Encasing Markets: How the Securities Brokerage and Fossil Fuel Industries Are (Mis)using Disclosure to Exploit Investors and Markets, Deflect Attention From Abusive Business Practices, and Block Reform

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Abstract. Protecting investors (and markets) through mandatory disclosure is a bedrock principle of federal securities regulation, especially the Securities Act of 1933 and the Securities Exchange Act of 1934.The wisdom of this approach has long been a subject of debate. Supporters of mandatory disclosure argue that disclosure rules are an efficient and effective response to market failures. Critics argue that disclosure requirements are wasteful and unnecessary, as market incentives will ensure optimal levels of disclosure.

In this article, I reframe disclosure discourse by layering in (i) research from the behavioral sciences concerning investor, issuer, and intermediary behavior; and (ii) recent scholarship by historians and social scientists examining how market fundamentalists have created a political climate in which "the magic of the marketplace" reigns supreme as a matter of regulatory philosophy and policy, and substantive regulation is seen as an assault on freedom. Drawing upon this expanded context, I argue that while disclosure is a useful regulatory tool, relying on disclosure to solve structural conflicts of interest and market failures reflects an overconfidence in markets that is undermining broader legislative goals. I explore this dynamic through two case studies—one involving financial intermediaries' embrace of regulatory disclosure as a means of fending off a fiduciary conduct standard for investor recommendations; and the other involving fossil fuel companies' embrace of climate risk disclosure rules as a means of fending off substantive climate-risk informed regulation of their business practices. Though far from the only examples of my thesis at play, these two case studies present paradigmatic real-world instances of how powerful actors, when faced with consequential reform initiatives that pose risks to their business models, are weaponizing compliance with disclosure regimes to virtue signal, deflect attention from problematic business practices, and block needed reforms.

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To address financial intermediary (mis)use of regulatory disclosure, I recommend that we bolster '33 and '34 Act regulatory disclosure by enacting a uniform, robust, non-waivable fiduciary standard for all financial intermediaries when they provide advice or make recommendations to retail investors. Adding a fiduciary standard for retail investor recommendations would better protect retail investors—a key legislative objective of the '33 and '34 Acts—while preserving investor autonomy and avoiding regulatory overreach.

To address fossil fuel company (mis)use of climate risk disclosure, I expose fossil fuel industry doublespeak on climate and disclosure and recommend coordinating disclosure rules with insights and regulatory strategies drawn from climate science, environmental law and regulation, and stakeholder dialogue concerning the costs and impacts of climate change. This would enhance the ability of securities markets to factor climate risk into securities pricing while reducing the risk that fossil fuel companies will use compliance with disclosure regimes to block substantive reform.

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Introduction

When Congress enacted the Securities Act of 1933 ('33 Act) and the Securities and Exchange Act of 1934 ('34 Act) (collectively "the Acts"), it established investor protection as a key legislative objective, and disclosure as the lynchpin of the Acts' investor and market protection regimes.[1] There were two considerations underlying this approach.[2] First, the Acts' architects opposed federal merits regulation,[3] believing instead that the federal government should ensure access to material facts via mandatory disclosure rules so that investors could make their own informed decisions. Second, drawing upon Louis Brandeis' sunshine-as-disinfectant theory, the Acts' architects believed that mandatory disclosure would have the added benefit of shaming market participants into abandoning sharp practices, thereby elevating standards of conduct in the investment industry.[4]

Ninety years later, disclosure is still the "organizing principle,"[5] "keystone,"[6] and "primary tool"[7] of federal securities regulation in the United States, so "well established" that it is "generally regarded as the appropriate or inevitable method of regulating corporate finance."[8] Over and over again, "disclosure, again

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1. *See e.g.*, SEC. & EXCH. COMM'N, REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS. PT. 3, H.R. DOC. NO. 88-95, at 1 (1963) [hereinafter SPECIAL STUDY] (referring to disclosure as "[t]he keystone of the entire structure of Federal securities legislation."); THE WHEAT REPORT. DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS 10 (1969) [hereinafter THE WHEAT REPORT] ("Disclosure is and has from the outset been a central aspect of national policy in the field of securities regulation."). *See also* Andrew Schwartz, *Mandatory Disclosure in Primary Markets* Vol. 5 UTAH L. REV. 1069, 1070 (2019); Allen Ferrell, *The Case For Mandatory Disclosure In Securities Regulation Around the World*, 2 BROOK. J. CORP. FIN. & COM. L. 81 (2007).
2. THE WHEAT REPORT, *supra* note 1, at 10.
3. Merits regulation would allow government officials to condition the offer or sale securities upon an assessment of investment merit. For example, merits regulation at the state level "gives a state, through its blue-sky commissioner, the authority to prevent an issuer from selling its securities in that state when the offering or the issuer's capital structure is substantively unfair or presents excessive risk to the investor." Roberta S. Karmel, *Blue-Sky Merit Regulation: Benefit To Investors Or Burden On Commerce?* 53 BROOKLYN L. REV. 105 (1987).
4. *Id. See infra* notes 86-90 and accompanying text.
5. Allen Ferrell, *Mandatory Disclosure and Stock Returns: Evidence From the Over-the-Counter Market*, 36 J. LEGAL STUD. 213 (2007).
6. SPECIAL STUDY, *supra* note 1, at 1.
7. Stephen J. Choi & Adam C. Pritchard. *Behavioral Economics and the SEC*. 56 STAN. L. REV. 1. 71 (2003) ("Disclosure is the primary tool of the present U.S. securities regulatory regime.").
8. J. Seligman, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 40 (2003). *See also* Schwartz, *supra* note 1, at 1069 ("Mandatory disclosure—the idea that companies must be required

disclosure, and still more disclosure" remains the default regulatory strategy for protecting investors and markets from fraud and abuse.[9]

The wisdom of this approach has long been a subject of debate. Supporters of mandatory disclosure argue that disclosure requirements are an efficient and effective response to market failures—specifically, agency costs and the persistent underproduction of information by issuers and other stakeholders.[10] Critics argue that disclosure requirements are "wasteful, or at least unnecessary" as market incentives will ensure optimal levels of disclosure.[11] Other scholars question the focus on *investor* disclosure, arguing that we ought to acknowledge explicitly the importance of disclosure for non-investor audiences.[12]

In this Article, I reframe this discourse by layering in two bodies of research and scholarship; *i.e.*, (i) research from behavioral sciences concerning retail investor, issuer, and intermediary behavior, and (ii) insights from historians and social scientists examining how market fundamentalists have created a political climate in which "the magic of the marketplace" reigns supreme as a matter of regulatory philosophy and policy, and substantive regulation is seen as an assault on freedom and broader economic goals.[13] Drawing upon this expanded

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by law to disclose certain information to the investing public—is the foundation of modern securities law, both for *primary markets*—where companies offer securities directly to investors—and for *secondary markets*—where investors trade securities with one another.")

9. Louis Loss et al., SECURITIES REGULATION 8 (2004). For an overview of the mandatory disclosure approach of the federal securities laws, *see* Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation,* 81 WASH. U. L. Q. 417, 421-30 (2003). *See also* Frank H. Easterbrook & Daniel Fischel, *Mandatory Disclosures and the Protection of Investors*, 70 VA. L. REV. 669 (1984) ("The securities laws . . . still have two basic components: a prohibition against fraud, and requirements of disclosure when securities are issued and periodically thereafter.").

10. Schwartz, *supra* note 1, at 1070-71. *See also* Ferrell, *supra* note 1, at 81-82 ("Proponents of mandatory disclosure have . . . argu[ed] that the information related by firms generates important informational externalities. One such informational externality that has received significant attention is the possibility that firm disclosures may improve the stock price accuracy of firms other than the disclosing firm. Given that firms will not consider these externalities when deciding which pieces of information to disclose, it is argued that a mandatory disclosure regime can be socially beneficial.") (citations omitted).

11. Schwartz, *supra* note 1, at 1070; Ferrell, *supra* note 1, at 81-82.

12. Ann M. Lipton, *Not Everything Is About Investors: The Case For Mandatory Stakeholder Disclosure* 37 YALE J. LEGIS. 499 (2020). *See also* Hillary A. Sale, *Disclosure's Purpose*, 107 GEO. L. J. 1045, 1046 (2019) ("Although investor protection is the disclosure goal often touted, this Article develops the purposes of disclosure extending beyond investors to issuers and the public . . . Disclosure's purpose, then, is to diminish asymmetries and the space for fraud, both for those within the entity and for the public affected by the entity.")

13. Naomi Oreskes and Erik M. Conway, THE BIG MYTH: HOW AMERICAN BUSINESS TAUGHT US TO LOATHE GOVERNMENT AND LOVE THE FREE MARKET 1 (2023). *See also infra* Section V.B. for a discussion of encasement theory.

context, I argue that, while disclosure is an important tool for addressing matters of regulatory concern under the '33 and '34 Acts, relying on disclosure alone to address structural conflicts of interest, fix failed systems, or to drive substantive regulatory reform reflects an overconfidence in markets that is undermining broader legislative goals. I further argue that powerful stakeholders are leveraging this dynamic, and weaponizing disclosure regimes to virtue signal, deflect attention from problematic business practices, and block needed reforms.

To this end, I center three specific market participants in this work—(i) retail investors[14] making individual investment decisions; (ii) non-fiduciary financial intermediaries[15] who assist retail investors with their investment activity; and (iii) fossil fuel companies working to shape climate risk disclosure rules. I chose these market participants for several reasons. First, each is a doctrinally, politically, and economically important subset of the investor-intermediary-issuer relationships and communities that lie at the heart of federal securities regulation. Second, both non-fiduciary financial intermediaries and fossil fuel companies are facing consequential regulatory reform initiatives that implicate core aspects of their business models and the proper role of disclosure in regulatory systems. For intermediaries, these reform efforts concern the conduct standard in play when making investment recommendations to retail investors. For fossil fuel companies, reform efforts include the Securities and Exchange Commission's ("Commission" or "SEC") proposed climate risk disclosure rules. Third, and relatedly, although seemingly worlds apart, non-fiduciary intermediaries and fossil fuel companies are (mis)using '33 and '34 Act regulatory disclosure in similar ways in connection with these reform initiatives, thereby exposing shared vulnerabilities in the current regime. These market participants and associated case studies thus

14. In 2019, the Securities and Exchange Commission adopted Regulation Best Interest, which defines retail customer as "a natural person, or the legal representative of such natural person, who: (i) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) Uses the recommendation primarily for personal, family, or household purposes." 17 C.F.R. § 240.15l-1(b)(1). As this suggests, the term retail investor traditionally has been used to refer to individual investors who purchase and sell securities for their own accounts. *E.g.*, Mary Jo White, Chair, Sec. Exch. Comm'n, Speech before the Consumer Federation of America (Mar. 21, 2014), https://www.sec.gov/news/speech/mjw-speech-032114-protecting-retail-investor [https://perma.cc/J57P-KZWG] ("[W]e are both focused on protecting the consumers in our securities markets—especially the individual investors, who we often refer to as 'retail' investors—who invest their own money to save for retirement, or to buy a home or to send their children to college. The retail investor must be a constant focus of the SEC—if we fail to serve and safeguard the retail investor, we have not fulfilled our mission.")

15. As set for the below, I focus on so-called broker dealers—stock brokerage firms in common parlance—as they traditionally (and still today) do not owe true fiduciary duties to investors.

provide timely, direct, and important examples of how the theory and dynamics discussed herein function in practice. In so doing, they highlight the urgent need for regulatory reform around '33 and '34 Act disclosure, given the risks and costs associated with investor abuse and climate change.

Then, with these issues and concerns in mind, I interrogate how these cohorts are engaging with the '33 and '34 Act regulatory disclosure regime:

- Do the rationales for investor protection through mandatory disclosure reflected in the '33 and '34 Acts line up with how retail investors, their financial intermediaries, or issuers behave in real life? If not, what is the "on the ground" reality for retail investors when it comes to investor protection?
- What is the proper role for '33 and '34 Act regulatory disclosure when it comes to issues such as climate change, where causes and consequences extend far beyond the issuer-intermediary-investor relationships that lie at the heart of federal securities regulation?
- Are non-fiduciary financial intermediaries and fossil fuel companies co-opting vulnerabilities in regulatory systems, and potentially (mis)using the '33 and '34 Act disclosure regimes, in ways that are undermining the goals and objectives of the '33 and '34 Acts?

As set forth below, this inquiry reveals deep disconnects between the assumptions and regulatory bets underlying the '33 and '34 Act disclosure regimes and how these regimes operate in real life. These disconnects, in turn, show how and why excessive reliance on '33 and '34 Act regulatory disclosure is vulnerable to misuse, and how and why financial intermediaries and fossil fuel industries have been exploiting these vulnerabilities to their advantage.

The first disconnect involves retail investors and their non-fiduciary financial intermediaries. The '33 and '34 Act disclosure regimes are based upon traditional tenets of financial economics; they assume that investors are rational, and that rational, well-informed investors operating in efficient markets will make wealth-maximizing investment decisions.[16] To the extent

16. Andreas Fuster, David Laibson & Brock Mendel, *Natural Expectations and Macroeconomic Fluctuations*, 24 J. ECON. PERSP. 67, 68 (2010) ("The rational agent of standard economic models is assumed to use all available information in order to make statistically optimal forecasts."); *see also* Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism,"* 151 U. PENN. L. REV. 1211, 1214-15 (2003) (noting most economists would agree full rationality encompasses the following basic components: (i) "people have well-defined preferences (or goals) and make decisions to maximize those preferences;" (ii) "those preferences accurately reflect (to the best of the person's knowledge) the true costs and benefits of the available options;" and (iii) "in situations that involve uncertainty, people have well-formed beliefs about how uncertainty will resolve itself, and when new information becomes available, they update their beliefs using . . . the presumed ability to update probabilistic assessments in light of new information").

that investors lack the training, acumen, or temperament to make wealth-maximizing decisions on their own, the '33 and '34 Acts place the burden of education upon the investor.

The problem is investors are not fully rational, even when they have access to disclosure materials or help from intermediaries.[17] Further, instead of filtering information for retail investors or correcting investor misperceptions, intermediaries have incentives to exploit investors' imperfect rationality and to weaponize disclosure in order to profit from investor mistakes.[18] To bridge the disconnect between the rational actors of economic theory and considerably messier on-the-ground realities, I propose to amend the '33 and '34 Acts and accompanying regulations to require all financial intermediaries (including broker-dealers) to comply with a robust, uniform, and non-waivable fiduciary standard when providing advice or recommendations to retail investors. The watered-down best interest standard and disclosure requirements of Regulation Best Interest (Regulation BI) (discussed below) would not meet this standard.

The second disconnect involves fossil fuel companies and the emergent body of climate risk disclosures rules and best practices. Climate change poses existential threats to human health and welfare that extend far beyond the issuer-intermediary-investor relationships that are the focus of federal securities law and regulation. Fossil fuel companies regularly purport to acknowledge this reality. And yet, even as they pay lip service to the "imperative" of reducing emissions,[19] fossil fuel companies are working to both minimize disclosure obligations and simultaneously to use compliance with disclosure rules to paint themselves as responsible actors—all while doubling down on their carbon-centric business models. To bridge the disconnect between issuers' stated commitment to both investor disclosure and energy transition on one hand, and the realities of their business model and practices on the other, I expose industry double-speak around climate change and climate risk disclosure and explore mechanisms for mapping securities law disclosure requirements against climate science, state and federal environmental law, and robust dialogue concerning the costs and impacts of climate change.

17. RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 3, 9 (2008) ("The false assumption is that almost all, people, almost all of the time, make choices that are in their best interest or at the very least are better than the choices that would be made by someone else. We claim that this assumption is false—indeed, obviously false."); Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers,* 84 CALIF. L. REV. 627, 699 (1996) (arguing behavioral economics explains risk mischaracterization by relying on work by economists and psychologists).

18. *See infra* Section IV.C. and accompanying notes.

19. ConocoPhillips, Comment Letter on Proposed Rule on the Enhancement and Standardization of Climate-Related Disclosures for Investors, at 1 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131839-302285.pdf [https://perma.cc/9RGM-XDSH] (hereinafter "June 2022 Comment Letter").

As context for these proposed reforms, Section II briefly examines the origins and objectives of the '33 and '34 Act regulatory disclosure regimes, focusing on the Acts' investor protection and market integrity mandates. Section III examines assumptions and regulatory bets underlying these regimes and explores how these assumptions and bets have shaped traditional disclosure discourse. Section IV explores disconnects between the assumptions and bets underlying '33 and '34 Act regulatory disclosure and on-the-ground realities, and examines costs and consequences associated with investor irrationality and stakeholder incentives. Section V exposes stakeholder (mis)use of '33 and '34 Act regulatory disclosure, focusing on non-fiduciary financial intermediaries and fossil fuel companies. Section VI proposes strategies for addressing this (mis)use, protecting and preserving disclosure as a regulatory tool, and aligning market participants' use of disclosure with the goals and objectives of the '33 and '34 Acts.

I. The Origins and Purposes of the '33 and '34 Act Mandatory Disclosure Regimes.

To understand why and how non-fiduciary intermediaries and fossil fuel issuers have been able to (mis)use '33 and '34 Act regulatory disclosure, we must first examine the origins of federal securities regulation in the United States. In particular, we need to understand why lawmakers began enacting federal legislation respecting investment activity beginning in 1933, and what they were hoping to accomplish with this body of legislation; why they chose mandatory disclosure as the Acts' lynchpin regulatory tool; and what assumptions and regulatory bets underlie this disclosure-centric approach. Although the Depression-era origins of the '33 and '34 Act disclosure regime detailed below are well-documented, this origin story offers important context for thinking about current vulnerabilities and opportunities for reform.

The following Section, which examines the legislative history and historical record underlying the '33 and '34 Act mandatory disclosure regime with these issues in mind,[20] reveals several key points: (i) protecting retail investors (and by extension markets) from fraud and abuse was (and still is) a stated core legislative objective of the '33 and '34 Acts; (ii) mandatory disclosure was (and still is) the cornerstone of the '33 and '34 Act investor protection and market integrity regimes; (iii) stakeholders have long expressed concerns about whether disclosure adequately protects retail investors; and (iv) because of these concerns, stakeholders have long emphasized the important role that financial intermediaries are supposed to play in filtering disclosure materials and educating investors.

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20. For detailed accounts of the origins of the federal securities law regime, *see* Seligman, *supra* note 8; Elizabeth Keller, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L. J. 329, 336 (1988).

There are important caveats and acknowledgements to keep in mind when reviewing these materials and key takeaways. First, identifying investor protection as a core legislative objective of the '33 and '34 Acts does not mean that investor protection is the Acts' *only* legislative objective. With the federal securities laws, Congress sought to protect investors while also fostering fair, orderly, and efficient markets and facilitating capital formation.[21] This is, in part, why the federal securities laws have always sought to balance the Acts' investor protection mandate with a sensitivity to regulatory burden.

Second, identifying mandatory disclosure as a cornerstone of the '33 and '34 Act investor protection regimes does not mean that disclosure is the Acts' only investor protection device. The '33 and '34 Acts both contain registration requirements and antifraud prohibitions. The '34 Act also provided for the creation of the Securities and Exchange Commission and established a licensing regime and a set of sales practices rules for securities industry professionals. Other provisions of the federal securities laws contain important investor protection tools, as well.[22] That said, investor protection through mandatory disclosure remains a foundational legislative objective under the federal securities laws generally, and the '33 and '34 Acts in particular.

Third, identifying limitations of disclosure as a regulatory tool and the potential misuse of disclosure by powerful market participants does *not* mean that mandatory disclosure is unnecessary, entirely ineffectual, or that it or should be eliminated. My view is that we should bolster disclosure where it makes sense as a regulatory tool—e.g., by adding a robust fiduciary standard when intermediaries interact with retail investors, and by working to expand transparency regarding material climate risks—but also recognize where and when we need to complement disclosure with substantive reforms under other bodies of law, as with the fossil fuel industry and greenhouse gas emissions.

Fourth, centering individual retail investor decision-making does not mean that retail investors are the *only* investors that matter, that they are the only audience for mandatory disclosure, or that use by retail investors is the only litmus test by which to gauge the utility or effectiveness of mandatory

21. *See* Ferrell, *supra* note 5, at 213-14 ("The organizing principle of U.S. securities regulation in the twentieth century has been the belief that mandatory disclosure of firm-specific information enables capital markets to function efficiently and in the interests of all investors.").

