Comment: The S.E.C. and the Damsel in Distress: A Contextual Analysis of the Duty of Best Execution

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The law affords many protections to securities investors. According to the Securities and Exchange Commission (S.E.C.), a stockbroker must comply with both the suitability\(^1\) and the best-execution\(^2\) rules when he or she sells or buys a security on behalf of an investor. By contrast, a subprime mortgage broker need not obey either of these rules.\(^3\) Scholars have questioned the unequal treatment of investors and borrowers and have focused on the counterintuitive elements of this unequal treatment. Many of these scholars have wondered why the law provides more protections to investors of securities than to borrowers of subprime mortgages even though the former are more likely to be more sophisticated consumers.\(^4\) Professors Kathleen C. Engel and

† Yale Law School, J.D. 2015; Vassar College, B.A. 2011. I am especially thankful to Professor Claire Priest for sparking my interest in women’s economic history, and to Professor Jonathan R. Macey for encouraging me to research this topic. I would additionally like to thank Scout Katovich for her helpful and insightful suggestions throughout the editorial process.

4. Howard Lax et al., Subprime Lending: An Investigation of Economic Efficiency, 15 Hous. Pol’y Debate 533, 545 (2004) (lower-income borrowers are about twice as likely to obtain mortgages in the subprime sector as in the prime sector); Lydia Saad, U.S. Stock Ownership Stays at Record Low,
Patricia A. McCoy discuss this paradox in the context of the suitability rule, a rule that requires brokers only to recommend investments that best further the investors' interests, and write:

If the duty of suitability is appropriate for financial instruments that have been the traditional province of the affluent, certainly it is appropriate for financial instruments that are peddled to the poorest rung of society.\(^5\)

Professor Jonathan R. Macey explores this puzzle more generally and observes:

Kafka would have loved this story: According to our current understanding of U.S. law, there is far better consumer protection for people who play the stock market than for people who are duped into buying a house with an exotically structured subprime mortgage . . . . \(^6\)

How, then, did the S.E.C create this anomalous regime of protections, and why did the public not protest these shelters for relatively wealthy and sophisticated consumers of financial products? In this comment, I argue that public opinion did not swell against these protections because the S.E.C tapped into a popular discourse about feminine frailty and highlighted the gender and vulnerability of the earliest victims of securities fraud.\(^7\) To substantiate this point, I focus on the S.E.C's development of the duty of best execution.

Three sections structure this comment. First, I provide historical background by documenting the rise of women investors in the early 1900s. Second, I draw on newspaper and magazine articles from this period to trace the contours of a popular discourse that framed women as inept investors and articulated a widespread narrative about these women's reliance on opportunistic stockbrokers. Third, I analyze the S.E.C opinions that created the duty of best execution to show how the S.E.C legitimated its heightened regulation.

\(^{5}\) \text{GALLUP (May 8, 2013), http://www.gallup.com/poll/162353/stock-ownership-stays-record-low.aspx (finding that 81\% of people who make over$75,000 a year own stock compared to just 21\% of people who make less than $30,000 per year.)}


\(^{7}\) For a more expansive discussion of the history of gender and securities regulation, see Christine Sgarlata Chung, \textit{From Lily Bart to the Boom-Boom Room: How Wall Street's Social and Cultural Response to Women Has Shaped Securities Regulation}, 33 Harv. J.L. & Gender 175 (2010).
Legal and technological shifts at the turn of the twentieth century sparked a dramatic increase in the number of female investors. Following the abolition of the coverture laws, women, who struggled to find gainful employment in an economy offering few opportunities to women, demanded property. Men, who still doubted women’s ability to manage property effectively, gave their wives and daughters securities because they knew that another man—most likely a stockbroker—would, in reality, control the assets. The expanding influence of radio and print magazine increased women’s interest in acquiring securities and improved their access to financial information. As a result of these legal and technological shifts, women became increasingly important investors in securities. In articles titled “Women Now Investing Millions,” “Daring to be ‘a Woman in Finance,’” “Women Learn How to Invest on Big Scale,” “Women Gain Power in Finance Rapidly,” “The Army of Women Who Watch the Ticker,” and “Ladies of the Ticker,” newspapers such as the New York Times and the Wall Street Journal covered the rise of the female investor.

