# Note

# Transforming Broker Discretion into Senior Executive Accountability

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## Abstract

*In the wake of recent scandals pervading the financial industry, Congress and federal securities regulators have attempted to rein in the abuse of discretion by those in positions to mismanage funds. Recent legislative and regulatory actions show an effort to incentivize compliant behavior and set standards of conduct. The most recent attempt is seen in the Securities and Exchange Commission's ("SEC") Regulation Best Interest standard for broker-dealers. This rule, however, like the other relevant laws affecting broker-dealers, is toothless in that the provision mandating compliance with the regulation requires only implementing reasonable methods of doing so. Rather than specify procedures that broker-dealers must implement to comply with the rule, the SEC leaves the discretion of how to comply with Regulation Best Interest with the very actors it seeks to regulate. In doing so, the SEC is taking greater precaution to protect the broker-dealer business model than investors. This Note studies the ineffectiveness of weak compliance mandates such as that in Regulation Best Interest and proposes a solution in the form of the United Kingdom's Senior Managers and Certification Regime, which prescribes specific formal requirements for regulated entities in order to ensure accountability among those who are most capable of causing harm to the financial industry—senior managers and executives. The SEC should issue an amendment to the Regulation Best Interest Compliance Obligation incorporating these more specific and prescriptive compliance mandates.*

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TABLE OF CONTENTS

INTRODUCTION .......... 1017
I. THE LACK OF EVOLUTION IN COMPLIANCE MANDATES .......... 1022
A. *The Securities Exchange Act of 1934* .......... 1022
B. *FINRA Rules for Compliance* .......... 1024
C. *The Sarbanes-Oxley Act of 2002* .......... 1025
II. THE FINANCIAL CRISIS AND RESULTING REGULATION .......... 1026
A. *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* .......... 1029
B. *Regulation Best Interest* .......... 1030
III. THE CURRENT COMPLIANCE REGIME HAS PROVEN INEFFECTIVE .......... 1032
IV. WHILE REG BI'S COMPLIANCE OBLIGATION PROMOTES RISK-FOCUSED SUPERVISION, SM&CR PROMOTES ACCOUNTABILITY AND DENOTES SPECIFIC CONDUCT .......... 1034
A. *Responsibility Placed at the Top* .......... 1035
B. *The Active Role of Regulators* .......... 1037
V. IMPLEMENTATION: PREVENTION AS AN ALTERNATIVE TO CRISIS MANAGEMENT .......... 1038
A. *The SEC Should Amend Reg BI's Compliance Obligation to Reflect the SM&CR Compliance Requirements* .......... 1039
B. *Placing Compliance Responsibility on Senior Managers Will Influence the Cultures They Create* .......... 1040
C. *SM&CR Certifications Will Keep Regulators Apprised of Malfeasance* .......... 1041
D. *Business Model Concerns* .......... 1043
CONCLUSION .......... 1044

## INTRODUCTION

Middle school art teacher Heather Heckel was thinking ahead when she invested in her retirement at age thirty-three.[1] She qualified for an investment offered uniquely to New York City public school-teachers that guaranteed a seven percent annual rate of return.[2] This

1 *See* Tara Siegel Bernard, *S.E.C. Adopts New Broker Rules that Consumer Advocates Say Are Toothless*, N.Y. TIMES (June 5, 2019), https://www.nytimes.com/2019/06/05/your-money/sec-investment-brokers-fiduciary-duty.html [https://perma.cc/VQS5-DRCN].

2 *Id.*

is a safe option at a favorable rate not available to the investing public.[3] Despite this provision of retirement security, a broker[4] advised her to transfer her retirement savings to a variable annuity charging an annual fee of over two percent.[5] Ms. Heckel lost $2,500 before she learned that her original investment was a better option and was able to get her money back.[6]

Brokers receive transaction-based compensation,[7] which means they do not get paid unless they complete a transaction by selling an investor a security.[8] A conflict of interest exists when the security the broker offers does not fit the needs of the individual.[9] For example, Ms. Heckel is a thirty-three-year-old public schoolteacher.[10] The variable annuity that the broker sold her was more suitable for affluent or

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3 *See* New York Teacher, *6 Investment Choices Lead to Peace of Mind*, UFT (Oct. 3, 2018), https://www.uft.org/news/you-should-know/secure-your-future/6-investment-choices-lead-peace-mind [https://perma.cc/K8LE-MRYK].

