THE MYTH OF INVESTOR PROTECTION: 
THE DODD-FRANK ACT AND THE OFFICE 
OF THE INVESTOR ADVOCATE

Chelsea P. Ferrette, University of Baltimore
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ABSTRACT

Are security investors protected when investor advocacy is a form of regulation? This article asks that question and answers “no.” This article looks at the SEC’s Office of the Investor Advocate (“OIA”) mandated by the Dodd-Frank Act of 2010. The OIA’s prime-objective is the advocacy and protection of investors. The OIA plans to meet its objective by ensuring retail investors’ interests are adequately represented, assisting them in conflict resolution, and identifying areas where regulatory changes benefit investors. This article posits, however, that the OIA cannot achieve its goals, because, first, the ever-increasing complexity of financial securities; second, the conflicts of interest inherent in the SEC; and third, the flawed approach by the Dodd-Frank Act to regulating through advocacy. This Article suggests proposals to remedy the inconsistencies with the OIA. It concludes that although the OIA was established in response to the increased call for securities reform, its ability to function and operate will actually hamper its ultimate-goal: protecting investors.

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INTRODUCTION

In soccer, both teams – investors and market insiders, if you will – know and understand the rules. I regularly watch soccer, and I have never seen a game where Team A and Team B could not agree on the size of the field, or which ball to use, and – generally – the players defer to the referee. It’s simple, Team A stops the ball from entering its goal, and simultaneously seeks to put the ball in Team B’s goal and vice-versa. The rules on the field are enforced by the referee in a generally straightforward manner. The referee controls the flow of the game. A poorly regulated game will be divisive, dirty, and would not even be a game; players become upset by the referee’s poor-calls or want thereof, and they become frustrated. A bad referee can ruin a potentially great game. Fans can tell, commentators can tell, and the players can tell.

This brief analogy illustrates the dichotomy of the simple versus the complexity of “balancing the playing field” for retail investors. Now, imagine that soccer analogy, but only one team enjoying an advantage solely by their awareness of new products to increase speed and performance. Would fans and novices be able to keep up? Or what if the professional soccer leagues decided that each field should be a different size? Don’t worry, the professionals are able to keep up with the changing field of soccer, but could the spectators?

Increased disclosure regulation and regulation by education of retail investors would have the same effect as a spectator reading a memo on soccer rules: complete confusion, absent the experience of investing. Under the current regulatory model and the revision prescribed in the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law by President Obama on July 21, 2010 (“Dodd-Frank Act”),1 balancing the playing field for retail investors is doomed for failure due to an asymmetry of information and time. By the time the corporate information is disseminated and understood by the retail investor it is already obsolete. In other words, the referee has already made the call, or the player has already committed the foul. Trading on obsolete information could cause a loss to investors and increase individual investor risk. The Dodd Frank Act does not improve the outmoded regulation structure, nor does it appreciate the workings of the market. It does not stay current with the increased complexity of financial products.2

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1 See The Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2010).
Retail investors’ constant cry for regulation is to “balance the playing field.” Even the most erudite of investors are not familiar with this changing landscape and changing complexities of either the market or the governing rules and regulations. There are three widely used bases for market regulation in order to balance the playing field for retail investors: (1) increase corporate disclosure requirements, (2) regulation by education, and (3) regulation by advocacy. The first two, disclosure and education, are self-help schemes that places a lot of fate and responsibility on the investor to protect themselves. Regulation by advocacy may be a new trend in the effort to protect investors, but it resembles the same fragmented crisis-response model of regulation as the other two, where a lack of awareness of systemic risk and indirectly investor risk exists. It is an understanding of both systemic and investor risk that is crucial for the SEC to prevent securities fraud in the future. The least effective method of regulation is through the Dodd-Frank Act’s approach to regulation by advocacy, and the shortcomings of said method shall be explored later in this article.7

This Article examines the establishment of the Office of the Investor

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7 Legal scholars have written on various forms of regulation of the securities market but these three forms seem to be the most highly regarded. This paper will not address the fundamental principles of exchange regulation, i.e. competition and self regulation. For a detailed analysis of exchange regulation, see Omig H. Dombalagian, Demythologizing the Stock Exchange: Reconciling Self-Regulations and the National Market System, 39 U. RICH. L. REV. 1069 (2005) [hereinafter Dombalagian, Demythologizing].


6 See infra Part I (addressing the other forms of “prescriptive regulation.”) The term prescriptive regulation was coined by Steven L. Schwarz. See Schwarz, Regulating the Complexity, supra note 2. The premise for prescriptive regulation is medical – (1) here are the symptoms that the stock market is presenting; (2) here is the proposed diagnosis; (3) here is the prescriptive regulation to attack the specific symptoms. The problem with prescriptive regulation is that it is reactionary instead of proactive to market forces and may not address the underlying cause of the problem, just the symptoms. For example, Dodd-Frank Act of 2010 is the most recent prescriptive securities regulation to address the symptom of weak market regulation and both consumer and investor protection, resulting from the market downturn of 2007 to 2009.

7 See infra Section I.C.
Advocate ("OIA") under the Dodd Frank Act and the regulation of investor protection through an analysis of achievable goals. Congress designed the OIA to combat regulatory capture, and as an external check, i.e. a system of self evaluation, on the SEC. Additionally, the OIA is to act as the legal protector of the retail investor against fraudulent activity, either by the market or the SEC. This Article asks: do the stated goals of the OIA address the issue of investor protection? Part I summarizes the historical fragmented regulatory schemes used to protect investors. Part II examines the legislative intent behind the OIA.

Part III asks whether the OIA will achieve its goals given its structure, its position within the SEC and its regulatory posture. Part III evaluates the current regulatory structures in comparison with the goals of the OIA and securities laws. Part III argues that the OIA does not introduce a new regulatory model, given its regulatory scheme, and falls far short of the goals and Congressional intent behind its creation. Part IV considers the life-span of the fatally-flawed OIA, and then proposes ways in which the OIA could go beyond just investor self-help, but be a federal agency acting on behalf of the investors. Part IV contends that OIA’s current model will not survive the ever-increasing complexity of the stock market or financial products unless the OIA is remedied. Part IV concludes that a system of preemptive regulation that is both independent and functional will be better able to protect the investor now and in the future.

I. THE REGULATORY PHILOSOPHIES OF INVESTOR PROTECTION

True federal financial regulatory reform is not a bad thing. As financial products become more complex and innovative, financial regulation must be as innovative, creative and proactive therewith. Some scholars declare that the natural evolution of regulatory reform is reactionary - crisis, then government intervention, and, finally, reform, and repeat ad infinitum. Whether it is labeled remedial legislation, prescriptive regulation, ad hoc regulation, or fragmented regulation, 

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9 See infra Section III. B.
12 See Cunningham & Zaring, supra note 10.
13 See Schwarcz, Regulating the Complexity, supra note 2.
15 See Cunningham & Zaring, supra note 10.
the premise is the same - a crisis is the essential triggering event toward regulatory reform. The order should be inverted: regulatory reform, crisis, and then government assessment. In both equations, the variable is economic crisis, whether now or in the future. The principle that would drive a reform-first scheme is the need for retail investor protection. I will later discuss a most radical proposal for financial reform, but will look at the staid modes – disclosure, education, and a new trend, advocacy, used in the recent decades to address investor protection. During an economic crisis the perception is that over regulation will suffocate the economy and deepen the crisis. However, that is not the case. It is not over regulation but poorly designed regulation which bends to the whims of political pressures, and thus ignores the need to protect investors.

A. Increased Disclosure Requirements

Disclosure requirements have historically been the means of regulating the market. Legal scholars have written extensively about the feasibility and effectiveness of disclosure regulation. Others have emphasized that mandatory disclosure requirements may negatively affect market forces.

