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ADMINISTRATIVE AGENCY OBSOLESCENCE AND INTEREST GROUP FORMATION: A CASE STUDY OF THE SEC AT SIXTY

Jonathan R. Macey*

INTRODUCTION

A fundamental precept of American law and jurisprudence is that "laws must change to meet the needs of changing times." In particular, the common law system of judging was thought to constitute a uniquely effective mechanism for dealing with the demands posed by rapid change. As Guido Calabresi presciently has observed, during the nineteenth century judges "creatively manipulated and changed common law rules in reaction to changing circumstances," and thereby "the common law was openly and legitimately kept up to date." But, as Dean Calabresi has observed, times have changed. The United States has become a nation dominated by statutes rather than by common law rules.

With the emergence of statutes has come the need to cope with the problem of statutory obsolescence in order to retain some of the flexibility and dynamism achieved through the process of common law judging. Scholars have suggested a wide variety of strategies for dealing with statutory obsolescence. Sunset laws, which would limit the time period for which statutes are in force, increased constitutional scrutiny, judicial updating, and even direct majoritarianism all have been proposed as mechanisms for dealing with the problem of obsolescence. Thus, for example, Dean Calabresi recommends giving common law courts the power to treat statutes precisely the way they treat common law rules.

This Article does not attempt to add to the rich literature on statutory obsolescence. Rather, its goal is to observe that the twentieth century has witnessed the birth of another phenomenon—the modern administrative agency—whose existence presents problems of

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1 GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 3 (1982).
2 Id. at 184.
3 Id. passim.
4 Id. at 59-65.
5 Id. at 8-15.
6 Id. at 81.
7 Id. at 70-72.
8 See id. at 82.
obsolescence and irrelevance even more profound than the problems posed by the existence of outdated statutes. The problem with agencies is basically the same as with statutes: what happens when technological change, market processes, or other exogenous variables cause the basic purposes of an administrative agency to cease to be relevant from the perspective of the public policies that originally led to the creation of the agency?

Put another way, the problem can be stated as follows: "an unmistakable function of both the dependent and the independent agencies, as conceived in the New Deal, was to give specificity to broad legislative mandates." But it stands to reason that when these mandates have been attained, or are no longer relevant, or when the goals set for the agency can be achieved through market forces without the need for agency intervention, the agency should cease to exist.

Part I of this Article considers the problem of administrative agency obsolescence in more detail. In Part I, I develop general principles and guidelines for determining obsolescence that might permit judges to evaluate a claim that an administrative agency should be closed down. In Part II of the Article, I apply the principles of agency obsolescence developed in Part I to a particular administrative agency, the Securities and Exchange Commission ("SEC" or "Commission").

I. THE PROBLEM OF ADMINISTRATIVE AGENCY OBSOLESCENCE

In the private sector, firms are motivated to provide products at competitive prices by the threat of financial loss, which, at the limit, means failure. The role of failure in a market economy is clear: when a firm misuses scarce resources by "producing unwanted products, or overproducing, or using inefficient production techniques, at the extreme it will fail, and the resources will find more socially desirable uses." In a market economy, it is common for individual businesses to fail. Indeed, it is not uncommon for entire industries to fail. Firms fail for one of two reasons: "either the firm has not responded to market forces with a satisfactory mix of price and product performance relative to its competitors in the industry, or else the product the firm is offering is not in sufficient demand by consumers to justify its production in the first place."

Because this Article is not about the efficient operation of admin-

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9 Id. at 45.
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Administrative agencies, I will not discuss strategies for improving the quality of the services offered by administrative agencies to the public. Rather, this Article is about the consequences and cures of administrative agency obsolescence. My argument is not that administrative agencies should be closed merely because they are being operated inefficiently. Inefficient operations can, in principle, be improved by changing incentive structures and personnel. Rather, my argument is that just as technological innovations in markets often cause whole industries to become obsolete—for example, the introduction of the automobile had disastrous consequences for the buggy whip industry—so too can technological innovation render administrative agencies obsolete.

The problem of market failure provides the basic public-interest justification for the displacement of private ordering by government intervention. Market failure occurs when market mechanisms do not supply the appropriate quantity of a product or service at the appropriate price. The identification of a market failure provides a necessary but not a sufficient condition for justifying the imposition of government regulation. But market failures can be cured.

Moreover, the mere identification of a market failure is not sufficient to justify government regulation, because such regulation involves costs as well as benefits. The costs are not only the direct costs of government regulation, such as bureaucrats' salaries, etc., but also the indirect costs in the form of the rigidities and barriers to entry caused by government regulation. Thus, those seeking to justify government regulation should presumably be required to show that the costs of the government regulatory scheme are outweighed by the benefits. The identification of a public good (i.e., a good from which those who do not pay for the good cannot be excluded from using it) might suggest a role for government in supplying that good if there is sufficient demand for it. Similarly, the existence of collective action problems provides a partial basis for justifying government intervention. For example, all of the members of a particular society might prefer to agree to provide transfer payments to the poorest members of the society. However, each individual member of that society might recognize that, acting individually, she could do little to benefit the poor. Moreover, each individual in the society would realize that the poor would not be noticeably affected if that individual alone declined to contribute to the poor, so long as all of the other members continued to participate. This collective action problem might well lead to a situation in which giving to the poor was suboptimal, even from the perspective of the well-to-do within the society. Govern-
mentally coerced transfer payments could be used to solve this problem by eliminating the free rider possibilities described above.

But again, it stands to reason that just as justifications arise for creating governmental programs, these justifications might also subside over time. In particular, market innovations that solve public good and collective action problems can be developed. For example, suppose that a particular production process is developed which produces a good very cheaply, but results in a great deal of pollution. The existence of pollution creates a cost that is not internalized by the producer of the good. In this circumstance, one might argue in favor of a tax on the producer that raises the price of the good to the price that would be charged if the producer had to bear the cost of its pollution. Alternatively, one might argue in favor of a regulation that reduces production to the level that would exist if the producer had to internalize the costs of its pollution. But these regulatory policies should be abandoned if new techniques are developed that permit more efficient production without pollution.

At the limit, it is easy to identify examples of obsolescence. The Rural Electrification Administration ("REA") was established to bring electricity to remote agricultural areas during the Great Depression of the 1930s. At the time the Administration was created, about eighty percent of farms did not have electricity. Now, one hundred percent have electricity. So, the REA shifted its focus to the provision of telephone service. Now one hundred percent of farms also have telephone service, but the REA continues to provide subsidized loans to its well-organized constituencies, which consist primarily of utility companies providing electric and telephone services to rural areas.12

A. The Nature of the Problem: Why Agency Obsolescence Matters

As noted above, failure plays an important and salutary role in the operation of market economies. The presence of failure assures that the resources previously devoted to the enterprise will find other, more efficient uses. The same, of course, can be said for the problem of agency obsolescence. By terminating the operations of an administrative agency, it is possible to divert the resources previously devoted to the operations of that agency to other, more valuable uses. Thus, terminating the operations of an obsolescent agency will produce net social gains.

The existence of failing institutions, whether such institutions are in the public sector or the private sector, may be a sign of health rather than a sign of malaise since it indicates that either innovation or competition is serving to remove the need for the obsolete firms or agencies. Indeed, it would be extremely disappointing if administrative agencies never became obsolete, since it would mean that the societal problems such institutions ostensibly were organized to confront were never solved.

For several reasons, the problem of administrative agency obsolescence has more serious consequences than either the problem of statutory obsolescence or the problem of obsolescence in private sector firms. The problem of agency obsolescence is more serious than the problem of statutory obsolescence because judges can and do update obsolete statutes by interpreting them in ways that preserve their usefulness through time. In other words, statutes are sufficiently flexible that they can be altered, or “interpreted dynamically,” to insure that they remain relevant.

By contrast, when administrative agencies become obsolete, they are likely to respond to their obsolescence in ways that impose very heavy costs on the firms they are supposed to regulate, or on society generally, or both. As obsolescence sets in, administrative agencies are likely to replace the publicly articulated goals that provided the initial justification for the creation of the agency with self-serving goals designed to insure that the agency will remain a secure place of employment for the officials who comprise its staff. As Anthony Downs pointed out in his classic work Inside Bureaucracy, over time, all bureaucracies will substitute private, bureaucratic objectives for the public objectives that characterized their origination. But it seems clear that this general problem becomes worse in the case of agencies facing obsolescence, since obsolescence makes the problem of bureaucratic self-interest far more immediate. Thus, it stands to reason that agency officials faced with the prospect of losing their jobs, and with them their large highly specific investments in human capital that have been devoted to learning agency policies, agency procedures, and agency culture, will fight hard to avoid that outcome.

For example, agencies that are faced with obsolescence are more likely to become “captured” by a particular segment of the industry than agencies that are not faced with obsolescence. This is because

13 See Macey & Miller, supra note 11, at 1155.
14 See CALABRESI, supra note 1, at 81-83.
15 Id. at 31-43.
16 ANTHONY DOWNS, INSIDE BUREAUCRACY (1967).
agencies that are not obsolete often can count on some significant measure of public support for their continued existence. By contrast, an agency that has been rendered obsolete by exogenous changes in the form of technological development or new marketplace developments will find that it must provide favors to discrete constituencies in order to preserve some measure of support for its continued existence.