4 A broker is an individual who deals in securities—financial assets in the form of stocks, bonds, and other investment instruments—on behalf of her customers, in this case, Ms. Heckel. *See Registered Financial Professionals*, FINRA, https://www.finra.org/investors/learn-to-invest/choosing-investment-professional/brokers [https://perma.cc/P7R3-9S8J]. This Note uses the term "brokers" to refer to the broker-dealers subject to the new Regulation Best Interest standard, *see* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) (codified at 17 C.F.R. pt. 240), because it is concerned with the individuals who act as agents on behalf of their customers (brokers), rather than those buying and selling securities for themselves (as dealers). *See id.*

5 *See* Bernard, *supra* note 1; *see also Annuities*, Investor.gov, https://www.investor.gov/introduction-investing/investing-basics/glossary/annuities [https://perma.cc/9S7V-DCAX] (explaining annuities). A variable annuity is a contract in which an investor pays an insurer a single payment or stream of payments, which are then invested into a variety of options, typically mutual funds. *See Variable Annuities*, Investor.gov, https://www.investor.gov/introduction-investing/investing-basics/glossary/variable-annuities [https://perma.cc/5QSY-Q5H5]. It is riskier than a guaranteed investment, in which an individual pays an insurer in exchange for a fixed rate of return. *See Variable Annuities: What You Should Know*, U.S. Sec. & Exch. Comm'n (Apr. 18, 2011), https://www.sec.gov/investor/pubs/varannty.htm [https://perma.cc/CZV4-536W]; New York Teacher, *supra* note 3. Variable annuities depend on the equity market and are thus subject to its volatility, which make it important for individuals to consult with brokers to determine whether this type of investment is a good fit for their needs and financial capabilities. *See Variable Annuities: What You Should Know*, *supra*.

6 *See* Bernard, *supra* note 1.

7 *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. at 33,319.

8 *See id.*; *see also* Consumer Fed'n of Am., A Framework for Addressing Broker-Dealer and Investment Adviser Conflicts of Interest When Providing Retail Investment Advice 1, https://consumerfed.org/wp-content/uploads/2019/04/CFA-Conflict-of-Interest-Framework.pdf [https://perma.cc/LW6T-XUAS] ("In the brokerage model, the firm and financial professional get paid only if a recommendation results in the completion of a transaction.").

9 *See* Consumer Fed'n of Am., *supra* note 8, at 1; Bernard, *supra* note 1.

10 *See* Bernard, *supra* note 1.

older investors who have already maxed out their safer retirement plans, such as 401(k)s.[11] The broker was incentivized to sell Ms. Heckel the annuity, however, because (1) brokers only get paid if the transaction is completed, and (2) variable annuities pay higher fees to the insurer and the broker.[12] In this case, the variable annuity that the broker sold Ms. Heckel charged four times the annual rate an average investor pays for the same type of mutual fund investment.[13]

Ms. Heckel was unaware of the broker's strong incentive to sell her a product inconsistent with her needs.[14] In fact, there are compliance systems[15] in place to curb this problematic behavior.[16] The broker

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11 *See Variable Annuities: What You Should Know*, *supra* note 5; *see also* Dinesh Chopra, Onur Erzan, Guillaume de Gantès, Leo Grepin & Chad Slawner, *Responding to the Variable Annuity Crisis* 5 (McKinsey Working Papers on Risk, Paper No. 10, 2009), https://www.mckinsey.com/~/media/McKinsey/dotcom/client_service/Risk/Working%20papers/10_Responding_to_the_Variable_Annuity_Crisis.ashx [https://perma.cc/3QY6-2ZEE] (noting that variable annuities "emerged as the natural product for affluent investors in their 50s and 60s as they transitioned from the accumulation to the decumulation stage of their investment lifecycle"); Daniel Kurt, *Variable Annuities: A Good Retirement Investment?*, INVESTOPEDIA (Dec. 11, 2020), https://www.investopedia.com/articles/personal-finance/090915/variable-annuities-good-retirement-investment.asp [https://perma.cc/QC45-V542] ("Where variable annuities may be worth a look is if you've maxed out your contributions to other tax-advantaged accounts.").

12 *See* Kurt, *supra* note 11 ("Further eroding your account are the notoriously high fees that insurance companies charge their annuity customers."); *see also* Chopra et al., *supra* note 11, at 10 (noting that some brokers "rely on variable annuities for a substantial portion of their income"); Matthew Frankel, *Should You Buy a Variable Annuity?*, MOTLEY FOOL (Aug. 22, 2018, 2:30 PM), https://www.fool.com/retirement/2016/09/24/should-you-buy-a-variable-annuity.aspx [https://perma.cc/ATH9-J57V] ("It's not uncommon for an agent to make a commission of 5% or so on the sale of an annuity.").