Although all of these articles agreed on the trend’s direction, they focused on different facets of the process. Some articles, with an eye to the past, noted the novelty of women’s increased market participation. One article, for example, warned that “[w]omen have invaded the stock market” and observed that a “recent survey has led to the estimate that women in the army of non-professional speculators have increased in the last decade from 2 to 35 per cent.” Others focused on the results of this trend and wrote: “[I]n nine out of ten large corporations whose shares are listed on the New York Stock Exchange women owners outrank men from one to fifteen per cent.” Still others looked to the future and speculated, “Accumulation of wealth by American women has been proceeding so rapidly during the last few years that

9. Cf. Carole Shammas, Re-Assessing the Married Women’s Property Acts, 6 J. WOMEN’S HIST. 1, 25 (1994) (“[S]tocks and bonds became a very attractive form of wealth for men to give to families because the management of it could be undertaken by others at a lesser cost than was the case with realty or a business.”).
17. McMullen, supra note 15, at 139.
18. The Sexes in Industry, INDEP. (N.Y.), Sept. 3, 1927, at 221.
if the rate is maintained, according to one statistician, the entire wealth of the
country will be in their hands by 2025. The articles’ hyperbolic predictions
and use of charged words like “invasion” evinced fears about the shift’s social
impacts and threat of undermining the day’s patriarchal system more generally.

THE NARRATIVE: INCOMPETENT WOMEN DEPEND ON OPPORTUNISTIC MEN

These articles did not merely document women’s increased market
presence. Instead, they presented evidence of this financial shift in a strikingly
consistent normative narrative. This narrative included three elements. First, the
authors argued that women were incompetent investors because they were
ignorant and/or irrational. Second, the authors explained that women should
depend on men for financial guidance because of their feminine incompetence.
Third, the authors worried that these men, chosen to serve as financial advisors,
would victimize their allegedly ignorant and irrational clients. In the following
paragraphs, I resurrect this narrative by illustrating how newspapers,
magazines, and books articulated its components.

Many articles used fairly general terms to portray women as inept
investors. One article, for example, described women as “very bad
speculators.” Another article compared women investors to “absentee-land-
lord[s].” A final article quoted a woman who doubted women’s ability and
interest in becoming successful investors: “I must say that I think it will be a
long time before the average woman will make up successfully as a ‘bull’ or a
‘bear.’ The majority will be well content to let the Jasons go forth and do battle
for the Golden Fleece.”

Other articles used more precise language and argued that women were
incompetent investors because they were inherently ignorant of finance and
business generally. In a 1902 article, the New York Times quoted a broker who
observed, “The average woman knows little about brokerage. Business instinct
is not innate in the woman . . . .” The author of a 1910 investment guide for
women agreed and began his guide by explaining, “In my experience as a
practising [sic] lawyer, no one fact has been more strongly impressed upon me
than that the majority of American women are almost entirely ignorant of the
ordinary rules and methods of business.” Similarly, the author of a 1929 New
York Times article presented women investors as completely irresponsible
investors, committed to the most superficial form of market analysis, and

24. JOHN HOWARD CROMWELL, THE AMERICAN BUSINESS WOMAN: A GUIDE FOR INVESTMENT,
PRESERVATION AND ACCUMULATION OF PROPERTY, at ix (1910).
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wrote, “[M]any women handle names of stocks with no notion of what sort of business they represent and sometimes do not even get the names correctly.”

Other writers attributed women’s alleged incompetence to their irrationality. In presenting women as irrational, these journalists followed in a long tradition of Western thought. A 1927 Independent article, which discussed the increasing importance of female investors, implored its readers to recognize the “social import” of these “revelations” because “[w]omen are much more sentimental than men.” A 1926 New York Times article adopted the same perspective and quoted a broker generalizing, “[W]omen are the biggest gamblers.” Similarly, a 1929 article noted, “When a woman gets going in the stock market her daring is said to surpass that of a man . . . . [S]he will go so far as to risk thousands because she has set her mind on making a few more hundreds.”

