unmasking the Administrative State: The Crisis of American Politics in the Twenty-First Century*, pp.19

incorporate some elements of the “regular order” through new rules. One of those rules that could help achieve more thoughtful deliberation would be to institute mandatory Committee hearings. Currently, Congressional Committees are not mandated to hold open hearings, this paper suggests changing that.¹⁷⁰ By instituting mandatory open Committee hearings, the public will have access to lawmakers’ ideas, concerns, and demeanors, which will grant the public more access to understanding how their legislative process operates. In addition to granting the public more transparency, it will also incorporate their opinions into the debates. As publicly broadcasted hearings can be an opportunity for the public to express their concerns informally before the bill moves forward.

The more the public has access to these hearings, the more potential there is for them to express their opinions, and more importantly, for those opinions to be heard and addressed by their elected representatives. To that end, all Committee hearings should be recorded. While currently, transcripts are recorded for every hearing, not all are recorded in video or audio format. By mandating Congress to record all their hearings in written, audio, and video formats, it will increase the likelihood that the public will engage with these hearings and with the legislative process more generally. Specifically, mandated audio and video recordings could be fruitful for providing sound-bites where politicians express their views in succinct several second formats. Thus, if anything is said that is controversial, or needs further deliberation, the public will have more tools to properly engage with the material and assess its value.

It must be noted that these proposals for amending Congressional operations and creating new committees, is not meant to serve as the sole solution to this complex problem. In fact, it is meant to serve as a redundancy, or a contingency plan, in the case when other branches or

¹⁷⁰ “The Legislative Process: Committee Consideration (Video ... - Congress,” accessed December 19, 2022, <https://www.congress.gov/legislative-process/committee-consideration>.

departments related to market safety fail. In fact, after the 2008 crisis, Dodd-Frank established the comprehensive Financial Stability Oversight Council (F.S.O.C.) that was tasked with identifying areas of risk within the economy.¹⁷¹ Furthermore, the F.S.O.C. has the mandate to add increased regulatory scrutiny on financial actors that they deem to be excessively risky. The function and intent of the F.S.O.C. sounds as if it would adequately protect the interests of the American people through maintaining market safety. However, the same tool that can be used to create more security in the financial system can also be used to destabilize the same system. As was proven during the Trump presidency, when he, along with former Secretary of the Treasury Steve Mnuchin effectively sought to dismantle the powers of the F.S.O.C. by conducting fewer and shorter meetings while decreasing its budget and staff.¹⁷² Thus, the proposition to help increase market safety through the Legislative branch would stand and still be helpful, despite the measures taken by the Executive branch. Both propositions will together help bolster our nation's defenses against market manipulation and instability.

Regarding the Executive branch's solution to market instability, the F.S.O.C., there are measures proposed to help strengthen it and make it a more viable defense. Firstly, the 117th Congress proposed the bill, H.R.528 - The Financial Stability Oversight Council Reform Act, to create more accountability on the Council. It suggests that the Council produce quarterly reports to Congress identifying its goals, finances, workforce, and steps to achieve their goals, along with a mandate to publish notices and leave a comment period of 90 days before the Council issues any reports or suggestions for legislation.¹⁷³ This proposition has been referred to the

¹⁷¹ "About F.S.O.C.," U.S. Department of the Treasury, March 31, 2022, <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/F.S.O.C./about-F.S.O.C.>

¹⁷² Gregg Gelzins, "5 Priorities for the Financial Stability Oversight Council," Center for American Progress, November 22, 2022, <https://www.americanprogress.org/article/5-priorities-financial-stability-oversight-council/>.

¹⁷³ Tom Emmer, "H.R.528 - Financial Stability Oversight Council Reform Act," Congress.gov, January 28, 2021, <https://www.congress.gov/bill/117th-congress/house->

House Committee on Financial Services on the same day it was introduced, on January 28, 2021. Such reforms to the Council could be fruitful, as it would ensure that the Council has to explain its decisions and plans to the Congress, and thus the American people, at large.

However, even if this bill does not move forward, there should still be steps taken to help improve the functionality of the F.S.O.C. despite the goals and potentially conflicting interests of the then sitting President. To that end, this paper suggests adding a non-voting seat to the F.S.O.C. decision making panel that currently includes ten voting and five non-voting members.¹⁷⁴ This non-voting seat could be filled by a Congressional representative, to thus ensure, at least in theory, that the interests of the American people are directly represented at the highest decision-making body of the F.S.O.C. Thus, even if Congress does not directly monitor the Council, it could always ensure that the Legislative branch is more directly familiar with the concerns and decisions of the experts on the Council. To further ensure that the Council is able to provide reasonable suggestions and that Congress will actively incorporate their suggestions, the non-voting seat could be filled by whoever serves as the Chair of the proposed joint House and Senate Committee on Securities and Market Safety.