13 Bernard, *supra* note 1.

14 *See id.*

15 There is currently no single model example for a compliance system, which is a set of procedures and controls designed to prevent misconduct within a company. *See* Jonathan D. Glater, *Here It Comes: The Sarbanes-Oxley Backlash*, N.Y. TIMES (Apr. 17, 2005), https://www.nytimes.com/2005/04/17/business/yourmoney/here-it-comes-the-sarbanesoxley-backlash.html [https://perma.cc/V78Z-FU86] ("Something as simple as requiring two people to sign a company check, for example, is one type of internal control."). Compliance systems can be an entire department within the company dedicated to ensuring compliance and preventing fraudulent behavior. *See, e.g.*, Monica Langley & Dan Fitzpatrick, *Embattled J.P. Morgan Bulks Up Oversight*, WALL ST. J. (Sept. 12, 2013, 11:23 PM), https://www.wsj.com/articles/embattled-jp-morgan-bulks-up-oversight-1379029490 [https://perma.cc/TPJ4-JADR] (discussing J.P. Morgan Chase's efforts to enhance compliance systems by hiring 5,000 extra employees, giving more autonomy to its top compliance officer and related managers, and hiring external consultants). Some firms even employ compliance systems in the form of computerized algorithms to comb records and flag issues. *See, e.g.*, *How Big Data Analytics Is Transforming Regulatory Compliance*, CREDIT SUISSE (Nov. 30, 2017), https://www.credit-suisse.com/about-us-news/en/articles/news-and-expertise/how-big-data-analytics-is-transforming-regulatory-compliance-201711.html [https://perma.cc/8PS3-Y6TT]. The wide variance in the way companies decide to ensure compliance with laws and regulations is a problem that this Note addresses.

16 *See infra* Parts I–II.

was obligated to disclose the conflict to Ms. Heckel by law, but did not do so appropriately because brokers and their institutions have significant discretion in how to comply with that requirement.[17] Weak compliance rules allow brokers to cave to strong monetary incentives while their clients pay the cost. In this case, that cost was a portion of Ms. Heckel's retirement savings.[18]

This situation is reminiscent of broker conduct before the financial crisis of 2007–2009, in which financial institutions failed to control broker misconduct in the face of monetary incentives.[19] Although institutions had compliance systems in place to deal with these conflicts, their wide discretion in how to implement those systems proved problematic on a systemic level.[20] As a result of the financial crisis, banks and insurance companies around the world lost over $1.1 trillion,[21] and retirement accounts lost $3.4 trillion.[22]

Studies examining the causes of this tailspin point largely to the actions of lightly monitored brokers and their monetary conflicts of interest.[23] Questionable motives pervaded the entire securitization system, indicating a lack of management and failure to ensure trustworthy recommendations that investors could rely upon.[24] This occurred even at the largest, most well-resourced financial conglomerates.[25]

In June of 2019, the U.S. Securities and Exchange Commission ("SEC") released a rule purporting to address the systemic problem of conflicts of interest in the form of the new Regulation Best Interest ("Reg BI") standard for brokers.[26] This rule has four specific obliga-

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17 *See* Bernard, *supra* note 1; *infra* Parts I–II.

18 *See* Bernard, *supra* note 1.

19 *See infra* Part II.

20 *See infra* Part II.

21 Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 Conn. L. Rev. 963, 968 (2009).

22 Sarah Childress, *How Much Did the Financial Crisis Cost?*, PBS: Frontline (May 31, 2012), https://www.pbs.org/wgbh/frontline/article/how-much-did-the-financial-crisis-cost/ [https://perma.cc/WNF4-2YZR].

23 *See, e.g.*, Wilmarth, *supra* note 22, at 1025 (stating that monetary conflicts of interest, primarily at larger financial conglomerates, "provide the most likely explanation for the links between securitization, higher-risk loans and rising default rates").

24 *See id.*

25 *See id.* at 994–95 (stating that "the four largest U.S. banks . . . , the five largest U.S. securities firms . . . , and seven major foreign universal banks . . . collectively dominated the markets for debt and equity securities" and other structured-finance securities based on nonprime mortgages).

26 *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with

tions of brokers: the Disclosure Obligation,[27] the Care Obligation,[28] the Conflict of Interest Obligation,[29] and the Compliance Obligation.[30] The focus of this Note will be primarily on Reg BI's fourth component, the Compliance Obligation, which states that "a broker-dealer must also establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest as a whole."[31]

This Note argues that the SEC, through the promulgation of Reg BI, endorsed a risk-focused supervision approach to the regulation of brokers and did nothing more than previous securities laws to curb broker discretion regarding conflicts of interest. Risk-focused supervision is the regulatory strategy of engaging in "highly deferential evaluations of the internal policies and procedures at megabanks."[32] This strategy was implemented in the era leading up to the financial crisis and had catastrophic consequences.[33] Leaving the decision of how to comply with Reg BI's components to those who have powerful incentives not to is problematic.