In addition to the fact that it may be easier for special interest groups to capture obsolete agencies than other agencies, obsolete agencies are also more likely to engage in bureaucratic struggles commonly characterized as "turf wars" than other agencies. Again, this prediction is consistent with my prediction that survival will become the central institutional focus for obsolete administrative agencies. An obsolete agency will attempt to retain some justification for its existence by claiming that areas of economic life that either currently are unregulated, or else currently are under the regulatory authority of a rival agency, should be brought under the authority of the obsolete agency.

Bureaucratic imperialism by obsolete agencies creates several kinds of problems. First, imperialistic agencies waste real resources by attempting to do work that currently is being accomplished, either by private sector actors or by other governmental agencies. Second, imperialistic agencies cause overregulation. Overregulation is caused by the fact that obsolete agencies seeking to expand their regulatory turf will attempt to regulate in areas that Congress had intended to leave unregulated. Moreover, in looking for new worlds to conquer, obsolete agencies inevitably will claim that "rival" regulatory agencies are not providing the public with sufficient regulatory protection in order to provide a justification for their efforts to expand their own jurisdiction. This, in turn, leads to overregulation.

I hasten to add, however, that bureaucratic efforts to claim new turf are not always met with hostility and opposition by the firms they are attempting to regulate. Rather, firms in a particular industry often will welcome new regulatory efforts, particularly those proposed by an administrative agency made desperate by obsolescence. This is because new regulation can protect existing firms by creating barriers to entry. New regulation also can provide benefits for certain segments of an industry, such as established firms over other firms, particularly newer firms. 17 Thus, as with agency capture, agency

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imperialism can be used by an agency to obtain much needed political support in the face of obsolescence.

In addition to the problems associated with bureaucratic capture and bureaucratic imperialism described above, a third set of social problems is caused by the strong incentives of obsolete agencies to disrupt and distort the creation and flow of information to the public regarding the firms it is supposed to regulate. Obviously, administrative agencies that lack any reason for existing are unlikely to admit the fact of their own obsolescence. Rather, they are more likely to skew the flow of relevant information to the public in order to make it seem as though problems that would serve to justify their existence still remain.

Moreover, administrative agencies often are organized to deal with real or perceived crises or with problems of apparently major proportions. Indeed, administrative agencies can only justify their huge staffs and significant budgets if they can persuade people that they are dealing with problems of significant proportions. Thus, not only do administrative agencies have an incentive to manufacture facts that would tend to support their continued existence, they also have an incentive to invent major crises and problems in order to attempt to make the “solution” of these crises and problems a way to justify their continued existence.

Similarly, bureaucrats in obsolete agencies have an incentive to deny that solutions to crises and problems exist outside the agencies themselves. For example, it is clear that the U.S. Postal Service has no incentive to admit that solutions generated by markets and new technologies, such as electronic mail, faxes, and Federal Express, have caused an erosion in the need for the postal service to continue to exist as a federally subsidized bureaucracy.

Thus far I have used economic analysis in the form of public choice theory to make predictions about how obsolete agencies are likely to act. These predictions strongly suggest that obsolete agencies are even less likely to advance the public interest than agencies that are not obsolete. The public choice model I am using in my analysis has been criticized for advancing a theory that “posits hyper-rational agency action.” For example, in an interesting essay about the Securities and Exchange Commission, Donald Langevoort argues that the assumption of hyperrationality that underlies public choice theory makes

the theory’s descriptive power . . . seem questionable in its applica-

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tion to the actions of administrative agencies, for there is both abundant anecdotal evidence and a vast body of research on organizational behavior that argues that the activity of bureaucracies is not characterized by a high degree of either sensitivity or responsiveness to external stimuli.\(^9\)

In particular, the literature from organizational theory that Langevoort cites argues that internal institutional biases towards "conservatism, risk avoidance, 'turf protection,' and routine" also serve to explain administrative agency behavior in important ways.\(^2\) Despite obvious overlaps and similarities between public choice theory and organizational theory, there is a clear tension between the two theories that is easy to describe. Where public choice posits that bureaucrats within administrative agencies seek to maximize the welfare of the institution according to criteria that are easy to measure externally (agency budgets, agency power, agency influence), organizational theory posits that the internal institutional biases described above provide the best criteria for predicting agency behavior.

Of course, to the extent that public choice theory and organizational theory presume that the bureaucrats inside agencies respond to incentives, the two theories are consistent both with standard economic theory and with each other.

Moreover, it stands to reason that the distinction between the internal incentives described in organizational theory and the external incentives described in public choice theory become blurred when an agency's very existence is threatened by obsolescence. For example, the reason organizational theory predicts that bureaucrats will avoid risk is because personnel are punished for making bad decisions but not rewarded for making good decisions. As Professor Langevoort has pointed out, "agency staffs rarely are rewarded for successes such as the anticipation and prevention of a problem or the efficient balance of costs and benefits of a particular rule, but inevitably blamed for publicly observed failures within their jurisdictions."\(^2\) But bureaucrats threatened with extinction from obsolescence are unlikely to be risk avoiders where the risks are taken in order to protect their sinecures. Here, blame avoidance clearly will be less important than survival.

Organizational theory also predicts that collective action problems will cause bureaucrats within agencies to ignore external incentives that otherwise would cause the agency to seek to expand its own

\(^{19}\) Id.
\(^{20}\) Id.
\(^{21}\) Id. at 530.
power and to pursue other discrete, organizationally-directed objectives. Langevoort, for example, has criticized public choice theory on these grounds.\textsuperscript{22} He notes that the external, institutional goals that public choice theory predicts will inform the objective functions of administrative agencies are not as influential as internal organizational goals. These latter goals include "enlarged or preserved turf or budget, more leisure time for the staff,"\textsuperscript{23} and "even the sense of pride or satisfaction that comes from doing a task well."\textsuperscript{24} He goes on to assert that

[m]ost of these goals, however, are unobtainable except through cooperative group effort. One naturally would assume, therefore, that agency behavior would be primarily inner-directed—that is, explainable largely in terms of the difficult process of mediating among the conflicting interests of group members—until external stimuli change in a sufficiently compelling fashion so as to draw a critical mass of attention outward.\textsuperscript{25}

The collective action problems identified by Langevoort consist of internal transaction and agency costs.\textsuperscript{26} Agency costs are the costs of monitoring the lower- and middle-level bureaucrats within an agency. Here the idea is that the goals of top agency officials, which might well consist of obtaining the greater prestige associated with an enlarged or preserved turf or budget, or the sense of pride or satisfaction that comes from being associated with an agency that is thought to be successful at serving public policy, may not be shared by lower-level officials. The difficulties associated with monitoring these lower-level officials to cause them to act in ways consistent with the upper echelons constitute agency costs. Similarly, transaction costs consist of the costs associated with drafting contracts that create incentives for lower-echelon personnel to act in ways consistent with the interests of their superiors.

Those who criticize public choice theory note that these agency and transaction costs prevent administrative agencies from achieving or even pursuing external objectives because these costs "operate as a counterweight to the incentives to maximize institutional utility in external terms" that are described in public choice theory.\textsuperscript{27} However, once an agency has become obsolete, particularly when that fact is beginning to become noticed by scholars, journalists, and interests

\textsuperscript{22} Id.
\textsuperscript{23} Id.
\textsuperscript{24} Id.
\textsuperscript{25} Id.
\textsuperscript{26} Id.
\textsuperscript{27} Id.
whose objectives would best be served by the demise of the agency, the collective action problems that might normally diminish the explanatory power of public choice theory disappear because agency personnel all share the same basic goal: survival. This shared goal of survival clearly constitutes sufficient "external stimuli" to draw an agency's attention outward. The shared desire not only to continue to be able to make a claim for relevance, but indeed for survival itself, provides a sufficiently strong set of incentives to overcome any of the collective action problems that affect the behavior of agency personnel at other times.

B. Indicia of Agency Obsolescence

The purpose of the preceding discussion has been to explain that the problem of agency obsolescence transcends the rather trivial fact that administrative agencies tend to waste real resources. As demonstrated above, the specter of obsolescence affects the nature of the decision-making process within the agency itself. In particular, the problems of (1) agency imperialism in the form of "turf-grabbing," (2) agency "capture" by special interest groups, (3) distortion of information flow to the public, and (4) manufactured or fabricated crises, which exist to varying degrees in all agencies at various times, all become more acute when agencies are faced with obsolescence. This is because the internal transaction and agency costs that normally curb the natural tendencies toward imperialism, capture, and information distortion, disappear when an agency is confronted with obsolescence.

Two practical implications emerge from the above discussion. The first implication is that administrative agencies have powerful weapons at their disposal with which to deal with their own obsolescence, while there is no obvious mechanism or incentive structure in place that would cause obsolete agencies to be put out of existence. The second implication of the above discussion is that it will be difficult to develop criteria for determining agency obsolescence. Since an agency can skew information flow when that information is contrary to its own institutional self-interest, and since the agency is likely to have powerful constituents with similar incentives to skew information flow, it stands to reason that the mere problem of identifying obsolete agencies, much less responding to the fact of their obsolescence in a public-regarding way, is extremely improbable. Despite the seemingly intractable problem of agency obsolescence, it seems worthwhile to study administrative agency obsolescence nonetheless for the reasons discussed above, namely that obsolescence has a strong effect on agency behavior.
With regard to the first implication, agencies’ ability to exert their own regulatory authority in such a way as to benefit certain market participants over others means that agencies can retain powerful support among special interest groups long after they have become obsolete. Similarly, the ability of administrative agencies to control their own agendas means that they can seek out new constituencies to replace old ones that have disappeared. The ability to retain old constituencies and to attract new ones means that agencies will find powerful allies in Congress who will continue to press for an agency to continue.