Although the more technical solutions, such as the batch proposal, are simpler, the more complicated alterations to Congressional functionality must be addressed in more detail. Specifically, even if measures such as building/revising more focused and dedicated committees, strengthening the F.S.O.C., and returning to regular order, were enacted, they still would not preclude future regulatory capture and outside influence. To that end, several caveats must be added to these proposals to enhance their viability. Firstly, to enhance the transparency of the

bill/528?q=%7B%22search%22%3A%5B%22financial+regulation%22%2C%22financial%22%2C%22regulation%22%5D%7D&s=5&r=4.

¹⁷⁴ “About F.S.O.C.,” U.S. Department of the Treasury, March 31, 2022.

new committees and the F.S.O.C., their meetings should be made public by mandate. Reasoning dictates that private actors will have more opportunities to influence Committee and Council decisions when the members' decisions will not be publicly scrutinized or held accountable. Furthermore, through these open meetings, the public should have the opportunity to comment and make suggestions on policy concerns. Thus, integrating active public opinion into the agenda setting and policy formation process could help negate the influence of private actors seeking to capture the regulators. Secondly, these committees should have clear and detailed mandates and goals such that their performance can be measured based on their success relative to such goals. Finally, and perhaps most importantly, these committees should be forced to incorporate independent research and analysis into their policy formulation. For example, a panel of academic journals, universities, and nonprofit unbiased think tanks can be employed to submit research on implications of a policy decision. Additionally, such a panel could also review findings of these committees and present their interpretations in such open meetings. Through the integration of public hearings and public opinion, clear goals, and the integration of independent research and review panels, the suggestions of crafting new committees, strengthening existing ones, and returning to regular order can more dutifully remain independent from the influence of regulated parties.

Apart from altering the operations of Congress to achieve more effective reforms, there are simpler ways of crafting, maintaining, and enforcing laws meant to mitigate securities manipulation, provide stability to the financial system, and provide equality of opportunity for investors. Namely, lobbying must be addressed. While lobbying is a fundamental aspect of the American political system generally, when it is applied to financial securities, it can tend to have disastrous nation-wide and even global consequences. Corinne Crawford illustrated the effects of bank lobbying on Congress towards the reinterpretation, amendment, and, ultimately, the repeal

of the Glass Steagall Act, when she said, “Practically from the day it was signed into law, banks lobbied for the repeal of the Glass Steagall Act. However, the lobbying efforts to loosen the restrictions of Glass Steagall increased significantly in the 1970’s. In the 1980’s numerous Congressional bills to repeal the Glass Steagall Act were introduced.”¹⁷⁵ Therefore, in order to maintain a robust and stable financial system Congress must enact limits for total dollars that can be spent on lobbying for the interests of third-party actors relating to financial securities, banking, and investment banking laws.

Not only should Congress enact this limit for each lobbyist, but also for each cause. Limiting the amount of money that can be spent on lobbying for a specific change will help ensure that third party actors would not be able to combine their limited spending to achieve broader goals for the industry. Through this limitation, common sense changes would still be enacted, as they would not need much convincing, while more manipulative interests and pressures would be curbed. These propositions could help solve the problems caused by gaps in regulation, failures in legislation to address the underlying cause of financial crises, and the amendment and repeal of common-sense legislation. Ultimately, however, there must be a combination of public interest in maintaining the integrity of the financial system, along with changes to Congress to facilitate active and effective regulations.

Given the issues plaguing the S.E.C.’s enforcement efforts, this paper suggests two practical recommendations that may be able to be created efficiently and will help alleviate some of the S.E.C.’s major hindrances affecting its capabilities to investigate, bring actions, and deter offenders. Particularly, given the political pressure due to some features explained by Stigler’s Capture Theory, along with the S.E.C.’s limited resources and human capital, and its constrained