In order to rein in the vast discretion the SEC afforded brokers in Reg BI and prevent the mistakes of the past from reoccurring, the SEC should amend the Compliance Obligation to require a compliance system akin to the United Kingdom's Senior Management and Certification Regime ("SM&CR"), a comprehensive and robust regulatory framework that implements specific compliance requirements for regulated entities and assures accountability for wrongdoing.[34] Some key compliance requirements of SM&CR include requiring senior managers to get approval from financial regulatory bodies before

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Financial Professionals (June 5, 2019), https://www.sec.gov/news/press-release/2019-89 [https://perma.cc/H34U-2Z7A]; Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,319 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

27 Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. at 33,321 ("[A] broker-dealer must disclose, in writing, all material facts about the scope and terms of its relationship with the customer.").

28 *Id.* ("[A] broker-dealer must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer.").

29 *Id.* ("[A] broker-dealer must establish, maintain, and enforce . . . written policies and procedures . . . reasonably designed to identify all such conflicts and at a minimum disclose or eliminate them.").

30 *Id.*

31 *Id.*

32 ARTHUR E. WILMARTH, JR., TAMING THE MEGABANKS 213 (2020).

33 *See id.* ("The Fed and the [Office of the Comptroller of the Currency] applied their policy of risk-focused supervision to the largest banks from the mid-1990s until the financial crisis began, and they never abandoned that policy despite its manifest failures.").

34 *See infra* Part IV.

starting their roles and documenting the explicit responsibilities for which they are accountable.[35]

Part I of this Note addresses the compliance mandates within federal securities laws, which have largely remained unchanged in the face of repeated blows to the integrity of the financial system. Part II discusses the financial crisis and resulting regulation. Part III demonstrates the failure of these compliance mandates as shown by the Wells Fargo scandal. Part IV introduces SM&CR and discusses ways that it improves compliance. Part V illustrates how the SEC should implement SM&CR and describes the ways it would prevent the occurrence of another financial crisis.

## I. The Lack of Evolution in Compliance Mandates

The federal government began to regulate brokers in 1934 when Congress created the SEC in response to the stock market crash of 1929.[36] Despite a series of subsequent reforms in response to other major financial crises and exposures of fraudulent behavior, the compliance mandates within each of these laws have largely remained unchanged. The SEC is explicit that compliance with Reg BI should not be construed as reducing any existing obligations of compliance with federal securities laws, such as provisions of the Securities Exchange Act of 1934 ("Exchange Act"),[37] or any Self-Regulatory Organization ("SRO") Rules, such as the Financial Industry Regulatory Authority's ("FINRA") suitability rule.[38] The following sections will cover the accountability and compliance requirements for the securities laws and rules currently in place.

### A. *The Securities Exchange Act of 1934*

The Exchange Act contains its own requirements for brokers and expectations for compliance. Section 13(b) requires corporate boards to establish and preserve a reasonable internal compliance system,

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35 *See infra* Part IV.

36 Will Kenton, *Securities Exchange Act of 1934*, Investopedia (Oct. 30, 2020), https://www.investopedia.com/terms/s/seact1934.asp [https://perma.cc/46PE-5QKK].

37 15 U.S.C. §§ 78a–78qq.

38 Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,327 (July 12, 2019) (codified at 17 C.F.R. pt. 240); *2111. Suitability*, FINRA, https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111 [https://perma.cc/K5YV-6UYL]. FINRA is a private corporation, referred to as an SRO, that regulates brokers and is itself regulated by the SEC. *See* Daniel P. Guernsey, Jr., Note, *Requiring Broker-Dealers to Disclose Conflicts of Interest: A Solution Protecting and Empowering Investors*, 73 U. Mia. L. Rev. 1029, 1036 (2019).

with an emphasis on maintenance of records and timely reporting.[39] However, it does not give much guidance on how this should be done, directing broker entities to "make and keep books, [and] records" and "devise and maintain a system of internal accounting controls sufficient to" assure that transactions and accounting are sufficiently recorded and reasonably appropriate.[40] Similar to Reg BI, section 13(b) has a compliance prong, stating that security-based swap data repositories ("SDRs")—centralized recordkeeping facilities that Congress established to "maintain accurate records of security-based swap transactions and the integrity of those records"[41]—"shall comply" with the rules listed in this section, although they have "reasonable discretion" with how they choose to do so.[42]

Section 15(b)(4)(e) of the Exchange Act implements supervisory requirements on those responsible for brokers.[43] Such a person will be held liable for a broker's misconduct if she is "deemed to have failed reasonably to supervise" that person.[44] However, an affirmative defense to this charge is that there are "established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation" and the supervisor had no "reasonable cause to believe that such procedures and system were not being complied with."[45]

The Compliance Obligation in Reg BI is equally as vague as those in the Exchange Act. In its final interpretation of Reg BI, the SEC states that brokers may not even need to implement new systems in order to ensure compliance.[46] Compliance required under existing

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39 Securities Exchange Act of 1934 § 13(b), 15 U.S.C. § 78m(b); *see also* Stavros Gadinis & Amelia Miazad, *The Hidden Power of Compliance*, 103 MINN. L. REV. 2135, 2182 n.259 (2019) ("In addition to providing accurate disclosure to investors, federal securities laws require corporate boards to maintain a reasonable system of internal controls, in accordance with Section 13(b) of the 1934 Securities Exchange Act.").