Moreover, over time, many organizations and individuals outside a particular administrative agency will develop in such a way that their survival depends on the continued success of that agency. For example, a law firm that specializes in appearing before a particular administrative agency, or an outside academic who has built a consulting career around his previous association with an agency, will find their respective economic futures to be inextricably tied with the future of the agency. Such individuals and groups will constitute powerful allies for virtually any administrative agency faced with extinction. For example, when the Administrative Conference of the United States was threatened with extinction during the congressional debates over the 1993 Budget Reconciliation Bill, earnest appeals were made to outside consultants for the agency, who, of course, were eager to provide support.

By contrast, collective action problems of familiar kinds generally will conspire to prevent the public from galvanizing into an effective political coalition to do anything about agency obsolescence. The collective action problems are caused by the fact that all of the benefits associated with driving an obsolete agency out of existence are spread broadly throughout society. These benefits come in the form of more coherent regulations, less government waste, and, as discussed below, better allocation of resources in society. Because of the widely distributed nature of the benefits associated with discovering and then doing something about agency obsolescence, it will not be rational for individual citizens to invest the resources necessary for dealing with agency obsolescence. This is because the considerable costs of discovering agency obsolescence and then forming an effective political coalition to deal with the problems caused by obsolescence would be highly concentrated among a small group. This group would realize that its proportional share of the widely distributed benefits it was generating would be far lower than the costs it was incur-

\[28\] The Author of this Article was among those consultants.
ring in discovering and dealing with obsolescence. This collective action problem would lead individuals and groups in normal circumstances to be rationally ignorant of the problems associated with agency obsolescence. Thus, agency obsolescence will not necessarily lead either to a diminution in demand for an agency existence by special interest groups or other organized distributional coalitions, or to an increase in opposition to an agency among those groups and individuals harmed by the waste and inefficiency generated by the obsolete agency.

The second practical implication of the discussion to this point concerns the difficulty of determining agency obsolescence. The ability of administrative agencies, their allies, and their constituents to generate and control information relevant to that agency makes it difficult to design systems that can reliably identify obsolete agencies and respond to that obsolescence in a constructive way. Nonetheless, it is possible to develop some general guidelines to assist in identifying obsolete agencies. First, of course, the discussion above suggests that obsolete agencies are likely to behave differently from agencies that are still viable, but perhaps suffering from acute organizational inefficiency. For example, an agency that is simply experiencing organizational slack without obsolescence is more likely to exhibit tendencies toward risk avoidance due to the fact that “agency staffs rarely are rewarded for their successes . . . but inevitably blamed for publicly observed failures within their jurisdictions.”

In addition, agency personnel are likely to exhibit a certain lethargy when obsolescence is not an issue because agency personnel have no meaningful incentives to increase output, and in any event, measuring bureaucratic output is exceedingly difficult to do. For these reasons, during ordinary times, bureaucrats will be able to consume more leisure than their private sector counterparts. Finally, one would not ordinarily expect an agency to make dramatic shifts in its institutional focus during ordinary times. Agencies might make marginal changes in operating strategies, but sudden efforts to grab additional turf, to toughen enforcement efforts dramatically, or to claim the existence of a crisis, are the peculiar hallmarks of agency obsolescence. In stark contrast is the ongoing equilibrium displayed by an agency that is responding primarily to the internal stimuli discussed in the literature on organizational theory.

Perhaps of greater importance than the general indicia of obso-

29 Langevoort, supra note 18, at 530.
30 See, e.g., MEIR DAN-COHEN, RIGHTS, PERSONS AND ORGANIZATIONS (1986); Downs, supra note 16.
lescence described above are particular indicia of obsolescence that will apply to specific instances of agency obsolescence. Up to this point, the discussion has focused on generic issues of obsolescence that apply with equal force to all sorts of administrative agencies. And, while these general indicia of obsolescence are interesting and important because they demonstrate the general types of problems posed by obsolescence, such general observations should not obscure the fact that different factors will cause different agencies to experience obsolescence. For example, the kinds of exogenous changes in market structures or technological developments that might render the Environmental Protection Agency obsolete would obviously be different from the changes that would render the Securities and Exchange Commission obsolete. Thus, attention must be paid to the nature and purposes of each individual agency before a determination of obsolescence can be made.

It seems fairly obvious that different factors will cause different agencies to experience obsolescence. What seems more interesting is the fact that different agencies are likely to respond to their own obsolescence in different ways. In particular, differences in agency goals, functions, constituencies, and even internal cultures will influence, at least to some extent, the strategies that an agency adopts in the face of obsolescence. In addition, the nature of the interest groups served by a particular agency will influence its response. Finally, the presence or absence of rival agencies performing similar functions and the relative political strength of those agencies will influence the way that an agency responds to obsolescence.

II. THE SECURITIES AND EXCHANGE COMMISSION

The basic causes of all agency obsolescence can be generalized at some level of abstraction. Specifically, agency obsolescence, like the obsolescence of firms in the private sector, is brought about by changes in technology or by the operation of market forces. However, as the above discussion has shown, the particular market forces or technological changes that cause obsolescence will differ from agency to agency. The same is true for firms in the private sector. The forces that drove buggy whip manufacturers out of business when the automobile was invented were different from the forces that drove health spas specializing in the treatment of polio victims out of business when the polio vaccine was invented.

Thus, different factors will cause different agencies to become obsolete. Because the individual characteristics of an obsolete administrative agency will determine how an agency responds to
obsolescence, it is important to examine particular administrative agencies in some detail in order to gain a more complete understanding of the causes and consequences of agency obsolescence. Similarly, the social costs associated with agency obsolescence will differ from agency to agency depending on the nature of the agency's work, and the strategy it chooses for dealing with obsolescence. Put simply, some agency obsolescence will impose greater costs on society than others.

This section of the Article will analyze a particular regulatory agency, the Securities and Exchange Commission, in order to apply the insights about agency obsolescence developed in the previous section to a particular administrative agency. An examination of the activities of the SEC over the past decade reveals that this agency is exhibiting all of the classic, and costly, indicia of an agency that perceives its own obsolescence. In particular, agency imperialism, in the form of "turf-grabbing," has pitted the SEC against banking regulators and the Commodities Futures Trading Commission. The predictable phenomenon of agency "capture" by special interest groups has led to subsidies to favored constituencies, particularly securities analysts, institutional investors, market professionals (traders and market makers), and retail brokerage firms. The distortion of information flow to the public and the manufacture or fabrication of crises have been well documented beginning with George Stigler's classic study of the SEC in which he showed that the Commission generated "proof" of the need for new regulatory initiatives by generating a series of case studies showing the existence of thieves and incompetents in the securities industry. Similarly, the SEC's insistence that foreign companies meet generally accepted accounting principles in the United States prior to listing on the New York Stock Exchange has hurt the development of the equity markets without providing any concomitant benefit for investors. However, the

31 See Susan M. Phillips & J. Richard Zecher, The SEC and the Public Interest 21-23 (1981) (arguing that a well-organized special interest group of securities analysts and institutional investors obtained a regulatory subsidy from the SEC of more than $1 billion when the SEC required securities issuers to supply data in particular formats that the securities analysts and institutional investors otherwise would have had to pay to obtain).


SEC's insistence that foreign companies comply with these principles is necessary in order to permit the SEC to cling to the fiction that mandatory disclosure and reporting rules provide benefits to investors.

Thus, all of the factors above that were said to become more acute when agencies are faced with obsolescence are vividly present with respect to the SEC. The SEC has engaged in agency imperialism in the form of "turf-grabbing," agency "capture" by special interest groups, agency distortion of information flow to the public, and agency manufacture or fabrication of crises. And, as suggested earlier, unique characteristics of the SEC's regulatory agenda have made the problems associated with that agency's obsolescence particularly acute. The Securities and Exchange Commission has regulatory authority over the capital formation process. The SEC's drafting, interpretation, and enforcement of its rules determine the process by which entrepreneurs obtain capital. Because of the SEC's unique position at the heart of the capital formation process, its response to obsolescence can impose particularly high costs on society. To the extent that regulators disrupt firms like bakeries, restaurants, airlines, or fishing fleets, there may be a distortion in the way that labor, capital, and other invested resources are used. But when the SEC disrupts the capital formation process because of inefficient regulations, it distorts the way that resources are allocated throughout society generally.36 Thus, the inefficiencies caused by the SEC's vigorous response to its own obsolescence may impose unusually high costs on society.

Historically, the existence of the SEC and its task of enforcing the federal securities laws could be justified on the grounds that they provided benefits and protections for the investing public. A succinct account of the original purposes of the SEC is provided by Phillips and Zecher in their classic work on the Commission.37 Public opinion had been swayed in favor of regulation by the stock market crash of 1929. After resisting pressures to regulate for several years, President Herbert Hoover finally appealed to Richard Whitney, the President of the New York Stock Exchange, to restrict trading activities and enact measures to curb the perceived manipulation of securities prices. When the New York Stock Exchange failed to enact regulatory measures on its own, a Senate investigation was launched at President Hoover's instigation. A significant amount of publicity accompanied this investigation, and numerous headlines about stock market abuses in the form of fraud, market manipulation, bucket ships, stock water-

36 Cf. Tussing, supra note 10, at 146.
37 PHILLIPS & ZECHER, supra note 31, at 8-12.
ing, and short-selling bear raids played a significant role in the 1932 presidential election between Hoover and Franklin Roosevelt.\footnote{Id. at 8.}

The 1932 election was thought to have produced a mandate for regulation. On May 27, 1933, the Securities Act of 1933\footnote{15 U.S.C. § 77 (1988).} was enacted substantially along the lines Roosevelt had suggested. The Securities Act of 1933 reflected a decision by Congress to employ a regime of mandatory disclosure to investors as the cornerstone of its regulatory philosophy. Congress thought that disclosure in the glaring light of publicity would provide investors with sufficient information to be able to make informed investment decisions that would serve to self-regulate the allocation of capital. This concept was implemented through the registration of securities . . . . The 1933 act had two basic purposes: to provide investors with sufficient material information to enable informed investment decisions and to prohibit fraud in connection with the sale of securities. The disclosure and antifraud provisions of the 1933 act remain a central focus of federal security regulation today.\footnote{Phillips & Zecher, supra note 31, at 9.}

In other words, regulatory intervention in the form of the Securities Act of 1933 was thought to have been necessitated by the fact that market forces did not generate the information that investors and other market participants need to make informed investment decisions. Congress believed that legally mandating the disclosure of corporate information would solve this problem.