22. For example, unlike broker-dealers, investment advisers (a type of financial intermediary discussed below) owe fiduciary duties to clients under the Investment Advisers Act of 1940. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). *See also Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979) ("§ 206 establishes federal fiduciary standards to govern the conduct of investment advisers."); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 471, n.11 (1977) (in reference to *SEC v. Capital Gains*, stating that the Supreme Court's reference to fraud in an "equitable" sense was "premised on its recognition that Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers").

disclosure. The federal securities have always anticipated a variety of audiences for mandatory disclosure, including sophisticated investors and financial intermediaries. Retail investor protection remains important, however, as a key touchstone by which we ought to measure the effectiveness of the federal securities law mandatory disclosure regimes, given the Acts' history and legislative objectives.

Finally, centering the individual retail investors' making individual investment decisions in disclosure discourse does not mean that aggregate or market-level impacts are unimportant. To the contrary, it matters, from an investor protection standpoint whether mandatory disclosure is linked to efficient price discovery and reduced volatility in some markets. Examining investor-level decision-making is important, however, because individual investors "do not always behave rationally, and although departures from rationality are sometimes random, they are often systematic."[23] Indeed, "[h]umans predictably err."[24] Identifying systematic departures from rationality is an important piece of the retail investor protection puzzle—especially with respect to markets for products or services that are comparatively less liquid or less transparent, and as to which market-level impacts may be muted or difficult to measure.

A. The Crash, the Great Depression, and the Pecora Hearings Pave the Way for Federal Securities Legislation.

Although there were panics[25] and proposals for federal legislation regulating corporate and investment activity prior to the 1930s,[26] it was not until after the 1929 stock market crash (the Crash), the ensuing Great Depression, and the so-called Pecora hearings that lawmakers finally began enacting federal legislation regulating investment activity.

23. *E.g.,* Brad M. Barber & Terrance Odean, *The Courage of Misguided Convictions*, 55 FIN. ANALYST J. 41, 41 (1999) ("[B]ehavioral models of financial markets consider not only how people should act but also how they do act. People do not always behave rationally, and although departures from rationality are sometimes random, they are often systematic.")

24. THALER & SUNSTEIN, *supra* note 17, at 7.

25. *E.g.,* Elizabeth Keller, *supra* note 20, at 336. As Keller points out, "no federal legislation resulted from these efforts; perhaps because the appearance of continuing prosperity and the prospects of gain lulled the nation into a belief that the economic system was fundamentally sound." *Id.* (citations omitted).

26. *E.g.*, Edward N. Gadsby, *Historical Development of the S.E.C.—The Government View*, 28 GEO. WASH. L. REV. 6, 6-8 (1959) (observing that "[f]ederal legislation regulating corporations, especially with REFERENCE to the disclosure of corporate affairs, was not dreamed up precipitously in the nightmare which followed the dramatic stock market collapse of 1929.").

The Crash and the Great Depression were the first two pieces of the legislative reform puzzle.[27] "Between September 1, 1929, and July 1, 1932, the value of all stocks listed on the New York Stock Exchange shrank from a total of nearly $90 billion to just under $16 billion—a loss of 83 percent."[28] Even blue chip securities lost a massive percentage of their value.[29] Individuals, households, and businesses across the country were cast into penury.[30]

The impact of the Crash was not limited to traditional moneyed or investor classes. In the years leading up to the Crash, as stock prices had soared[31] markets

27. *See* S. REP. NO. 73-1455, at 7 (1934) (regarding S. Res. 84 ("a resolution to investigate practices of stock exchanges with respect to the buying and selling and the borrowing and lending of listed securities") and S. Res. 56 and 97 ("resolutions to investigate the matter of banking operations and practices, transactions relating to any sale, exchange, purchase, acquisition, borrowing, lending, financing, issuing, distributing, or other disposition of, or dealing in, securities or credit . . . with a view to recommending necessary legislation")) [hereinafter PECORA REPORT]. These hearings, commonly known as the Pecora Commission Hearings, set the stage for the Banking Act of 1933, the Securities Act of 1933, and the Securities Exchange Act of 1934. ("The annals of finance present no counterpart of this enormous decline in security prices.").

28. Seligman, *supra* note 8, at 1. *See also* Loss, *supra* note 9, at 269-70 ("The aggregate value of all stocks listed on the New York Stock Exchange on September 1, 1929, was $89 billion. In the break of September and October they fell by $18 billion. In 1932 the aggregate figure was down to $15 billion—a loss of $74 billion in two and one-half years. The bond losses increased the total drop in values to $93 billion."); *id.* at 269 ("From 1920 to 1933, approximately $50 billion of securities were sold in the U.S., but by 1933 half of these securities were worthless.")

29. Seligman, *supra* note 8, at 2. (observing that "[l]eading 'blue chip' securities, including General Electric, Sears, Roebuck, and U.S. Steel common stock," lost 90 percent of their value from 1929 to 1932.) *See also 431 Days: Joseph P. Kennedy and the Creation of the SEC (1934-35)*, SEC. EXCH. COMM'N HIST. SOC'Y, https://www.sechistorical.org/museum/galleries/kennedy/lastDays_d.php [https://perma.cc/NS7T-JBJK] ("In September 1929 the market started to decline. In October Wall Street financiers tried to prop it up but to no avail. Within two months the New York Stock Exchange lost $18 billion in value. The slide continued, and by mid-1932 85 percent of its worth was gone.")

30. *E.g.,* PECORA REPORT, *supra* note 27, at 7 ("The economic cost of this down-swing in security values cannot be accurately gauged. The wholesale closing of banks and other financial institutions; the loss of deposits and savings; the drastic curtailment of credit; the inability of debtors to meet their obligations ; the growth of unemployment; the diminution of the purchasing power of the people to the point where industry and commerce were prostrated; and the increase in bankruptcy, poverty, and distress—all these conditions must be considered in some measure when the ultimate cost to the American public of speculating on the securities exchanges is computed.")

31. *See. e.g.,* Gary Richardson et al., *Stock Market Crash of 1929,* FED. RSRV. HIST., https://www.federalreservehistory.org/essays/stock-market-crash-of-1929 [https://perma.cc/E5P8-W86X] ("The Roaring Twenties roared loudest and longest on the New York Stock Exchange. Share prices rose to unprecedented heights. The Dow Jones Industrial Average increased six-fold from sixty-three in August 1921 to 381 in September 1929. After prices peaked, economist Irving Fisher proclaimed, 'stock prices have reached 'what looks like a permanently high plateau.''")

had enjoyed a period of unprecedented expansion.[32] This was driven, in part, by demand from retail investors who had begun buying and selling securities in larger numbers beginning in the late 1800s.[33] Some commentators cite pre-Crash retail investor participation (and particularly female retail investor participation) in the stock market as evidence of an unhealthy speculative mania in the years leading up to the Crash.[34] Merino and Neimark observe that business and political leaders had encouraged retail investors to invest in securities for both socio-political and economic reasons—e.g., to "facilitate[]" the transition from an agrarian (small land owner shopkeeper) society to a corporate one consisting of small shareholder interests, without requiring basic structural changes" and to "preserve[] the perception that a viable middle class, essential to effective political participation, still existed."[35] For these leaders, mass participation in the stock market was "a necessary condition to preserving democracy."[36] Geist likewise observes that even small investors and savers were "dragged into the maelstrom" of the markets during the Roaring '20s by the financial community who were "all too eager to use someone else's money to continue . . . expansionist dreams for American industry".[37] Whatever the reason for their participation, retail investors' expanded presence in the market prior to the Crash meant that ordinary Americans experienced devastating financial losses when markets collapsed.[38]

The political fallout from these events was massive. President Herbert Hoover was in office when the Crash began in 1929. Following the hands-off

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32. "[A] dramatic expansion" appears to have "occurred in the U.S. stock market during the period 1885-1930." Mary O'Sullivan, *The Expansion of the U.S. Stock Market, 1885-1930: Historical Facts and Theoretical Fashions, in* 8 ENTERPRISE & SOCIETY 489, 491-92 (Cambridge Univ. Press 2007) (positing that institutional and retail demand for corporate stock following World War I, as well as changes in the supply of corporate securities during this period may have contributed to expansion in U.S. stock market in the years leading up to the Crash).

33. Barbara Dubis Merino & Marilyn Dale Neimark, *Disclosure Regulation and Public Policy: A Sociohistorical Reappraisal*, 1 J. OF ACCT. & PUB. POL'Y 33, 37-39 (1982).

34. *See* Christine Sgarlata Chung, *From Lilly Bart to the Boom Room: How Wall Street's Social and Cultural Response to Women Has Shaped Securities Regulation*, 33 HARV. J. LAW & GENDER 175, 196-200 (2010).

35. Merino & Neimar, *supra* note 33, at 37-39.

36. President Coolidge, for example, "equated individual freedom with the opportunity to participate in private enterprise" and business leaders such as J.P Morgan also encouraged stock ownership, "citing the benefits to be obtained if most people had a vested interest in the existing economic order." Merino & Neimar, *supra* note 33, at 38.

37. CHARLES R. GEIST, WALL STREET: A HISTORY 151 (4th ed. 1997).

38. *Id.* at 198 (observing that the brokerage community did not suffer as much as it had in prior panics—and also fared better than the industry's customers, because brokers had liquidated their own inventories before selling customer positions.)

approach of his predecessor Calvin Coolidge,[39] Hoover sought to reassure the country that the fundamental business of the nation was "on a sound and prosperous basis."[40] And with his political base firmly opposed to federal legislative intervention,[41] Hoover initially urged only "voluntary" action on the part of business to maintain employment and wages and (later) to eliminate abusive stock market practices.[42]

The Depression made Hoover's hands-off, prosperity-is-around-the-corner narrative untenable. Franklin Roosevelt (Roosevelt or FDR) made the dire state of the nation's economy a key campaign issue in the run-up to the 1932 presidential elections: He argued that Hoover had encouraged a speculative boom prior to Crash but then minimized the severity of the market collapse, delayed relief, and blocked reforms.[43] FDR also made the need for legislative/ regulatory reform a key campaign pledge, repeatedly calling for the "revision of the laws relating to the sale of securities to the public"[44] and for "letting in the light of day on issues of securities, foreign and domestic, which are offered for sale to the investing public."[45]

The Pecora hearings were the third piece of the legislative reform puzzle. In March of 1932, the Senate passed a resolution calling for an investigation into the causes of the Crash by its Banking and Currency Committee ("the Committee").[46] The Committee's stated purpose was to determine why stock

39. President Coolidge had been briefed by numerous experts about "troubles in financial market", as Elizabeth Keller points out, but he believed that regulation was the responsibility of the states, and "clung to a faith" in a laissez faire philosophy respecting securities regulation at the federal level. Keller, *supra* note 20, at 336.

40. Seligman, *supra* note 8, at 4. *See also* WILLIAM STARR MYERS & WALTER H. NEWTON, THE HOOVER ADMINISTRATION 14 (1936).

41. The financiers who supported Hoover's Republican party were opposed to federal legislative intervention into investment matters. Seligman, *supra* note 8, at 4-5 (internal citations and quotations omitted). They argued that the Crash had been caused by ordinary investors who had succumbed to a get-rich-quick mentality and speculative mania—not regulatory failures or misconduct by Wall Street insiders. *Id.* So, while they and members of the Hoover administration acknowledged that that "[v]alues" might have to be "adjusted" as a result of the Crash, they argued that the market's collapse would allow "enterprising people" to "pick up the wreck from less competent people. *Id.* at 5 (attributing comments to Andrew Mellon). *See also* Keller, *supra* note 20, at 337. For Hoover, championing federal legislation in the face of these attitudes carried political risk.

42. Seligman, *supra* note 8, at 4-5.

43. *E.g.*, Seligman, *supra* note 8, at 18-20.

44. *E.g.*, OFFICE OF THE GOVERNOR OF THE STATE OF NEW YORK, MESSAGE OF GOVERNOR FRANKLIN D. ROOSEVELT TO THE LEGISLATURE (N.Y. 1932).

45. Governor Franklin D. Roosevelt, Address Accepting the Presidential Nomination at the Democratic National Convention in Chicago (July 2, 1932).

46. S. Res. 84, 72nd Cong. (1st Sess. 1932); S. Res. 371, 72nd Cong. (2d Sess. 1933).

prices had crashed so calamitously beginning in 1929, and to propose legislation to reduce the risk of future crashes.[47] But by January 1933, what became known as the Pecora hearings (in honor of the transformational role played by the Committee's fourth and final general counsel Ferdinand Pecora[48]) had an "obviously political purpose" as well—namely, to generate widespread public support for a federal legislative action respecting securities offerings.[49]

Armed with subpoena power, FDR's support, and a reformer's mindset, Pecora subpoenaed Wall Street titans to testify before Congress on subjects ranging from their personal income taxes to preferred lists[50] whereby favored insiders traded on inside information to manipulative trading pools.[51] Pecora and his team unearthed bombshell after bombshell: Wall Street luminaries had paid little or no income tax in the early 1930s; some of the nation's most respected financial institutions had misled investors as to the merits of securities; leading bankers had offered privileges to favored insiders not afforded to ordinary investors, and so on. The Pecora hearings revealed that the nation's economic troubles were not solely the result of mistakes by unsophisticated investors caught up in a speculative mania, as Hoover's administration had suggested; instead, it appeared that Wall Street insiders had unloaded millions of dollars of worthless securities on an unsuspecting public.[52]

Pecora's revelations were front page news. As James Landis, one of the architects of the federal securities laws later would put it, the Pecora hearings "indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people's money."[53] In the wake of the hearings, the idea that the federal government, having encouraged stock ownership, had an obligation to

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47. *Id.*

48. Ferdinand Pecora was retained by the Committee as its fourth—and final—general counsel on January 24, 1933 and under his leadership, the Committee held hearings during February and March of that year. PECORA REPORT, *supra* note 27 at 2.

49. *Id.* at 2-5, 20-38 (describing the hearings). *See also* MICHAEL PERINO, THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE (2010); Donald A. Ritchie, *The Pecora Wall Street Exposé, in* 4 CONGRESS INVESTIGATES: A DOCUMENTED HISTORY 2555 (Arthur M. Schlesinger, Jr. & Roger Bruns eds., 1975).

50. *What Will Happen to the House of Morgan*, THE LITERARY DIGEST, June 10, 1933, at 3.

51. FERDINAND PECORA, WALL STREET UNDER OATH: THE STORY OF OUR MODERN MONEY CHANGERS 3, 190 (1939). *See also* Seligman, *supra* note 8, at 20-38; Ritchie, *supra* note 49, at 2561-76. Pecora and his team found, for example, that a number of Wall Street titans—including J.P. Morgan—had paid little or no federal income tax in 1931 and 1932. *See* Seligman, *supra* note 8, at 33-34.

52. *See generally* Ritchie, *supra* note 4 at 2555-57.

53. James M. Landis, *The Legislative History of the Securities Act of 1933,* 28 GEO. WASH. L. REV. 29, 30 (1959).

protect investors from fraud and abuse by Wall Street insiders, began to take hold.[54] Finally, there was "broad public support for direct federal regulation of the stock markets."[55]

B. The Federal Securities Laws Investor Protection Mandate.

1. President Roosevelt's Charge.

Against this backdrop, FDR made enacting federal investor protection legislation a priority from his first days in office. In his March 4, 1933, inaugural address, FDR referenced the lingering effects of the Crash and the Great Depression.[56] Less than one month later, Roosevelt sent a letter to Congress calling for legislation to protect "the public" from fraudulent securities offerings via "full publicity" of material facts:

54. Joseph Kennedy, the first Chair of the Securities and Exchange Commission, would make this point in a 1934 speech advocating for federal securities legislation. Joseph P. Kennedy, Chairman, Sec. Exch. Comm'n, Address at the National Press Club (July 15, 1934) ("The billions of dollars of capital required by the war and the many billions since, have made in this nation a vast number of security holders"—arguing "[w]ho, then, dare say that these more than sixteen million stock holders and bondholders have not a claim upon the Government to protect them? It was the Government largely who brought them into being, which urged them to become investors. Can there be any doubt the Government owes them the responsibility to check improper financial practices—that it owes this vast army responsibility to supervise the industry? Certainly not. And the very fact that the Government has taken these steps, which are purely protective and in no sense finally prohibitive, will do more to restore and upbuild confidence in security trading than any device that has been employed since the New York Stock Exchange met under the buttonwood tree in 1792 at a place that is now in Wall Street.")

55. *Id. See also* Keller, *supra* note 20, at 338; Landis, *supra* note 53, at 30 ("As the criticism mounted, doubts as to the value of the very system of private enterprise were generated, and a wide demand was prevalent for the institution of procedures of governmental control that would in essence have created a capital issues bureaucracy to control not only the manner in which securities could be issued but the very right of any enterprise to tap the capital market."); Gadsby, *supra* note 26, at 9 (observing that the '33 Act "was drafted in the realization that lax financial and ethical standards were undermining the integrity of our capital markets, destroying investor confidence and leading to business and financial enterprises of this country to the brink of disaster.").

56. *See* President Franklin D. Roosevelt, Inaugural Address (Mar. 4, 1933), *in* FRANKLIN DELANO ROOSEVELT (Supp. 1933), at 3, 4 ("Values have shrunken to fantastic levels; taxes have risen; our ability to pay has fallen; government of all kinds is faced by serious curtailment of income; the means of exchange are frozen in the currents of trade; the withered leaves of industrial enterprise lie on every side; farmers find no markets for their produce; the savings of many years in thousands of families are gone. More important, a host of unemployed citizens face the grim problem of existence, and an equally great number toil with little return. Only a foolish optimist can deny the dark realities of the moment.")

> To the Congress:
>
> I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.
>
> In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.
>
> Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.
>
> There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.
>
> This proposal adds to the ancient rule of caveat emptor, the further doctrine, "Let the seller also beware." It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.
>
> The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.
>
> This is but one step in our broad purpose of protecting investors and depositors. It should be followed by legislation relating to the better supervision of the purchase and sale of all property dealt in on exchanges, and by legislation to correct unethical and unsafe practices on the part of officers and directors of banks and other corporations.
>
> What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others.[57]

2. Protecting "The Public" and "Honest Business" From Fraud and Abuse.

Guided by FDR's charge, the architects of what would become the '33 and '34 Acts made protecting "the investing public" and "honest business" from fraud and abuse a foundational legislative objective.[58] They specifically targeted the exploitation of retail investors at the hands of unscrupulous issuers and promoters who had pushed billions of dollars of risky or worthless securities

57. Letter from President Franklin D. Roosevelt to Congress (Mar. 28, 1933), *in* 77 CONG. REC. 937 (1933).

58. *E.g.*, S. REP. NO. 73-47, at 1 (1933) ("The purpose of this bill is to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities offered for sale in interest and foreign commerce and providing protection against fraud and misrepresentation").

into customer accounts, as excerpts from the legislative history[59] reflect.[60] They saw protecting ordinary investors (and honest businesses) from fraud and abuse as essential to restoring investor confidence in markets.[61] And, they saw restoring investor confidence as essential to the nation's economic recovery.[62]

59. *E.g.*, *id. at* 2 ("The necessity for the bill arises out of the fact that billions of dollars have been invested in practically worthless securities, both foreign and domestic, including those of foreign governments, by the American public through incomplete, careless, or false representations. The result is dire national distress."); H.R. REP. NO. 73-85, at 2 (1933) ("The background of the President's message is only too familiar to everyone. During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High-pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises.")

60. *See also* 77 CONG. REC. 2914 (1933) ("This is the purpose of the legislation, so that every investor may know more about the assets behind the securities, the practices of the corporation issuing the securities, the motives that are behind the negotiating bank, whether it is a promoter who wants to make a commission rather than to serve the public in an honest way or not. These are the facts that the American people are entitled to know not only to save the investment funds of the small investor but to restore confidence in the banking system of America.")

61. *Supra* note 58, at 1 (1933) ("The aim [of the bill] is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power. It is the conviction of the committee that these aims may be largely achieved upon the basis of fidelity to truth. Confidence must and may be restored upon the enduring basis of honesty with the public.") Joseph Kennedy would express similar sentiments in a July 1934 address to the National Press Club, stating "[A]n important part of the job we are trying to do here in the S.E.C. [is] to reassure capital as to its safety in going ahead and to reassure the investor as to the protection of his interests, by restricting certain practices which have proved to be detrimental to their interests, and by making available adequate information to the public upon which it can act intelligently." *See* Kennedy, *supra* note 54.