18 See Cunningham & Zaring, supra note 10 at 92 (discussing the reason for differing approaches to the economic crisis of 2007-2009 was because of competing political pressures placed on regulators to react).
Dodd-Frank continues the tradition of requiring more disclosure by corporations without restricting the riskiness of the corporations’ financial products or activities. In addition, the continued use of disclosure as a regulatory scheme negates that fact that it is not an effective method of regulation.

The intended purpose of disclosure is to prevent or eliminate information asymmetries among market players. Some argue that increased disclosure requirements do little to reduce financial risk to investors, and actually decreases market liquidity. This is because disclosure places the burden on the issuer or the market players to inform investors and the whole market. The asymmetry of information persists where the investor is neither informed, nor educated nor knowledgeable of his or her investments, as the investments become more sophisticated or the individual risk increases. For example, investors, knowledgeable about the market, understand that risk exists and will protect themselves by asking for additional information. Those less knowledgeable do not understand that the risk exists, and often bear the brunt of both individual investment and systemic risk. The Dodd-Frank Act attempts to level the risk-disparity by utilizing “efforts to enhance the regulation of systemic risk.” However, increased disclosure requirements do not decrease systemic risk because as overall risk increases investors become more concerned about their personal risk than that of the market. For example, the more knowledgeable

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22 See The Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2212.
23 See Omarova, The Dodd Frank Act, supra note 2 at 95 – 96 (noting that Dodd-Frank relies on regulatory methods such as disclosure and data reporting which merely improve but do not change the regulatory landscape).
24 But see Dalley, supra note 19 at 1131 (positing that disclosure regulation can work if there is an “articulated purpose, an identified mechanism through which it can accomplish that purpose, a design that takes into account the operation of that mechanism, and a careful analysis showing that the benefits of the system outweigh its cost.”)
25 See Schwarz, Systemic Risk, supra note 14 at 218; Dalley, supra note 19 at 1094 – 96.
26 See Schwarz, Systemic Risk, supra note 14 at 219.
27 See Goshen & Parchomovsky, supra note 20 at 737-40.
28 Mandatory disclosure requirements and its twin regulatory sister, investor education, rely on four uses of market information: (1) access to market information; (2) comprehension of market information; (3) market information’s effects to change investor behavior and (4) availability of market information as a means to market efficiency. These regulatory methods, disclosure and investor education, what Paula J. Dalley calls “regulation-lite”, are politically popular because they involve less government intervention in regulatory reform, they allow a theory of investor choice (or blame the investor victim depending on your stance) to prevail by placing the burden of investment decision making on the individual, and it does little to disrupt the operation of the market. See Dalley, supra note 19 at 1090.
29 See Schwarz, Systemic Risk, supra note 14 at 218; Dalley, supra note 19 at 1093 (“disclosure preserves individual choice while avoiding direct governmental interference.”)
31 See Schooner, supra note 30 at 997.
investor will not, by default, be more knowledgeable, but he or she will have the means to more promptly and easily acquire market information. Less knowledgeable investors lack such means so readily available to the more knowledgeable investor. Therefore, the ability to disseminate and acquire information will be what ultimately decrease the investor risk of the knowledgeable investor, who by virtue of his position allocates or shifts the investor risk onto less knowledgeable investors. The problem is not that the less knowledgeable investor needs more knowledge, but that he will always have less time to disseminate or comprehend it.

B. Regulation by Education

Since grammar school, educators expound that the best way out of the harshness of any given economic situation is to educate the affected populace. Education is the salve to heal all wounds. The theory goes that if law makers adopt education as the ideal model, then those affected will be on the road to recovery. The “regulation through education” model has been in existence for a very long time. The model of regulation through education has been expounded by both legal scholars and lawmakers as a means towards investor protection. As time has shown, increased investor education does not equal investor protection. Some have even argued that the resources being used in the regulation through education model could best be allocated to other means which produce more effective results.

Legal scholars contend that information of securities transactions have value. Securities disclosure regulations were established not as a way to

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34 Id.


38 See Schwartz, Systemic Risk, supra note 14, at 244 (“[A]verage investors do not revisit their portfolios daily. Because they focus on finance only from time to time, the chances are high that any knowledge gained through education would evaporate over a couple of years.”)

39 See Willis, supra note 35 at 259.

40 See Onnig H. Dombalagian, Licensing the Word on the Street: The SEC’s Role in Regulating Information, 55 BUFF. L. REV. 1, 7 (2007) [hereinafter Dombalagian, Licensing] (discussing the intellectual property value and protection of firm’s trade secrets).
educate security investors,\textsuperscript{41} but as a way to standardize and ensure accurate valuation.\textsuperscript{42} When information, either pre- or post-offering, is not forthcoming, security investors are forced to take it upon themselves to become “educated” about a company’s offering.\textsuperscript{43} The burden is on the investor to help themselves. Thus, disclosure of market information is not considered education when other laws beside the securities law state that the dissemination of the information infringes on the company’s rights.\textsuperscript{44}

In the age of Internet and twenty-four hour access to information, investor education can be viewed as a compilation of data points.\textsuperscript{45} Yet, if various security investment data are being considered copyrighted information,\textsuperscript{46} would retail investors need licenses in order to educate themselves regarding security transactions? As financial products become increasingly more complex,\textsuperscript{47} more “designers” of new financial products have sought protection of proprietary rights of these products.\textsuperscript{48} Does this leave retail investors, as the end users of financial products, in need of a Geek Squad\textsuperscript{49} in order to decipher both the financial product and the investment transaction itself?\textsuperscript{50} Dissemination of information for investor education considered trademark infringement when the information constitutes misappropriation.\textsuperscript{51}

C. Regulation by Advocacy

The new trend is a move towards regulation by advocacy. For example, the Taxpayer Advocate Service of the IRS looks after the interests of investors.\textsuperscript{52} Similarly, Congress charged the Office of Advocacy of the


\textsuperscript{42} See Dombalagian, \textit{Licensing, supra note 40 at 7}.

\textsuperscript{43} See id. at 9 (stating that investors must rely on market based approaches when mandatory disclosure regulations do not apply).

\textsuperscript{44} See id. at 11-12 (discussing the premise that courts have upheld a tort theory of misappropriation to protect a company’s trade secrets and company have argued the use of copyright law regarding unauthorized dissemination as misappropriation of property).

\textsuperscript{45} See id. at 12.

\textsuperscript{46} See id. at 12-13 (discussing case law affirming that compilations based on valuations and pricing information is protected under copyright law).

\textsuperscript{47} See Schwarz, \textit{Regulating the Complexity, supra note 2 (discussing the complexity of financial securities)}.

\textsuperscript{48} See Dombalagian, \textit{Licensing, supra note 40 at 22 (discussing exchanges and investment banks seeking statutory and regulatory protection of their financial products)}.

\textsuperscript{49} Trademark of BestBuy.

\textsuperscript{50} See Schwarz, \textit{Regulating the Complexity, supra note 2; But see Omarova, The Dodd-Frank Act, supra note 2 at 93 (stating that the problem may be a never ending cycle where regulation based on unrealistic premises may actually increase the shifting of risk, regulatory arbitrage, and the innovativeness of creating more complex financial instrumentalities which in essence would make the regulation ineffective)}.

\textsuperscript{51} See Dombalagian, \textit{Licensing, supra note 40 at 25-27 (discussing the indexed based ETF cases where the court rejected claims by NASDAQ, McGraw Hill, and Dow Jones asserting that the dissemination of index pricing in order to educate investors and the subsequent use by the investors did not constitute misappropriation)}.