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Reserve Board.45

Interestingly, regulatory authority to implement and enforce the Securities Act of 1933, whose reporting requirements fell primarily on issuing companies rather than on financial intermediaries or market makers, initially was given to the Federal Trade Commission. The Securities and Exchange Commission was not founded until a year after the Securities Act of 1933 was passed. It has been said that the only compromise given to Wall Street as a result of its "massive campaign" against the early congressional versions of the Securities Exchange Act of 1934 was that regulatory authority over the securities laws should be removed from the Federal Trade Commission to a separate administrative agency, which became the SEC.46 While it has been argued that Roosevelt "seems to have lost little when the scope and composition of the new commission is examined,"47 over time the narrower focus of the more specialized agency made it more susceptible to interest group capture by narrowing the scope and range of the agency's interests and causing the preferences of its regulatory clientele to become more homogeneous.48

It was thought that passage of the Banking Act of 1933, the Securities Act of 1933, and the Securities Exchange Act of 1934 would benefit the capital allocation process by instilling investor confidence in the banking industry and in the securities markets. Whatever the merits of this regulatory philosophy sixty years ago, times have changed. In particular, several important new technologies and recent developments in the financial markets have eroded the need for the regulations promulgated by the Securities and Exchange Commission under the auspices of the securities laws. These new technologies and market developments also have erased the historic distinctions between the securities industry and the banking industry. In fact, in today's modern global banking and securities markets, the very rules that were thought to help the process of capital formation and allocation now actually increase the costs of raising capital and harm American industry, particularly for newer, smaller firms.

In an ideal world, the formulation of regulatory policy in the financial services industry would be informed and guided by economic

46 PHILLIPS & ZECHER, supra note 31, at 10.
47 Id.
considerations. Outdated and obsolete regulations would be repealed and replaced by more relevant laws. But by now, as we all know, this is not the case. Political considerations guide and inform regulation in the financial services industry. And, as is so often the case, the political considerations that guide the regulatory process have led to substantive policies that are at best nonsensical and at worst amorally redistributive when viewed from an economic perspective.

As developed in the preceding section, it seems clear that once a regulatory agency is formed, that agency will deny that it has become obsolete and will respond to a shrinking demand for its traditional services by seeking to expand its regulatory turf into other areas. Thus, to gain a better understanding of recent regulatory trends in the financial services industry one should look not to the work of financial economists and specialists in banking and securities, but instead to the work of economists like James Buchanan, Gordon Tullock, and William Niskanen, who have used the insights of economic theory to gain a better understanding of the political process.49

It is only upon examining this public choice literature that one can understand the regulatory environment in the financial services industry. The behavior of regulators in this industry is due to exogenous economic pressures that, left alone, would result both in major changes in the structure of the financial services industry and in the need for regulation. However, these economic pressures threaten the interests of bureaucrats in administrative agencies and other interest groups by causing a diminution in demand for their services and products. In response to these threats, pressure is brought to bear for "reforms" that will eliminate the "disruption" caused by these market forces.

The net result of this dynamic is as clear as it is depressing. One observes continued government intervention in the financial markets long after the need for such intervention has ceased. Such intervention stifles the incentives of entrepreneurs to devote the resources and human capital necessary to develop new financial products and to develop strategies that assist the capital formation process by helping markets operate more efficiently.

The dynamic described above applies with great force to regulatory issues that concern the securities industry. Developments in the marketplace deeply threaten the interests of regulators by destroying

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the pretense that regulators are helping the financial markets work better.

A. Regulation of the Securities Markets

Historically, the publicly articulated justification for the securities laws was that market forces did not generate the accurate information that investors and other market participants need to make informed decisions about how to allocate capital. In particular, the complex disclosure and antifraud rules that govern the behavior of those who wish to issue securities, launch tender offers or proxy contests, or even simply to communicate with their fellow shareholders, all spring from the same basic—and outmoded—regulatory philosophy. At its core, this regulatory philosophy assumes that both issuers and investors benefit from a regulatory system of mandated disclosure.

Mandated disclosure was thought to benefit investors because it provided them with information. Disclosure was thought to benefit firms and markets by increasing the demand for securities, the basic operation of the securities markets. Three closely related economic developments have greatly diminished market demand for the core functions of the Securities and Exchange Commission. First, as financial markets have developed, they have become more efficient. In an efficient capital market, the current price of a security will be the best estimate of the future price, because the current price will "'fully reflect' all available information" about the future cash flows to the investors who own the security. Over time, securities markets have become increasingly more efficient as technology has developed and as market professionals who compete to find mispriced securities have emerged in huge numbers.

These market professionals engage in arbitrage in the form of basic research to locate overvalued securities. Arbitragers, portfolio managers, investment analysts, brokers, and industry specialists employed by investment banks "devote their careers to acquiring information and honing evaluative skills." The buying and selling by these informed investment professionals ensures that all relevant information about securities is rapidly transformed into price.

While there is some controversy in the finance literature around

the edges of the efficient capital markets hypothesis,\textsuperscript{52} there is virtually complete consensus about the fact that market forces impound information sufficiently fast that the arbitrage possibilities presented by new information disappear incredibly quickly, often in milliseconds.\textsuperscript{53} As markets have become more efficient, society's need to devote resources to support a statutory regime of mandatory disclosure designed and enforced by the SEC has disappeared. Any information that was supplied by the force of law now is supplied by the marketplace.

The economic assumptions necessary to operationalize the efficient market hypothesis are simple. Information has value. This value can be exploited for economic gain by securities traders who (1) make human capital investment in acquiring the evaluative skills necessary to identify misprized securities, and (2) engage in rivalrous competition with competing traders to implement trading strategies that provide profits to the most effective traders while simultaneously driving securities prices to their correct or efficient levels. Consequently, rivalrous competition among securities professionals drives securities prices to their efficient levels. The implications of this analysis are clear. If market forces in the form of rivalrous competition among market professionals are driving securities prices to their correct levels, then the regulatory regime of mandatory disclosure, which comprises the core of the SEC's regulatory mandate, is simply unnecessary.\textsuperscript{54}

It is true, of course, that the possibility of fraud continues to exist even in the most efficient markets. But the opportunities for manipulation and fraud are probably fewer now than at any time in history. Moreover, rules against fraud existed long before there was an SEC, and such rules are all that is needed now. Some recent scholarship in


the field of financial economics has emphasized the role played by unprofessional, uninformed, market participants—dubbed “noise traders” in the literature—whose activities are thought to play an important role in the operation of financial markets. Some have thought that the existence of these noise traders implies a role for the SEC. The notion is that if the financial marketplace is populated by two groups of traders, and one group is well informed, and the other systematically uninformed, then there might possibly be a role for the Securities and Exchange Commission in protecting these uninformed noise traders from their better-informed rivals.

There are at least three critical flaws in this analysis. The first flaw stems from the simple fact that no market participant is forced into the role of noise trader. An uninformed trader is only uninformed because he chooses not to invest the resources necessary to become informed. These resources consist of the investment of time in the human capital skills necessary to evaluate the characteristics of individual securities, and the time necessary to implement those skills.

Indeed, even those people who lack the natural endowment necessary to develop the evaluative skills necessary to become informed traders can eliminate the disadvantages caused by asymmetries in information between themselves and their better-informed trading partners. By purchasing the services of a market professional, such as a mutual fund manager or investment adviser, even smaller investors can remove themselves from the ranks of uninformed noise traders, and, for a fee, join the ranks of the market professionals. In other words, noise traders can opt out. They are noise traders because they choose to be noise traders. For investors pursuing a “buy and hold” strategy which involves acquiring a diversified portfolio of securities as long-term investments and holding them to obtain a market rate of return, it may be irrational for an investor to “rent” the services of an informed trader because the costs may be greater than the perceived benefits. Put differently, noise traders may not be acting irra-

55 See Schleifer & Summers, supra note 52, at 19.
56 See Langevoort, supra note 53.
57 Of course, there is nothing wrong with the fact that noise traders must pay a fee to avoid the consequences of uninformed trading. After all, the market professionals must invest substantial amounts of time acquiring the human capital required to become a market professional. No such investments would be made if these market professionals could not command a fee for their services.
58 Even small investors can obtain a fully diversified portfolio by purchasing shares in one of the many mutual funds that are designed to mimic broad market indexes, such as the Fidelity Market Index Fund, which mimics the performance of the Standard and Poor’s 500. There generally are no front or back end “loads” charged for investing in such funds, and the annual fees charged by investment advisers for managing such funds are extremely low.
tionally. The mere fact that noise traders systematically lose when trading against their better-informed rivals is not a sufficient basis upon which to conclude that noise traders are irrational, or that they are in need of regulatory protection.