62. As Joseph Kennedy would put it, "[e]verybody says that what business needs is confidence. I agree. Confidence that if business does the right thing it will be protected and given a chance to live, make profits and grow, helping itself and helping the country." Kennedy, *supra* note 54.

C. Investor Protection Through Mandatory Disclosure.

1. Competing Regulatory Philosophies.

When it came time to draft statutory language, several different regulatory philosophies were in play. Industry "diehards" advocated for a minimalist regime like the fraud then in place in New York,[63] or "preferably, stern enforcement of the penal laws without even the power somewhere to enjoin fraud."[64] Supporters of this approach argued that anything more would be both ineffective and unduly burdensome.[65]

Other stakeholders called for regulation along the lines of state so-called "blue sky" laws.[66] Although statutory language varied from state to state,[67] these laws typically contained registration and qualification provisions for securities offerings, licensing provisions for sellers, and antifraud prohibitions, or some combination thereof, and some in some cases allowed (or even called for) officers of the state to weigh in on the merits of individual offerings.[68]

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63. *Id.* The New York Stock Exchange had a regulatory system in place prior to the crash; requirements were purely voluntary and easily avoided, however, and not rigorously enforced. *Id. See also* Seligman, *supra* note 8, at 47.

64. Loss, *supra* note 9, at 271.

65. *Id.* at 271-72. As Keller observed, industry trade groups lobbied to New York free of the sort of licensing and registration laws that characterized the state blue sky regimes described below. Keller, *supra* note 20, at 332.

66. State securities laws came to be known as Blue Sky Laws because some legislators believed that "if securities legislation was not passed, financial pirates would sell citizens everything in [the] state but the blue sky." Parrish, *supra* note 49, at 5 n.1; Keller, *supra* note 20, at 331 n. 16 (observing that "[v]ariations of this famous quote can be found in many of the accounts of the history of the blue sky legislation."). Beginning in 1911 with the state of Kansas, states across the country had enacted blue sky laws in the years before the Crash. Rick A. Fleming, *100 Years of Securities Law: Examining a Foundation Laid in the Kansas Blue Sky*, 50 WASHBURN L.J. 583 (2011); Gadsby, *supra* note 26 at 8. *See also* MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL 6 (1970).

67. Keller, *supra* note 20, at 331 ("Blue sky laws varied from state to state but can be classified into two broad categories: antifraud laws and licensing laws."); Gadsby, *supra* note 26, at 8; John C. Doerfer, *The Federal Securities Act of 1933*, 18 MARQ. L. R. 147, 148 (1934) (identifying three types of Blue Sky Laws: Those requiring qualification of securities up for sale; those listing qualifications for licensed dealers; and those containing antifraud prohibitions).

68. Although "[m]any states boasted of great success with their blue sky legislation . . . there was little documented proof as to their effectiveness." Keller, *supra* note 20, at 332 (citations omitted). As Keller has observed, blue sky laws were ineffective for several reasons, including the delegation of enforcement to unspecialized attorneys, inadequate funding, and a race-to-the-bottom scenario whereby states were "deliberately lax" in regulation/enforcement "in order to attract outside industry and to prevent the exodus of industry to more lenient states. *Id.* (citations omitted). Industry stakeholders also identified ways to avoid blue sky laws. *Id.* at 332-33. *See also* SELIGMAN, *supra* note 8, at 45 ("In the brutal glare that followed the stock market crash, it was apparent to virtually all

A third approach, suggested by FDR's charge, drew upon the disclosure-focused British model, and called for investor protection via the disclosure of material facts concerning securities offerings.[69]

2. The Framers Choose Disclosure.

The British disclosure-focused model carried the day.[70] As Landis would later explain, the architects of the '33 and '34 Acts rejected merits regulation—i.e., federal officials acting as advisors, guarantors, or gatekeepers based upon assessments of investment quality or merit—as a matter of regulatory philosophy and policy.[71] Instead, they sought to "[remain] true to the conception voiced by the President in his message of March 29, 1933 to the Congress, namely that [the '33 Act] requirements should be limited to full and fair disclosure of the nature of the security being offered."[72]

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commentators and congressional witnesses on the subject that the blue sky laws never really had a chance to succeed.")

69. LOSS, *supra* note 9, at 272. As James Landis later put it, "[a]fter a brief session with [Felix] Frankfurter, where we determined to take as the basis of our work the English Companies Act with which Cohen was very familiar, Cohen, Corcoran and I set to work." Landis, *supra* note 53, at 34 (citation omitted). The British heritage of the federal securities laws is well documented. *See e.g.*, STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS, 1690-1860 (1998) (discussing regulation of the earliest securities markets in the United States and England, as well as widespread attitudes that informed the development and structure of early regulatory regimes in both countries); Robert L. Knauss, *A Reappraisal of the Role of Disclosure*, 62 MICH. L. REV. 607, 610-613 (1964); Brian J. Kilbride, *The British Heritage of Securities Legislation in the United States*, 17 SW. L. J. 258, 263 (1963) (discussing origins of the philosophy of full disclosure); Doerfer, *supra* note 67, at 150.

70. The drafters acknowledged the British origins of their approach but noted that they added to the sanctions available under British law "the right of the Commission to suspect the registration of any security if inadequate compliance with the stated requirements for disclosure or misrepresentations of fact were found to exist in its registration statement." Landis, *supra* note 53, at 34.

71. Landis, *supra* note 53, at 31 (noting that a fundamental weakness of the so-called Thompson Bill—a bill drafted by Huston Thompson (a former member of the Federal Trade Commission) and introduced on March 29, 1933 (the day of Roosevelt's charge described above)—was that it "went beyond the most severe of these [Blue Sky] state statutes in lodging extensive powers to control the issuance and sale of securities in the federal government.") Landis also commented on what he saw as an "essential weakness" in the Thompson Bill's registration requirement—namely, the idea that registration would take effect immediately upon the filing of a prospectus, but with the regulator having the power to revoke registration based upon the inadequacy of the prospectus, misrepresentation or fraud or the "unsoundness" of the security. *Id.* at 32. Landis saw this reference to merits regulation as holding "an incalculable threat over the seller of securities, so dire and yet so unpredictable that it is doubtful whether responsible investment bankers would have willingly chosen to subject themselves to the possibility of its exercise." *Id. See also* Keller, *supra* note 20, at 339.

72. Landis, supra note 53, at 34.

Guided by this approach, the '33 and '34 Acts have two fundamental investor protection components: a fraud prohibition, and requirements of disclosure when securities are issued and periodically thereafter.[73] The '33 Act—or the "truth in securities" law as it came to be known—prohibits fraud in the offer and sale of securities and requires issuers to register covered offerings and to disclose material facts about those offerings via a prospectus.[74] The '34 Act prohibits fraud in connection with the purchase and sale of securities (thus picking up secondary market trading) and requires periodic and event-driven disclosures.[75] The "dominating principle" behind this regime is that anyone willing to make the required disclosures (and to abstain from fraud) can sell or buy whatever he wants at whatever price the market will sustain.[76]

II. Assumptions and Regulatory Bets Underlying '33 and '34 Act Regulatory Disclosure.

A. Access To Information and Investor Decision-making.

The framers chose disclosure for several reasons.[77] First, as noted above, the framers were opposed to the idea of federal merits regulation, believing that that the federal government's proper role in investment matters should be limited to fraud prevention and to ensuring that investors have access to material facts so that they can make their own informed investment decision. [78] By securing to

73. 15 U.S.C. § 77c et seq.; 15 U.S.C. § 78q-1. *See also* Easterbrook & Fischel, *supra* note 9, at 669.

74. 15 U.S.C. § 78q-1 et seq. *See also* Doerfer, *supra* note 69, at 162 ("The salient feature of the securities act is compulsory information.").

75. 15 U.S.C. § 78a et seq. *See also* Statement, Secs. & Exch. Comm'n, Statement of the Purposes of the Securities and Exchange Commission, Accomplishments up to August 13, 1934, and Future Program (on file with Secs. & Exch. Comm'n Hist. Soc'y).

76. Easterbrook & Fischel, *supra* note 9, at 670; 15 U.S.C. § 77c et seq. *See also* Gary Gensler, Chair, Secs. & Exch. Comm'n, Speech at The Practicing Law Institute's SEC Speaks: Kennedy and Crypto (Sept. 8, 2022) ("The Securities Act of 1933 was about companies raising money from the public. Investors could decide which risks to take; companies that issued securities to the public were required to provide full, fair, and truthful disclosures to the public. FDR called this law the 'Truth in Securities Act.'"), https://www.sec.gov/news/speech/gensler-sec-speaks-090822 [https://perma.cc/W8N8-YWP6].

77. THE WHEAT REPORT, *supra* note 1, at 3 (citing legislative history).

78. H.R. REP. NO. 73-1383, at 11 (1934), reprinted in 1 SECURITIES LAW COMM., FEDERAL BAR ASS'N, FEDERAL SECURITIES LAWS: LEGISLATIVE HISTORY, 1933-1982, at 792, 804 (1983) ("No investor, no speculator can safely buy and sell securities . . . without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers or sellers as to the fair price of the security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and

investors "the means of understanding the intricacies of the transaction into which they are invited,"[79] the framers also hoped to reduce information asymmetries between investors and other market participants[80] and thereby to "diminish . . . the space for fraud."[81] Notably, the framers were not trying "to shield the public from ventures deemed to be of dubious merit"[82] nor were they

secreting of important information obstructs the operations of markets as an indices of real value. There cannot be honest markets without honest publicity.") *See also* THE WHEAT REPORT, *supra* note 1, at 10, 49; George A. Blackstone, Assoc. Dir., Secs. & Exch. Comm'n Div. of Corp. Fin., Training Program Lectures: The Securities Act of 1933 (Feb. 28, 1957), at 1 ("[T]he second major objective of the Act is to provide for registration, with the Commission, of initial public offerings of a security by an issuer. The purpose of requiring registration is to make sure that the investing public will be given sufficient business and financial facts about the issuer of a new security so that it can make an informed decision[.] . . . Passing upon the merits of a security is not the purpose of the Act. The purpose of the Act is to get the information to the public. Whether it is a speculative or gilt-edged security makes no difference to the Commission. It is rather a matter of letting the investor himself decide, after weighing the available facts, whether or not to buy the security.")

79. THE WHEAT REPORT, *supra* note 1, at 49 (internal citations omitted).

80. Paredes, *supra* note 9, at 418 ("Disclosure is designed to solve the informational asymmetries that exist between companies and investors. The logic is that by arming investors with information, mandatory disclosure promotes informed investor decision making, capital market integrity, and capital market efficiency."). *See also* Joel Seligman, *The Obsolescence of Wall Street: A Contextual Approach to the Evolving Structure of Federal Securities Regulation*, 93 MICH. L .REV. 649, 649-50 (1995).

81. Sale, *supra* note 12, at 1046.

82. THE WHEAT REPORT, *supra* note 1, at 49. Indeed, as William O. Douglas observed in a 1933 law review article, "[t]here is nothing in the ['33] Act which would control the speculative craze of the American public, or which would eliminate wholly unsound capital structures," or which would prevent any number of other ill-advised or sharp practices by issuers or other stakeholders. William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L. J. 171, 171 (1933). Joseph Kennedy, in his capacity as the SEC's first Chair, made similar comments. *E.g.*, Kennedy, *supra* note 54 ("Publicity will be an important element in the new conditions. Publicity, not of an occasional nature, but regular and informative. It will not be enough for a new enterprise to be candid in its original prospectus; it will supply its investors, from time to time, with publicity of such a nature that all will be as well informed as any individual could be. The greater the publicity, the more protected the public will be, and the more corrective the influence upon the financiers. Those who inveigh against publicity do so usually for private purposes. The sort of publicity we have in mind with respect to corporations will do them no harm and the public much good. The S.E.C. desires to encourage proper investments. But, at the same time, it should be pointed out that the speculative risk in any investments, whether it be stocks or bonds, will be present in the future as it has been in the past; for no body of men—no government—no nation, is sufficiently wise to define the perfect investment, or to guarantee it, or to eliminate the risks of speculation."); Letter from Joseph P. Kennedy, Chair, Secs. & Exch. Comm'n, to Mr. H. Head, SECS. & EXCH. COMM'N HIST. SOC'Y (June 15, 1935) (on file with the Secs. & Exch. Comm'n Hist. Soc'y) ("I wish to say emphatically that you have been misinformed if you have been told that the stock market is now safe for anybody. Acting under the Securities Exchange Act of 1934, the Securities and Exchange Commission has made every effort

seeking to establish federal officials as arbiters of investment quality.[83] They simply wanted investors to have access to truthful information about securities so that investors could make informed decisions about what to buy and sell. These ideas—that government's proper role is to ensure access to information, and that investors are responsible for (and capable of) using disclosure materials to make informed and hopefully wealth-maximizing investment decisions—represent the first set of assumptions/regulatory bets underlying the '33 and '34 Act regulatory disclosure regimes.

B. The Power of Disclosure to Expose and Deter.

Second, Brandeis's sunshine-as-disinfectant theory also seems to have been at work.[84] In his seminal work *Other People's Money*, Brandeis famously argued that "[p]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants . . . ."[85] Applying this theory to the retail investor/customer-intermediary relationship, Brandeis argued in a 1913 magazine article entitled *What Publicity Can Do* that retail investors' "servility" in the face of excessive fees and commissions (for example) was the result of ignorance.[86] He predicted that investors would walk away and refuse to commit their capital if only they knew the truth.[87]

to limit abuses that were prevalent in the past but neither the Commission nor any other Governmental or private party can make speculation safe. . . . Allow me to warn you again that nothing done by the Government makes stock market speculation safe.")

83. *See, e.g.,* House Report No. 1383, at 4. ("The mechanism . . . for compelling disclosures and for insisting that disclosure shall be both adequate and true has been carefully framed, so that neither action nor non-action by the Federal Trade Commission can be interpreted as a guarantee or approval of any particular security issued. . . . Thus the grant of control to the Federal Trade Commission conveys with it no right to pass upon the merits of any security, but simply to insist that whatever its merits, facts essential to its character are to be disclosed.")

84. Loss has opined that Brandeis is the person "who left the greatest mark on the disclosure philosophy of federal securities regulation in this country." LOSS, *supra* note 9, at 276.

85. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914).

86. Louis D. Brandeis, *What Publicity Can Do*, HARPER'S WEEKLY, Dec. 20, 1913, at 10-11 ("Publicity is justly commended as a remedy for social and industrial diseases."). *See also* THE WHEAT REPORT, *supra* note 1, at 50.

87. Brandeis, *supra* note 86, at 11-12 ("Is it not probable that, if each investor knew the extent to which the security he buys from the banker is diluted by excessive underwritings, commissions and profits, there would be a strike of capital against these unjust exactions? . . . Compel bankers when issuing securities to make public the commissions or profits they are receiving. Let every circular letter, prospectus or advertisement of a bond or stock show clearly what the banker received for his middleman-services, and what the bonds and stocks net the issuing corporation. That is knowledge to which both the existing security holder and the prospective purchaser is fairly entitled. If the bankers' compensation is reasonable, considering the skill and risk involved, there can

The '33 and '34 Act architects, who are said to have been "disciples" of Brandeis,[88] likewise believed that mandatory disclosure would (in addition to educational benefits) further protect investors by shaming issuers and intermediaries into abandoning sharp practices for fear of an investor strike.[89] This idea—that mandatory disclosure will expose and thereby deter sharp practices by issuers and intermediaries—represents a second set of assumptions/bets underlying the '33 and '34 Acts.

C. Intermediaries and Expert Investors as a Key Regulatory Bet.

A third set of assumptions and regulatory bets underlying '33 and '34 Act regulatory disclosure also has to do with intermediaries. From the very beginning of federal securities regulation in the United States, the wisdom of the framers' disclosure-centric approach was a subject of debate, particularly with respect to retail investors (and especially female retail investors[90]). In the early days of federal securities regulation, industry stakeholders pushed back on mandatory disclosure as being both burdensome and ineffectual, citing retail investors' presumed ignorance of (and lack of interest in) investment matters. In a September 15, 1933, letter from an investment firm to the Federal Trade Commission (the federal agency initially charged with enforcing the nascent body of federal securities laws), for example, the firm's representative questioned whether retail investors were capable of (or even had any interest in) making use of disclosure materials:

> I think it is an indisputable fact that investors by and large are woefully ignorant; in fact, unbelievably so as far as any sound knowledge of securities is concerned. This applies as well to people of large means who have invested money for years as to people of small means and to too great an extent to commercial bankers. While there are a few exceptions investors in the main depend on someone for advice and are for the most part incapable of forming any opinion of their own as to the merits of a security on the basis of cold facts submitted to them. Running somewhat ahead of my story, I believe that a prospectus submitted on the basis of the Securities Act of 1933 will be beyond the comprehension of the vast majority of investors and I am satisfied that a very large percent of investors will not even attempt to read

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be no objection to making it known. If it is not reasonable, the investor will 'strike,' as investors seem to have done recently in England.").

88. Landis served as a law clerk for U.S. Supreme Court Justice Brandeis in 1925. David. A. Ritchie, *Reforming the Regulatory Process: Why James Landis Changed His Mind*, 54 BUS. HIST. REV. 283, 289 n. 17 (1980).

89. THE WHEAT REPORT, *supra* note 1, at 50-51 ("The registration process has sometimes been referred to as a housecleaning: one of its most valuable consequences is the elimination of conflicts of interest and questionable business practices which, exposed to the public view, have what Justice Frankfurter once termed 'a shrinking quality.'") *See also infra* note 87.

90. *See generally* Sgarlata Chung, *supra* note 34.

> such prospectuses. I know from experience that it is hard to get them to read a circular of even the briefest character.[91]

For such stakeholders, the supposedly "dire" economic consequences of mandatory disclosure outweighed what they saw as at best theoretical benefits to investors.[92]

Early investor protection advocates also questioned whether retail investors possessed the ability or temperament to make use of disclosure materials.[93] For example, in *Other People's Money*, Brandeis wrote that "[f]or a small investor to make an intelligent selection from these many corporate securities—indeed to pass an intelligent judgment upon a single one—is ordinarily impossible. He lacks the ability, the facilities, the training and the time essential to a proper investigation."[94] Brandeis thus sought the disclosure of commissions, as reflected in the magazine article excerpt referenced above, so that investors could at least assess the financial incentives (and potential conflicts of interest) of individuals and firms trying to sell securities to them.[95] William O. Douglas also questioned whether retail investors were likely to benefit from the highly technical information contained in a '33 Act offering prospectus, commenting in a 1933 law review article that such materials would

91. Letter from E.G. Parsly to Baldwin Bane, Chief, Sec. Div. (Sept. 15, 1933) (on file with Secs. & Exch. Comm'n Hist. Soc'y).

92. *See, e.g.*, William O. Douglas, *Protecting the Investor*, 23 YALE L.J. 522 (1934) (observing in reference to the '33 Act that opponents of mandatory disclosure requirements "frequently point[ed] with alarm to certain of its dire consequences," claiming that "[b]ankers, directors, and even stockholders" were being "driven into retirement," that new capital could not be obtained, and that refunding operations were being made impossible by the 33 Act's disclosure requirements); Bernard Flexner, *The Fight On the Securities Act*, ATL. MAG., Feb. 1934, at 231 (observing that after the '33 Act passed both houses of Congress without a dissenting vote, Wall Street stakeholders engaged in a "well-subsidized campaign of propaganda against the Act to force its abolition under the guide of amendment," citing lack of capital issues).

93. As Merino and Newmark observe, even before the Crash, the Industrial Commission (U.S. Congress, House, 1900), the Hughes investigation (Can Antwerp 1913), and the Pujo hearings (U.S. Congress, House 1913) had all documented examples of practices harmful to stockholders. Merino & Neimark, *supra* note 33, at 38. "None of the investigations advocated corporate disclosure as being of direct use to stockholders." *Id.* The lack of interest in/support for disclosure "reflected the skepticism of most progressive reformers toward the utility of financial disclosure to investors." *Id.* at 39.