\textsuperscript{52} See Brett McDonnell & Daniel Schwarz, \textit{Regulatory Contrarians}, 89 N.C. L. REV. 1629, 1673-74
Small Business Administration, with, among others, the duty to “represent the views and interests of small businesses before other Federal agencies whose policies and activities may affect small business.”\textsuperscript{53} Within the Department of Transportation—specifically, the Federal Highway Administration—several offices have advocacy roles: the Associate Administrator for Safety, and the Office of Legislative Affairs and Government Communications.\textsuperscript{54}

These regulatory philosophies are not new concepts; they are simply tweaked versions of the same thing. Countless years have been wasted upon these regulatory philosophies. Many more years continue to be wasted, and then re-wasted. Until there is passage of actual regulatory reform, instead of regulatory tweaks on old flawed models, investors will remain unprotected.\textsuperscript{55}

II. THE GOALS OF THE SEC’S OFFICE OF THE INVESTOR ADVOCATE

The Dodd-Frank Act was intended “[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail,’ to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”\textsuperscript{56}

Congress designed the OIA “to combat the ‘regulatory capture’”\textsuperscript{57} that is perceived to exist in the industry.\textsuperscript{58} Congress set out to work with the SEC to better represent retail investors’ interests and to help resolve any internal problems the investor had with the SEC and other self-regulatory organizations.\textsuperscript{59} The OIA will achieve this by identifying common problems that retail investors have with financial service providers and with investment products and suggests ways in which the SEC or the SROs’ policies can be altered to better serve retail investors.\textsuperscript{60} The OIA
recommends policy changes to the SEC and Congress on the investors’ behalf, prioritizing retail investors throughout the rulemaking process.61 The OIA, to combat regulatory capture, is an “external check” or a system of self-evaluation that the SEC lacks. Ultimately, so the advocates say, the OIA will increase the SEC’s transparency and accountability.62 To completely separate the OIA from the SEC, the appointed Investor Advocate cannot be employed by the SEC’s employ for at least two years preceding the appointment, nor for at least five years following his or her service as Investor Advocate.63

The OIA includes an appointed ombudsman for retail investors, with the belief that the OIA can respond more appropriately to investor feedback, avoiding the repetition of past mistakes—e.g. the failure of the SEC to expose Ponzi schemes until it was too late.64 The presumption goes that if investors were given their own attorney general, id est their own protector, then Ponzi-type schemes would be thwarted by the ombudsman’s ability to receive and process complaints in an efficient and centralized manner. So, a vast array of investor complaints would, ideally, show a common-actor threaded throughout each. The ombudsman would act aggressively to bring down that malicious actor.

The public seems to express a concern that the parameters of the ombudsman position should be carefully structured to ensure complete independence and guarantee their confidentiality.65 Specifically, many argue that the Organizational Ombudsman model should be the model utilized to effectively safeguard retail investors’ confidentialities. Advocacy groups, such as the Derivative Project and the Public Investors Arbitration Bar Association, question the qualifications that will surround the Investor Advocate position, such as the types of experiences the candidate must have, the candidate’s relationship with the SEC, and the scope of the Investor Advocate’s responsibility.66

The present status of the OIA is tenuous. On May 4th, 2011, the Senate’s subcommittee for Financial Services and General Appropriations

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of the Senate Appropriations Committee heard testimony from SEC Chairman Mary Schapiro regarding the SEC’s budgetary requests wherein the Chairman requested funding for the OIA. On June 23, 2011, when the House of Representatives Appropriations Committee approved the FY 2012 Financial Services and General Government Appropriations Bill for the year ending September 30, 2012, the bill was silent on the funding of the OIA. The comments contained in the bill mostly critique the Commission for its “inefficiencies” which are rooted in the Commission’s non-compliance with a report promulgated by the Boston Consulting Group.

In a letter dated June 30, 2011, from SEC Chairman Schapiro (“Chairman Schapiro’s letter”), she writes that the SEC requests prior pre-programming approval from the Committees on Appropriations from both the House and the Senate to establish the OIA. So far, the Senate Appropriations Committee has not voted on any aspect of the SEC’s budgetary requests. Likewise, the House has not responded to Chairman Schapiro’s letter. Thus the present financial status of OIA remains unknown.

The OIA should be briefly distinguished from the Office of Investor Education and Advocacy (“OIEA”). OIA is not the equivalent of the current OIEA. The OIEA existed for over a decade. In Chairman Schapiro’s letter, she uses the OIEA as an example of a unit within the SEC that performs functions which, she asserts, are similar to the functions which the Securities Exchange Act of 1934 assigns to the Investor Advocate. Chairman Schapiro is silent on whether, in pointing out these similarities, she views the creation of the OIA as duplicative or a reinforcement of an existing regulatory regime. In the letter, Chairman Schapiro is silent on whether, in pointing out these similarities, she views the creation of the OIA as duplicative or a reinforcement of an existing regulatory regime.


69 See id.

70 Letter from Mary L. Schapiro, S.E.C. Chairman, to the Committees on Appropriations of the House of Representatives and the Senate (June 30, 2011), http://www.sec.gov/spotlight/dodd-frank/investoradvocatel etter063011.pdf (explaining that in the absence of the OIA the other divisions of the SEC will be employed to accomplish the same goals).


73 See Letter from Mary L. Schapiro to the Committees on Appropriations of the House of Representatives and the Senate, supra note 70. The OIEA website is silent on the policy functions performed by the OIEA. As a result, it is not clear how the OIEA conducts research and makes recommendations on retail investor interests to the other units within the Commission. The OIEA is headed by Director Lori Schock, who previously held the same position from 2001 to 2007, before leaving to serve as the Associate Director of FINRA’s Investor Education Foundation and Office of Investor Education. Director Schock returned to OIEA in 2009. She appears to have a strong background in investor education, which is consistent with the OIEA’s presence on the web.

74 See id.
Schapiro discusses the OIEA’s complaints resolution function, the investor education function, and the investor research/policy recommendations function.\textsuperscript{75} The OIA’s ombudsman is a feature distinguishable from the OIEA. The OIA ombudsman\textsuperscript{76} is charged with, \textit{inter alia}, liaising between the SEC and retail investors in order to resolve investor complaints. Currently, the OIEA does not perform such a function.

III. \textbf{WHY THE OFFICE OF THE INVESTOR ADVOCATE WILL NOT ACHIEVE ITS GOALS}

As an office of the SEC, the OIA can be a force to achieving comprehensive protection for retail investors. The OIA’s mission is ensuring that the interests of retail investors are adequately represented and identifying areas in which the investors can benefit from regulatory change. Its mission, however, will fail. First, the increased complexity of financial securities and the fragmented approach to regulation by advocacy leads to an office where the form—the structure of the office—is valued more than function, the actually advising, advocating and protecting investors. Such an approach, although popular, increases both investor and systemic risk by widening the chasm of obstacles that impede OIA’s ability to achieve its goals.

Second, the OIA will fall victim to its surrounding environment. Currently, the SEC is in a very unfavorable light, subjecting the SEC to possible regulatory capture—\textit{i.e.} becoming dominated by players from the very industry Congress charged it with regulating.\textsuperscript{77} The placement of the

\textsuperscript{75} The letter is consistent with the description of the OIEA on the OIEA website, investor.gov. The online presence of the OIEA is almost exclusively dedicated to investor education, but the website does provide information on how to file a complaint with the SEC. The website makes clear, however, that the OIEA does not have financial examiners whose job is dedicated to complaints resolution; the OIEA is not an analogous to state regulators, such as the Maryland Office of the Commissioner of Financial Regulation or consumer advocates such as the Federal Consumer Financial Protection Bureau. Rather, the OIEA will transfer a complaint to the appropriate regulatory body. The timeframe for complaints resolution is not discussed on the website. On the other hand, the website links to webpage containing an extensive list of SEC Frequently Asked Questions, which assists the user in self-help.