As long as noise traders obtain a market rate of return (which they inevitably will if they own a diversified portfolio of securities and pursue a strategy of long-term investing), they cannot be considered irrational merely because their occasional forays into the marketplace cause them to sell into rising markets or to buy into falling markets. When noise traders enter the market, they do so for exogenous reasons, having nothing to do with the specific characteristics of the individual securities that comprise their portfolios. These exogenous reasons include changes in a noise trader’s individual taste for risk, changes in preferences for liquidity, or the inevitable need to adjust the ratio of investment to consumption during different phases of one’s lifetime. Clearly it is not irrational for noise traders to decline to purchase the services of investment professionals so long as the anticipated benefits from such purchases in the form of higher returns on investment is lower than the anticipated costs. These costs will manifest themselves either in the form of fees to investment professionals or in the form of the investment in human capital necessary to acquire the skills necessary to transform oneself into such a professional.

The second reason why the mere existence of noise traders does not justify the continued role of the SEC in a world of efficient securities markets stems inexorably from the first. The reason uninformed noise traders systematically lose when they trade with market professionals is that, by hypothesis, such noise traders are less informed than their trading rivals. But the reason noise traders are not as well informed as the people with whom they are trading is not that the information they need to overcome their informational disadvantage vis-à-vis their trading partners is unavailable to them. Rather, the information necessary is in the public domain. Uninformed noise traders simply choose not to invest the resources necessary to acquire it and to process it into an effective trading strategy. Put differently, the decision by noise traders to remain noise traders rather than transforming themselves into informed traders in the ways described above is identical to the decision of an ordinary consumer to patronize a convenience store rather than a discount store. The customer pays a bit more by going to the convenience store, but he saves the inconvenience of travelling to the discount store. The uninformed noise trader is not being “ripped off” any more than the convenience store shop-
per. The SEC is not necessary to "protect" uninformed noise traders any more than a regulatory agency is necessary to protect consumers who choose to shop at convenience stores.

For the past sixty years the SEC has been forcing information into the marketplace. But it cannot force people to use that information. Noise traders do not use the information that the SEC mandates issuers to disclose because it is not economical for them to use it. Unfortunately, like all market participants, noise traders must bear their pro rata costs of the regulatory burden imposed by the SEC whether or not they avail themselves of its benefits.

A final point about noise traders that generally goes unrecognized by those who would use them to justify the existence of the SEC is that the existence of a cadre of uninformed traders is essential to the proper functioning of a modern securities market. Modern securities markets are characterized by three types of traders: noise traders, whose trades are uninformed and whose demand for securities is exogenous; market professionals who invest resources to become informed about a firm's intrinsic value; and market makers or specialists who purchase and sell securities in order to clear the market and provide liquidity when there are temporary imbalances in order flow.\footnote{See Jonathan R. Macey & David D. Haddock, Shirking at the SEC: The Failure of the National Market System, 1985 U. ILL. L. REV. 315.}

Under this basic market microstructure, the existence of some noise traders whose trading is not guided by superior information is critical to the basic existence of the market. This is because the existence of market makers or specialists is necessary to supply the marketplace with liquidity. But these market makers and specialists (often called dealers) incur costs in regularizing order flow. These costs are reflected in the dealers' charges to traders, which come in the form of the distance, or spread, between the bid and asked prices that are charged for each transaction. This spread will reflect not only the costs of maintaining an inventory, including the opportunity cost of holding a nondiversified portfolio of securities, it also will include the expected losses incurred when the dealer trades with other traders.

Dealers are better informed than noise traders. Consequently, dealers will systematically profit in trades against such noise traders. In other words, if we "assume that all trading is triggered by idiosyncratic liquidity motives [i.e., noise trading] and that the dealer, accordingly, is never at a disadvantage because of an asymmetric distribution of information . . . [\textendash}\textendash] the dealer profits from the random
occurrence of liquidity transactions at the bid and the ask.\textsuperscript{60} On the other hand, when market professionals, who are better informed than the dealer, enter the market, dealers systematically will lose because informed traders (again, by hypothesis) will never conduct a trade unless they are buying at a price lower than the (soon to be revalued) value of the security or selling at a price higher than the (soon to be revealed) value of the security.\textsuperscript{61} Thus, market makers and specialists will be driven out of business if noise traders leave the market because they will lose money if their only trading partners are market professionals. Thus, noise traders are essential to a properly functioning securities market because unless some investors trade for noninformational reasons, dealers will be unable to survive as suppliers of market liquidity services.\textsuperscript{62}

Because market makers and specialists make money when trading with noise traders and lose money when trading with market professionals, these professional traders will adjust their spreads to reflect the probability that any particular trade will be with a professional, as opposed to a noise trader. The higher the expected probability of trading with a noise trader, the narrower the spread. The higher the probability of trading with a market professional, the wider the spread.

When an order to buy or to sell arrives, the dealer does not know whether it is from an informed trader [market professional] or from a liquidity [noise] trader. If it is from an informed trader, the transaction is not profitable from the dealer's point of view. The dealer therefore takes the defensive action of increasing the ask quote and lowering the bid. . . .

The dealer cannot, however, achieve total protection by sufficiently widening the spread. Regardless of how much the ask is raised and the bid is lowered, any informationally motivated trade, if it occurs, is at the dealer's expense because an informed public investor does not seek to trade unless he or she profits from the transaction.\textsuperscript{63}

Thus, ironically, the SEC ultimately would destroy the very markets it is supposed to nurture and protect if it ever were to succeed in a quixotic effort to remove noise traders from the market.

In sum then, the securities markets can be divided into three

\textsuperscript{60} ROBERT A. SCHWARTZ, THE EQUITY MARKETS 399 (1988).


\textsuperscript{62} SCHWARTZ, supra note 60, at 400.

\textsuperscript{63} Id. at 399.
structural components: (1) market makers and specialists; (2) informed traders (insiders); and (3) uninformed traders, each with distinct roles. Market makers and specialists provide liquidity services. Informed traders, known as market professionals, provide information to the market in exchange for the arbitrage profits that come from locating mispriced securities. These informed traders contribute to the allocational efficiency of the economy by insuring that the capital allocation process functions properly, thereby causing assets to flow to their highest valued uses. Finally, there are uninformed noise traders. Once we see that such traders are not systematically exploited but are essential to the very existence of the securities markets, it becomes plain that the SEC has no role in protecting such traders from abuses that simply do not exist.

The Supreme Court’s recent acceptance of the fraud-on-the-market theory in Basic Inc. v. Levinson\textsuperscript{64} gave official recognition to the fact that securities markets have come to be efficient. More importantly, the case evinced a clear understanding that securities investors trading in efficient markets do not rely at all on SEC-mandated disclosure. Instead, they rely on the efficiency of the market’s price-setting mechanisms. The increased demand for permitting securities to be sold through shelf registration of the sort permitted under Rule 415\textsuperscript{65} and the system of integrated disclosure, and perhaps most importantly, Rule 144A,\textsuperscript{66} which allows for the free trading of unregistered securities among institutional investors, also provide strong evidence of the diminution in need for SEC-mandated disclosure in a world of efficient capital markets.

The development of superior mechanisms for coping with risk also deprives the SEC of one of its primary justifications for existence. Not only does the rise of institutional investors, particularly mutual funds, enable small investors to hire sophisticated intermediaries, but these investors have acquired important tools for dealing with risk. Portfolio insurance, the emergence of a robust market in options swaps, futures, and other derivative financial products enable investors to eliminate the very sorts of investment risks that the SEC is charged with regulating. Put simply, investors’ opportunities to hedge are greater than ever before. And while these hedging opportunities are not costless, the markets are sending a pretty clear signal that they are less costly and more effective than the dubious regulatory alternative provided by the SEC.

\textsuperscript{64} 485 U.S. 224 (1988).
\textsuperscript{65} 17 C.F.R. § 230.415 (1993).
\textsuperscript{66} 17 C.F.R. § 230.144A (1993).
The emergence of significant competition among exchanges and among competing jurisdictions for the production of efficient legal rules also has contributed to the demise in demand for the services of the Securities and Exchange Commission. For example, the decision by a firm to list its securities, either on the New York Stock Exchange (or "NYSE"), or on the National Association of Securities Dealers Automated Quotations System ("NASDAQ"), or on any smaller, or regional exchanges reflects a decision to comply with the rules of that exchange. Even prior to the creation of the SEC, the New York Stock Exchange had rules requiring outside audits and the submission of balance sheets and income statements to the Exchange.\(^6\) The existence of these informal rule-making structures for exchange trading is a direct substitute for a Securities and Exchange Commission. By listing on an exchange or on an over-the-counter market, a firm makes a credible commitment to abide by a certain set of rules for the protection of investors.

The value to a firm of making such a commitment is clear. Only by making such a commitment could a firm gain access to capital at competitive prices because a failure to make an appropriate commitment to investors would send a very bad signal. The ability of exchanges to impose sanctions, such as fines or delisting, on listing firms makes the commitment associated with listing credible to outside investors. One clear advantage of securities laws promulgated by an exchange over those promulgated by the SEC is that the latter, as a monopoly, has fewer incentives to innovate and no incentives to customize its legal rules to meet the individualized needs of particular market participants. By contrast, today U.S. stock exchanges engage in vigorous competition with both domestic and international competitors for listing business. This vigorous competition provides exchanges with strong incentives to draft innovative rules that provide effective protections for investors and ensure low capital costs for issuing firms. When the SEC was created however, it was possible to argue that few firms could avail themselves of the customized, off-the-rack legal rules concerning accounting and disclosure because there were no rival exchanges of consequence, and only the largest, best capitalized firms were eligible for listing. Moreover, the New York Stock Exchange was a monopoly for many years, and, as such, it could be argued that the Exchange needed to come under government supervision in order to protect it from abusing its monopoly position.