94. BRANDEIS, *supra* note 85, at 7-8.

95. *Id.*

be "small comfort" to those in need of investment guidance,[96] and raising similar concerns in another law review article the following year.[97]

Notwithstanding these misgivings, the Acts' framers and early supporters went along with a disclosure-focused investor protection regime in part because they believed that even if individual retail investors were unable make full use of disclosure materials, expert investors would incorporate disclosure materials into pricing determinations, thereby improving price discovery and market quality for all,[98] and that financial intermediaries would filter and help retail investors identify and use disclosure material. [99] This idea—that financial intermediaries will filter disclosure materials for retail investors and help

96. William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, YALE L.J. 171, 172 (1933). *See also* JOHN KENNETH GALBRAITH, THE GREAT CRASH 1929 166 (Houghton Mifflin Co., 1955) ("Full disclosure was required on new security issues, although no way was found of making would-be investors read what was disclosed.").

97. Douglas, *supra* note 92, at 523-24 ("The ['33] Act presupposes that the glaring light of publicity will give the investors the needed protection. But those needing investment guidance will receive small comfort from the balance sheets, contracts, or compilation of other data revealed in the registration statement. They either lack the training or the intelligence to assimilate them and find them useful or are so concerned with a speculative profit as to consider them irrelevant. And wise and conservative investors will find the Securities Act useful but not necessary and from it will gain but little real protection against an occasional Krueger or Insull.") *See also* A.A Berle, Jr., *Management Power and Stockholders Property*, 5 HARVARD BUS. REV. 424, 430 (1927) ("The individual shareholder may at once be eliminated from the discussion as a means of control. With increasing distribution of stock, the mere expense of enforcing any right, or even of obtaining the information necessary to indicate its violation, becomes a conclusive obstacle.") That said, in *The Modern Corporation and Private Property*, Berle and his co-author Gardiner Means championed disclosure by corporations on the grounds that investors were separated from direct management, and thus must buy and sell corporate securities based upon the market's appraisal, as expressed via price. A.A. BERLE, JR. & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 300-325 (1933).

98. Douglas & Bates, *supra* note 96, at 172 ("Thus the effects of such an Act, though important, are secondary and chiefly of two kinds: (1) prevention of excesses and fraudulent transactions, which will be hampered and deterred merely by the requirement that their details be revealed; and (2) placing in the market during the early stages of the life of a security a body of facts which, operating indirectly through investment services and expert investors, will tend to produce a more accurate appraisal of the worth of the security if it commands a broad enough market.") (citation omitted); *see also* Douglas, *supra* note 92, at 523-24.

99. THE WHEAT REPORT, *supra* note 1, at 53 ("This means that the results of the Act so far as investors are concerned are primarily two-fold: (1) the requirement that the truth about securities being told will in and of itself prevent some fraudulent transaction which cannot stand the scrutiny of publicity: (2) even those an investor has neither the time, money, nor intelligence to assimilate the pass information in the registration statement, there will be those who can and will do so, whenever there is a broad market. The judgment of those experts will be reflected in the market price. Through them investors who seek advice will be able to obtain it.") (citation omitted)

investors navigate markets—represents a third set assumptions/regulatory bets underlying the current regime.

D. Assumptions and Regulatory Bets Frame Regulatory Discourse.

These three sets of assumptions and regulatory bets have had a profound and lasting impact on disclosure discourse in the United States. Early assessments of '33 and '34 Act mandatory disclosure tended to affirm the "fundamental importance of adequate disclosure by issuers as a most vital means of investor protection."[100] These assessments likewise affirmed a limited role for the federal government in investor protection—i.e., fraud prevention and ensuring full disclosure of material facts—and echoed the regulatory policy justifications for mandatory disclosure cited above. These early accounts also emphasized the important role that intermediaries are supposed to play in price discovery, filtering information, and in educating and advising retail investors,[101] even while acknowledging concerns about intermediaries' competence and incentives.[102]

Although the law-and-economics movement that followed these early assessments brought important new tools and methodologies for examining the impact of disclosure upon securities pricing and other market metrics, it did not

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100. SEC. & EXCH. COMM'N, REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS, PT. 1, H.R. DOC. NO. 88-95, at VII (1963) [hereinafter SPECIAL STUDY]. *See also id.* at 591 ("Full disclosure has always been a major purpose of the Federal Securities laws" . . . "[f]ederal regulation based on this principle is designed to assure ample and reliable data for decisionmaking by investors and the financial community, as distinguished from the Federal Government's assuming the more paternalistic role of passing on the merits of securities."); *id.* at 552 ("Under the Federal scheme of regulation, the role of the Government is essentially to assure adequate disclosure.")

101. THE WHEAT REPORT, *supra* note 1, at 51-52 ("By and large, the Commission has responded to the various needs for disclosure in pragmatic fashion. Thus, where an issuer of securities possessed unusually speculative elements, it was felt that special efforts should be made to call these factors to the attention of the ordinary investors—hence the development of the "introductory statement" to the prospectus. By contrast, the detailed financial information required by the schedule to Form 10-K report could be intended only for the skilled analyst. Indeed, it was recognized from the beginning that a fully effective disclosure policy would require the reporting of complicated business facts that would have little meaning for the average investor. Such disclosures reach average investors through a process of filtration in which intermediaries (brokers, bankers, investment analysts, publishers of investment advisory literature, and occasionally lawyers) play a vital role. The values of the filtration process are also pertinent, albeit to a lesser degree, to the '33 Act registration process. The prospectus is designed to help the investor to make an informed decision. It also is intended to assist those to whom investors look for professional advice.")

102. *E.g.*, SPECIAL STUDY, *supra* note 100, at 588 (acknowledging that "[n]o amount of disclosure in a prospectus can be effective to protect investors unless the securities are sold by a salesman who understands and appreciates both the nature of the securities he sells and his responsibilities to the investor to whom he sells.")

fundamentally alter disclosure discourse, in my view. Legal scholars and economists generally agree, under the law and economics framework, that disclosure provides benefits to investors and markets.[103] They have disagreed on whether disclosure should be voluntary (and driven by market forces) or mandatory.

Proponents of mandatory disclosure argue that disclosure requirements are an efficient and effective response to market failures—specifically, agency costs and the persistent underproduction of information by issuers and other stakeholders.[104] These scholars argue that disclosure requirements address agency costs by taking the decision whether to disclose out of the hands of managers who might otherwise seek to conceal information about the corporation or the behavior of corporate insiders.[105] Recalling Brandeis, supporters of mandatory disclosure also argue that disclosure requirements can deter bad behavior "as managers can be expected to police their actions to avoid having to provide embarrassing disclosures later."[106] While acknowledging that mandatory disclosure can be expensive, these scholars argue that the benefits of mandatory disclosure—e.g., reduced opportunities for fraud, addressing agency costs and the underproduction of information, and in some cases improving price discovery and reducing volatility—are worth the cost.[107]

103. Easterbrook & Fischel, *supra* note 9, at 673 ("Accurate information is necessary to ensure that money moves to those who can use it most effectively and that investors make optimal choices about the contents of their portfolios. A world with fraud, or without adequate truthful information, is a world with too little investment, and in the wrong things to boot."). Although the '33 and '34 Acts proceeded the rise of the neoclassical economics in the history of American economic thought, the Acts' theoretical underpinnings—discussed above—dovetail well with the law-and-economics paradigm of efficient markets, rational actors, and the role of government in protecting against market failure (thus enabling market function). Thus, it is not surprising that law and economics movement offered new methodologies, but did not fundamentally change discourse, in my view.

104. Schwartz, *supra* note 1, at 1070-71 (*citing* John C. Coffee, *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984)). *See also* Ferrell, *supra* note 1, at 81-82 ("Proponents of mandatory disclosure have . . . argu[ed] that the information related by firms generates important informational externalities. One such informational externality that has received significant attention is the possibility that firm disclosures may improve the stock price accuracy of firms other than the disclosing firm. Given that firms will not consider these externalities when deciding which pieces of information to disclose, it is argued that a mandatory disclosure regime can be socially beneficial.") (citations omitted).

105. Ferrell, *supra* note 1, at 86 ("Empirical evidence indicates that many controlling shareholders around the world divert corporate resources to themselves on a substantial scale. Logic and empirical evidence suggest that controlling shareholders' ability to engage in this diversion of corporate resources can be adversely affected by the imposition of mandatory disclosure requirements.")

106. Schwartz, *supra* note 1, at 1071.

107. Schwartz, *supra* note 1, at 1080.

Critics of mandatory disclosure argue that disclosure requirements are wasteful and unnecessary, and that market incentives would, if left undisturbed, result in optimal levels of investor disclosure.[108] These scholars argue that issuers who wish to sell securities have incentives to voluntarily provide robust disclosure for fear that potential investors will not offer top dollar, or even walk away entirely, otherwise.[109] They also argue that intermediaries who are repeat players, such as stock exchanges seeking to maintain relationships with investor customers, have incentives to ensure that issuers and other covered persons make full and fair disclosure of material facts, as well.[110]

III. Centering the Individual Retail Investor, Non-Fiduciary Intermediaries, and Certain Issuers In Disclosure Discourse.

Viewed collectively, the problem with these assumptions and regulatory bets, and with existing disclosure discourse, in my view, is that they do not adequately take into account how real-world issuers, intermediaries, and retail investors behave, nor do they fully consider the impact of certain socio-political and economic movements (namely, neoliberalism and market fundamentalism) on disclosure discourse and policy. In the following Section, I map two bodies of research and scholarship onto the disclosure policy and discourse discussed above: i.e., (i) insights from the behavioral sciences concerning investor, issuer, and intermediary behavior, and (ii) insights from works by Quinn Slobodian, Naomi Oreskes, Eric M. Conway and others examining the origins and impact of neoliberal economic theory and market fundamentalism upon regulatory policy and discourse. This exercise exposes deep disconnects between the assumptions and regulatory bets described above and how these regimes operate in real life. It also shows how placing undue load on regulatory disclosure to

108. *E.g.,* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L. J. 2359, 2378-81 (1998); Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1465-70 (1997). *See also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 256 (1991). For a catalog of some well-known critics of mandatory disclosure, *see* Ferrell, *supra* note 1, at 81-82. *See also* SUSAN PHILLIPS AND RICHARD ZECHER, THE SEC AND THE PUBLIC INTEREST 51 (1980) ("From the public interest viewpoint the economic case for our current mandatory disclosure system is extremely weak.")

109. Ferrell, *supra* note 1, at 85 ("The earliest comprehensive evaluations of the effects of a firm's disclosure decision . . . contained a powerful conclusion: In a world in which a firm has private information about the quality sf its product and disclosure is costless, firms will voluntarily publicly disclose their private information as a signal of their products quality.").

110. *See* Schwartz, *supra* note 1, at 1084; EASTERBROOK & FISCHEL, *supra* note 108, at 256; Easterbrook & Fischel, *supra* note 9, at 692-96 (arguing that increasing public confidence in markets, protecting unsophisticated investors, and increasing the supply of truthful information are all "poorly supported rationales" of mandatory disclosure).

corral messy markets may be only the latest manifestation of long-standing paradigms of economic thought and regulatory policy.

A. Retail Investors Are Not Reliably Rational.

The first disconnect that I highlight concerns the rational choice underpinnings of the '33 and '34 Act regulatory disclosure systems and the rationality (or lack thereof) of retail investors. As noted above, the '33 and '34 Act mandatory disclosure regimes are based upon traditional tenets of financial economics and a rational choice theory approach to investor behavior:[111] The Acts assume that investors are rational,[112] that investors can and will use disclosure materials to make rational, wealth-maximizing decisions,[113] and that markets will efficiently reflect the judgments of rational, well-informed investors in securities pricing.[114] To the extent an individual investor is personally unable to use disclosure materials in this way, the '33 and '34 Acts place the burden of education upon the investor.

As I have outlined in previous work (which is referenced below and summarized here), these assumptions do not match up with how real-life investors, intermediaries, or issuers behave.[115] First, unlike their hypothetical *homo economicus* counterparts, real-life retail investors are not reliably rational.[116] Instead, they exhibit persistent and well-documented decision-

111. *See, e.g.*, Paredes, *supra* note 9, at 424, 480-84 (observing that the efficient capital market hypothesis has profoundly influenced financial economics and the development and enforcement of the federal securities laws).

112. As discussed in Section IV below, numerous commentators have remarked on this point. *See id.* at 418-21; *see also* Langevoort, *supra* note 17, at 699 ("[M]ost doctrinal structures invoke the assumption of dominating rationality.").

113. *See, e.g.,* Langevoort, *supra* note 17, at 699 (observing that securities act disclosure regimes operate on the assumption that investors who receive these disclosures are "willing and able to use [disclosed information] wisely" when making investment decisions).

114. The efficient market hypothesis (EMH) is built on the idea that financial markets fully, accurately, and instantaneously incorporate all available information into market prices. EMH, in turn, is based on the idea that "market participants are rational economic beings, always acting in their own self-interest and making decisions by trading off costs and benefits weighted by the statistically correct probabilities and marginal utilities." Andrew W. Lo, *Reconciling Efficient Markets with Behavioral Finance: The Adaptive Markets Hypothesis*, 7 J. INV. CONSULTING 1, 1 (2005) ("Much of modern investment theory and practice is predicated on the Efficient Markets Hypothesis (EMH)."); Camerer et al., *supra* note 13, at 1214-15 ("The standard approach in economics assumes 'full rationality.'").

115. Christine Sgarlata Chung, *The Devil You Know: A Survey Examining How Retail Investors Seek Out and Use Financial Information and Investment Advice*, 37 REV. BANKING & FIN. L. 653, 675-85 (2017).

116. *E.g., The*Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 Minn. L. Rev. 749,749 (2008) ("[Consumers] suffer from imperfect information and imperfect rationality, and consequently might fail to make choices that maximize their preferences."); Peter Bossaerts, *What Decision Neuroscience Teaches Us About Financial*

making biases.[117] These biases speak to the role that emotions play in decision-making,[118] cognitive limitations,[119] and investors' use of *heuristics*, or decision-making shortcuts, especially when decisions are complex or time-pressured.[120] For retail investors, these biases are linked to well-documented and persistent mistakes[121] such as excessive trading,[122] failure to diversify portfolios or the use

Decision Making, 1 ANN. REV. FIN. ECON. 383, 384 (2009) ("At the individual level, normative analysis has long been known to make invalid predictions."). *See* Langevoort, *supra* note 17, at 699 (arguing that behavioral economics explains risk mischaracterization by relying on work by economists and psychologists).

117. *See, e.g.,* Lo, *supra* note 114, at 1 ("[P]sychologists and experimental economists have documented a number of departures from market rationality in the form of specific behavioral biases that are apparently ubiquitous to human decision-making under uncertainty, several of which lead to undesirable outcomes for an individual's economic welfare."); *see also* Cary Frydman & Colin F. Camerer, *The Psychology and Neuroscience of Financial Decision Making*, 20 TRENDS IN COGNITIVE SCIENCE 661, 663 (2016) (noting some decisions are clearly mistakes, such as failing to invest in a company retirement plan that matches the employee contribution and failing to refinance a mortgage); Andrew W. Lo & Dmitry V. Repin, *The Psychophysiology of Real-Time Financial Risk Processing*, 14 J. COGNITIVE NEUROSCIENCE 323, 332 (2002) (explaining their study findings which suggest "emotional responses are a significant factor in the real-time processing of financial risks").

118. *See, e.g.,* Andrew W. Lo, *Fear, Greed, and Financial Crises: A Cognitive Neurosciences Perspective*, *in* HANDBOOK ON SYSTEMIC RISK 622, 663, 641 (Jean-Pierre Fouque & Joseph A. Langsam eds., 2013) (exploring recent neuroscience research in an effort to identify fundamental drivers of financial crises and strategies for dealing with crises).

119. *See, e.g.*, Hazel Bateman et al., *Risk Information and Retirement Investment Choice Mistakes Under Prospect Theory*, 16 J. BEHAV. FIN. 279, 279 (2015) ("[E]xisting research has highlighted the gap between the financial competence of ordinary people and the skills needed to make sound financial decisions in retirement planning.").

120. *See, e.g.*, Gerd Gigerenzer & Peter M. Todd, *Fast and Frugal Heuristics: The Adaptive Toolbox*, *in* SIMPLE HEURISTICS THAT MAKE US SMART 1, 5 (1999) ("Humans . . . make inferences about their world with limited time, knowledge, and computational power."); *see also* Anjali D. Nurismulu & Peter Bossaerts, *Risk and Reward Preferences Under Time Pressure*, 18 REV. FINANCE 999, 1019 (2014) ("Our results suggest that, when put under extreme time pressure, human decision-making is not only different (from what it is otherwise) but also biased.").

121. *See, e.g.,* Barber & Odean, *supra* note 23, at 27.

122. *See, e.g.,* Brad M. Barber & Terrance Odean, *Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors*, 55 J. FIN. 773 (2000) (finding that empirical evidence supports the view that overconfidence leads to excessive trading, and further finding that excessive trading leads to lower net annualized geometric mean return when compared to households that trade less frequently.); Terrance Odean, *Do Investors Trade Too Much?*, 89 AM. ECON. REV. 1279, 1296 (1999) ("This paper takes a first step towards demonstrating that overall trading volume in equity markets is excessive by showing that it is excessive for a particular group of investors: those with discount brokerage accounts. These investors trade excessively in the sense that their returns are, on average, reduced through trading. Even after eliminating most trades that might be motivated by liquidity demands, taxloss selling, portfolio rebalancing, or a move to lower-risk securities, trading still lowers returns. . . . Overconfident investors may trade even when their expected gains through trading are not enough to offset trading costs. In

of naïve diversification strategies;[123] over-extrapolating from past returns;[124] relying upon advisors who turn out to be incompetent or unethical, or both, for reasons of affinity,[125] or some combination thereof. These mistakes, in turn, are associated with reduced investment returns, losses, and other economic and non-economic harms.[126]

B. Retail Investors May Find It Difficult to Learn From Past Experience or Mistakes.

The second disconnect concerns the de-biasing power of information and investor education. Contemporary rational choice theorists acknowledge the imperfect rationality of human decision-makers but see education as a key strategy for dealing with this state of affairs.[127] The idea is that investors will mitigate their imperfect rationality through self-education (e.g., by learning from their own and others' mistakes) and by getting help from expert sellers of financial goods and services.[128]

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fact, even when trading costs are ignored, these investors actually lower their returns through trading. This result is more extreme than is predicted by overconfidence alone.")

123. *See, e.g.*, Hersh Shefrin & Meir Statman, *The Disposition to Sell Winners Too Early and Ride Losers Too Long: Theory and Evidence*, 40 J. FIN. 777 (1985); Schlomo Bernartzi & Richard H. Thaler, *Naïve Diversification Strategies in Defined Contribution Savings Plans*, 91 AM. ECON. REV. 79 (2001); Barber & Odean, *supra* note 122, at 773. *See also* JOHN NOFSINGER, THE PSYCHOLOGY OF INVESTING 84-87 (2014).

124. *See, e.g.*, Shefrin & Statman, *supra* note 123(discussing the tendency to sell stocks appreciating in value prematurely in order to realize gain and to hold on to depreciating stocks to avoid realizing losses); *see also* NOFSINGER, *supra* note 123, 84-87.

125. *See* Langevoort, *supra* note 17, at 699. *See also* Stephen Lumpkin, *Consumer Protection and Financial Innovation: A Few Basic Propositions*, 2010 OECD J. FIN. MKT. TRENDS 117, 124 (2010) ("The fact that retail customers cannot readily discern the quality of financial products . . . makes them vulnerable to misconduct on the part of financial service providers. . . . They are also vulnerable to conflicts of interest, the possibility that an institution or its agents above those of the client. . . . Even worse, service providers might engage in outright fraud.")

126. *See generally* Sgarlata Chung, *supra* note 115.

127. Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 1, 113 (2006) (arguing that "[p]art of growing up consists in the expansion of one's cognitive powers so as to reduce the costs of . . . errors . . . [p]art of it [also] consists in choosing tasks that minimize the exposure to risk, perhaps by hiring individuals with formal training to work as agents on matters of particular difficulty" and explaining that exploring how people succeed in spite of their limitations, instead of assuming "pervasive human frailties," is a better way to understand rational behavior).

128. Proponents of this approach tend not to be fans of legal intervention beyond mandatory disclosure and anti-fraud rules *See, e.g.*, *id.* at 127-32 ("Anyone can enter the market on information. It does not take a government to broadcast the dangers of borrowing, any more than it takes a government to broadcast the dangers of obesity.").