Others outside of the New York Times also regarded women as inherently irrational and talentless investors. J. George Frederick wrote in his 1930 book titled Common Stocks and the Average Man, “Quite obviously, however, women are somewhat less competent to use their own judgment in investment than men. It is not unfair to say that they have not the same coolness of judgment, as a rule, as men.”

After articulating their vision of women as incapable investors, these authors often highlighted women investors’ subsequent dependence on male brokers. Some used mostly descriptive phrases to prove women’s dependence. For example, a 1902 article observed, “The woman speculator, according to the brokers, lacks independence . . . . She is willing enough to trust her funds to the hands of brokers . . . .”

Similarly, a 1926 article quoted a broker who said, “It is almost a matter for psychological research, this trust that women place in the financial advice of friends.”

Other commentators adopted a more prescriptive stance and argued that ignorant and irrational women should depend on their mostly male stockbrokers. In his 1908 classic, Henry Clews analogized independent female investors to doomed ships and wrote, “[W]omen are like a ship at sea in a heavy gale without compass, anchor or rudder. They have no ballast apart from men, and are liable to perish when adversity arises.”

25. McMullen, supra note 15, at 139.
27. The Sexes in Industry, supra note 18, at 221.
29. McMullen, supra note 15, at 139.
32. Robison, supra note 13, at 10.
33. HENRY CLEWS, FIFTY YEARS IN WALL STREET 437 (1915).
came to the same conclusion and wrote, "Very few women should attempt to make their own investment analyses." 34

Throughout this period, beginning in the early 1900s and leading up to the 1929 stock market collapse, newspapers and books expressed popular fears that opportunistic brokers would take advantage of these ignorant, irrational, and dependent women investors. Hetty Green, at one point the richest woman in America, 35 wrote in a 1900 edition of Harper's Bazaar that women investors are "just the prey the sharpers are looking for." 36 John Howard Cromwell's 1910 guide for women investors also warned its readers about opportunistic brokers: "[M]any a woman who ought to have been in independent circumstances during her entire lifetime, has come to an old age of poverty because of her inability to protect herself against that army of rascals to which a defenceless [sic] woman of means presents a golden opportunity." 37 On a similar but less dramatic note, a 1926 Wall Street Journal article explained, "There are plenty of brokers who will speak in a disparaging way of women as customers, and there are many good stories in Wall Street where the broker had the best of the joke and the worst of the transaction." 38

These fears of the vulnerable woman investor and the exploitative stockbroker were so prevalent that the Better Business Bureau investigated the phenomenon. Its findings, however, did not assuage popular fears. According to an article in the New York Times, the report concluded that the "unscrupulous salesman will collect $700,000,000 from women in exchange for bonds and stocks of little or no value." 39 Furthermore, this narrative was so pervasive that even commentators from the period actually acknowledged its existence. Eunice Fuller Barnard wrote in a 1929 North American Review article that the image of "the widow victimized out of her husband's life insurance by the first wily [broker]" is "strongly entrenched in the popular imagination. . . ." 40

S.E.C.'S DEVELOPMENT OF THE RULE OF BEST EXECUTION

Congress passed the Securities Act in 1933 41 and the Securities and Exchange Act in 1934. 42 Proponents of these statutes explicitly tapped into the narrative described above. Representative Chapman, for example, speculated

34. FREDERICK, supra note 30, at 289.
36. Hetty Green, Why Women Are Not Money Makers, HARPER'S BAZAAR, Mar. 10, 1900, at 201.
40. Barnard, supra note 10, at 409.
that if Congress had passed the Securities Act of 1933 before the Depression, “thousands of widows and orphans would not today be saddened and crushed as the result of having invested their money in worthless securities and having had their earnings filched from them by unconscionable promoters.”