OIA within the SEC structure, although admirable, may actually prevent the OIA from truly protecting investors. In other words, the OIA will suffer from guilt by association. The investors will perceive the OIA in the same corrupt light as the SEC.

The problem is that the SEC itself needs reform. Regulatory capture, at one extreme, and laissez faire approaches to Wall Street’s misdeeds, at another, has led to the cops helping the robbers.78 OIA’s goal of strengthening the authority of the SEC to take action seems ironic, given the conflict of interest between the regulators and the regulated. The domino effect from the SEC’s lack of enforcement could possibly lead to OIA’s failure to strongly advocate on behalf of investors. This lack of advocacy would hinder another of OIA’s goals: assuring the interests of retail investors are adequately represented. This may be premature speculation. It is still too early for anyone to tell.

Finally, OIA might not achieve its goals because, similar to the regulatory philosophies already discussed, regulation by advocacy is not a new means to protect investors, but rather a variation on the previous, fragmented modes of regulation. Dodd-Frank may go further than some prior forms of prescriptive legislation; however, regulation by advocacy neither gives teeth to the OIA, nor truly advocates on behalf of the investor.

A. Increased Complexity of Financial Securities

The overall goals of the OIA, in terms of investor protection, may be hampered for several reasons, including the increased complexity of financial securities, which can “obscure the ability of market participants to see and judge consequences.”79 This would lead to a form-versus-function imbalance, where the creation and debate surrounding the OIA is considered more important than the Office’s ability to actually effectuate its goals. The imbalance, coupled with the SEC’s myopia to anticipate financial consequences, could increase systemic and investor risk. For example, one aspect of the economic crisis of 2007 – 2009 was the sale of mortgage-backed securities, such as collateralized debt obligations (“CDOs”).80 At inception, the CDOs seemed to be a valid and a solid investment, where the underlying debt being collateralized was a diversified

78 Indeed, SEC Chairman Shapiro has repeatedly characterized the Commission as a law enforcement agency or used the language of law enforcement to characterize the Commission’s mission. See e.g., supra note 67.
79 See Schwarcz, Regulating the Complexity, supra note 2 at 220.
pool of mortgage obligations and the rating agencies gave the resulting CDOs top grades. Sophisticated investors purchased the CDOs based on the presumed safe nature of the underlying debt and the rating agencies’ stellar evaluation of the potential risk of investment. Nevertheless, the increased complexity of CDOs and other such products made evaluation of the investor risk difficult for market participants, thus leading to over-investment of various toxic assets.

OIA aims to ensure that the interests of the retail investors are adequately represented. Does such representation require that the OIA employ individuals who understand complex securities like CDOs? If so, would OIA be better off than those who relied upon the rating agencies to make their investments? Some of the smartest business people and investors in the world praised the surety offered by CDOs, but they could not have been more wrong. OIA, in this sense, would be an arbiter of investor risk, rather than an advocate of investor protection, because OIA will not anticipate the consequences.

The flow of time, the market’s evolution and the increasing complexity of financial securities are economic constants. In previous economic downturns and during the most recent crisis, many market players did

83 See id.
84 See id.
85 See id.
87 See id.
88 See Steve L. Schwarz, Regulating the Complexity, supra note 2 at 223–4 (discussing the collapse of the mobile home market); Cunningham & Zaring, infra note 134 (regarding more recent economic crises).
not comprehend the effects of trading in sophisticated securities.\footnote{See id.} Regardless of whether the suitability of complex and exotic securities applies to the investors,\footnote{See Willa E. Gibson, Investors Look Before You Leap: The Suitability Doctrine is not Suitable for OTC Derivatives Dealers, 29 Loy. U. Chi. L. J. 527, 530-31 (1998) [hereinafter Gibson, Investors]; Willa E. Gibson, Are Swap Agreements Securities or Futures?: The Inadequacies of Applying the Traditional Regulatory Approach to OTC Derivative Transactions, 24 J. CORP. L. 579, 410 (1999); Zeke Faux, Individual Investors Duped by Derivatives, 2008, BUS. Wk., Sep. 30, 2010, http://www.businessweek.com/magazine/content/10_41/b4198043663903.htm.} the investors’ constant and increasing demand for more financial choice has lead to a plethora of nuanced financial products.\footnote{See generally, Cally Jordan, The Dangerous Illusion of International Financial Standards and the Legacy of the Financial Stability Forum, 12 SAN DIEGO INT’L L.J. 333 (2011); Lee C. Buchheit, Did We Make Things Too Complicated?, 27 Int’l Fin. L. Rev. 24, 24 (2008). See also Michael Lewis, The End, PORTFOLIO, Nov. 11, 2008, available at http://www.portfolio.com/news-markets/national-news/portfolio/2008/11/11/The-End-of-Wall-Streets-Boom.} In response to this demand, the regulatory agencies have not kept pace with market forces.\footnote{See id.} Where traditional regulatory rules have placed the burden on the securities providers,\footnote{See supra note 91.} they have caused more confusion among investors due to the want of guidance.\footnote{See supra note 77.} The OIA was designed to close this asymmetrical gap between investor demand and the regulators’ desire to protect the investor.\footnote{See supra Section II regarding the Congressional intent on the creation of the OIA.} Yet, when financial innovation matches the demand for new products, the regulators have the responsibility to be just as proactive with innovation. OIA will be hampered in its quest to protect investors unless it recognizes that there will always be “new” and unregulated financial products.

**B. The Fox in the Henhouse – The Regulatory Capture of the SEC**

The second reason why the OIA will not achieve its stated goals is because the SEC suffers from “regulatory capture.”\footnote{See supra Section II regarding the Congressional intent on the creation of the OIA.} Regulatory capture means that the regulatory agency, or the members thereof, have become so entrenched with the industry they regulate that their regulations appear arbitrary or, worse, reek of corruption, causing a blurring of the line between the regulator and the regulated.\footnote{See Sigler, Economic Regulation, supra note 77 (providing the primer on regulatory or agency capture); Jonathan R. Macey, The Distorting Incentives Facing the U.S. Securities and Exchange Commission, 33 HARV. J. L. & PUB. POL’Y 639, 664 (2010) (discussing the SEC’s capture by the mutual fund industry). See generally, Eric R. Pogue, The Catastrophe Model of Risk, Regulation and the Regulatory Legacy of Three Mile Island and Love Canal, 15 PENN. ST. ENVTL. L. REV. 463, 480 (2007) (defining agency capture as the co-opting of a government agency’s agenda by the interest they are tasked to regulate).} It’s an osmotic environment, where the regulators and the regulatees often switch roles. This regulatory osmosis between the two groups, which is exacerbated during times of
crisis, makes it difficult for investors to know whether pleas for assistance will be answered, and if not answered, then why they were not.98 When the objectivity of the SEC is questioned, then its decisions are cynically appraised.