The problem, once again, is that the real world does not work this way. A deep and robust body of literature from the behavioral sciences demonstrates that access to information, self-education, and education by others are not cure-alls for investor misperception and mistakes.[129] For example, as Oren Bar-Gill has observed, the speed with which a consumer learns about latent risk associated with a product depends on how frequently the consumer uses the product and how frequently the risk materializes. If a risk is remote or the number of transactions is low, it may take many years before a consumer learns about the risk.[130] Learning may also be slower than anticipated if goods and services are non-standard, because "the information obtained by one consumer might not be relevant to another consumer who purchased a different version of the nonstandard good."[131] Attribution bias may also interfere with learning.[132] Finally, mistakes and mis-predictions in consumer estimates of use patterns also can impact consumer learning.[133] These risks may be magnified when the underlying product or service is complex, as is generally the case for investments and other financial goods and services.[134]

These potential learning barriers impact retail investors. Consumer investment products often involve risks that are latent (or otherwise non-obvious) for retail investors—for example, interest rate risk and credit risk. Financial goods and services also often requires investors to make estimates and perform complicated calculations to understand financial impact over time,[135] and low levels of financial literacy mean some investors may have difficulty making these estimates, performing necessary calculations, or making wealth-

129. Sgarlata Chung, *supra* note 115, at 675-85.

130. Bar-Gill, *supra* note 116, at 755-56.

131. Bar-Gill, *supra* note 116, at 756-57; *see also* Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1122, 1128 (2009) (arguing learning is slower in the mortgage market because transactions are not frequently repeated).

132. Simon Gervais & Terrance Odean, *Learning to be Overconfident*, 14 REV. FIN. STUD. 1, 1-2 (2001) (internal citations omitted); Barber & Odean, *supra* note 122, at 773 (finding, to the extent trading by individual investors is motivated by overconfidence, higher trading will correlate with lower profits).

133. Bar-Gill, *supra* note 116, at 756-58.

134. *See* Steve L. Schwarcz, *Rethinking the Disclosure Paradigm in a World of Complexity*, 2004 U. ILL. L. REV. 1, 4-5 (2003); Sgarlata Chung, *supra* note 115, at 738.

135. *See* Thomas Lee Hazen, *Public Policy: Rational Investments, Speculation, or Gambling?—Derivatives Securities and Financial Futures and Their Effect on the Underlying Capital Markets.*, 86 NW. U. L. REV. 987 (1992) (showcasing the speculation required by investors in securities to understand financial impacts over time).

maximizing decisions.[136] Further, because financial products and services tend to be both complex and non-standard/heterogeneous, investors may find it difficult to compare products.[137] Any of these biases or potential misperceptions or mistakes has the potential to increase fees or to reduce investor returns, or both.[138]

C. Sellers of Financial Goods and Services Have Incentives to Exploit Retail Investor Misperceptions and Mistakes.

Assumptions about financial intermediaries also do not reliably hold up in real life. The '33 and '34 Act disclosure regimes assume that honest and skilled intermediaries will want to educate investors to capture the "gains of correction."[139] In the real world, however, conflicts of interests between investors on one hand and issuers and/or intermediaries on the other are inevitable,[140] and even reputable intermediaries may have (more) powerful

136. *See* Judy T. Lin et al., *Financial Capability in the United States*, FINRA FOUNDATION (July 2022), https://www.finrafoundation.org/sites/finrafoundation/files/NFCS-Report-Fifth-Edition-July-2022.pdf [https://perma.cc/9ZYL-TKA6].

137. *See* Bar-Gill, *supra* note 131, at 1122 ("Limited processing ability might prevent borrowers from accurately aggregating the different price components into a single, total expected price that would serve as the basis for choosing the optimal loan.").

138. *See* Bar-Gill, *supra* note 131, at 1122.

139. Sanford J. Grossman, *The Informational Role of Warranties and Private Disclosure About Product Quality*, 24 J. LAW & ECON. 461, 461-83 (1981); Sanford J. Grossman & O.D. Hart, *Disclosure Laws and Takeover Bids*, 35 J. FIN. 323, 323-34 (1980); W. Kip Viscusi, *A Note on "Lemons" Markets With Quality Certification*, 9 BELL J. ECON. 277, 277-79 (1978); Ginger Zhe Jin et al., *Is No News (Perceived As) Bad News? An Experimental Investigation of Information Disclosure* 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 21099, 2015), http://www.nber.org/papers/w21099.pdf [https://perma.cc/N2U7-MNJG] ("A cen-tral tenet of the economics of information is that market forces can drive firms to voluntarily and completely disclose . . . information . . . . The mechanism behind this idea is simple: consumers treat all non-disclosing companies the same, so the best businesses among those will have an incentive to separate themselves through disclosure.").

140. *E.g.*, Securities and Exchange Commission Staff, *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest*, *available at* https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest#_ftn14 [https://perma.cc/6FEK-K7R9] ("All broker-dealers, investment advisers, and financial professionals have at least some conflicts of interest with their retail investors. Specifically, they have an economic incentive to recommend products, services, or account types that provide more revenue or other benefits for the firm or its financial professionals, even if such recommendations or advice are not in the best interest of the retail investor. This can create substantial conflicts of interest for both firms and financial professionals. The nature and extent of conflicts will depend on various factors, including a firm's business model. Consistent with their obligation to act in a retail investor's best interest, firms must address conflicts in a way that will prevent the firm or its financial professionals from providing recommendations or advice that places their interests ahead of the interests of the retail investors.")

incentives to exploit rather than correct retail investors' misperceptions and mistakes.[141]

For example, Gabaix and Laibson have observed that firms have an incentive to hide (or, as they put it, "shroud") negative information about their products or services in markets where "myopic" consumers[142] incompletely analyze future preferences, choices, and behaviors.[143] In such markets, sellers may choose to capitalize on the mistakes consumers inevitably make rather than correct them.[144] Gabaix and Laibson describe this as the "curse of debiasing" or the "curse of education," because from the perspective of the sellers, educating consumers makes them less profitable. Gabaix and Laibson argue in markets where de-biasing is a curse from the seller's perspective, sellers tend not to educate consumers about mistakes, nor do they seek to expose consumers' misperceptions or errors.[145]

Many of the markets where the curse of de-biasing appears to involve financial decisions, complex goods or services, or both. For example, Professor Bar-Gill has argued cell phone carriers "design their contracts in response to systemic mistakes and misperceptions of their customers," resulting in complex cell phone contracts that are difficult to compare, thus "impos[ing] welfare costs on consumers, [and] reducing the net benefit that consumers derive from wireless service."[146] Bar-Gill argues credit card providers also have incentives to shape products and services around consumer's "systematic deviations from perfect rationality," and "[a]bsent legal intervention, the sophisticated seller will

141. Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q. J. ECON. 505, 505-06 (2006) (explaining competition may allow some firms to use another firm's exploitation of consumers for financial gain).

142. Myopia in true context refers to a "tendency in decision makers to focus on information immediately related to their choice or judgment and to ignore other (e.g., background) information." Christopher K. Hsee et al., *Medium Maximization*, 30 J. CONSUMER RES. 1, 2 (June 2003).

143. Gabaix & Laibson, *supra* note 141, at 507.

144. Gabaix & Laibson, *supra* note 141, at 502 (explaining in some markets, firms are more likely to hide information from consumers). Oren Bar-Gill argued "such a strategic response to consumer misperception gives sellers a strong incentive to create multidimensionality." Bar-Gill, *supra* note 116, at 769.

145. Gabaix & Laibson, *supra* note 141; *see also* Paul Heidhues et al., *Deception and Consumer Protection in Competitive Markets*, *in* SWEDISH COMPETITION AUTHORITY, THE PROS AND CONS OF CONSUMER PROTECTION 45 (Sten Nyberg ed., 2012) (pointing out "server limitations" to "safety in-markets" argument and arguing "that there is a potential role for active consumer protection policies.").

146. Oren Bar-Gill & Rebecca Stone, *Mobile Misperceptions*, 23 HARV. J. L. & TECH. 49, 51 (2009).

often exploit the consumer's behavioral biases."[147] Bar-Gill identified incentives for complexity and exploitation in the mortgage market as well,[148] noting existing structures disincentivize mortgage brokers from being loyal agents, and also noting the complexity of mortgage products means that both consumers and "so-called experts often get it wrong."[149]

Retail investors also may well be the sort of myopic consumers that Gabaix, Laibson and Bar-Gill describe, since product complexity and investors' bounded rationality make it difficult for investors to estimate or perform the calculations needed to chart the most economically rational path forward. And, the temptation to exploit rather than correct consumer mistakes may be magnified—or at least left largely unchecked—by generally low levels of financial literacy,[150] a complex and difficult-to-navigate choice environment (discussed below),[151] and a governing legal and regulatory regime that does not always require the intermediary to put the interests of the investor first.

D. The Complexity of Modern Markets.

Finally, the complexity of modern markets also poses challenges for investors and limits the de-biasing power of information and education.[152]

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147. *See also* Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2003). Paul Heidhues & Botond Köszegi, *Exploiting Naïvete about Self-Control in the Credit Market*, 100 AM. ECON. REV. 2279, 2280 (2010).

148. *See* Bar-Gill, *supra* note 131, at 1122 ("Increased complexity may be attractive to lenders, as it allows them to hide the true cost of the loan in a multidimensional pricing maze."); *see also id.* at 1126-27 (arguing lenders' incentive to increase complexity and hide fees will be stronger in a market with imperfectly rational borrowers).

149. Bar-Gill, *supra* note 131, at 1128-29.

150. FINANCIAL CAPABILITY IN THE UNITED STATES, *supra* note 136 at 3 (discussing impacts of low(er) levels of financial literacy.) *See* Gary R. Mottola, *In Our Best Interest: Women, Financial Literacy, and Credit Card Behavior*, 6 NUMERACY 1 (2013). It is worth noting that the financial services industry has long tried to use the guise of financial literacy education to fend off substantive consumer protection law and regulation. *See, e.g.*, Helaine Olen, *Stop Trying To Make Financial Literacy Happen*, Forbes Magazine (January 29th, 2015), https://slate.com/business/2015/01/financial-literacy-its-noble-but-way-less-important-than-actual-consumer-protection.html [https://perma.cc/JT5R-4NPN] ("The organizations most interested in promoting financial literacy are the ones that benefit the most from laws that assume consumers can be educated-and don't need legal protection from corporate financial predators.").

151. *See* Bar-Gill, *supra* note 131, at 1122 ("Limited processing ability might prevent borrowers from accurately aggregating the different price components into a single, total expected price that would serve as the basis for choosing the optimal loan.").

152. Thaler & Sunstein, *supra* note 17, at 3-13.

1. So Many Investment Options, So Much Information, So Many Intermediaries.

As I have outlined in previous work, retail investors face an enormously complex choice architecture.[153] Consider, for example, choices concerning intermediaries. Retail investors traditionally have worked with two types of financial intermediaries for their securities investing and trading—broker-dealers and investment advisors. Broker-dealer is the technical name for what retail investors often think of as a stock broker/ brokerage firm—i.e., a person or firm that is in the business of buying and selling securities on behalf of its customers (as broker), for its own account (as dealer), or both, typically (as a historical matter) in exchange for a commission or other transaction-based fee.[154] The Financial Industry Regulatory Authority (FINRA) reports that as of 2022, there were 620,882 registered representatives (individual licensed employees) working at 3,378 registered firms.[155]

Investment advisors are persons or firms that, for compensation, are engaged in the business of providing advice to others or issuing reports or analyses regarding securities.[156] Investment advisors traditionally have charged investors a fee representing a percentage of assets under management for their services. The Investment Advisor Association reports that as of 2022, there were

153. Sgarlata Chung, *supra* note 115, at 687-700.

154. The Securities Exchange Act of 1934 defines broker as "any person engaged in the business of effecting transactions in securities for the account of others." Securities Exchange Act of 1934, ch. 404, 48 Stat. 881, § 3(a)(4), 15 U.S.C. § 78c(a)(4) (2012). The Securities Exchange Act defines dealer as "any person engaged in the business of buying and selling securities . . . for such person's own account, through a broker or otherwise." § 3(a)(5). Broker-dealer rules are set forth in the Securities and Exchange Act of 1934 and the regulations promulgated thereunder and in rules promulgated by the Financial Industry Regulatory Authority (FINRA) (the self-regulatory organization (SRO) for the broker-dealer industry). SEC DIV. OF TRADING & MKTS., INVESTOR PUBLICATION: GUIDE TO BROKER-DEALER REGISTRATION (Apr. 2008), https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html [https://perma.cc/C927-PWSH].

155. *2023 FINRA Industry Snapshot*, FINRA (2023), https://www.finra.org/sites/default/files/2023-04/2023-industry-snapshot.pdf. [https://perma.cc/6RVM-BF9M] *Id.* at 2 ("Anyone actively involved in a FINRA-registered firm's investment banking or securities business must be registered as a representative with FINRA (FINRA-registered representative). To become registered, securities professionals are required to pass qualification exams to demonstrate competence in their particular securities activities. A FINRA-registered representative's duties may include supervision, sales of securities or training of persons associated with the member firm.") *Id.* at 13 ("Firms conducting securities transactions and business with the investing public must be registered with FINRA. Firms must meet.")

156. *See* Investment Advisers Act of 1940 § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (2012).

15,114 SEC-registered investment advisers serving 61.9 million clients.[157] Although not all of these individuals or firms focus on the retail market, of course, investors may find it difficult to locate and choose an intermediary that meets their needs.

The huge number and types of investment products also presents challenges for retail investors. For example, as of year-end 2022, there were 7,393 U.S mutual funds holding in excess of USD $ 22.1 billion in assets[158] and 2,844 exchange traded funds (ETF) with over USD $ 6.5 trillion in assets.[159] The total average daily trading volume for equities in 2022 was USD $ 601.6 billion.[160] Statistics concerning other products and market segments tell similar stories.

Barber and Odean have observed that this fire hose of options creates substantial search and sorting challenges for retail investors:

> [w]hen buying a stock, investors are faced with a formidable search problem. There are thousands of common stocks from which to choose. Human beings have bounded rationality. There are cognitive—and temporal—limits to how much information we can process. We are generally not able to rank hundreds, much less thousands, of alternatives. Doing so is even more difficult when the alternatives differ on multiple dimensions.[161]

And instead of helping retail investors make better decisions, the volume of information and options can overwhelm or confuse decisionmakers[162] or have lulling effect with respect to investor vigilance, particularly with respect to conflicts of interest.[163]

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157. INVESTMENT ADVISER ASSOCIATION, INVESTMENT ADVISER INDUSTRY SNAPSHOT 2023 2 (2023). *https://investmentadviser.org/wp-content/uploads/2023/06/Snapshot2023_Final.pdf* [https://perma.cc/9GLQ-58J4].

158. *2023 Fact Book: A Review of Trends and Activities in the Investment Company Industry*, ICI (2023), https://www.icifactbook.org/23-fb-data-tables.html#sec1 [https://perma.cc/4SJF-CQCM].

159. *Id.*

160. *US Equity and Related Statistics*, SIFMA (Jan. 2, 2024), https://www.sifma.org/resources/research/us-equity-and-related-securities-statistics/ [https://perma.cc/46SV-RUC5].

161. Barber & Odean, *supra* note 122, at 785 ("Attention-driven buying results from the difficulty that investors have searching the thousands of stocks they can potentially buy."). *Id.* at 786.

162. Paul Heidhues & Botond Köszegi, *Futile Attempts at Self-Control*, 7 J. EUR. ECON. ASS'N 423 (2009); *see also* Michael D. Grub, *Consumer Inattention and Bill Shock Regulation*, 82 REV. ECON. STUD. 219 (2015) (arguing that providing more information to certain consumers in certain markets can reduce social welfare).

163. In one study, researchers found disclosures regarding conflicts of interest did not improve decision-making because those who received the disclosures failed sufficiently to discount the conflicted advice, and thus failed to mitigate the effects of disclosed bias. Daylian M. Cain, George Loewenstein & Don Moore, *When Sunlight Fails to Disinfect: Understanding the Perverse Effects of Disclosing Conflicts of Interest*, 37 J. CONSUMER RES. (2011).

2. Regulatory Complexity.

Regulatory complexity further complicates matters. As noted above, retail investors traditionally have looked to broker-dealers and investment advisors for help with investment activity. These two types of intermediaries exist in very different regulatory siloes. (And because innovations—such as robo-advisors—generally must navigate within existing silos these categories remain relevant.[164]) Investment advisors historically have owed fiduciary duties of care and loyalty to investors when providing investment advice.[165] Broker-dealers traditionally owed investors a duty to seek the best execution reasonably available for customer securities orders[166] and the duty to comply with a "suitability rule" [167] when recommending a securities transaction or investment strategy involving securities to a customer. (Regulation BI, and its impact upon broker-dealer duties, is discussed below.) Neither the best execution standard nor the suitability rule is a fiduciary standard.

The financial services industry has always pitched having both the broker-dealer and investment advisor model in the retail investor financial services market as a benefit to investors from the perspective of investor choice. The problem from an investor protection point of view, however, is that retail investors appear to be confused by this nomenclature and unaware of differences in governing legal obligations. In a 2008 study, for example, the RAND Center for Corporate Ethics, Law, and Governance found that even when the distinction between firm types and legal obligations is clear as a legal/ regulatory matter, these distinctions are not clear to consumers.[168] According to the RAND researchers, this disconnect between legal/regulatory rules and

164. Robo-advisors—i.e., electronic platforms that provide automated investment advisory services based upon proprietary computer algorithms—generally must register as investment advisers with either the SEC or one or more state securities authorities. *See Investor Bulletin: Robo-Advisers*, U.S. SECS. & EXCH. COMM'N (Feb. 23, 2017), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_robo-advisers [https://perma.cc/5K54-WTWW].

165. *See supra* note 22.

166. *See Fact Sheet: Regulation Best Execution*, U.S. SECS. & EXCH. COMM'N (Dec. 14, 2022), https://www.sec.gov/files/34-96496-fact-sheet.pdf [https://perma.cc/6RL4-V2MX].

167. The suitability rule requires a broker-dealer to "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the [firm] or associated person to ascertain the customer's investment profile." *Rule 2111 Suitability*, FINRA (June 30, 2020), https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111 [https://perma.cc/2DGQ-9A72].

168. ANGELA A. HUNG ET AL., INVESTOR AND INDUSTRY PERSPECTIVES ON BROKER-DEALERS AND INVESTMENT ADVISORS 2 (2008) ("The main purpose of this study was to provide the SEC with a factual description of the current state of the investment advisory and brokerage industries for its evaluation of the legal and regulatory environment concerning investment professionals.").

customer perceptions exists in part because today's "firms tak[e] many different forms and offer[] a multitude of services and products."[169] In addition, many firms and financial professionals do not to use the legal terms "broker-dealer," "investment advisor," or "registered representative" in customer-facing marketing materials; instead; they use generic titles such as "advisor, financial advisor, or financial consultant."[170] The RAND study opined that "because of this diversity of business models and services," and nomenclature creep, "investors typically fail to distinguish broker-dealers and investment advisers along the lines that federal regulations define."[171] As a result, investors may not always know what type of firm they are dealing with or what legal standards—i.e., fiduciary or not—apply.[172]

As I have previously argued, there is a real concern that intermediaries operating under non-fiduciary standards will nudge consumers towards suboptimal investment options.[173] For example, in a 2013 Report on Conflicts of Interest in the financial services industry, FINRA observed that "the history of finance is replete with examples of situations where financial institutions did not manage conflicts of interest fairly."[174] According to the Report, one of the most "fundamental" potential conflicts of interest arises in the distribution channel when broker-dealers sell "products or services to generate revenue or

169. *Id.* at xiv.

170. *Id.* at xix.

171. *Id.* at xiv.

172. As the Consumer Federation of America has argued, presenting participants with written materials describing key differences between broker-dealers and investment advisers does not appear to dispel confusion. *CFA Letter to SEC on Rand CRS Testing Study*, CONSUMER FED'N OF AM. (Dec. 7, 2018), https://consumerfed.org/wp-content/uploads/2018/12/cfa-letter-to-sec-on-rand-crs-testing-study.pdf [https://perma.cc/5BFR-PP89]. As Langevoort likewise has observed, the legal status of broker-dealers has long been "very muddled" and while "there is a fiduciary-like dimension to their work . . . regulation has not yet been able to work through either the normative problem or the political thicket to achieve anything approaching coherence." Langevoort, *supra* note 17, at 995-96.