But now the National Association of Securities Dealers (or "NASD") has emerged as a vigorous rival for the New York Stock

\(^6\) Benston, supra note 54.
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Exchange for the listings of all firms, including firms that clearly would be eligible for listing on the Big Board. Moreover, many smaller firms whose size would prevent them from qualifying for listing on the New York Stock Exchange are now eligible to be traded under the auspices of the NASD. Thus, all publicly traded firms can achieve the kind of signalling once provided by the NYSE if they so choose.

In addition, since state corporate law in the United States serves as the basic source for firms' internal rules of corporate governance, it has the potential to provide a substitute for the SEC to the extent that rules governing the issuance and trading of securities are necessary. Indeed, from 1911, when Kansas passed the first state securities law, until 1933, when the Securities Act of 1933 was passed, state law governed securities transactions. In her careful studies of the jurisdictional competition for corporate charters, Roberta Romano has shown that the vigorous competition among states for the revenues associated with state chartering for corporations not only produces more efficient corporate law rules than a national system of lawmaking would, but it also produces: (1) corporate law rules that are highly responsive to changing circumstances; and (2) a cadre of lawyers and judges with major investments in the human capital necessary to develop the expertise to maintain a sophisticated system of corporate laws in a rapidly changing business environment.

Unlike a monopolistic federal agency, states' interests in obtaining the significant revenues associated with corporate chartering drive them to craft efficient corporate law rules to attract such chartering business. Moreover,

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69 There are an estimated 55,000 publicly traded corporations in the United States. Of these, approximately 3,500 are traded on the New York Stock Exchange or the American Stock Exchange, while 4,970 are listed on the NASD's automated quotation system (NASDAQ). The remainder of the stocks are not listed on any exchange or other self-regulatory organization ("SRO"). Richard W. Jennings et al., Securities Regulation: Cases and Materials 634 (7th ed. 1992). Presumably, these firms find that the costs of listing on an exchange or SRO is too high to justify the benefits. This is certainly understandable for smaller firms, where there is insufficient trading to justify the costs of formal listing. In light of the fact that there are positive and often substantial costs to listing, it would be erroneous to conclude that a failure to list is an indication of untrustworthiness on the part of a corporation.
[e]ven if states do not have the high-powered incentives of tax revenues to compete for the chartering business of [certain] corporations [such as close corporations] they may still have an incentive to produce efficacious close corporation codes: there may be spillover effects for their public corporation business, such as developing a reputation for having a good business climate.73

Thus, even if a positive role for government in facilitating the public offering and trading of securities were still necessary or appropriate, the existence of substitutes in the form of state legislatures and private securities exchanges, both of whom have better incentives to fashion efficient rules than the SEC, suggests strongly that the SEC is no longer necessary.

A final argument for the obsolescence of the SEC comes from modern financial theory. In the years since the Roosevelt administration gave birth to the SEC, financial economists have invented portfolio theory and the capital asset pricing model, which provide investors with tools for reducing risk far superior to the bureaucratic alternative offered by the SEC.74 The lessons provided by these cornerstones of financial theory are now well known and need only be summarized here. Portfolio theory has provided a better understanding of how diversification works, not only to reduce risk, but also to eliminate certain types of risk from the investment process.75 The capital asset pricing model explains how the markets value financial assets. The basic lesson of the capital asset pricing model is that, in competitive capital markets, investors will receive expected returns commensurate to their non-diversifiable risk.76

One lesson of modern financial theory is that the risk associated with owning a portfolio of securities is not related to the particular risk characteristics of the individual securities in the portfolio. This is because investors can eliminate such risk through diversification. Rather, the risks that investors face correspond to the broader market risk. Thus, there is considerably less demand for the firm-specific disclosure rules promulgated and enforced by the SEC than once was believed.

It would indeed be surprising if the SEC had responded to the news that it had become irrelevant and unnecessary as a positive force in the capital markets by quietly going away. Instead, in the time-

73 ROMANO, supra note 72, at 25.
74 See, e.g., Harry Markowitz, Portfolio Selection, 7 J. Fin. 77 (1952) (on portfolio theory); William F. Sharpe, Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk, 19 J. Fin. 425 (1964) (on the capital asset pricing model).
75 See Markowitz, supra note 74.
76 See Sharpe, supra note 74.
honored way of bureaucrats everywhere, the SEC has responded by taking actions designed to fabricate new demand for its services. These actions predominantly involve efforts to expand its regulatory jurisdiction into new areas and to manufacture or fabricate crises. Indeed, the modern history of the SEC has been the story of a regulatory agency far more interested in inventing problems that do not exist and expanding its own jurisdiction to restore its relevance than in protecting the interests of investors or issuers.

Examples of SEC imperialism abound. Indeed, the history of the SEC over the past decade has been that of an agency seeking to find continued relevance in a changing world. The costs of that search to the public have been enormous.

B. Rule 19c-4 and Executive Pay

In 1990, the SEC lost a lawsuit brought by the Business Roundtable to challenge an effort by the Commission to intrude on the ability of the states to promulgate the rules that affect the internal governance of their domestically chartered corporations. This suit, Business Roundtable v. SEC, challenged SEC Rule 19c-4, which barred national securities exchanges and national securities associations (also known as self-regulatory organizations or SROs) from listing the stock of a corporation that takes any corporate action with the effect of nullifying, restricting, or disparately reducing the per share voting rights of existing common shareholders. Rule 19c-4 was promulgated by the SEC under the authority of section 19 of the Securities Exchange Act of 1934, which gives the SEC regulatory authority over self-regulatory organizations.

Under section 19, SROs must submit any proposed changes in their rules to the SEC, which must then approve the proposal if it is found to be consistent with the requirements of the Exchange Act and the regulations thereunder. By forcing a standardization of the rules regarding disparate voting rights, the SEC tried to use its authority to eliminate competition among exchanges and states regarding the legality of one-share, one-vote voting requirements. The SEC took the position that the statutory language of section 19(c) provided the agency with the authority to enact Rule 19c-4. This statutory lan-

77 905 F.2d 406 (D.C. Cir. 1990).
79 Id.
81 See id. at 26,381-82.
language gives the Commission the power to amend the rules of an SRO, in the absence of a proposal by the SRO, where the change is “necessary or appropriate” to insure the fair administration of the SRO, or for reasons “otherwise in furtherance of the purposes” of the Exchange Act. In particular, the SEC argued that it enacted Rule 19c-4 in order to better regulate the corporate proxy process by helping to “ensure fair shareholder suffrage.”

The Business Roundtable case represents a high point in SEC imperialism. In a single stroke the Commission sought simultaneously: (1) to quash the ongoing battle among the exchanges regarding the legality of dual class voting stock (which was the primary vector along which competition among the exchanges was taking place at the moment); and (2) to assert its ability to supersede traditional state law prerogatives to govern in this area. Throughout the litigation, the SEC took what the United States Court of Appeals for the District of Columbia Circuit characterized as the “surprising” position that it retained regulatory authority over virtually all of the internal affairs of U.S. corporations including requirements for independent directors and independent audit committees, shareholder quorums, shareholder approval for certain major corporate transactions, and other matters traditionally governed by state law. The Court of Appeals declined to give the SEC authority to usurp the traditional authority of the states to regulate the internal affairs of corporations, and vacated Rule 19c-4.

A similar criticism can be levelled against the SEC’s efforts to intervene in the internal management of corporations by forcing corporations to disclose clearer and more detailed information about compensation of top executives. The new SEC rules require corporate boards of directors, the group responsible under state law for compensation decisions, to disclose the reasoning behind their decisions, and to provide graphical comparisons of a company’s stock performance with that of the rest of the industry.

While the new rules regarding compensation may properly be viewed as mere palliatives, since they do not alter the ability of firms to pay whatever compensation they deem appropriate, the SEC made it clear that it took the substantive view that executive compensation

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83 Id. at 410.
84 See Fischel, supra note 70 (discussing the value of competition among exchanges and with the over-the-counter market in this context).
85 See Business Roundtable, 905 F.2d at 412.
86 See id. at 416-17.
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was too high. In defense of the new disclosure obligations, then SEC Chairman Richard Breeden told reporters the story of a corporation's chief executive officer who was awarded stock options that will be worth $219 million in ten years if the company's stock performance merely keeps pace with the return on U.S. government securities.

The new rules regarding executive compensation represent not only another attempt by the SEC to intrude on state lawmaking power, they also reflect an effort to make a highly visible appeal to popular sentiment during an election year when populist sentiment was running high. Such an appeal, however ill-advised, is perfectly consistent with the predictions made in this Article regarding the behavior of an administrative agency confronted with obsolescence.

C. Turf Wars with the CFTC

The litigation over Rule 19c-4 and the executive compensation controversy are only the most recent in a series of disputes brought about by the SEC's efforts to expand its regulatory turf. Despite the fact that the Commodities Futures Trading Commission ("CFTC") has "exclusive jurisdiction" over futures contracts under the Commodities Trading Act, the SEC has taken the position that futures contracts involving securities are subject to the jurisdiction of the SEC. Similarly the SEC has taken the position that trading in futures contracts on Government National Mortgage Association ("GNMA") certificates and Treasury bills is subject to SEC approval and not that of the CFTC. Similar disputes have taken place over the issue of who has regulatory authority over trading of stock index participation instruments.