The SEC’s twisted relationship with those it regulates was brought to light in July 2011 by Darcy Flynn, a thirteen-year veteran attorney of the SEC.99 Flynn informed Congress and the National Achieves Records Administration that the SEC had been systematically destroying records generated from matters under inquiry (“MUI’s”).100 A MUI is the SEC’s set of preliminary inquiries into possible criminal activities.101 Flynn detailed to Congress that around 18,000 MUIs were completely destroyed by the SEC over the course of seventeen years.102 Notable mentions among the destroyed records were MUIs against Bernie Madoff, Deustche Bank, Lehman Brothers and SAC Capital.103

Erasing the MUI records means that any later complaints against fraudulent entities must undergo a fresh inquiry by the SEC investigator, and she would not be able to refer back to past witnesses and reports contained within the older MUIs to help guide her investigation.104

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98 See William Cohan, One More Reason to Shut the SEC and Start Over, BLOOMBERG, Aug. 29, 2011, available at http://www.bloomberg.com/news/2011-08-30/one-more-reason-to-shut-sec-and-start-over-commentary-by-william-d-cohan.html (stating that many Freedom of Information Acts requests sent to the SEC are not answered). See generally, Pogue, supra note 96 at 480 (“In the context of the Catastrophe Model, the capture theory is notable in at least two respects: (1) traditional agency capture may be part of the explanation for why agencies are hesitant to regulate adequately before catastrophes; and (2) an agency’s overreaction after a catastrophe may be explained by the agency’s agenda being captured by the strong political and public sentiment regarding the catastrophe.”)
101 See Taibbi, supra note 95.
102 See id.; See also Cohan, supra note 98; Wyatt, supra note 100.
Therefore, investor complaints about fraudulent activity could not and cannot tell the SEC if there was or is a pattern surrounding certain actors. It is reasonable to ask whether Bernie Madoff’s Ponzi scheme would have been thwarted had the SEC investigators actually had access to past-MUIs.\textsuperscript{105}

Even when MUIs were prepared for acceleration to a subpoena action, they were often dismissed or closed by an enforcement director who was either a former Wall Street insider or was looking to move into a role at a Wall Street investment bank or law firm.\textsuperscript{106} And there was no obligation by that director to justify his or her reason for dismissing the subpoena action.\textsuperscript{107}

Flynn blew the whistle on the destruction of the MUIs in a letter to Senator Charles Grassley (R. Iowa), a member of the Senate’s Judiciary Committee.\textsuperscript{108} Grassley, outraged by the SEC’s horrendous recordkeeping practices which bordered on criminal a letter to SEC Chairman Mary Shapiro requesting clarification of Flynn’s allegations and a response by August 31, 2011.\textsuperscript{109} As a result of Grassley’s letter, the SEC reversed its policy\textsuperscript{110} and temporarily froze the destruction of any additional MUIs.\textsuperscript{111}

The employment background of prior and current SEC officials and their failure to enforce or properly investigate valid MUIs\textsuperscript{112} throughout the last decade has led to the very reasonable conclusion that the SEC has succumbed to regulatory capture.\textsuperscript{113} It has become too cozy with those

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\textsuperscript{105} See Taibbi, supra note 99.
\textsuperscript{107} See Taibbi, supra note 99.
\textsuperscript{112} See e.g. Gretchen Morgenson, Hey S.E.C., That Escape Hatch is Still Open, N.Y. TIMES, Mar. 5, 2011, at BU1 (discussing how the SEC has refused to enforce its own rules against credit rating agencies).
\textsuperscript{113} See Taibbi, supra note 99; Cohan, supra note 98; The Kojo Nnamdi Show, supra note 106 (describing Jonathan R. Macey’s, professor at Yale Law School, study on why the SEC has failed to find financial irregularity over the last decade).)
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from whom it must protect the investors. Some wonder whether the SEC desired the securities fraud schemes run by Bernie Madoff and whether the SEC wanted the economic crisis to occur.114 Systemic corruption would mean more jobs and resources would be allocated to our securities police force, the SEC, so that it might address the very events that the MUIs had documented.115 If these question strike the reader as cynical, then please remember the SEC’s fundamental purpose, investor protection, and try to answer: why were the MUIs destroyed? What benefit is incurred upon investors by the systematic destruction of the SEC’s criminal inquiries? How does the investor benefit when the SEC literally forgets the investors’ complaints in less than a year? The investor does not benefit, but the target of the complaint does. That target is given a tabula rasa to try again.

The placement of the OIA within the fractured SEC fails to protect investors due to the systemic regulatory capture of the SEC, and the temporarily frozen policy of destroying MUIs.116 The SEC has indicated that it has changed its document destruction policies;117 however, with many years’ worth of MUIs destroyed, future civil actions may not have the necessary evidence to prosecute the offenders.118 Congress created the OIA within the SEC—via the Dodd-Frank Act—as a means to better equip the SEC to respond to investors’ feedback and to more effectively disseminate information that could potentially expose illegal practices by firms in a more prompt manner.119 Yet, the OIA should be aiding the investors against the impropriety of the SEC, not just the actions of financial firms. The SEC’s apparent problem is not its ability to respond to investors’ feedback or to disseminate their complaints. The SEC suffers from regulatory capture, which is an entirely different beast than ability: the SEC lacks the impetus to act against bad actors and itself. Chances are the impetus lacks because the bad actors are already working for the SEC. OIA should be completely separated from this atmosphere in order to avoid the taint the SEC surely has.

114 See Cohan, supra note 98.
115 See The Kojo Nnamdi Show, supra note 106 (discussing that more jobs at the SEC, coupled with the SEC’s personnel’s inherent conflicts of interest would mean that the enforcement division of the SEC has no real incentive to actually resolve financial crisis). But see 156 Cong. Rec. H5237 (June 30, 2010) (statement of former U.S. Rep. Paul Kanjorski (D. Pa.) acknowledging the need for additional funding to the SEC in order for the agency to keep pace with the financial innovations in the market).
116 See Taibbi, supra note 99.
117 See supra note 108.
118 See Taibbi, supra note 99.
C. New Law, Same Old Regulatory Paradigm – Emperor Still Has No Clothes.

Disclosure and leveling - balancing the playing field - for investors by the SEC has not resulted in investor protection. None of the many regulatory philosophies discussed thus far have successfully protected investors. The Dodd-Frank Act’s call for the OIA to regulate via an advocacy approach takes the form of “the emperor’s new clothes:” the call for reform has been given, but no “clothes” have arrived to shield investors from the market’s harsh nature. Continuing the metaphor, the emperor is still just as bare. Similar to other philosophies of regulation, regulation by advocacy may be a new approach to the ever-present and growing need for investor protection, but it resembles the same regulatory paradigm of crisis-response regulation that already exists. Just as the emperor paraded his exposed person, praising his garments, do investors flaunt the OIA as a new method to the old model when both are illusions. Fragmented regulation, including regulation by advocacy, leads directly to the lack of awareness of systemic risk, and indirectly to investor risk. Yet, the current fragmented model has both proponents touting its benefits and opponents critical of its usefulness.

Regulation by advocacy is nothing new – it’s the same crisis driven model of reform. Thus, similar to the other regulatory philosophies, OIA, as a regulator, will not appreciate the systemic or investor risk because of a failure to adopt new regulatory techniques which causes information asymmetry.

120 See Marc I. Steinberg and Jason B. Myers, Lurking in the Shadows: The Hidden Issues of the Securities and Exchange Commission’s Regulation FD, 27 J. CORP. L. 173, 177 (2002) (Regulation FD, a leveling the playing field prescriptive regulation, was enacted to combat the system of selective disclosure of material information from analysts to their clients).
123 See Schwarz, Systemic Risk, supra note 14 at 196-197 (providing an in-depth discussion of systemic risk).
124 See Cunningham & Zaring, supra note 10 at 49 (2009) (arguing that the benefits of the fragmented regulatory model allow for financial innovation, regulatory discipline and product alternatives). See also Schwarz, Systemic Risk, supra note 14 at 230-231 (stating that although it sometimes does not work, the remedial legislation can be used to quantify the cost and benefits of the regulation on the crisis and reduce moral hazard costs, i.e. the costs of predicting when a crisis occurs whether the company will be bailed out or allowed to fail).
125 See Schwarz, Systemic Risk, supra note 14 at 230-231 (arguing that remedial legislation does not always work either because of delay in timing to respond to the crisis triggering event or the harm committed was so severe that the regulatory band-aid had no effect).
126 See supra Section II.
What is meant by regulation by advocacy? It means a call for regulatory reform, or in the case of the creation of the OIA, actual regulation, where the impetus of the regulation is to advocate on behalf of investors. Regulation by advocacy has been applied before, and with some positive results. Scholars raise the question as to why the SEC has not already adopted advocacy regulation. For regulation by advocacy to work effectively the SEC would not only comment on financial regulation but would also either have to take a cost-benefit-analysis approach to rulemaking, or employ or rely on an army of economists to do it for them, or both. Such an approach, if adopted by the SEC through OIA, would incrementally decrease the information asymmetry gap. Yet, the gap would still exist.