173. Sgarlata Chung, *supra* note 115, at 674-676 (citing FIN. INDUS. REGULATORY AUTHORITY, REPORT ON CONFLICTS OF INTEREST (2013), https://www.finra.org/rules-guidance/reports/conflicts-of-interest [https://perma.cc/4BB5-EVM8].

174. REPORT ON CONFLICTS OF INTEREST, *supra* note 173, at 1-2. In a 2015 report on the effects of conflicted investment advice on retirement savings, President Obama's Council of Economic Advisors cited a range of studies showing conflicted advice can lead to higher fees, biased advice, inappropriate risk-taking, inappropriate account rollovers, inappropriate diversification, asset misallocation, and market mistiming, and thus lower investment returns. COUNCIL OF ECON. ADVISORS, THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS 13 (2015), https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf [https://perma.cc/6PJQ-JXLB].

profit without proper regard to suitability standards."[175] Conflicts in the distribution channel are "magnified," according to FINRA, when a firm favors proprietary products or products for which the firm receives revenue sharing payments to the detriment of customer interests.[176]

A firm interested in nudging customers toward proprietary products or products where the firm benefits from revenue sharing might highlight these products on websites,[177] prioritize them in search results[178] place them on a "preferred" list of funds, or offer incentives to marketing staff to preferentially mention these products.[179] As the Report recognized, these steps can "limit customer choice," or "adversely affect the independence of the firm's new product or review process or a registered representative's recommendations."[180] Creating a decision-making environment limiting choice or encouraging customers to purchase costlier products to benefit the firm increases risk of investor harm.

IV. Stakeholders Are Using Regulatory Disclosure Under the '33 and '34 Acts to Deflect Attention Away From Suspect Business Practices and to Block Reform.

As discussed above, limits of human rationality, intermediary incentives, choice architecture dynamics, regulatory complexity, and investor confusion all make disclosure (even when routed through expert intermediaries) far from a cure-all for retail investor irrationality or decision-making.[181] These are reasons enough to consider how to bolster the '33 and '34 Act disclosure regimes. I argue below, however, reform is needed for the additional and independent reason that powerful market participants are leveraging and weaponizing these challenges to deflect attention away from problematic business practices and block reform.

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175. REPORT ON CONFLICTS OF INTEREST, *supra* note 173.

176. *Id.* at 23.

177. *Id.* at 23-24.

178. *Id.*

179. *Id.* at 24.

180. *Id.*

181. For example, researchers found providing the Summary Prospectus to investors—a shorter and theoretically more "digestible" disclosure document than the full prospectus—did not change retail investors' mutual fund selections and did not make investors behave more rationally with respect to loads and redemption fees. John Beshears et al., *How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices* (Nat'l Bureau of Econ. Rsch., Working Paper No. 14859, 2009), https://www.nber.org/system/files/working_papers/w14859/w14859.pdf [https://perma.cc/6PX3-Z9D4].

A. Regulatory Capture.

The idea that powerful industry stakeholders might try co-opting regulatory tools and systems finds partial expression in the concept of regulatory capture. In his 1971 work *The Theory of Economic Regulation*, George Stigler challenged the idea that regulatory systems arise and exist solely to advance the public interest by correcting market failures. Stigler argued for a theory of regulatory capture instead, or the idea that regulation is "acquired by the industry and is designed and operated primarily for its benefit."[182]

B. Encasing Markets.

The concept of market encasement represents an important addition to the literature examining stakeholder attempts to co-opt and control regulatory systems, in my view. In *Globalists: The End of Empire and the Birth of Neoliberalism*, Quinn Slobodian examined the origins of the neoliberal economic policies that underlie contemporary global trends in regulatory discourse and policy. Slobodian challenged received wisdom that neoliberalism is based upon the idea of global laissez faire self-regulating markets,[183] arguing instead that neoliberalism's core belief is that "markets are not natural but are instead products of the political constructions of institutions to encase them."[184] The fundamental goal of the neoliberal project, according to Slobodian, was (and is) to block political and/or regulatory intrusion into markets,[185]—i.e., to "encase" markets so as to "inoculate" and "safeguard" capitalism against the threat of democracy[186] and thereby protect private capital rights".[187]

Encasement theory offers important insights for disclosure discourse, in my view, because it explains something that might otherwise seem counterintuitive – i.e., why powerful market actors might affirmatively seek out regulation

182. *See* George Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971). Coming from a very different perspective, Brandeis appears to have arrived at a similar standpoint. Jonathan Sallet, *Louis Brandeis: A Man For This Season*, 16 COLO. TECH. L.J. 365, n.(2018).

183. QUINN SLOBODIAN, GLOBALISTS: THE END OF EMPIRE AND THE BIRTH OF NEOLIBERALISM 2 (2008).

184. *Id.* at 7. Scholars from law and political economy movement also have spoken to markets as a construct. *E.g.*, K. Sabeel Rahman, *Structural Inequality Part I*, LPE PROJECT (Feb. 28, 2018), https://lpeproject.org/blog/structural-inequality-and-the-law-part-i [https://perma.cc/EB7E-MSY3] ("While Hayek is correct that economic systems are indeed diffuse and lack a single coherent will, they are not "natural" systems beyond human agency. Markets are themselves products of law and politics, and the aggregate dynamics of market systems are similarly the result of background legal and political choices.").

185. *Id.* at 12.

186. *Id.* at 2, 4-5.

187. *Id.* at 12.

through disclosure. One dominant narrative from existing discourse is that entrenched actors oppose regulation generally, such that their main goal is to capture, gut, and ideally eliminate such systems. Of course, some actors may (still) take this approach. But as the case studies highlighted herein demonstrate, there are sophisticated and powerful actors who are actively seeking out regulatory disclosure—at least those rules that they can make in their own image—when faced with consequential rulemaking that poses risks to their business models. Encasement theory shows us that these actors are embracing regulatory disclosure as a strategy to fend off substantive regulation—the idea being that disclosing what they are doing is far more palatable to these actors than substantive constraints on their preferred ways of doing business. Encasement theory also shows us that "free markets" do not just happen; rather, powerful actors construct markets to prevent political and regulatory intrusions in business practices and to protect their private capital rights. Encasement theory thus helps to explain why powerful actors might actively seek out disclosure as a type of market-shaping regulation, especially when they are the ones doing the shaping. Trying to set the terms of the market via state power, in the form of regulatory disclosure systems, may seem contrary to market fundamentalism in theory, but is a natural part of it in practice.

Relatedly, in their 2023 work *The Big Myth: How American Business Taught Us To Loathe Government and Love the Free Market*, Naomi Oreskes and Erik M. Conway trace the origins and impacts of neoliberalism and so-called "market fundamentalism" upon regulatory discourse and policy.[188] Oreskes and Conway define market fundamentalism as a "quasi-religious belief that the best way to address our needs—whether economic or otherwise—is to let markets do their thing, and not rely on government."[189] The belief that markets function best when unregulated, and that any government action respecting markets is an assault on freedom and a step on the road to socialism or even totalitarianism, has long run deep in American culture, culminating in the 1980s in connection with Ronald Reagan's presidency, according to Oreskes and Conway. They argue that Reagan used tools that market fundamentalists had "honed over decades" in order to change the "national narrative" from one where the public accepted a "vigorous role for the federal government because history had demonstrated the need" to a narrative in which "[d]eregulation was the word of the day" and government was perceived as an "outside threat, interfering where it did not belong."[190] Oreskes and Conway argue that this shift in sentiment

188. Oreskes & Conway, *supra* note 13.

189. *Id.* at 3.

190. *Id.* at 286-87.

explains why contemporary political, legal, and economic discourse is so hostile to the idea of substantive regulation.[191]

Contemporary disclosure policy—specifically, our over-reliance on disclosure as a means of addressing structural conflicts of interests and market failures, coupled with a deep hostility towards substantive regulation—reflects and echoes these scholars' observations, in my view. Making regulatory disclosure a principal load-bearing regulatory tool speaks to the enduring influence of neoliberal thought and market fundamentalism on regulatory policy and discourse in the United States, and it represents a magical faith in the ability of markets to always arrive at the ideal answer.[192] And, as set forth below, when powerful market participants construct markets in their image and leverage magical thinking about market solutions combined with a hostility towards substantive regulation, we see the infrastructure of encasement at work—in markets where financial intermediaries have disclosure requirements but not a true fiduciary obligation to put retail investors' interests first, and in markets where fossil fuel companies seek to both limit disclosure obligations and to use purported compliance with disclosure rules to evade scrutiny and block reform.

191. As Paula Dalley has observed, "[r]egulatory disclosure schemes blossomed in the 1980s under the Reagan administration as part of a trend to inform and educate rather than regulate." Paula J. Dalley, *The Use and Misuse of Disclosure as a Regulatory System*, 34 FLA. ST. UNIV. L. REV. 1089, 1092-93 (2007) (observing that post-Reagan, regulatory disclosure schemes are seen as "preserv[ing] individual choice while avoiding direct governmental interference" and that such schemes "appeal[ed] to those with a promarket political orientation," because disclosure was thought to "address[] market failure without disturbing other beneficial features of the market."). As Dalley further observed, the preference for disclosure-based regulatory schemes in the wake of the Reagan years may reflect "an improved ability by regulated groups to use the legislative process to avoid direct regulation," as well as "increased influence by regulated parties on agency rulemaking." *Id.*

192. In the epistemology of Friedrich Hayek, one of the intellectual forefathers of neoliberalism, the market represents the sum of all possible knowledge. It is almost a super-consciousness, transcending the limits of any one human actor. If one has faith in the processing power of the overarching market like this, it makes sense that more input would always be the answer. Friedrich von Hayek, *The Pretence of Knowledge*, THE NOBEL PRIZE, https://www.nobelprize.org/prizes/economic-sciences/1974/hayek/lecture/ [https://perma.cc/S8A9-JPTF] (December 11, 1974) ("Into the determination of these prices and wages there will enter the effects of particular information possessed by every one of the participants in the market process—a sum of facts which in their totality cannot be known to the scientific observer, or to any other single brain. It is indeed the source of the superiority of the market order, and the reason why, when it is not suppressed by the powers of government, it regularly displaces other types of order, that in the resulting allocation of resources more of the knowledge of particular facts will be utilized which exists only dispersed among uncounted persons, than any one person can possess.").

C. Applying Encasement Theory to the Financial Services Industry.

The financial services industry is wealthy and enormously powerful, contributing billions to our gross domestic product (GDP)[193] and spending millions on lobbying.[194] Not all of this spending is by broker-dealers or touches retail investors, of course, but given the financial stakes,[195] principles of regulatory capture may explain, in part, why our existing regime typically allows industry stakeholders to use proof of disclosure as a defense to liability; that is, even in situations where it is clear the investor did not understand or even consider the disclosed information when making the decision at issue.[196]

Mapping encasement theory onto this analysis exposes how broker-dealers, in particular, are using their market power not just to capture the current disclosure regime but also to encase the market for retail investor financial services entirely so that disclosure, and not a robust fiduciary standard or similar set of substantive requirements and/or prohibitions, will remain the '33 and '34 Acts' primary investor protection tool. With the '33 and '34 Act mandatory disclosure regimes firmly in place, key players in the broker-dealer industry now appear to be *inviting* (or at least not actively opposing) disclosure requirements.[197] This is not because disclosure requirements have become less robust over the years compared to earlier periods. Rather, it is because key players in the broker-dealer industry understand that disclosure is far less disruptive to their business model and practices compared to a true fiduciary

193. *Value Added by Industry as a Percentage of Gross Domestic Product*, BUREAU ECON. ANALYSIS, https://www.bea.gov/data/gdp/gdp-industry [https://perma.Fcc/4XAQ-A2YJ] (last visited June 2023).

194. The Securities and Investment Industry spent reportedly spent $139,016,163 on lobbying at the federal level in 202Fglo2, *see Securities & Investment, Ctr. for Responsive Pol.*, OPENSECRETS https://www.opensecrets.org/federal-lobbying/industries/summary?cycle=2022&id=F07 [https://perma.cc/B2U6-W4BR] (last visited June 22, 2023) (breaking down the industry profile of the financial sector), the fourth highest amount (sorted by industry) in 2022. *See Industries Year 2022*, OPENSECRETS, https://www.opensecrets.org/federal-lobbying/industries?cycle=2022 [https://perma.cc/SJ5V-A2HP] (last visited June 22, 2023). *See also Client Profile: Securities Industry & Financial Mkt Assn: Summary for 2022*, OPENSECRETS (Apr. 24, 2023), https://www.opensecrets.org/federal-lobbying/clients/summary?id=D000000229&cycle=2022 [https://perma.cc/5FCK-FTSP].

195. *See* Stigler, *infra* note 212, at 3.

196. Easterbrook and Fischel have observed that the securities laws—particularly mandatory disclosure rules—may be "designed to protect special interest at the expense of investors" and they have argued that "there is little reason to think that the disclosure rules would produce benefits observable in the form of returns to investors." Easterbrook & Fischel, *supra* note 9, at 671, 709.

197. As Paula Dalley has observed, this trend is not limited to securities regulation: "[f]or the past several decades, legislators and regulators have adopted disclosure schemes to accomplish regulatory goals" with the result that "[m]andatory disclosure has become a sort of 'regulation-lite' extolled even by those who would ordinarily oppose regulation." Dalley, *supra* note 191, at 1090.

standard or other similarly robust set of conduct rules. Encasement theory thus exposes how the financial services industry is using the power of the state, in the form of regulatory disclosure, to keep the market for retail investor financial services free from other more onerous intrusions into their private capital rights.

1. Regulation Best Interest.

Regulation Best Interest (Regulation BI) offers an example of this approach. Regulation BI addresses the conduct standard that broker-dealers must follow when recommending transactions and related matters to customers. Investor protection advocates and other stakeholders have long expressed concerns about the lack of a fiduciary standard in the broker-dealer-customer relationship.[198] They also have questioned whether conflicts of interest cause firms to nudge consumers towards suboptimal investment options, particularly when fiduciary standards do not apply.[199]

Broker-dealers consistently have argued that imposing a true fiduciary standard would increase costs for investors and reduce investor choice. Thus, when faced with a renewed push to expand the fiduciary standard into broker-dealer spaces, the industry pushed back.[200] Through its trade association SIFMA,

198. *E.g. Testimony of Barbara Roper Before the H. Financial Services Committee Subcommittee on Investor Protection, Entrepreneurship & Capital Markets On Putting Investors First? Examining the SEC's Best Interest Rule*, CFA (March 14, 2019), https://www.congress.gov/116/meeting/house/109115/witnesses/HHRG-116-BA16-Wstate-RoperB-20190314.pdf [https://perma.cc/73QD-LN86].

199. REPORT ON CONFLICTS OF INTEREST, *supra* note 173, at 1. In a 2013 Report on Conflicts of Interest in the financial services industry, FINRA observed "the history of finance is replete with examples of situations where financial institutions did not manage conflicts of interest fairly." *Id.* at 1-2; *see also* Donald Langevoort, *Psychological Perspectives on the Fiduciary Business*, 91 B.U. L. REV. 995, 999 (2011) ("[T]here is room to exploit in the securities business—more often in subtle ways than blatant ones—and there are rich payoffs from doing so."). In a 2015 report on the effects of conflicted investment advice on retirement savings, President Obama's Council of Economic Advisors cited a range of studies showing conflicted advice can lead to higher fees, biased advice, inappropriate risk-taking, inappropriate account rollovers, inappropriate diversification, asset misallocation, and market mistiming, and thus lower investment returns. COUNCIL OF ECON. ADVISORS, *supra* note 174, at 13.

200. The financial services industry also has opposed the expansion of the fiduciary standard under the Employee Retirement Income Security Act (ERISA). For the Department of Labor's latest proposal, *see Fact Sheet: Retirement Security Proposed Rule and Proposed Amendments to Class Prohibited Transaction Exemptions for Investment Advice Fiduciaries*, U.S. DEP'T OF LABOR (Oct. 31, 2023), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/retirement-security-proposed-rule-and-proposed-amendments-to-class-pte-for-investment-advice-fiduciaries [https://perma.cc/95KC-VA2C]. As of this writing, SIFMA is seeking additional time for comment. *Joint Trade Associations Urge Department of Labor to Extend Timeline on Proposed Retirement Security Rule*, SIFMA (Nov. 8, 2023), https://www.sifma.org/

the brokerage industry pushed for the "best interest" standard—and opposed the imposition of a uniform fiduciary standard—during the comment process for what would become Regulation BI.[201] They also lobbied federal officials on this issue.[202]

In Regulation BI, the brokerage industry got what it wanted. As adopted, the stated goal of Regulation BI is to ensure that "regardless of whether a retail investor chooses a broker-dealer or an investment adviser (or both), the retail investor will be entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that is in the best interest of the retail investor and that does not place the interests of the firm or the financial professional ahead of the interests of the retail investor."[203] This was pitched as a way preserve the economic viability of the broker-dealer model (by not imposing a robust fiduciary standard upon broker-dealers when recommending transactions to customers) while still ensuring that financial services professionals would act in the best interest of customers when making recommendations.

In reality, however, Regulation BI allows the brokerage industry to use regulatory disclosure to avoid a true fiduciary standard when making recommendations to customers, and more broadly to keep the fiduciary standard out of the broker-dealer regulatory regime. Regulation BI provides

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resources/news/joint-trades-associations-urge-department-of-labor-to-extend-timeline-on-proposed-retirement-security-rule/ [https://perma.cc/DFY4-QK29]. SIFMA has been critical of past efforts to expand the fiduciary standard in this space. *SIFMA Comment Letters Critical of DOL Fiduciary Rule*, SIFMA (April 17, 2017), https://www.sifma.org/resources/news/sifma-comment-letters-critical-of-dol-fiduciary-rule/ [https://perma.cc/TH38-HJED].

201. *Regulation Best Interest (Reg BI)*, SIFMA (Aug. 7, 2018), https://www.sifma.org/resources/submissions/regulation-best-interest-reg-bi/ [https://perma.cc/Z9XB-3W7A]. Consumer protection advocates have been critical of purported best interest standards in other contexts involving consumer financial products, as evidenced by this April 4, 2023 bulletin from the Consumer Federation of America concerning the insurance industry entitled. *Why NAIC's Fake "Best Interest" Standard Does Not Protect Retirement Savers from Harmful Advice*, CFA (Apr. 4, 2023), https://consumerfed.org/consumer_info/why-naics-fake-best-interest-standard-does-not-protect-retirement-savers-from-harmful-advice/ [https://perma.cc/G2QV-DSA6].

202. According to OpenSecrets' database, SIFMA also spent millions of dollars lobbying federal officials and agencies (including the SEC) during the relevant period on a variety of topics, including Regulation Best Interest. *Client Profile: Securities Industry & Financial Mkt Ass'n: Summary for 2022*, *supra* note 194. For example, SIFMA's Lobbying Disclosure Act (LDA) Form for the Fourth Quarter of 2019 reveals that SIFMA lobbied federal officials on the specific issue of Regulation Best Interest. *Securities Industry and Financial Markets Association Lobbying Report*, U.S. SENATE (Jan. 21, 2020, 5:25 PM), https://lda.senate.gov/filings/public/filing/ae9f1183-4c68-4e70-9d03-9d80b947a9a4/print/ [https://perma.cc/49LT-GRPT] (listing "SEC Final Regulation Best Interest" as a specific lobbying issue).

203. Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86031, 84 F.R. 33318, 33319 (June 5, 2019) ("Reg BI Adopting Release").

that when making a recommendation to a retail customer, a broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests.[204] This is called the "General Obligation." Regulation BI further provides that the General Obligation is satisfied only if the broker-dealer complies with four component obligations. These obligations are: (i) providing required disclosure before or at the time of the recommendation, about the recommendation and the relationship between the retail customer and the broker-dealer ("Disclosure Obligation"); (ii) exercising reasonable diligence, care, and skill in making the recommendation ("Care Obligation"); (iii) establishing, maintaining, and enforcing policies and procedures reasonably designed to address conflicts of interest ("Conflict of Interest Obligation"), and (iv) establishing, maintaining, and enforcing policies and procedures reasonably designed to achieve compliance with Regulation Best Interest ("Compliance Obligation").[205]

Drilling down on the Disclosure Obligation, Regulation BI provides that broker-dealers must, "prior to or at the time of the recommendation, provides the retail customer, in writing, full and fair disclosure" of the following:

> (A) All material facts relating to the scope and terms of the relationship with the retail customer, including:
>
> (1) That the broker, dealer, or such natural person is acting as a broker, dealer, or an associated person of a broker or dealer with respect to the recommendation;
>
> (2) The material fees and costs that apply to the retail customer's transactions, holdings, and accounts; and
>
> (3) The type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer; and
>
> (B) All material facts relating to conflicts of interest that are associated with the recommendation.[206]

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204. In particular, Regulation BI provides that "A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.") *Id.*

205. For FINRA's summary of Regulation BI's requirements, *see Reg BI and Form CRS*, FINRA (Jan. 13, 2023), https://www.finra.org/rules-guidance/guidance/reports/2023-finras-examination-and-risk-monitoring-program/reg-bi-form-crs [https://perma.cc/PPE8-SXQY].

206. Regulation BI's Conflict of Interest Obligation requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to:

There are layers of problems with this approach. First, Regulation BI assumes that individual retail investors appreciate differences between legal and regulatory categories and standards—e.g., broker-dealer vs investment advisor, recommendations vs. advice, best interest vs. fiduciary standard. There is little evidence that investors appreciate such technical distinctions in legal standards or regulatory silos. Second, Regulation BI assumes that the obligation to disclose non-fiduciary status (along with fees and material conflicts of interest) will enable retail investors to make informed decisions about what type of intermediary to use and how to manage and mitigate risks and conflicts of interests.[207] Again, the evidence supporting this assumption at the level of individual retail investors making individual investors is thin, at best.[208] There are other gaps, as well.[209]

(A) Identify and at a minimum disclose, in accordance with paragraph (a)(2)(i) of this section, or eliminate, all conflicts of interest associated with such recommendations;

(B) Identify and mitigate any conflicts of interest associated with such recommendations that create an incentive for a natural person who is an associated person of a broker or dealer to place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer;

(C) *(1)* Identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, in accordance with subparagraph (a)(2)(i), and *(2)* Prevent such limitations and associated conflicts of interest from causing the broker, dealer, or a natural person who is an associated person of the broker or dealer to make recommendations that place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; and

(D) Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.

Regulation Best Interest: The Broker-Dealer Standard of Conduct, *supra* note 203.

207. As the Consumer Federation of America has observed, "[t]he regulation of broker-dealers and investment advisers relies heavily on disclosure to protect investors. Between them, Form CRS, the ADV Form, and Reg. BI disclosures are supposed to enable investors: 1) to make an informed choice among different investment professionals and 2) to arm them with important facts, including information about costs and conflicts of interest, they need to protect themselves when working with an investment professional." Letter to Chairman Gensler on Advice Standards, CONSUMER FED'N OF AM. (APR. 19, 2021), https://consumerfed.org/wp-content/uploads/2021/04/Letter-to-Chairman-Gensler-on-Advice-Standards.pdf [https://perma.cc/BGC9-X9CL].

208. As the Consumer Federation of America also observed, "[t]he Commission gives all this weight to disclosure in its regulation of brokers and advisers despite overwhelming evidence, including in studies that the Commission itself initiated, that these disclosures are not effective either in supporting an informed selection among investment professionals or in arming investors to protect themselves against harmful practices." *Id.*

209. For example, Regulation BI does not apply to recommendations made to retirement plans or to recommendations involving non-securities. *Despite the SEC's Regulation Best Interest, Retirement Savers Still Remain Vulnerable to Bad Advice in Critical Ways*, CONSUMER FED'N OF AM. (Apr. 4, 2023), https://consumerfed.org/consumer_info/

Discourse from the Regulation BI rulemaking process is revealing. In 2018, the RAND Corporation released a study performed at the Commission's behest in connection with the Regulation BI rulemaking process.[210] The study observed that Regulation BI proposed to require both investment advisers and broker dealers to provide a relationship summary disclosure to clients and customers to inform them as to the relationships and services that the firm offers, the applicable standard of conduct, fees and costs, and conflicts of interest.[211] The goal of the survey and associated interviews was to collect feedback on a sample/ draft relationship summary disclosure form. It was *not* designed to test respondents' objective comprehension (or lack thereof) respecting the substance of the disclosures.

In its Report, the RAND researchers noted, in quantitative terms, varying levels of satisfaction with specific disclosures in the model form. What is striking, however, is that the in-depth interviews described in the Report showed that even after a careful reading of the proposed disclosure materials, many of the respondents failed to understand key pieces of information that would have "help[ed] them determine whether a brokerage or advisory account would best suit their needs."[212] As the investor rights advocacy group the Consumer Federation of America (CFA) observed, most of the interview subjects "[did] not understand key differences between the fiduciary standard for investment advisers and the best interest standard for broker-dealers, nor [did] they understand the harmful impact that conflicts of interest can have on the recommendations they receive.[213]

A January 2023 Risk Alert released by the SEC's Division of Examinations reveals that disclosure failures, conflicts of interest, and investor confusion

despite-the-secs-regulation-best-interest-retirement-savers-still-remain-vulnerable-to-bad-advice-in-critical-ways/ [https://perma.cc/J82T-ZZWY].

210. Angela A. Hung et al., *Investor Testing of Form CRS Relationship Summary*, RAND CORPORATION (November 2018), https://www.sec.gov/about/offices/investorad/investor-testing-form-crs-relationship-summary.pdf [https://perma.cc/7AU3-EP7M].

211. *Id.* at 50-51.

212. CFA Letter to SEC on Rand CRS Testing Study, *supra* note 172.

213. *Id.* (arguing the difficulty of developing disclosure suitable for retail investors "is an important reason why we have consistently urged the Commission to minimize the central importance of the disclosures by adopting a strong fiduciary standard, backed my meaningful limits on conflicts, for broker-dealers and investment advisers alike."). As the CFA further observed, the proposed relationship disclosure materials did not change the fact that (i) "Most investors do not have a good understanding of key differences between broker-dealers and investment advisers"; (ii) "Many investors do not appear to understand brokers' and advisers' legal obligations or how they relate to conflicts"; (iii) "Investors do not appear to understand important differences in monitoring obligations for brokers and advisers"; and (iv) "Investors are confused and overwhelmed by CRS fee disclosures. *Id.*

remain significant issues three years after Regulation BI went into effect.[214] As the alert observed, some broker-dealers have dually-licensed financial professionals—meaning people who are licensed as registered representatives of the broker dealers and who also serve as an investment adviser representative.[215] Commission staff found that "[s]ome broker-dealers with financial professionals holding multiple licenses failed to establish reasonably designed policies and procedures to ensure that the financial professional was disclosing to retail customers the capacity in which the financial professional was acting. As a result, the staff observed instances where the capacity of the financial professional was not being disclosed to the retail customer prior to or at the time of the recommendation."[216] The Commission further found that "[s]ome broker-dealers failed to establish policies and procedures reasonably designed to identify the disclosures that should be made with respect to conflicts that are specific to financial professionals that interact with retail customers in multiple capacities."[217]

For the broker-dealer industry, Regulation BI was a big win. The industry got to keep what was essentially their pre-Regulation BI non-fiduciary conduct standard,[218] knowing that the additional and specific disclosures required by Regulation BI were not likely to have a material impact on retail customer interactions. Under Regulation BI, disclosure still can result in "informed consent on the part of the investor, such that practices that are not in investors' best interests, if disclosed, may nonetheless be permissible."[219] This (mis)use of disclosure to preserve an industry-friendly status quo, and to block the

214. *Observations from Broker-Dealer Examinations Related to Regulation Best Interest*, DIV. OF EXAMINATORS (Jan. 30, 2023), https://www.sec.gov/file/exams-reg-bi-alert-13023.pdf [https://perma.cc/QN39-N33Y].

215. *Id.*

216. *Id.*

217. *Id.*

218. The Consumer Federation of America observed at the time of the Commission's vote to adopt Regulation BI, FINRA Rules already required broker's recommendations to be "consistent with their customers' best interests." Regulation BI did not change that standard. *CFA "Best Interest" Bait and Switch*, CONSUMER FED'N OF AM. https://consumerfed.org/wp-content/uploads/2019/06/CFA-Best-Interest-Bait-and-Switch.pdf [https://perma.cc/N4EY-7MUT] (last visited July 19, 2023).

219. Letter to Chairman Gensler on Advice Standards, *supra* note 207. There are other examples of how non-fiduciary intermediaries are using disclosure to block substantive reforms. For example, as set forth in an MSRB interpretive notice, Rule G-17 requires a variety of disclosures relating to the role of underwriters—including disclosure of certain conflicts of interest and the *non-fiduciary* nature of the issuer-underwriter relationship. *See What to Expect from Your Underwriter*, MSRB (Jan. 01, 2012), https://msrb.org/msrb1/pdfs/MSRB-Rule-G-17-For-Issuers.pdf [https://perma.cc/99CN-74AP].

imposition of a true fiduciary standard, is an example of encasement that risks undermining the '33 and '34 Acts' investor protection goals.[220]

D. Applying Encasement Theory to Fossil Fuel Issuers.

1. Proposed Climate Risk Disclosure Rules.

A second example of the attempted co-opting and (mis)use of mandatory disclosure concerns the fossil fuel industry and the Commission's proposed climate risk disclosure rules. As with the prior case study involving non-fiduciary financial intermediaries and Regulation Best Interest, fossil fuel companies are engaged in an active and highly consequential fight over regulatory policy with implications for both the industry's core business model (exploration, extraction, and production) and the role and function of disclosure as a regulatory tool. Additionally, as with the prior case study, the fossil fuel industry offers a compelling and real-time example of how a powerful actor is (mis)using disclosure to block what they see as more onerous political, legal, and/or regulatory interference with their preferred methods of doing business. Finally, as with the prior case study, encasement theory helps to explain why these actors, perhaps counterintuitively, are not afraid to embrace and hijack the state's regulatory power as expressed in a disclosure regime to get the "free" (from substantive regulation) market that they want.

On March 15, 2021, the SEC issued a request for public comment on whether existing disclosure rules and regulations adequately and appropriately address climate change risks, uncertainties, and impacts.[221] One year later, in March 2022, the SEC released proposed rule changes respecting climate risk disclosures. The proposed rules were designed to "require registrants to provide certain climate-related information in their registration statements and annual reports" including "information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition."[222] The required disclosures were slated to include

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220. Investors rights advocates raised similar concerns about guidance on the Investment Advisers Act fiduciary standard released along with Regulation BI, noting that it too "continues to over-rely on disclosure without any evidence that the required disclosures are effective in protecting investors' interests." Letter to Chairman Gensler on Advice Standards, *supra* note 207; *CFA and AFR Warn: SEC's "Regulation Best Interest" Will Harm Vulnerable Investors*, CONSUMER FED'N OF AM. (May 30, 2019), https://consumerfed.org/in_the_media/cfa-and-afr-warn-secs-regulation-best-interest-will-harm-vulnerable-investors/ [https://perma.cc/4CYJ-ENFY].

221. Allison Herren Lee, *Public Input Welcomes on Climate Change* Disclosures, U.S. SECS. & EXCH. COMM'N (Mar. 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures [https://perma.cc/8JT3-HCG4].

222. *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors*, U.S. SECS. & EXCH. COMM'N (Mar. 21, 2022), https://www.sec.gov/news/press-release/2022-46 [https://perma.cc/FX24-T2AU].

disclosure of greenhouse gas emissions (GHG) and certain climate-related financial metrics in audited financial statements.

The proposed rule changes were designed to require registrants to disclose information about (i) the registrant's governance of climate-related risks and relevant risk management processes; (ii) how any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term; (ii) how any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; and (ii) the impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements.

The proposed rules also require[d] registrants to disclose information about its direct GHG emissions (Scope 1) and indirect emissions from purchased electricity or other forms of energy (Scope 2). In addition, the proposed rules also would have required registrants to disclose GHG emissions from upstream and downstream activities in its value chain (Scope 3) if material or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions. These proposals for GHG emissions disclosures were intended to provide investors with decision-useful information to assess a registrant's exposure to, and management of, climate-related risks. The proposed rules contained a safe harbor for liability from Scope 3 emissions disclosure and an exemption from the Scope 3 emissions disclosure requirement for smaller reporting companies. The proposed disclosures also were intended and designed to be similar to those that many companies already provide "based on broadly accepted disclosure frameworks, such as the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol."[223]

According to SEC Chair Gensler, the purpose of the proposed rule changes was to "provide investors with consistent, comparable, and decision-useful information for making their investment decisions" and to "provide consistent and clear reporting obligations for issuers."[224]

"Our core bargain from the 1930s is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures. Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions. Today's proposal would help issuers more efficiently and effectively disclose these risks and meet investor demand, as many issuers already seek to

223. *Id.*

224. *Id.*

do. Companies and investors alike would benefit from the clear rules of the road proposed in this release. I believe the SEC has a role to play when there's this level of demand for consistent and comparable information that may affect financial performance. Today's proposal thus is driven by the needs of investors and issuers."[225]

The idea is to ensure disclosure of material facts having to do with climate risk so that investors (and by extension markets) can factor climate risk/exposure into investment risk assessment and pricing determinations.[226]

2. ConocoPhillips

As an example of how powerful fossil fuel industry players have tried to leverage '33 and '34 Act disclosure norms and the Commission's rulemaking process to encase markets—and thereby shut down dialog and limit reform—I have chosen to focus on ConocoPhillips ("CP"). Headquartered in Houston, Texas, CP describes itself as "the world's largest independent exploration and production ("E&P") company."[227] As discussed below, CP submitted two letters as part of the Commission's rulemaking process respecting climate risk disclosure, and it also formally and informally lobbied federal officials—including Commission staff.

A review of CP's comment letters, Lobbying Disclosure Acts ("LDA") forms available through OpenSecrets and materials obtained through a Freedom of Information Act (FOIA) request reveals that CP focused on several key messages in connection with the Commission's proposed rulemaking. First, CP touted its climate change bona fides, purporting to acknowledge the reality of climate change, the impact of greenhouse gas (GHG) emissions resulting from fossil fuel use on global average temperatures, and the need for swift action. In its June 11, 2021 comment letter, for example, CP said that "[w]e have long recognized the need for action to address climate change and have been reporting on our performance to reduce our GHG emissions since 2003."[228] In its June 2022 comment letter, CP said that "acknowledge[s] the findings of the Intergovernmental Panel on Climate Change that greenhouse gasses from the use of fossil fuels contribute to increases in global temperatures."[229] CP also said that it supports the Paris Agreement, and believes that the Paris Agreement's

225. *Id.*

226. *Id. See also* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 94478, 87 F.R. 29059 (Mar. 21, 2022).

227. *Response to SEC Request for Public Input*, CONOCOPHILLIPS 1 (June 11, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8906881-244210.pdf [https://perma.cc/6XF7-TJFH] (hereinafter "June 2021 Letter").

228. *Id.*

229. June 2022 Comment Letter, *supra* note 19, at 1.

"central aim"—to reduce greenhouse gas emission and thereby to limit the increase in global average temperature—"is a worldwide imperative for companies and governments alike."[230]

Second, CP tried to position itself as an industry leader in responding to the climate crisis. In one June 2022 letter, for example, CP claimed to have a "net-zero operating emissions ambition" and touted the "valuable" role it says that it is playing in the energy transition away from fossil fuels.[231]

Third, CP acknowledged the need for climate risk disclosures and tried to position itself as the oil and gas industry leader respecting such disclosure. For example, in its June 2021 letter, CP acknowledged "investor interest in obtaining decision-useful information around climate-related risks."[232] CP made a similar point in its June 2022 letter, saying that "providing stockholders with information on climate-related risks is an important step towards transparency, accountability and action on climate change.[233] CP also touted the quality and quantity of its climate-related disclosures, its alignment with existing disclosure frameworks, and its commitment to disclosure generally in the June 2022 letter.

CP likely lobbied federal officials around this messaging. A review of CP's Lobbying LDA forms available through OpenSecrets reveals that that CP has lobbied federal officials on the specific issue of climate risk disclosure for the past several years.[234] CP's Q1 2021 LDA, for example, reports that CP lobbied the Commission on "Environmental, social, and corporate governance disclosure communications- planning only. SEC communications and Request for Information responses on climate related financial disclosures."[235] In its Q1 2022 LDA, CP reported that it had lobbied on the issue of "[d]etermination of impact of SEC's 'Enhancement of Climate-related Disclosure for Investors.'" (planning only").[236] In its Q1 2023 LDA, CP reported that it had lobbied lawmakers and the Commission on "[c]oncerns and unintended consequences of SEC File No. A7-10-22 "The Enhancement and Standardization of Climate-Related Disclosure for

230. *Id.*

231. *Id.*

232. June 2021 Letter, *supra* note 227, at 1.

233. June 2022 Comment Letter, *supra* note 19, at 1.

234. *ConocoPhillips Summary,* OPENSECRETS (2022), https://www.opensecrets.org/orgs/conocophillips/summary?id=D000000303 [https://perma.cc/85FK-AVZY].

235. *ConocoPhillips Lobbying Report,* U.S. SENATE (Apr. 19, 2021, 9:33 AM), https://lda.senate.gov/filings/public/filing/d2002b91-8b4f-4114-b33b-19a5a73dc6f3/print/ [https://perma.cc/JY53-3UQ6].

236. *ConocoPhillips Lobbying Report,* U.S. SENATE (Apr. 20, 2022, 1:57 PM), https://lda.senate.gov/filings/public/filing/d2f692b0-e3ad-40ab-a46d-a9a579bae82d/print/ [https://perma.cc/8U72-H2H9].

Investors."[237] (The American Petroleum Institute (API), an industry trade group (of which CP reportedly is a member[238]), likewise lobbied the Commission on the issue of climate risk disclosure, as well: In its 2021 Q3 LDA disclosure, for example, the API disclosed that it lobbied the Commission on "Efforts related to climate-related financial disclosure proposals.")[239]

Although we do not know the substance of these discussions, email communications exchanged between Jody Freeman and John Coates obtained through a Freedom of Information Act (FOIA) request may suggest areas of focus. Jody Freeman is the Archibald Cox Professor of Law at Harvard Law School and Director of HLS's Environmental and Energy Law Program. She also was, until August 2023, a CP board member, a post for which she reportedly received $367,584 in compensation in 2022.[240] John Coates is a Harvard Law School professor who was named Director (Acting), Division of Corporation Finance during the relevant period.[241]

The FOIA emails reveal that Freeman reached out to Coates around the time Coates was transitioning into his role at the Division of Corporation Finance to set up a meeting between Coates and two senior CP officials—a Senior Vice President for Strategy, Exploration, and Technology and CP's Global Head of Sustainability. In advocating for the meeting, Freeman commented that the two CP officials are "hugely knowledgeable, thoughtful, and interested in solving problems—I can promise that you will get high value from this engagement."[242] Freeman further touted CP's disclosure *bona fides*, stating that "ConocoPhillips is widely recognized as the oil and gas industry leader on climate related

237. *ConocoPhillips Lobbying Report*, U.S. SENATE (Apr. 20, 2023, 2:55 PM), https://lda.senate.gov/filings/public/filing/69ccaaaa-91f4-4df3-8a5f-9631e664dfba/print/ [https://perma.cc/9Q4X-JXDP].

238. American Petroleum Institute, Members, https://www.api.org/membership/members [https://perma.cc/HE2A-GXWB] (last visited April 03, 2024).

239. *American Petroleum Institute Lobbying Report*, U.S. SENATE (Apr. 20, 2021, 5:03 PM), https://lda.senate.gov/filings/public/filing/c1b2a4b4-e0c7-49ec-ae90-67e0bf0666fa/print/ [https://perma.cc/RDT3-E8PH].

240. *2023 Proxy Statement*, CONOCOPHILLIPS 51 (Apr. 3, 2023), https://static.conocophillips.com/files/resources/conocophillips-2023-proxy.pdf [https://perma.cc/W48W-WR6X].

241. CV available at https://hls.harvard.edu/faculty/john-c-coates/ [https://perma.cc/2CSM-WDBT] (last visited June 23, 2023).