As noted above, such disputes over turf are a classic symptom of regulatory obsolescence. And, while turf wars are common for all agencies at various times in their existence, what is striking about the SEC's experience with turf wars in recent years is how frequently they occur, and how central they are to the Commission's regulatory agenda.

88 Id. at A18.
91 Stock index participation instruments are contracts of indefinite duration based on the value of an index or a basket of securities in which the seller promises to pay the buyer the value of the index as determined on a previously agreed upon "cash out day." See Kurt Eichenwald, U.S. Weighs Role Shifts for Market Regulators, N.Y. TIMES, Dec. 5, 1989, at D2. 92 See supra p. 914.
D.  *Turf Wars Against Regulators of Banks and Broker-Dealers*

The SEC has also fought battles in recent years with the Comptroller of the Currency over the issue of whether it had regulatory authority over commercial banks' activities as broker-dealers. This controversy arose when the Comptroller began to allow national banks to offer discount brokerage services to the public.93 Another example of the SEC's efforts at turf grabbing involves the Commission's efforts to grab regulatory authority over the U.S. government securities markets away from that market's primary regulator, the Department of the Treasury, in the wake of the recent unpleasantness in the primary market for those securities.94 The SEC's ill-fated attempts to assert regulatory authority in all of these areas represented the grasping attempts of an agency without a purpose seeking to hold onto its budget. Here a bill, strongly supported by the SEC, which would have given the Commission greater powers to regulate the government securities market against perceived “manipulation” was voted down in Congress on the grounds that it was “restrictive and unnecessary.”95

Clearly the Department of the Treasury, the agency responsible for financing the federal government's budget deficit, and which issues U.S. government securities, should have regulatory authority over the initial sale and subsequent trading of government securities, since it is the agency with the strongest incentives to have that market operate fairly and efficiently. The SEC, by contrast, has no claim of expertise to regulate the securities issued by the U.S. government since these securities are free of credit risk, and thus not in need of any benefits that the SEC's pro-disclosure regulatory regime might offer. Similarly, the SEC's efforts to expand its regulatory authority by requiring government-sponsored agencies, such as the Federal National Mortgage Association, to register their stock and debt securities with the SEC in the same manner as public companies can only be described as an effort to expand the Commission's own power in light of the lack of need for further disclosure from such agencies.96

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E. Loan Participations

Still another manifestation of the SEC's relentless efforts at turf expansion concerns the Commission's efforts to cause loan participations sold by commercial banks to be characterized as securities, so that these investment instruments—and the banks that issue them—would fall under the SEC's regulatory jurisdiction. The Securities and Exchange Commission filed an amicus brief in Banco Espanol de Credito v. Security Pacific National Bank,\(^97\) arguing that loan participations were securities and thus subject to rescission benefits of section 12(2) of the Securities Exchange Act of 1933.\(^98\)

As the name implies, a loan participation involves the sale of a stake in a loan from the commercial bank originating the loan to other financial institutions or individuals. Loan participations permit the primary lender to reduce the risks associated with a particular loan, and allows other investors to reduce the search costs associated with finding investment vehicles for excess funds.

Often, as was the case in Banco Espanol, the originating bank assumes no responsibility to purchasers of loan participations if the borrower's ability to make repayment on the loans were to become compromised. In Banco Espanol, when the borrower began defaulting on its loans and entered bankruptcy, prior purchasers of loan participations brought suit contending that the loan participations were securities within the meaning of the Securities Act of 1933. The contention that the loan participations were securities permitted the plaintiffs to claim that they were entitled to rescind their purchase agreements under section 12(2) of the 1933 Act.\(^99\)

The Securities and Exchange Commission filed an amicus brief in the litigation on behalf of the plaintiff banks.\(^100\) If the court had sided with the plaintiffs and with the SEC in Banco Espanol, it would have succeeded in extending its regulatory authority beyond the realm of the securities industry and far into the commercial banking industry. In light of the vigorous competition in the United States between the commercial banking industry and the securities industry,\(^101\) obtaining regulatory authority over a portion of the commercial banking industry would have had the effect of strengthening dramatically the Com-

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\(^97\) See 973 F.2d 51 (2d Cir. 1992).
\(^99\) See Banco Espanol, 973 F.2d at 54 (citing section 12(2) of the 1933 Act, 15 U.S.C. § 77l(2) (1988)).
\(^100\) See id. at 52-53.
mission's ability to serve its traditional clientele, the investment banking industry. This newfound ability to provide benefits to its powerful clientele would have provided a valuable new source of political support for the Commission.

The United States Court of Appeals for the Second Circuit affirmed the district court's grant of summary judgment against the SEC and the plaintiffs and in favor of the defendant issuing bank. The opinion represents a major defeat for the SEC in its relentless efforts to expand the scope of its regulatory turf into other areas. The decision is important because traditionally judges have viewed the imposition of regulatory authority as providing benefits to market participants without any concomitant burdens. In fact, allocating regulatory authority to the SEC over a particular investment vehicle does impose costs on market participants. These costs come in the form of higher transaction costs, as trading becomes more expensive due to increased regulatory burdens and greater risk of legal liability; higher barriers to entry, as the fixed costs of entering the securities business increase when the SEC obtains regulatory authority; and less innovation, because such innovation not only brings with it litigation risks under securities law, but also requires costly regulatory approvals from the Commission.

Thus, the opinion in Banco Espanol reflects the fact that the SEC has lost considerable prestige in recent years. While lawyers and judges may not be fully cognizant of all of the technical reasons for the decline in society’s need for the SEC’s regulatory services, they are quite capable of understanding the effects of the regulatory burden imposed by the SEC on capital formation and entrepreneurship. For its own part, the SEC took a considerable gamble in Banco Espanol by risking its prestige in a rather shameless effort to expand its regulatory turf. The effort was particularly unseemly in light of the fact that the Comptroller of the Currency, which has regulatory authority over national banks such as the defendant in Banco Espanol, previously had issued detailed policy guidelines governing the sale of loan participation. Thus, as the Second Circuit observed, the existence of an alternative regulatory scheme “indicated that application of the securi-

102 Banco Espanol, 973 F.2d 51.
104 Judge Oakes's dissent in Banco Espanol reflects this traditional approach (“[T]he majority opinion . . . makes bad banking law and bad securities law . . . .”). See Banco Espanol, 973 F.2d at 56 (Oakes, J., dissenting).
105 See id. at 55.
ties laws [and hence the SEC] was unnecessary."\textsuperscript{106}

F. Proxy Reform

The SEC recently promulgated important rules that reform the proxy system in order to make it easier for institutional investors to communicate with one another.\textsuperscript{107} In addition to the new disclosures regarding executive pay described above,\textsuperscript{108} these rules make it easier for institutional investors to communicate with one another for the purpose of affecting corporate policy. The new rules will allow shareholders to vote for a combination of management nominees and outside challengers in board elections. Under prior rules, shareholders were required to oppose the entire management slate if they wanted to vote for a single rival. Similarly, the new rules allow shareholders to oppose a single proposal within a proxy statement without being forced to oppose the entire package of management proposals.

In addition, the new rules permit shareholders for the first time to publish their views about a company in the press or the media without prior approval by the SEC. Prior rules, which were generally regarded as "cumbersome and costly,"\textsuperscript{109} forbade shareholders to communicate with more than ten other shareholders without getting advance clearance from the Commission.\textsuperscript{110} As John Pound has pointed out, prior SEC rules were so restrictive that they had a clear chilling effect on investors who wished to bank into an effective political coalition to monitor and influence management behavior.\textsuperscript{111} The SEC, for example, refused to allow a dissident shareholder to argue that his company should spend more money on research and development on the ground that the dissident shareholder did not have a reasonable basis for knowing the "right" level of such expenditures.\textsuperscript{112} The SEC even had forbidden firms from asserting that a candidate for a firm's board of directors is "highly regarded" on the grounds that the firm did not supply any supporting documentation for its assertion.\textsuperscript{113}

While the recently enacted reforms to the proxy system do no

\textsuperscript{106} Id.
\textsuperscript{108} See Hilzenrath, supra note 87 and accompanying text.
\textsuperscript{112} Id.
\textsuperscript{113} Id.
damage to the corporate governance and capital formation processes, they do not do much good either because they do not go nearly far enough in encouraging market forces to affect corporate governance.  Proxy battles are a poor substitute for hostile takeovers as mechanisms for controlling the agency costs that are a natural by-product of the separation of ownership and management in the large, publicly-held corporation because the market for corporate control is a far more efficient corporate governance device than the proxy contest system. This is because the gains from winning a proxy contest must be shared with all of the shareholders in the firm that is the subject of the proxy battle, while a takeover entrepreneur can capture all of the gains associated with a successful takeover. Consequently, when an investor identifies an undervalued firm, that investor will prefer to launch a takeover rather than mount a proxy contest, all else equal. The reason so much attention has been focused on the proxy system is that the market for corporate control has been destroyed by a combination of ill-considered regulations, including the Williams Act, which requires parties to disclose their intentions and qualifications before making a tender offer.