40 Securities Exchange Act of 1934 § 13(b), 15 U.S.C. § 78m(b)(2).

41 *Security-Based Swap Data Repositories*, U.S. SEC. & EXCH. COMM'N (Dec. 19, 2017), https://www.sec.gov/divisions/marketreg/security-based-swap-data-repositories.htm [https://perma.cc/KR4H-YUCL]. Security-based swap transactions are "financial contracts in which two counterparties agree to exchange or 'swap' payments with each other" due to "changes in a stock price, interest rate or commodity price." U.S. SEC. & EXCH. COMM'N, THE REGULATORY REGIME FOR SECURITY-BASED SWAPS 3, https://www.sec.gov/swaps-chart/swaps-chart.pdf [https://perma.cc/GK33-E8RE].

42 15 U.S.C. § 78m(n)(3).

43 *Id.* § 78o(b)(4)(E).

44 *Id.*

45 *Id.*

46 Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,397 n.809 (July 12, 2019) (codified at 17 C.F.R. pt. 240) ("In order to comply, broker-dealers

securities laws, such as the supervisory requirements of section 15(b)(4)(E), could be considered sufficient for compliance with Reg BI.[47] Considering the vague nature of both the Compliance Obligation in Reg BI and the compliance requirements within the Exchange Act, the SEC is not asking for any additional measures to be taken. Nor is it providing any clarity about what those measures should entail beyond "reasonableness." FINRA has taken a similar approach.

## *B. FINRA Rules for Compliance*

Although FINRA has specific rules addressing conflict of interest obligations of brokers, the guidance on compliance with them is similarly vague and undefined. FINRA Rule 2111, referred to as the "suitability rule," requires a broker to "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security . . . 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."[48]

FINRA released guidance to address which means of compliance were necessary under Rule 2111, as the rule itself does not lay out any mandated procedures.[49] Under the guidance, appropriate means to ensure compliance include establishing a "tone from the top" in which management is responsible for creating an ethical environment and accountability, as well as "articulated structures, policies and processes to identify and manage conflicts of interest," and compliance training for employees.[50] FINRA, however, like the SEC in its final interpretation of Reg BI, makes clear that the "guidance is not intended to influence any firm's choice of a particular business model or reasonable approach to ensuring compliance with suitability or other regulatory requirements."[51] Thus, the discretion of compliance

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could adjust their current systems of supervision and compliance, as opposed to creating new systems.").

47 *See id.*

48 *2111. Suitability*, *supra* note 38.

49 *See* FINRA, Regulatory Notice 12-25: Additional Guidance on FINRA's New Suitability Rule (2012) [hereinafter Regulatory Notice 12-25], https://www.finra.org/sites/default/files/NoticeDocument/p126431.pdf [https://perma.cc/W9XP-WY6T]; FINRA, Regulatory Notice 13-31: FINRA Highlights Examination Approaches, Common Findings and Effective Practices for Complying with Its Suitability Rule (2013) , https://www.finra.org/sites/default/files/NoticeDocument/p351220.pdf [https://perma.cc/BN3Z-2RW2].

50 FINRA, Report on Conflicts of Interest 5–6 (2013), https://www.finra.org/sites/default/files/Industry/p359971.pdf [https://perma.cc/5XXA-3S6E].

51 Regulatory Notice 12-25, *supra* note 49, at 2; *see also* FINRA, *supra* note 50, at 2

with the FINRA rules on conflict of interest and suitability remains with brokers—those whose conflicts the rules intend to address.