242. Dharna Noor, *Harvard Environmental Law Professor Resigns From ConocoPhillips After Months of Scrutiny*, The Guardian (Aug. 4, 2023, 5:58 PM), https://www.theguardian.com/us-news/2023/aug/04/harvard-professor-resigns-conocophillips-board [https://perma.cc/TR9T-ZRM4].

disclosure."[243] Freeman also referenced CP's work on/ alignment with existing disclosure frameworks.[244]

The meeting appears to have occurred, according to the FOIA email traffic, and there appears to have been substantive follow-up communications, as well. Freeman has come under criticism for these communications for several reasons—including for using her Harvard Law School email account to arrange meetings between CP personnel and Commission staff. It also is noteworthy that Freeman proceeded outside the lobbying registration and disclosure framework established by federal law.

So, how do CP's actual business practices match up with this messaging? In a nutshell, CP is not an industry leader in responding to the climate crisis. Climate Action 100+ (CA100), an "an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change"[245] has developed a "disclosure framework" that evaluates "the adequacy of corporate disclosure in relation to key actions companies can take to align their businesses with the Climate Action 100+ and Paris Agreement goals."[246] According to CA100's benchmarks, CP has not set substantive emissions reduction goals, has not aligned its capital spending with its nominal net-zero pledges, and has done little to ensure that its direct and indirect lobbying activities further its stated decarbonization commitments.[247] The Carbon Tracker Initiative, a think tank that analyzes the impact of the energy transition on capital markets, also ranks CP's climate plans towards the bottom of all major investor-owned fossil fuel companies.[248]

In fact, CP appears to be doubling down on its fossil fuel-centric business model. CP's lobbying expenditures and political contributions are particularly revealing in this regard. According to OpenSecrets, CP "supercharged its federal lobbying operation in 2022" as it sought final approval for Willow, a controversial oil project in the Alaskan Arctic that President Biden's administration authorized in March 2023.[249] OpenSecrets reports that CP spent

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243. *Id.*

244. *Id.*

245. *About Climate Action 100+*, CLIMATE ACTION 100+, https://www.climateaction100.org/about/ [https://perma.cc/7MYT-J7Q3] (last visited July 18, 2023).

246. *Company Assessment: ConocoPhillips*, CLIMATE ACTION 100+ (Oct. 2022), https://www.climateaction100.org/company/conocophillips/#skeletabsPanel5 [https://perma.cc/7SL5-HJNJ].

247. *Id.*

248. Mike Coffin, *Absolute Impact 2021: Why Oil and Gas 'Net Zero' Ambitions are Not Enough*, CARBON TRACKER (May 27, 2021), https://carbontracker.org/reports/absolute-impact-2021/ [https://perma.cc/THS5-9A7R].

249. Jimmy Cloutier, *ConocoPhillips Increased Lobbying Spending in 2022 Ahead of Biden-approved Oil Project*, OPENSECRETS (Mar. 16, 2023, 3:54 PM), https://www.

$8,690,000 USD on lobbying at the federal level in 2022 compared to $4,439,800 USD in 2021.[250] This placed CP third on a list of oil and gas industry clients ranked by spending on federal lobbying in 2022, following only Koch Industries (No. 1) and Occidental Petroleum (No. 2).[251] A review of CP's Lobbying Disclosure Act (LDA) forms reveals that that CP has lobbied on range of issues in recent years including taxation, oil and gas regulation generally and the Willow project in particular.[252]

CP also made $3,675,698[253] in political contributions in 2022, mainly to Republican lawmakers and candidates for office.[254] Alaska's senior senator Lisa Murkowski was at the top of the contribution list in 2022 ($41,450 total with $31,450 coming from individuals affiliated with CP and $10,000 coming from CP itself). In its reporting, OpenSecrets has commented on the close ties between CP's lobbying team and Senator Murkowski.[255]

CP's claims about being a leader respecting disclosure also are belied by CP's conduct, especially when viewed from the vantage point of the Acts' investor protection and market integrity objectives. One way the CP is seeking to maintain the regulatory status quo—rather than leading—is to urge the Commission to leverage existing frameworks and standards versus promulgating new (and more rigorous) disclosure rules. For example, in its June 2021 letter, CP urged the Commission to "leverage" existing reporting disclosure

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opensecrets.org/news/2023/03/conocophillips-lobbying-2022-willow/#:~:text=In%20many%20states%2C%20the%20oil,Alaska%20and%20the%20federal%20government [https://perma.cc/HWH7-X9AL].

250. *ConocoPhillips Summary*, *supra* note 234.

251. Inci Sayki & Jimmy Cloutier, *Oil and Gas Industry Spent $124.4 Million on Federal Lobbying Amid Record Profits in 2022*, OPENSECRETS (Feb. 22, 2023, 3:52 PM), https://www.opensecrets.org/news/2023/02/oil-and-gas-industry-spent-124-4-million-on-federal-lobbying-amid-record-profits-in-2022/?utm_source=Twitter&utm_medium=social&utm_campaign=twitt_gas-oil-lobbying/2/23/23 [https://perma.cc/36BY-8G2Z].

252. *See ConocoPhillips Lobbying Report*, *supra* note 235; *ConocoPhillips Lobbying Report*, *supra* note 236; *ConocoPhillips Lobbying Report*, *supra* note 237.

253. *ConocoPhillips Summary*, *supra* note 234.

254. For example, in the 2022 election cycle, approximately. 76% of CP's contributions to Congressional Candidates went to Republican candidates. *ConocoPhillips Recipients*, OPENSECRETS (2022), https://www.opensecrets.org/orgs/conocophillips/recipients?id=D000000303 [https://perma.cc/R2RA-ZWVD]. This is consistent with CP's spending over time, according to OpenSecrets data. *ConocoPhillips Totals*, OPENSECRETS, https://www.opensecrets.org/orgs/conocophillips/totals?id=D000000303 [https://perma.cc/W3LX-VV6P] (last modified 2022).

255. *Id.*

frameworks and standards to establish ESG reporting standards in order to "minimize disclosure- and compliance- related burdens on companies."[256]

CP also has urged the Commission to adopt frameworks rather than requirements. In its June 2021 comment letter for example, CP urged the Commission to use a "hybrid" approach to disclosure that shies away from "a global standard with prescriptive metrics" and makes "sparing[]" use of minimum disclosures[257] and/or mandatory disclosures.[258] June 2022 letter, CP that Scope 1 and 2 emissions disclosures should not be mandatory, citing the "feedback" that it has received "investors and other stakeholders" that its current emissions disclosures made in reports to regulators and in public sustainability reports "already satisfy" their needs.[259]

CP also has sought to leverage traditional securities laws principles to declare certain topics and proposed rules to be out of bounds. For example, in its June 2022 letter, CP urged the Commission to pare back proposed disclosure requirements, arguing that the disclosures called for by the Commission's proposal would be "far more extensive than what would be considered material by reasonable investors" under traditional securities law principles.[260] Sounding very much like the stockbrokers who objected to prospectus disclosure requirements in the early days of the '33 and '34 Act, CP also repeatedly has argued (including in its June 2022 letter) that the costs and burdens of the proposed disclosure rules would outweigh benefits to investors.

Through the example of CP, we see a two-pronged approach to climate risk rules emerging from the industry. Fossil fuel companies—and CP is far from alone—are trying to weaken disclosure expectations and hamper enforceability of new regulations. Yet they are simultaneously embracing the idea (or at least the rhetoric) of disclosure in an effort to paint themselves as responsible actors. It is inadequate to describe CP's response to the SEC's proposed rules merely as one of opposition. There are ways in which CP and its industry cohort have welcomed disclosure discourse—insofar as it allows them to undermine the case for broader sorts of regulation as well. In this way, CP and its cohorts have used disclosure to encase markets—and thereby block both discourse and substantive reform.

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256. *2023 Proxy Statement*, CONOCOPHILLIPS (Apr. 3, 2023), https://static.conocophillips.com/files/resources/conocophillips-2023-proxy.pdf [https://perma.cc/AA9L-HH45].

257. June 2021 Letter, *supra* note 227, at 3.

258. June 2022 Comment Letter, *supra* note 19, at 9 ("Scope 1 ad 2 emissions should not be made mandatory.").

259. *Id.*

260. *Id.* at 2.

V. Proposed Reforms

Faced with the realities of bounded rationality, self-serving industry stakeholder incentives, and a political climate that equates substantive regulation with an assault on freedom, the prospect of meaningful reform appears bleak. I am also mindful of concern that even well-intended regulatory strategies can result in coercion or impose undue costs and burdens on personal freedoms and autonomy.[261] With these considerations in mind, and recognizing that both the timing of and strategy for reform will require careful consideration and consensus-building, the following Section proposes reforms that take into account the strengths and limitations of regulatory disclosure schemes, preserve the agency and autonomy of retail investors and other stakeholders, and remain vigilant respecting the risks of both regulatory failure and regulatory overreach.[262]

A. Make the Fiduciary Standard the Industry Standard for Investment Recommendations and Advice.

As a first step in addressing the (mis)use of '33 and '34 Act regulatory disclosure by non-fiduciary intermediaries, I propose that we amend the '33 and '34 Acts and accompanying regulatory regimes to require all financial intermediaries (including broker-dealers) to comply with a robust, non-waivable fiduciary standard when providing advice or making recommendations to retail investors. There are two components to this proposal. First, intermediaries would have to comply with fiduciary duties of care and loyalty when providing advice or making recommendations to retail investors about products, services, account types, or investment strategies.[263]

261. Lauren Willis, *The Financial Education Fallacy*, 101 AM. ECON. REV. 429 (2011). Citing the lack of research demonstrating a "causal chain from financial education to higher financial literacy to better financial behavior to improved financial outcomes . . . in part due to biases, heuristics, and other non-rational influences on financial decisions," Professor Willis argues "the entire enterprise [around financial education] is misguided." *Id.* at 1. Willis argues we may not want a society where financial education effectively functions as financial regulation because of the "time, expense, and invasion of privacy" necessary to create such a system, and living in a world with a highly effective system of financial education would reduce individual autonomy to an unacceptable degree. *Id.*

262. *See* Camerer et al., *supra* note 16, at 1214 ("The latest entrant into the paternalism debate comes from the introduction of behavioral economics developments into legal analysis. By cataloging a list of common decision-making errors that even highly competent, well-functioning people make in predictable situations, this research potentially broadens the scope of situations in which paternalistic policies could usefully be developed.").

263. This articulation of the fiduciary standard is consistent with proposals by SEC Staff (among others) respecting a uniform fiduciary standard for broker-dealers (historically not subject to a fiduciary standard) and investment advisors (subject to a fiduciary standard). *See Study on Investment Advisers and Broker-Dealers vi*, SEC. & EXCH. COMM'N

This would include information, recommendations and/or advice respecting products, services, strategies, or specific instructions to buy, sell or hold,[264] and it would require intermediaries to consider a range of issues.[265]

Second, intermediaries should not be able to "opt out" or "contract out" of the fiduciary standard for advice or recommendations via disclosure (in the manner of Regulation BI) or private ordering under this proposal. In my view, this approach is preferable to requiring contracting between investors and intermediaries on this point, or requiring only that financial intermediaries disclose their non-fiduciary status, largely because (i) disclosing conflicts of interest may not improve investor outcomes and may in fact make investors more vulnerable to opportunistic behavior; (ii) consumers do not reliably understand the differences between fiduciary and non-fiduciary regimes; and (iii) there is confusion in the marketplace about different entity types and legal standards.

In making this proposal, I acknowledge the fiduciary standard is not a cure-all or guarantor of outcomes. Fiduciary obligations cannot insulate investors from the ups and downs of the market, and even well-intentioned and un-conflicted intermediaries, acting diligently and loyally, may recommend products or strategies that result in sub-optimal returns or losses. The fiduciary standard also likely would not deter a determined solo bad actor. However, this proposal would put the burden of care and loyalty upon the experienced party

(2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf [https://perma.cc/5MZC-3RR3] ("[T]he Staff recommends that the uniform fiduciary standard of conduct established by the Commission should provide that: the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers . . . shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.").

264. For example, I would apply the fiduciary rule to what Tamar Frankel terms "sales talk"—i.e., broker "sales speak" that historically has contained persuasions such as "trust me," "I have experienced the same and bought the same," "my entire family is invested in this stock," "we know the price will rise very soon," or "look at all the millions that other investors in the stock have collected." Tamar Frankel, *The Failure of Investor Protection by* Disclosure, 81 UNIV. CINCINNATI L. REV. 421, 437 (2013).

265. A partial list might include (i) material financial characteristics and material risks of the proposed asset, product, service, or strategy, including any market, credit and/or liquidity risks; (ii) fees charged and any financial incentives available to the seller in connection with the asset, product, service, or strategy; (iii) the impact of selling or terminating the investment, including any termination fees or fees associated with early redemption; (iii) the impact of proposed transactions on the investor's overall economic condition, defined broadly to include the investor's risk tolerance, current financial condition, investing timeline, tax circumstances, and investing goals and objectives, now and in the future. Sgarlata Chung, *supra* note 115, at 749.

and repeat player—i.e., the financial intermediary.[266] And it would do so without overriding investors' agency or autonomy respecting their investment decisions. Investors would still be the final decision-makers on all non-discretionary accounts under my proposal. A uniform and robust fiduciary standard also would address the race to the bottom dynamic that characterized Regulation BI wherein investment advisors sought to water down duties of loyalty to better compete with broker-dealers and the non-fiduciary best interest standard.

B. Coordinate Climate Risk Disclosure With Insights From Climate Science, Environmental Law and Regulation.

The second reform proposed herein relates to climate risk disclosure. I support a robust climate risk disclosure regime in the manner of the Commission's June 2022 proposal. And, I oppose attempts by fossil fuel industry issuers to use the '33 and '34 Act disclosure regimes to virtue signal around issues of climate change even as they seek to minimize obligations, avoid scrutiny and block reform.

With this dynamic in mind, I propose that we layer into the climate risk disclosures consideration of other bodies of substantive law concerned with climate change causes and impacts, including (but not limited to) environmental law requirements and standards respecting air quality and GHG emissions. I also propose to layer in insights from scientific community compiled and/or set forth in the Fourth National Climate Assessment Report and other types of scientific literature regarding the science underlying and the impacts and costs of climate change.[267] One purpose of this layering is to ensure that conversations about materiality and climate risk disclosure better reflect the true costs of

266. Camerer, et al., *supra* note 16, at 1212. Colin Camerer and his co-authors argue that a regulation is asymmetrically paternalistic "if it creates large benefits for those who make errors, while imposing little or no harm on those who are fully rational." *Id.* The authors further argue asymmetrically paternalistic regulations "are relatively harmless to those who reliably make decisions in their best interest, while at the same time advantageous to those making suboptimal choices." Here, the investor/intermediary relationship fits this paradigm—for the reasons discussed above, investors often make suboptimal choices; at the same time, professional financial intermediaries can be counted on to make choices that are in intermediaries' best interest. As for relative costs and benefits, the broker-dealer industry has long argued—without much empirical evidence—that imposing a fiduciary standard on advice or recommendations would increase costs or decrease investor choice. The size of the investment advisory industry (where the fiduciary standard already applies) suggests that a can be made while still putting investors' interests first. So long as firms and investors have the option of providing and paying for trade execution services only, choice would be preserved.

267. U.S. GLOB. CHANGE RES. PROGRAM, IMPACTS, RISKS, AND ADAPTATION IN THE UNITED STATES: FOURTH NATIONAL CLIMATE ASSESSMENT, VOLUME II 1 (David Reidmiller et al. eds., 2018).

climate change, including the cost of both impacts and mitigation. Another is to position disclosure as part of a broader regulatory approach to climate risk and climate-driven materiality that would include specific substantive regulatory requirements and prohibitions across a range of substantive law areas.

Then, because the risk of regulatory capture and the misuse of regulatory regimes also exists with respect to these other substantive law areas, I further propose that stakeholders vigorously push back on efforts by fossil fuel companies to frame or limit conversations about materiality. Once again, CP offers a cautionary tale. In its June 2022 letter. CP argued against the requirement of Scope 3 disclosures on the grounds Scope 3 emissions are not material, citing comments from the company's largest investors.[268] Notably, CP did not address the fact that substantial numbers of its shareholders have said that they *want* the company to set Scope 3 targets.[269] Considering a range of stakeholder voices is particularly important where—as here—a monied, powerful industry sector is resisting reform.

Conclusion

In making the proposals above, I hope to commence a conversation about what regulatory disclosure under the federal securities laws can do, and what such disclosure cannot do. With respect to non-fiduciary financial intermediaries, disclosure requirements can improve securities pricing and market quality in some contexts. Disclosure cannot, however, eliminate "hard-wired" limits of human rationality or stakeholder incentives to exploit investor misperceptions and mistakes. This fundamental conflict between investors on one hand and intermediaries on the other is why a robust fiduciary standard—requiring the intermediary to put the investor's interest first—makes sense for the retail investor financial services market.

268. June 2022 Comment Letter, *supra* note 19, at 10.

269. *In 2021, 58% of voting shareholders reportedly voted in favor of a shareholder proposal requesting CP to set concrete emission reduction targets.* 58% of ConocoPhillips Shareholders Vote for Follow This Climate Proposal, *SHAREHOLDERS (May 11, 2021), https://www.follow-this.org/58-of-conocophillips-shareholders-vote-for-follow-this-climate-proposal/* [https://perma.cc/84NQ-UYCJ]. Although support for a similarly worded proposal decreased to 39% in 2022, following what appears to have been a robust outreach effort by CP, shareholder interest in, and support for, specific targets around emissions suggests that CP is perhaps not the best arbiter of materiality or shareholder sentiment on this topic. Liz Hampton, ConocoPhillips' Shareholders Vote Against New Emissions-reduction Targets, REUTERS (May 10, 2022, 3:26 PM), https://www.reuters.com/business/sustainable-business/conocophillips-shareholders-vote-against-scope-3-emissions-reduction-targets-2022-05-10/ [https://perma.cc/K9DS-2N73].

In the case of climate risk, disclosure requirements are a valuable tool for helping sophisticated stakeholders factor climate risk into securities pricing. But regulatory disclosure under the securities laws is a starting point—not the end point—for making real progress on addressing the climate crisis. Targeted regulation of climate risk-producing business practices and models is important, too. This is, in part, why coordinating disclosure under the '33 and '34 Act with other bodies of law concerned with climate change, and factoring in both science and shareholder insights into the financial impacts of climate risk makes sense.

Vigilance is important here, especially because stakeholders like CP are making "stay in your lane" arguments respecting the SEC's jurisdiction even as they seek to both pare back disclosure obligations and also to use regulatory disclosure under the '33 and '34 Acts to tout their climate change and disclosure bona fides. Remaining mindful of these issues also is important in the wake of the Supreme Court's decision in *West Virginia v. EPA*,[270] where the Court held, in a 6-3 decision, that the Clean Air Act did not authorize the Environmental Protection Agency to establish GHG emissions caps using a generation shifting approach as contained in plan previously announced by the EPA, but which was not them in effect.[271] Some commentators have expressed concerns that this decision could be used to challenge the Commission's authority to adopt and enforce its proposed climate risk disclosures rule. To mitigate this risk, coordinating disclosure with substantive law requirements and prohibitions makes sense.

At the end of the day, if we are to protect and preserve disclosure as a regulatory tool and support the legislative goals and objectives of the '33 and '34 Acts, we have to be willing to undertake a clear-eyed appraisal of the purposes of and strengths and challenges surrounding the '33 and '34 Act regulatory disclosure regimes. Adding a fiduciary standard for retail investor recommendations would better protect retail investors—a key legislative objective of the '33 and '34 Acts—while preserving investor autonomy and avoiding federal merits regulation. Linking climate risk disclosure to applicable substantive law rules and robust stakeholder conversations about climate change would enhance the ability of securities markets to factor climate risk into securities pricing while reducing the risk of stakeholder (mis)use of disclosure systems to virtue signal and block reform across substantive law disciplines. For all of these reasons, it is time for reform.

270· *See generally West Virginia v. EPA*, 142 S. Ct. 2587 (2022).

271. *Id.* at 2616. The recently argued (as of this writing) *Loper Bright Enterprises, et al v. Raimondo, et al.*, Docket No. 22-45 case now pending before the Supreme Court—in which petitioners ask the Court to overrule *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984), or at least to clarify that what petitioners characterize as statutory silence concerning controversial powers expressly but narrowly granted elsewhere in the statute does not constitute an ambiguity requiring deference to the agency—also speaks to the need for law reform.