The numerous moving parts in the financial market decrease the regulators’ ability to evaluate systemic risk, thus causing information asymmetry. This begs the question: Can a financial system have both government intervention in a financial crisis and regulatory evaluation of systemic risk? Scholars answer no, and cite recent financial history. Historically, when the increased financial complexity of securities was coupled with governmental intervention, the resulting outcome was an inherent ignorance of systemic risk. Thus, the regulatory response to the proliferation of new and complex financial products is not a recent phenomenon. In the fragmented regulatory reform approach, where crisis leads to government intervention, such an approach does not create

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128 See supra Section II for a more detailed discussion.
129 See Edward Sherwin, The Cost-Benefit Analysis of Financial Regulation: Lessons from the SEC’s Stalled Mutual Fund Reform Effort, 12 STAN. J. BUS. & FIN. 1, 56-57 (2006); See also supra Section I.C.
130 See Sherwin, supra note 129.
131 See id.
132 See id.
133 See Cunningham & Zaring, supra note 10 at 50-51 (noting that while the system knew what the regulators are doing, because of regulation fragmentation, the regulators were blinded to overall systemic risk in the market which lead to financial crisis).
134 See Cunningham & Zaring, supra note 10 at 51-55 (showing that with the S&L crisis in the 1980s, government responded with federal takeover of the institutions; in 1987, when the Dow Jones Industrial Average fell by more than 20% in a single day, government responded with measured and specifically tailored reform proposals to address the specific exotic securities; in 1997 with the collapse of the hedge fund LTCM and the lack of regulation of such products by the SEC or CFTC, no regulatory reform was initiated despite numerous requests for by proponents such as Elizabeth Warren and Brooksley Borne calling for regulation of hedge funds); the corporate accounting scandals of 2000s lead to the enactment of Sarbanes-Oxley Act of 2002). Similarly, when the economic crisis of 2007-2009 occurred, the government responded with the passage of the Dodd-Frank Act of 2010.
135 See, e.g., Russo & Vinciguerra, supra, note 86 at 1497; Thomas Lee Hazen, The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and For Corporate Law, 70 N.C. L. REV. 137, 176 (1991); Gibson, Investors, supra note 90 at 561.
In other words, the financial regulators, such as the SEC, are always a step behind in regulatory enforcement, and the crooks are a step ahead, therefore the crooks are winning. In order to both comprehend the investor risk and decrease the crimes against investors, the SEC must think like a crook. The SEC must hasten its pace to lessen the gap between its lagging regulatory enforcement and the step-ahead criminal. Government intervention, followed by regulatory reform in a financial crisis means that after the criminal deed occurs and the damage is done, the government steps in and notices the current laws are lax. It then decides to strengthen the legal regimen to catch the criminal, when that criminal idiotically decides to commit the exact same crime, in the exact same manner, in the future and under the exact same circumstances – a very reactive approach. Advocacy in the midst of a reactive approach is not advocacy but rhetoric. It solidifies only what occurred and how to prevent its re-occurrence. “Government, rather than the private sector, has the incentive…to become informed about systemic risk.”

Thus, an understanding of both the systemic risk and the investor risk is critical for the SEC to ask how the next financial crime might occur, not to be a reporter or, to continue the crooks-analogy, a forensics-team.

Given this analysis, ideally the OIA’s role in regulatory advocacy for investors would be in the conducting of cost-benefit-analysis of the SEC’s rulemaking, or trying to comprehend the nature and potential uses of complex securities and transactions in order to regulate against abuse and protect investors. Rather, OIA was contemplated to use the current regulations to advocate on behalf of investors. The Dodd-Frank Act did not call for the OIA to use a new formula to anticipate market conditions, but rather asked the OIA to advocate for investors amidst current market conditions. Such a fragmented regulatory approach throws the proverbial regulatory kitchen sink at the problem, where some benefits emerge, but the effectiveness is imperceptible. Thus, regulation by advocacy as proposed

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137 See Davidoff, supra note 127.
138 Some may argue rightfully or wrongfully that the SEC’s current agency capture is the agency’s way of thinking like a crook.
141 See Schwarcz, Regulating Complexity, supra note 2.
142 See supra Section II.
144 See Cunningham & Zaring, supra note 10.
with the creation of the OIA will not achieve its stated goals because like the other regulatory paradigms, the OIA will not comprehend the degree of investor risk to a level to actually meeting that needed for investor protection.

IV. PROPOSED SOLUTIONS AND A STARTING POINT

Title IX of the Dodd-Frank Act defines the actual function of the OIA.\textsuperscript{145} While the Office’s stated goals are admirable, as discussed in Section II, the OIA lacks clear direction and function about how it will protect retail investors. While the fragmented regulatory regime of crisis-based regulatory response created the OIA, it does not mean that the OIA must succumb to it limitations ignoring potential advocacy avenues.

The OIA can achieve its goals using the traditional regulatory philosophies and the premises of investor protection, by implementing three adjustments. The first proposal, which Section A will expound on, is the call to invert the order of the traditional fragmented approach to regulatory reform. Instead of a crisis-driven regulation, the first proposal advocates for an anticipatory preemptive reform model, where regulatory reform occurs prior to a crisis happening. When the anticipated crisis does occur, the government, at that time, can analyze whether or not the established regulation actually aided or harmed retail investors. Some scholars have argued that “comprehensive reform is not something for prosperous financial times,”\textsuperscript{146} however, traditional crisis-driven regulation has not protected investors either.\textsuperscript{147} An anticipatory preemptive approach would shift the nature of the OIA from strictly advisory to one of a true regulatory advocate.

The second proposal, which Section B explores, considers the current state of the SEC and whether the OIA benefits by being located within the agency. The OIA cannot effectively operate when it is currently located within the SEC. An independent OIA which reports directly to Congress, but is not housed at the SEC, would be able to advocate for and protect retail investors against not only the market but also the abuses of the SEC.\textsuperscript{148} What the fragmented regulatory philosophies have shown is that

\textsuperscript{147} See Cunningham & Zaring, supra note 134.
\textsuperscript{148} See Taibbi, supra note 99.
Retail investors are not protected by the agency whose purpose is to protect investors against bad actors. The OIA could be an office that reports both to Congress regarding investor protection and to the Inspector General and Congress regarding the lack of investor protection by various financial government regulators. As the comic book asks, “Who watches the Watchmen?” The answer could be the OIA.

Lastly, Section C invites the discussion of the OIA advocating for a normative shift in the regulatory framework in order to reduce investor risk. This would require the OIA to propose the limitation of choice in financial products and the explicit prohibition of the phenomenal degree of complexity that certain transactions have. This approach is quite idealized. The current regulatory philosophies in their post-crisis approach have not decreased the rise in the complexity of financial products. A normative shift would accomplish two things. First, by accepting the existence of the ever increasing number of complex financial products, the normative shift in regulation would look at the degree to which the system can accept such products and not at the specific products themselves. Second, the normative shift in regulation analyzes the prohibition of certain complex transactions and asks whether this would directly decrease systemic risk, thus indirectly decreasing the risk to investors.