Representative Rankin also conceptualized the victims of securities fraud as defenseless female investors when he promised that the Securities Act of 1933 would have prevented brokers from selling worthless bonds to “widows and orphans.”

This tactic became so prevalent during the congressional debates that one participant wondered “how curious it is that tears for the widow and orphan appear wherever utility or stock exchange goes on the operating table.”

When the S.E.C., in deciding a number of cases, read the rule of best execution—a rule requiring brokers to sell and buy securities on behalf of investors at the most efficient prices—into section 17(a) of the Securities Act and section 15(c)(1) of the Securities and Exchange Act, it followed the legislators’ cue and played into the narrative described above. Many of these earlier decisions highlighted the victimized investor’s gender and evoked this narrative in a number of ways. In In re Charles Hughes & Co., an early articulation of the shingle theory—a predecessor to the duty of best execution—the S.E.C. called three female witnesses and asked each to introduce herself as a housewife.

By choosing only female witnesses and by encouraging these women to draw attention to their gender by emphasizing their identities as “housewives,” the S.E.C. prepared the public to accept its increased regulation by subtly reminding the public of the many defenseless women victimized by securities fraud. The strategy appears to have succeeded. On appeal, the appellate court reemphasized the gender of the investors and wrote, “The customers were almost entirely single women or widows who knew little or nothing about securities or the devices of Wall Street.”

A New York Times article published shortly after the Second Circuit decision also focused on the victims’ gender by quoting the appellate court’s decision and by writing in bold letters set off from the rest of the text, “Buyers Nearly All

44. 78 CONG. REC. 8086, 8108 (1934) (statement of Rep. Rankin).
46. See, e.g., In re Duker & Duker, 6 S.E.C. 386, 386 (1939) (holding that “[w]here dealer charges his customers a price which bears no relation to the prevailing market price ... the inherent misrepresentation as to the value of the security is a fraud on the purchaser, and revocation of such dealer’s registration is in the public interest.”).
47. For Furbeck’s introduction, see Transcript of Record at 44, In re Charles Hughes & Co., 13 S.E.C. 676 (1943); for Knebel’s introduction, see Transcript of Record at 53, 63, 13 S.E.C. 676; and for Zinnel’s introduction, see Transcript of Record at 67-69, 13 S.E.C. 676.
By contrast, the Second Circuit did not mention the victim’s male gender in any of its twenty-three security fraud cases decided between 1940 and 1950.50

In a similar case handed down in the same year, the S.E.C. called attention to the gender of the victims of securities fraud in In re Lawrence R. Leeby & Co. by noting that the victims were “Miss Esther McDevitt and Mrs. Virginia Smith” and by describing Mrs. Smith as a “widow.”51 Additionally, in 1948, five years after the Leeby decision, the S.E.C. once again emphasized the gender of the victims of securities fraud, writing, “Of the 128,264 shares of preferred stock sold, 102,957 were sold to six widows who were wholly uninformed in securities matters.”52 In In re Hughes, 27 S.E.C. 629 (1948), the S.E.C. called two witnesses to explain how an opportunistic stockbroker took advantage of them. The S.E.C. opinion described these two witnesses—the only witnesses mentioned in the opinion—as “a housewife” and “also a housewife.”53 This same opinion, however, never mentioned the gender of the defendant, Arleen Hughes. The fact that the S.E.C. opinion highlighted the victims’ gender and underplayed the defendant’s gender suggests that the combination of being both victims and women made the witness’ gender particularly salient.54 Unable to fit Arleen Hughes’s gender into a narrative that portrayed women as victims and men as fraudsters, the S.E.C. may have subconsciously left this element of her identity out of the opinion.

Duker v. Duker, 6 S.E.C. 386 (1939), is the only major case from this era that imposed the duty of best execution but did not discuss the victim’s gender. Even this case, however, taps into the narrative of the defenseless woman investor and the opportunistic stockbroker. In footnote 6, Duker v. Duker cites Birch v. Arnold & Sears as the common law source of the rule of best execution.