### C. The Sarbanes-Oxley Act of 2002

As a result of massive corporate scandals resulting from poor compliance regimes and accounting fraud, such as those involved in Enron, consumer advocates stressed the dire need for better internal governance systems assured by people at the top of public companies.[52] Congress responded by enacting the Sarbanes-Oxley Act of 2002,[53] which directs the boards of public companies to enhance internal controls to ensure proper monitoring of lower-level employees and ethical accounting practices.[54] The Sarbanes-Oxley Act's emphasis on upper-level managers is demonstrated in section 302, which directs the SEC to adopt rules requiring those in the roles of Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") to sign off on annual and quarterly reports and certify that they are in compliance with the Exchange Act.[55]

Section 404 also demonstrates this attempt to bring senior-level executives into the compliance regime.[56] It requires public companies to assess and annually report on their own compliance controls regarding financial reporting.[57] Section 404, however, received considerable backlash from corporate executives, who bemoaned the costs of complying with this requirement and the extra burden its implementation places on executives—even in the face of the catastrophic impact that a handful of executives, such as Enron CEO Jeff Skilling, had on their shareholders.[58] Specifically, critics cited the differing business

("FINRA stresses that this report is not intended to express any legal position, and does not create any new legal requirements or change any existing regulatory obligations.").

52 *See* Neil H. Aronson, *Preventing Future Enrons: Implementing the Sarbanes-Oxley Act of 2002*, 8 STAN. J.L. BUS. & FIN. 127, 132 (2002).

53 Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15, 18, 28, and 29 U.S.C.).

54 *See* Gadinis & Miazad, *supra* note 39, at 2152–53.

55 *See* Sarbanes-Oxley Act § 302; *see also SEC Requires CEO and CFO Certification of Quarterly and Annual Reports*, MORRISON FOERSTER (Sept. 4, 2002), https://www.mofo.com/resources/insights/sec-requires-ceo-and-cfo-certification-of-quarterly-and-annual-reports.html [https://perma.cc/XP54-SLQD] ("The legislative purpose behind Section 302 is to ensure that a company's CEO and CFO take a proactive role in their company's public disclosure and to give investors more confidence in the accuracy, quality and reliability of a company's SEC periodic reports.").

56 *See* Sarbanes-Oxley Act § 404.

57 *See* U.S. SEC. & EXCH. COMM'N, SARBANES-OXLEY SECTION 404: A GUIDE FOR SMALL BUSINESS, https://www.sec.gov/info/smallbus/404guide.pdf [https://perma.cc/GE5K-2T2G].

58 *See* Glater, *supra* note 15; *see also* Troy Segal, *Enron Scandal: The Fall of a Wall Street*

structures of different companies as a reason why these requirements should not hold.[59] Their complaints seem to have had an impression on the SEC in designing Reg BI, as shown by its lack of explicit requirements for executives.[60]

Despite these attempts at limiting abuses of discretion by financial actors with conflicts of interest, this law proved insufficient to protect the financial sector from abuses that led to the financial crisis.

## II. The Financial Crisis and Resulting Regulation

The financial crisis was partially the result of risky lending strategies by mortgage brokers and the subsequent mass default on loans by borrowers who contracted beyond their means.[61] Borrowers' defaults on their loans proved catastrophic for the economy because of the securitization of those loans by brokers at large complex financial institutions ("LCFIs").[62] LCFIs are financial conglomerates resulting from a series of bank mergers and the consolidation of banking and securities activities.[63] Bank mergers concentrated a large share of banking assets in fewer entities and the consolidation of lending and securitization introduced another problematic conflict of interest.[64]

Because the same entity was both lending to borrowers and selling securities to investors, an "originate to distribute" strategy dominated LCFIs.[65] Lenders at these large banks knew that nonprime loans could be packaged into private-label residential mortgage-backed securities ("RMBS"), which generated much higher fees than prime loans that were packaged into government sponsored enter-

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*Darling*, Investopedia (Jan. 19, 2021), https://www.investopedia.com/updates/enron-scandal-summary/ [https://perma.cc/SUA4-XKH6] (stating that shareholders lost $74 billion in the four years prior to Enron's bankruptcy).

59 *See, e.g.*, Glater, *supra* note 15 ("Executives from smaller public companies said they should not have to meet the same requirements as larger companies, which they said have more resources to handle regulatory compliance.").

60 *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 26.

61 *See supra* text accompanying notes 19–25.

62 *See* Wilmarth, *supra* note 21, at 1024 ("Five studies have confirmed the linkage between higher levels of securitization and higher-risk lending."). Securitization is the process of pooling assets in the form of debt obligations—such as mortgage loans—and repackaging them as securities to be sold to investors, who then benefit from the payments on the loan. *See* Andreas Jobst, *What Is Securitization?*, Fin. & Dev., Sept. 2008, at 48, 48–49.

63 *See* Wilmarth, *supra* note 21, at 975.

64 *See id.* at 975–76 ("As a consequence of the bank merger wave, the share of U.S. banking assets held by the ten largest banks more than doubled, rising from twenty-five percent in 1990 to fifty-five percent in 2005.").