If the SEC were interested in furthering the public interest rather than its own regulatory agenda, it would petition Congress to repeal the Williams Act and to preempt the confiscatory state antitakeover statutes that undermine the market for corporate control. At the same time, publicly-held corporations should be permitted to design whatever internal rules of corporate governance they wish. The firms that want to make outside takeovers more difficult, either by imposing share-transfer restrictions or otherwise, should be free to do so. As takeovers become more costly, the probability that such a takeover will occur goes down. Thus, each firm's shareholders face a tradeoff between maximizing the probability of a takeover occurring and maximizing the premium they will receive should such a takeover occur. This decision should be left to the shareholders of each firm to decide for themselves.

Finally, the revisions of the proxy rules that recently were enacted do not go nearly far enough in facilitating the role that institu-

114 Only with the decline of activity in the merger and acquisition market, primarily caused by the imposition of tough state antitakeover legislation and the decline in sources of financing for such transactions, has the proxy mechanism emerged as an alternative to mergers and hostile takeovers as methods for registering dissatisfaction with firm performance or behavior. See Philip C. Berg, The Limits of SEC Authority Under Section 14(a) of the Exchange Act: Where Federal Disclosure Ends and State Corporate Governance Begins, 17 J. Corp. L. 311, 312-13 (1992).

tional investors play in corporate governance. As Mark Roe pre-
sciently observed, a few rather obscure rules, when taken together,
effectively deprive institutional investors of an effective voice in mat-
ters of corporate governance. Under the Glass-Steagall Act, banks are forbidden from owning stock or affiliating with investment banks that can own stock. Under the Bank Holding Company Act, bank holding companies cannot own control blocks in companies not closely related to banking. The Investment Company Act of 1940 imposes severe taxes and regulations on the entire portfolio of mutual funds that own blocks of stock that account for ten percent or more of the shares of public companies. Finally, a series of state laws restrict the ability of insurance companies to obtain a controlling interest in public companies. For example, under New York law, life insurance companies can invest no more than two percent of their assets in the stock of a single issuer. Forty other states have similar limitations. Thus, virtually all institutional investors with the resources to acquire enough stock to have a meaningful voice in the affairs of the public companies in which they have invested are deterred from doing so by some law or other. The result is that management of the American public corporation has been separated from ownership far more than would be the case if market forces were permitted to operate unconstrained by regulation.

G. Penny Stock Reform Act of 1990

While most of the above examples describe efforts by the SEC to expand its own bureaucratic turf by engaging in agency imperialism, the Penny Stock Reform Act of 1990 illustrates other manifestations of agency obsolescence discussed earlier. These manifestations include the distortion of information flow to the public and the manufacturing or fabrication of a crisis in order to create the impression

116 Mark Roe, Political and Legal Restraints on Ownership and Control of Public Companies, 27 J. Fin. Econ. 7 (1990).
that there is a need for the regulatory agency's services when, in fact, none exists.

Penny stocks are equity securities, generally in highly risky or speculative companies, that trade at low prices in the over-the-counter market. The Penny Stock Reform Act of 1990 pitted one group, entrepreneurs in start-up companies, which has little political power and almost no access to the SEC, against powerful constituents of the Commission, namely the organized exchanges and the NASD.

On the bizarre grounds that speculative, high-risk stocks require greater regulation than other stocks because they impose greater risks, the Penny Stock Reform Act established a system for more disclosure and regulatory oversight for the operation of the penny stock market in the wake of claims of widespread abuses by traders in that burgeoning market. In particular, the Penny Stock Reform Act required dealers in penny stocks to disclose to customers details of the firm's compensation arrangement for broker-dealers before executing a penny stock transaction.\(^{122}\) The Act also requires the preparation of a "risk disclosure" document detailing the level of risk associated with a penny stock investment,\(^{123}\) and that broker-dealers disclose the bid and ask prices for the stock or comparably accurate and reliable pricing information if bid and ask prices are not available.\(^{124}\) The Act further requires broker-dealers selling penny stocks to supply investors with monthly statements of the market value of their stock.\(^{125}\) The SEC additionally requires broker-dealers selling penny stocks to issue potential clients a suitability statement containing a determination by the broker that a particular transaction is appropriate for the investor in light of his finances and investment goals.\(^{126}\)

The Act also mandates the development of an automated quotation system for penny stocks. This system will collect and distribute information about penny stocks in a more systematic way than previously had been done in order to improve the quality of regulatory surveillance, and to enable market participants to comply with the SEC's new regulatory requirements.\(^{127}\)

The Penny Stock Reform Act and the accompanying rules promulgated by the SEC to implement the Act will have the effect of impeding the ability of small businesses to raise capital. It will benefit entrenched SEC constituencies by curbing the migration of order flow

\(^{126}\) 17 C.F.R. § 240.15g-100 (1993).
away from the organized exchanges and towards the relatively unregulated over-the-counter markets. The differential regulatory burdens on broker-dealers specializing in penny stocks creates a barrier to entry for new investment banking firms attempting to enter the market by specializing in emerging, high-risk firms.

The lack of information about penny stocks and the low trading volume in such stocks will make it extremely difficult, if not impossible, to comply with the terms of the Act. For example, there are clear economies of scale associated with the use of automated quotations systems: the greater the volume of trading activity, the lower the per trade cost of such a system. The requirement that penny stocks use automated quotation systems is nonsensical in light of the fact that the low volume of trading activity in such stocks renders such systems uneconomical. Similarly, the lack of trading activity in penny stocks will make it exceedingly difficult to comply with the requirement that customers get accurate information about bid-asked spreads and monthly price information. For thinly traded, illiquid companies, such information may simply be impossible to obtain. The reason that penny stocks are highly speculative, indeed, the reason that they are penny stocks, is because the market lacks as much information about such stocks as it has about other stocks. The reason the market lacks such information is because it is inefficient, that is, too costly, for market participants to produce such information. The fact that penny stocks were cheap is a strong indication that investors who traded in such stocks were not being ripped off: the low prices reflected the high risks associated with such stocks, including the risks associated with a systematic lack of information about such stocks.

In its efforts to obtain stricter regulation of the penny stock market the SEC made much use of anecdotal evidence concerning investor abuses in that market, which created genuine fear that a major crisis existed in the nation's securities markets, despite the fact that investors in penny stocks already were protected by a host of state and federal antifraud rules, including SEC Rule 10b-5.\(^\text{128}\) The House Committee Report explaining the purpose and scope of the Penny Stock Act was frank in its realization that the new legislation might kill the penny stock market. The Committee Report noted that

\[\text{[a]ny contributions that the penny stock market, as it presently operates, makes to the economy, must be weighed against the significant economic consequences of the penny stock market's diversion of $2 billion, which would otherwise be invested in the creation and expansion of legitimate small businesses. Equally distressing is}\]

the loss of investor confidence in the marketplace.\textsuperscript{129}

Of course, there is no indication of why firms that fund themselves through the issuance of penny stocks are less legitimate than other small business. Nor is there any realization of the irony behind a report that simultaneously justifies a statute to control a market so successful at raising capital that it is diverting too many resources from other industries, yet expresses concern about the lack of investor confidence in the marketplace.

The Commission's successful efforts to regulate penny stocks provide a classic example of an administrative agency seeking to create a demand for its own existence by turning an industry into a cartel, thereby establishing that industry as a major source of political support for the agency. The SEC's efforts on behalf of the Penny Stock Act provided a major service to the established firms and exchanges by eliminating their fastest growing competitors—start-up brokerage firms and market makers providing capital and liquidity to firms issuing penny stocks.

\textbf{CONCLUSION}

The picture that emerges from all of this is one of the SEC as a highly politicized organization intent on preserving its own bureaucratic turf despite the mounting evidence of its own obsolescence and irrelevance. The SEC's major litigation efforts and regulatory initiatives have been designed to protect the Commission's regulatory turf, rather than to further important areas of public policy.

By now it is well known that political expediency, not economic rationality, often drives the policy-making process in Washington. What is less well understood is how the economic forces that drive markets alter the preferences of the bureaucrats and the firms they regulate. Clearly most, if not all, administrative agencies exhibit the qualities described here as providing the hallmarks of regulatory obsolescence. All agencies will engage in imperialism in the form of "turf-grabbing"; will succumb to "capture" by special interest groups; will distort information flow to the public to serve their own interests; and will manufacture or fabricate crises. What may be different about the SEC is the fact that with the Commission in recent years, this sort of behavior has not been simply random or opportunistic, but has been a defining characteristic feature of the SEC. As Edward H. Fleishman,

a former SEC Commissioner pointed out shortly after resigning from the Commission:

The Securities and Exchange Commission has all but extinguished the deregulatory attitude prevailing when I arrived in 1986, and the self-restraining and self-critical faculties that are essential to any agency serving the public interest. Since early 1990, the S.E.C. has turned toward expansion of its jurisdiction and toward imposition of regulatory solutions for market problems that have no signs of developing.\footnote{Edward H. Fleischman, \textit{The S.E.C. Must Keep on Deregulating}, N.Y. TIMES, Apr. 12, 1992, § 3, at 15, col. 2.}

The purpose of this Article has been to shed some light on the reasons for this dramatic change in attitude by the SEC. While regulators of other financial intermediaries, such as banks, have continued to engage in the strategies of risk avoidance and opportunistic imperialism typical of regulatory agencies, the SEC has engaged in a wholesale campaign of imperialistic turf expansion. The rationale is that the banking crisis has provided a continued public interest justification for the bank regulatory agencies that saves them from concerns about their own obsolescence. By contrast, the market forces and exogenous technological changes catalogued in this Article have obviated any public interest justification for the SEC that may have existed. Unlike these other agencies, the SEC must now search for a new clientele, and seek to provide existing clients with new reasons for supporting its existence.