¹⁷⁵ Crawford, “The Repeal Of The Glass-Steagall Act And The Current Financial Crisis,” pp. 128

enforcement powers, both limited by Congress and the Supreme Court, this first suggestion takes these measures into account and offers a practical way to help alleviate some of these issues, while concurrently strengthening the S.E.C.'s enforcement capabilities. The first suggestion is for the S.E.C. to encourage self-reporting on the behalf of companies. Specifically, this suggestion offers the S.E.C. the opportunity to institute a new regulatory Rule, primarily on its own behalf, that will encourage companies and individuals to self-report potential violations by providing incentives that could include leniency in enforcement actions, such as reduced fines, or jail time in criminal cases. This suggestion bypasses the potentially captured elements of Congress while accounting for the S.E.C.'s constrained resources by streamlining the Commission's capacity to bring enforcement actions. Furthermore, such a suggestion would alleviate its resource constraints by allowing funding to be used in more pressing projects, while simultaneously increasing the S.E.C.'s capacity to more effectively regulate the securities markets by bringing more actions to the Judiciary and thus heightening their deterrence effect.

The S.E.C. can further effectively enhance its enforcement capabilities by strengthening its existing whistleblower protections. The whistleblower program has been successful in terms of helping the Commission obtain civil penalties for infractions.¹⁷⁶ Specifically, as the second highest amount of total whistleblower awards were given in the Fiscal Year 2022, the Commission also ordered the highest amount of total compensation it ever had through actions, civil penalties, and disgorgements, totaling \$6.439 billion.¹⁷⁷ This paper suggests increasing the monetary awards granted to whistleblowers to compensate them for their potential difficulties in working in the industry in the future, coupled with heightened identity protection measures so

¹⁷⁶ U.S. Securities and Exchange Commission. "Press Release," SEC Emblem, November 15, 2022, <https://www.sec.gov/news/press-release/2022-206>.

¹⁷⁷ Ibid

that the identity of the whistleblower can remain anonymous in all public suits, hearings, and enforcement actions. Through these two measures, both of which may be able to be instituted by the Commission on its own accord, without needing further approval from Congress, or a larger budget, the Commission will be able to further encourage whistleblowers to come forward alleviating some of the constraints on the S.E.C. while strengthening its enforcement capabilities.

There are some very important lessons for the U.S. to learn from the E.U.'s handling of the G.F.C., although not all of them are easily transferable to the U.S.'s political regulatory system. Specifically, the U.S. could draft more specific legislation and give more authority to its regulators to affect change in the market and impose penalties on infractors. Furthermore, the U.S. could learn from the E.U.'s 'bail-in' mechanism where the financial system was essentially taxed into providing funding for its own mistakes. In order to make such changes possible, the U.S. could adopt a collaborative funding approach that forces companies to help fund the regulatory bodies that govern them, which would disincentivize risky behaviors.

Firstly, Given the differences between U.S. and E.U. regulation, it is tempting to recommend the U.S. to craft more clear and specific legislation to handle market crises. However, such a recommendation would be too simple, as it may ignore the U.S.'s specific government structure and history. However, a simple way to increase the strength of the U.S.'s structural market reforms would be through granting more authority to the F.S.O.C., rather than solely granting it recommendatory powers. Since Dodd-Frank granted the F.S.O.C. such broad jurisdiction and authority to monitor the markets and coalesce data from both government agencies and private financial institutions, if the U.S. were to grant the F.S.O.C. the power to enact regulatory rules unilaterally, it may be more effective at mitigating future crises.

The U.S. could also attempt to implement a similar system to the E.U.'s 'bail-in' mechanism through forcing companies to pay a portion of their profits to a joint fund to use in

emergencies. Much like that of the E.U., this fund could be used to support rapid liquidation of institutional assets in the case of a financial crisis or the implosion of any particular bank. There is a risk, however, that such an effort might encourage financial institutions to engage in riskier behavior in order to make up the difference in profits they would be losing by paying into the joint fund. Thus, for such an effort to be successfully implemented without many consequences, it must be accompanied by stricter monitoring and penalties of parties that go over agreed upon risk thresholds.

Finally, in order to combat the regulators' lack of resources, while making such a 'bail-in' mechanism more effective, the U.S. could implement a collaborative funding approach. Such an approach would force private sector financial institutions to directly fund the regulators through a pooled system of funds, almost seen as an additional tax on the industry. Thus, regulatory bodies would not solely rely on taxpayer funds or fees imposed on penalized entities. Rather, this proposal suggests a shared sense of responsibility on both the government and the financial services industry to upkeep the proper maintenance and regulation of one of the most vital and pervasive industries. The percentage of profits that a company would need to give could be proportional to their risk profile, so that companies that engage in less risky behavior would not be incentivized to take on more risk to cover this new operating expense. Such a proposal would be justified given the billions of dollars that were spent directly investing in failed financial institutions and the trillions spent on stabilizing the market.

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