65 *See id.* at 995, 1025.

prise ("GSE")-issued RMBS.[66] This created an incentive to originate higher-risk loans for the sake of securitizing those loans and selling them to investors, who were under the assumption that their brokers did due diligence that the borrowers were creditworthy.[67] LCFIs had little regard for the value of their products, however, because they could get the risk of default out of their books and earn healthy fees by selling it.[68]

American LCFIs consist of the most recognizable names in finance, such as Merrill Lynch and Citigroup.[69] Senior managers at these institutions "received incentive-based compensation that strongly encouraged them to incur excessive risks in order to produce short-term profits."[70] For example, Citigroup insiders revealed a culture of "haphazard management," with the senior risk officer and the head of mortgage-related securities traders being old friends who exchanged favors.[71] Insiders say that this lack of independence within risk management "clouded [the] judgement" of "the very people charged with overseeing deal makers eager to increase short-term earnings—and executives' multimillion-dollar bonuses" and as a result, nobody was reined in from the enticing monetary incentives.[72] This also occurred at the United Kingdom's largest banks.[73]

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66 *Id.* at 1025. Although both private-label RMBS and GSE-issued RMBS are securitized mortgages, private-label RMBS "do not conform to the criteria set by Government Sponsored Enterprises" such as Freddie Mac and Fannie Mae. *Understanding . . . Mortgage Securitization*, SECURITIZATION, http://securitization.weebly.com/private-label-mbs.html [https://perma.cc/7KE5-ZZ6R]. They are thus riskier and carry a higher rate of return, which led people to invest in them rather than safer government-backed securities with lower rates of return. *See id.* ("When the bubble eventually collapsed and debt issuers were unable to make good on their securities, investors absorbed the brute impact of the firm failures.").

67 *See* Wilmarth, *supra* note 21, at 1026.

68 *See* Matt Levine, Opinion, *You Can Securitize People Now*, BLOOMBERG: MONEY STUFF (Feb. 25, 2020, 12:29 PM), https://www.bloomberg.com/opinion/articles/2020-02-25/you-can-securitize-people-now [https://perma.cc/RAX5-3WCM].

69 *See* Wilmarth, *supra* note 21, at 976–77.

70 *Id.* at 1034–35.

71 Eric Dash & Julie Creswell, *Citigroup Pays for a Rush to Risk*, N.Y. TIMES (Nov. 23, 2008), https://www.nytimes.com/2008/11/23/business/worldbusiness/23iht-23citi.18059343.html [https://perma.cc/Z2N3-A8XC] (stating that "[t]he two men took occasional fly-fishing trips together" and that "insufficient boundaries were established in the bank's fixed-income unit to limit potential conflicts of interest involving" the two managers).

72 *Id.* One trader at Citigroup said, "I just think senior managers got addicted to the revenues and arrogant about the risks they were running . . . . As long as you could grow revenues, you could keep your bonus growing." *Id.*

73 *See* Wilmarth, *supra* note 21, at 1004 ("The U.K.'s credit boom most closely resembles the U.S. experience. . . . As in the U.S., the U.K. credit boom produced a rapid growth in financial sector debt and financial industry profits.").

The regulatory regime did little to curb this abuse. Supervisors had the affirmative defense of having reasonable compliance systems in place,[74] combined with the deferential review of compliance programs taken on by regulators during this time.[75] For example, in 2006, Citigroup executive Charles Prince claimed that the executives were in control and that they "set a tone at the top" and "set up safety nets to catch people who make mistakes."[76] This seems to have appeased regulators at the time, who did not realize until late 2007 that "Citigroup and other megabanks had transferred more than $1.3 trillion of high-risk, illiquid assets to off-balance-sheet vehicles in transactions that resembled Enron's manipulative shell games."[77]

Post-financial crisis, executives got away primarily unscathed with their lucrative bonuses and payoffs.[78] The SEC omitted attempts to hold individual executives civilly liable, instead opting for settlements with LCFIs for amounts much less than their total assets, in which executives neither admitted nor denied wrongdoing.[79] This slap-on-the-wrist strategy traveled to Capitol Hill. During questioning at a U.S. House of Representatives hearing regarding CEO pay and the mortgage crisis, the questioning from congressional lawmakers was as "light touch" as the regulatory strategy employed during the years preceding the financial crisis.[80]

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74 *See* 15 U.S.C. § 78o(b)(4)(E).

75 *See* Wilmarth, *supra* note 32, at 213–14.

76 Dash & Creswell, *supra* note 71 (quoting Charles Prince III, Chief Executive, Citigroup, Statement (2006)).

77 Wilmarth, *supra* note 32, at 214.

78 For example, E. Stanley O'Neal, the CEO of Merrill Lynch, got a $162 million payoff when he was forced to retire, despite Merrill Lynch's stock plummeting forty-five percent in 2007. *See* John Cassidy, *Subprime Suspect: The Rise and Fall of Wall Street's First Black C.E.O.*, New Yorker (Mar. 24, 2008), https://www.newyorker.com/magazine/2008/03/31/subprime-suspect [https://perma.cc/NS44-9Y7X]. O'Neal claims that he was appropriately held accountable for the failure of oversight at his bank. *See id.* Likewise, the CEO of Citigroup, Charles Prince, walked away from a disaster of his own making with stock then valued at $68 million and a $12.5 million cash bonus for 2007, despite Citigroup reporting losses in the billions that same year. *See* Dash & Creswell, *supra* note 71.