A. Current Structure Proposal – Anticipatory Preemptive Regulation

Anticipatory preemptive regulation is a response to the fragmented crisis-driven model of regulation. Anticipatory preemptive regulation reform in the OIA would entail advocacy and regulation of the financial industry during prosperous economic times and provides independence, transparency, predictability, legitimacy and credibility for the regulatory system. Although the concept of anticipatory preemptive reform has been debated previously, the promotion of the concept as an approach to

149 See Alan Moore & Dave Gibbons, Watchmen, 9, (Dan Didio ed., D.C. Comics 1987) (1986). The Watchmen initially was a twelve issue limited comic book series published by D.C. Comics. The collective comic series was first compiled into a graphic-novel and later turned into a movie. The Watchmen is a graphic-novel with many different socio-political concepts and philosophical inquiries, which asks who watches the superheroes? It is not that the superheroes are mysterious, but that they believe themselves above the law and humanity itself, which they arrogantly police. The story ultimately concludes that superheroes are just as fallible as men, and it is their arrogance, their failure to understand their own beliefs, which leads to the death of countless many, and the loss of humanity’s soul. Here the analogy is to the SEC, where it is not that they believe themselves mysterious, but like the superheroes in the Watchmen, they believe themselves to be above the law. When the SEC’s actions place the safety of investors’ trust in regulatory enforcement in jeopardy, it too will lead to a death: that of investor protection.

150 See Schwartz, Systemic Risk, supra note 14 at 214-218 (stating that ex ante regulation can be a direct means of preventing economic panic, and indirectly systemic risk);

151 See Cunningham & Zaring, supra note 10 at 71-74 (discussing the concept in relations to former United States Treasury Secretary, Henry Paulson’s preemptive regulatory blueprint (“Paulson’s Blueprint”) for the 2008 crisis).
reduce investor risk is novel. Anticipatory preemptive reform contradicts the classic crisis-driven approach to regulatory reform, and proposes that regulation can predict that financial calamities will occur, based on past financial history. Thus anticipatory preemptive regulation would place the onus on the regulator to anticipate the consequences of systemic risk, and indirectly investor risk.

In the age of mega Ponzi schemes, market instability, and pension plan explosions, there is a strong need for investor advocacy. It is needed now more than ever. What exactly does the functional term “investor advocacy” mean? Does it address the age old question of “[h]ow can and should we regulate our economic affairs in light of [economic] ignorance?” Dodd-Frank and the creation of the OIA was meant to answer these questions. One of the stated goals of the OIA is the identification of areas in which retail investors could benefit from regulatory change. What is not specified is whether the regulatory change contemplated to advise retail investors was a change in the regulation (rules), the creation of a new regulatory philosophy (process), or a change in the regulatory body itself (structure) or all of the above. Dodd-Frank by creating the OIA introduces a small shift towards regulatory reform. Although, incremental regulatory reform is good, it does not go far enough to protect investors. What is needed is anticipatory preemptive regulatory reform. If the current structure of the OIA must be maintained, then allow it to adopt an anticipatory preemptive reform model where it would advocate a function over form approach to regulatory

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158 Congressional intent is silent as to what is meant by this stated goal of the OIA. See id. See also Section II supra.

159 See Cunningham & Zaring, supra note 10 (expounded the virtues of incremental regulatory reform).

160 See Schwarcz, Systemic Risk, supra note 14 at 212 (stating that the SEC lacks the expressed authority to manage systemic risk by trying to restrain the increasing nature of complex securities or transactions). See also Goldstein v. SEC, 451 F. 3d 873 (D.C. Cir. 2006).

161 See Cunningham & Zaring, supra note 10 at 71-74.
This approach rejects the traditional fragmented crisis-response regulatory model.

According to Cunningham and Zaring, the following features of an anticipatory preemptive regulatory reform model are: (1) regulation during prosperous and/or calm economic conditions; (2) which is presented before a clear need for reform has been articulated by the market; (3) where regulatory innovation or renovation may or may not be proportionate to an anticipated crisis; (4) is not drafted in response to any manifest urgency; and (5) could suggest a revision or even elimination of regulatory agencies which seem to have redundant authorities and missions. What emerges is a clear, un-fragmented, non-crisis driven regulatory scheme. An anticipatory preemptive reform model is not cobbled together because of the urgent need to react to a pending crisis. Instead, it is given the time to be thoroughly vetted, where objectives are established, options and alternatives are presented, consequences are analyzed to see whether or not the measure decreases systemic and/or investor risk and decisions are made without the restraint of a rigid crisis respond timeframe.

Critics argue that “comprehensive reform is not something for prosperous financial times”. While others endorse that an ex ante approach, such as an anticipatory preemptive model, can be a means to prevent economic panic which may trigger systemic risk. What makes the anticipatory preemptive model work is unlike the crisis-driven approaches, a preemptive approach assumes as given that because of financial innovation, securities will continue to be more and more exotic, markets will increase in complexity and the need for regulation is a constant response, and not a variable response, of the market. Thus the function of anticipatory preemptive regulatory scheme is to take the constants in the market and to formulate regulation accordingly.

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162 See id. (describing the Paulson’s Blueprint which adopts a anticipatory preemptive regulatory approach rather than the traditional crisis response regulatory model). But see Schwarcz, Systemic Risk, supra note 14 at 212 (stating that the SEC lacks the expressed authority to manage systemic risk by trying to restrain the increasing nature of complex securities or transactions).

163 See Cunningham & Zaring, supra note 10.

164 See Cunningham & Zaring, supra note 10 at 71-74. The elements were derived from the authors’ observations of the Paulsen’s preemptive blueprint.

165 See id. at 73 (citing Stuart Banner & Larry Ribstein’s conclusion regarding the benefits of crisis-driven regulatory reform). See e.g. STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION (1998); Ribstein, supra note 146 at 79-83.

166 See Schwarcz, Systemic Risk, supra note 14 at 214-218.

167 See Schwarcz, Systemic Risk, supra note 14 at 217 (“[R]egulation intended to avert panics should attempt to take into account what it is beyond the triggering events that sorts the magnitude of the consequences and should apply only to deter panics that trigger large consequences.”)
B. Modified Proposal – An Independent Regulatory Body

The establishment of the OIA could combat the regulatory capture of the SEC and go towards a notion of an independent government regulator.\(^{168}\) Although housed in the Securities and Exchange Commission, it reports directly to Congressional committees.\(^{169}\) Unbiased advocacy for investors requires this independent management. Investors need a voice in securities regulation. OIA could be that voice. As mentioned above, the inherent conflict which exists in housing a quasi-independent office within another begs several questions. Will it be effective; is it really independent? Will investors have a right through the OIA to criticize actions taken by the SEC if the investors feel that the SEC is not doing enough to protect investors from reported or known fraudulent activity?\(^{170}\) And more importantly, will the OIA act on the investors’ complaints about the SEC? Alternatively, housing the OIA in the SEC may allow investors the opportunity make their complaints better heard by the SEC but, on the other hand, it may cause the OIA to be less-critical of the regulator of said regulator.\(^{171}\) Perhaps, the OIA, by sharing the SEC’s lunch-room and parking garage will be invited to SEC events and parties, and will therefore become just as guilty as the SEC staff-personnel who attended Bernie Madoff’s niece’s wedding.\(^{172}\) The cozy-environment at the SEC might be too cozy, and when you’re so cozy with the SEC who cares about the investors?