50. I came to this conclusion by reading through the twenty-three cases on Westlaw decided between 1940 and 1950 that mention the words “securities” and “fraud.”
51. In re Lawrence R. Leeby & Co., Exchange Act Release No. 34-3450, 13 S.E.C. 499, 499 (June 26, 1943) (“Where respondent broker-dealer sold oil royalty interests at retail prices bearing no reasonable relationship to the contemporaneous wholesale price, and no circumstances appear warranting [sic] the excessive mark-ups charged, held there is an inherent misrepresentation as to the fair price of the security, and a fraud upon the purchaser, in violation of Section 17(a) of the Securities Act.”).
52. In re May & Phinney, Doing Bus. as May-Phinney Co. & Wash. Nat’l Co., 27 S.E.C. 814, 821-31 (1948) (“Where registered broker-dealer, in the purchase of securities from and sale of securities to customers whose confidence he had gained and for whom he acted as agent, obtained secret profits by selling such securities at prices greatly exceeding his cost and current market prices, held, willful violation of Section 17(a) of the Securities Act of 1933 and Section 15(c)(1) of the Securities Exchange Act of 1934 and rule thereunder.”).
53. In re Hughes, 27 S.E.C. 629, 629 (Feb. 18, 1948) (“Where registered broker-dealer, who is also a registered investment adviser, sells her own securities to clients to whom she purportedly renders impartial investment advice and fails to disclose fully to such clients the nature and extent of her adverse interest, including her cost of the securities and the best price at which the security might be purchased in the open market, held, willful violation of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.”).
execution. Lacking the polish of a federal agency’s decision, Birch uses insulting and hyperbolic language to describe the female plaintiff’s ignorance. The opinion described her as “densely ignorant” and “in a constant state of confusion” and noted that “she did not know whether she was buying securities directly from the defendant, or, through them as brokers, from others, nor, when selling, whether she was selling directly to them, or through them to others.” In the most infantilizing portion of the opinion, the S.E.C. described her as completely incapable of performing the most basic tasks and wrote, “She had to be shown how to cut coupons from bonds, and an employee of her bank made out her deposit slips for her.” Extreme and stereotypical visions of feminine frailty and incompetence produced to some extent the problem that the S.E.C. sought to solve.

CONCLUSION

Legal and technological changes during the turn of the twentieth century radically reshaped the securities market. Women became a prevalent—if not dominant—demographic of investors. Newspaper articles and other widely read sources did not welcome women into the market. Instead, they created and proliferated a narrative that portrayed women as incompetent investors dependent on morally corrupt male stockbrokers. Congress, motivated by these fears and stereotypes, passed the Securities Act of 1933 and the Securities and Exchange Act of 1934. In reading the duty of best execution into these laws and by repeatedly describing the victims of securities fraud as “housewives” and “widows,” the newly created S.E.C. exploited these popular prejudices and fears to justify its decisions to increase protections for securities investors. By both perpetuating degrading stereotypes of women and by creating stringent consumer protection laws, legislators and the S.E.C. circuitously pursued the public good. Scholars have not fully determined this circuitous pursuit’s normative valence. They have not studied the long-term effects of using these degrading stereotypes to motivate a regulatory regime. While the emotional costs remain hidden but ripe for empirical study, the regulatory costs seem immediately apparent. When these explicitly sexist visions of women faded from the public discourse, this specific regulatory regime lost one of its major justifications. As a result, scholars began to question the regime’s legitimacy and wondered why it afforded so many protections to such sophisticated consumers. Thus, at a more general level, this process suggests that regulatory

55. Duker v. Duker, 6 S.E.C. 386, 388 n.6 (1939) (citing Birch v. Arnold & Sears, 192 N.E. 591, 596 (Mass. 1934)). In the same footnote, Duker also cites Matthews, Lynch & Co. v. Hughes, a 1939 case decided by the Illinois Circuit Court, County of Sangamon. The only named victims in this case are also women: Amelia Becker and Mary Dietz.
57. Id.
regimes based in such antiquated notions may not only harm the public, but also undermine the legitimacy of the governments that propagate these regulatory regimes.