Pundits will argue that the OIA increases the already bloated bureaucracy of the federal government. Yet, the current structure of the SEC, whose main objective is regulating and enforcement leaves little room for investor protection.\(^{173}\) Since more investors have lost more money per capita than in any other time in market’s regulatory history, the regulatory focus has been one of caveat emptor, and not of protecting the investor, or

\(^{168}\) See Kuster, supra note 58 at 266. See generally, Cohan, supra note 98 (expounding the premise that due to regulatory capture the SEC should be scraped and redesigned over again); See also Omarova, Rethinking the Future, supra note 11 at 705 (asking the very questions necessary to consider in the creation of a new self-regulatory financial body).


\(^{170}\) One of the primary purposes of the OIA is to assist investors with resolving problems they may have with the SEC or another self-regulatory organization. See 15 U.S.C. § 78d (g)(4) (2011). Yet the provision does not create any causes of action for retail investors and it is somewhat vague as to the powers of the OIA ombudsman and how he or she will handle investor complaints. See generally Roberta Karmel, The Future of the Securities and Exchange Commission as a Market Regulator, 78 U. Cin. L. REV. 501 (2009) [hereinafter Karmel, The Future].

\(^{171}\) See Tiabbi, supra note 99 (criticizing the laissez-faire nature of the SEC in terms of its securities investigation and record keeping). See generally Karmel, The Controversy, supra note 17 at 165 (advocating a merger of the SEC with the Commodities Futures Trading Commission).


\(^{173}\) See Goshen & Parchomovsky, supra note 20 at 713; See also discussion supra Sec. III.C
policing the market. An independent agency whose sole purpose is to advocate the retail investor’s interest will accomplish more because it will not be distracted by regulatory or enforcement considerations which pervade the SEC.

C. Investor-centered Proposal – A Normative Shift in Regulation

A discussion of the normative shift in regulation invites a conversation of what would be the most radical approach to investor protection and the increased complexity of financial securities. This is just the starting point of a discussion, the scope of which is outside the focus of this paper, but the basic concept is relevant here because the idealized purpose of securities regulation is protecting investors and decreasing systemic risk. The SEC has utilizes various regulatory approaches in an effort to achieve these goals. The creation of the OIA is driven by the idealized regulatory purpose where investor protection through advocacy, would be expounded. Yet, the OIA lacks the necessary impetus, either in conception or potential execution, to stay the course. The creation of the OIA, and that of the Dodd-Frank Act, does not go far enough in regulatory reform to anticipate and adjust for the effects of future market risk on investors.

When first created, the actual purpose of the securities laws was not investor protection, but market efficiency. Ninety years ago, the investors faced the same issues of information asymmetry, financial innovation, systemic and investor risk that are now being discussed by legal scholars. The original Ponzi scheme by Charles Ponzi was orchestrated in the early 1920s, and the information asymmetries and unaccounted financial innovations were to his benefit, of which he took full advantage. Almost ninety years later, Bernie Madoff took advantage of the information asymmetries and unaccounted financial innovations, much like Charles Ponzi, to achieve his own scheme.

Fraud is always fraud. Securities fraud is always securities fraud. Over a time span of ninety years, Ponzi schemes occurred in the 1920s and today

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174 See Omarova, The Dodd-Frank Act, supra note 2 at 97, n. 48 (2011).
175 See id. (stating that “Congress could have imposed explicit limits, or even outright prohibitions, on certain derivative transactions, based on their riskiness from a systemic perspective. Thus one such alternative approach would be mandatory pre-approval of OTC derivative instruments, which would effectively put the regulators in the position to decide what level of risk is socially acceptable, as a matter of public policy. Regardless of their desirability or potential effectiveness, such measures would have signaled a significant normative shift in the regulatory process.”) See also Omarova, Rethinking the Future, supra note 11 at 701 -05 (calling for a normative shift in the self-regulation of the financial industry).
176 See Goshen & Parchomovsky, supra note 20 at 713. (stating that the widely accepted assumption that the securities regulation is a consumer protection law is false).
177 See id.
because financial products have become so complex that they are incomprehensible. The complexity of derivatives, swaps, hedge fund and the like have made it virtually impossible for retail investors to get a grasp of not only what the products are, but also how to invest in them. Financial innovation is a given, a constant. Like the string theory in physics, not all scientific and financial innovations need to be accepted. There must come a point when some financial innovations fall off the range of being accepted by the market and thus not presented to retail investors for trading. Just because a trader designed a new financial product, it does not mean investors should be allowed to trade in a product that has no market utility and actually increases investor risk. CDOs were such a product. The only purpose of CDOs, in the end, was to make a profit for the trader. Their market utility had little to no value and was one of the causes of the downfall in the economy in 2007-2009. Similarly, the risks to investors, masked by the rating agencies high assessments of CDOs, were astronomical. There should be a limit to the degree by which the system can accept such products from being trading. Yes, financial innovation will continue to exist. Yet, not all financial products are made the same.

Second, ideally securities regulation desires to decrease systemic risk, investor risk or both. Unlike the original incarnation of the Securities Exchange Act, subsequent amendments have tried to patch the holes of securities fraud. Whether by the use of cost-benefit analyses, empirical studies, or what I advocate in this Article, an anticipatory preemptive based model and, a debate on the normative shift in regulatory reform, financial regulation ought to be a shield against fraudulent activity.

Regulation can be a catalyst to market efficiency. Complex transactions, like complex securities, are a constant in the market. There will always be a desire to structure a transaction in answer of a financial nuance. Systemic risk as a variable can be manipulated, either up or down. Prohibition of certain transactions can act as an advancement in market efficiency because certain complex transactions may disrupt the flow of the market. Complex transactions are like boulders on a riverbank. They can either stay on the bank or fall into the river. When boulders fall into the river, they can divert the stream of water. When rivers divert, flooding occurs. The increased systemic risk of a diverted river causes flooding on dry land. Here, complex transactions, like boulders diverting a river onto dry land, can be limited or prohibited from causing an increase in systemic risk. Regulation and the prohibition of complex transactions from falling into the stream of financial commerce can be a means of decreasing systemic risk.
The fundamental flaw in current regulatory scheme is its narrow scope and its lack of a true investor-centered approach. An investor-centered approach to regulation should allow for individual choice of financial products while at the same time limiting the choice of financial products and/or explicitly prohibiting certain securities transactions from occurring. Thus the normative shift in regulation would refocus the OIA to advocate on behalf of investors by shifting the regulatory center in its execution away from purely market efficiency to one of the idealized concept of investor protection.

**Conclusion**

Given that the Dodd-Frank Act was recently passed, the net benefits of the OIA will not be known or seen for a number of years. There must be further analysis in the future to determine if the OIA has been a benefit or detriment to investor protection.

The fragmented regulatory philosophies of disclosure, investor regulation, and the Dodd-Frank approach to regulatory advocacy places the burden on the investor to protect themselves ills in the market. Regulation by advocacy, as proposed in the Dodd-Frank Act, does not give the OIA enough authority to truly advocate on the investor’s behalf. A revised OIA could shift the burden from the investor and self-help to the OIA and investor advocacy where the OIA can regulate from a position of strength.

Furthermore, the OIA’s current structure may not survive the ever-increasing complexity of the stock market or financial products, unless it is remedied. Increased complexity of financial securities and securities transactions may be factors which widen the chasm of obstacles that impeded OIA’s ability to achieve its goals. Another may be the OIA’s placement within the SEC which may cause the OIA to fall victim of its surrounding environment because of the regulatory capture of the SEC. A better designed OIA, one that is both independent and advocates preemptive regulation, could protect investors now and in the future. An anticipatory preemptive approach would shift the nature of the OIA from strictly advisory to one of regulatory advocacy. An independent OIA which reports directly to Congress, and is not housed at the SEC, would be able to advocate for and protect retail investors against not only the market but also the abuses of the SEC.

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178 See Omarova, *Rethinking the Future*, supra note 11 at 701.