79 *See, e.g.*, Jesse Eisinger, *Why the S.E.C. Didn't Hit Goldman Sachs Harder*, New Yorker (Apr. 21, 2016), https://www.newyorker.com/business/currency/why-the-s-e-c-didnt-hit-goldman-sachs-harder [https://perma.cc/KV9J-G5DK] (stating that "statutes weren't strong enough in some areas and resources were scarce," but pointing out that more nuanced reasons were at play such as a reluctance to go after such high-level executives); Michael A. Santoro, *Why Haven't the S.E.C.'s Lawyers Held Wall Street Accountable?*, New Yorker (July 31, 2013), https://www.newyorker.com/news/news-desk/why-havent-the-s-e-c-s-lawyers-held-wall-street-accountable [https://perma.cc/UF9T-JW44] ("The cases brought against individuals have involved lower-level executives and haven't been successful.").

80 *See* Broc Romanek, *Up Close and Personal: House Hearing on CEO Pay and the Mortgage Crisis*, Harv. L. Sch. F. on Corp. Governance (Mar. 24, 2008) https://

The lack of senior manager accountability and the large executive payouts angered consumer activists and the public at large.[81] People wanted to see some sort of regulatory action taken to ensure mismanagement of this scale would not happen again.[82] Legislators tried to appease these concerns with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[83]

### A. *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*

Congress enacted Dodd-Frank to address regulatory failures that contributed to the financial crisis. Although Dodd-Frank addresses many different areas in the financial sector, the part relevant for purposes of this Note is section 913.[84]

Section 913 of Dodd-Frank was the impetus for Reg BI. It directed the SEC to conduct a study ("The Section 913 Study") to evaluate "[t]he effectiveness of existing legal or regulatory standards of care" applicable to brokers.[85] The Section 913 Study recommended

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corpgov.law.harvard.edu/2008/03/24/up-close-and-personal-house-hearing-on-ceo-pay-and-the-mortgage-cri/ [https://perma.cc/5CL6-TNGT] (describing the House hearing on CEO severance pay post-crisis and stating that "[b]oth [political] sides were careful not to sully the reputations of the three CEOs who all represented classic American success stories, and clearly the CEOs . . . seemed to be emboldened as the hearing went on and the 'light' touch was evident"). *But see* Jenny Anderson, *Chiefs' Pay Under Fire at Capitol*, N.Y. TIMES (Mar. 8, 2008), https://www.nytimes.com/2008/03/08/business/08pay.html?_r=1&scp=1&sq=severance¶ay&st=nyt&oref=slogin [https://perma.cc/2GPR-FX7D] (stating that "[t]he questioning mainly fell along party lines," with Democrats going tough on the CEOs while Republicans were reluctant to do so).

81 *See* Edward J. Schoen, *The 2007–2009 Financial Crisis: An Erosion of Ethics: A Case Study*, 146 J. BUS. ETHICS 805, 818 (2017); John Dunbar & David Donald, *The Roots of the Financial Crisis: Who Is to Blame?*, CTR. PUB. INTEGRITY (May 19, 2014, 12:19 PM), https://publicintegrity.org/inequality-poverty-opportunity/the-roots-of-the-financial-crisis-who-is-to-blame/ [https://perma.cc/U7MP-CFYN]; M.H. Miller, Opinion, *I Came of Age During the 2008 Financial Crisis. I'm Still Angry About It.*, N.Y. TIMES (Sept. 15, 2018), https://www.nytimes.com/2018/09/15/opinion/sunday/financial-crisis-student-loans-recession.html [https://perma.cc/4Z24-D767]; Gretchen Morgenson & Louise Story, *In Financial Crisis, No Prosecution of Top Figures*, N.Y. TIMES (Apr. 14, 2011), https://www.nytimes.com/2011/04/14/business/14prosecute.html [https://perma.cc/8SXS-7MLB].

82 *See, e.g.*, Shawn Mankad, George Michailidis & Andrei Kirilenko, *On the Formation of Dodd-Frank Act Derivatives Regulations*, PLOS ONE, Mar. 25, 2019, at 1, 1, https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0213730 [https://perma.cc/V9S5-Y25N] ("Accordingly, driven by public outcry, governments around the world responded with stricter regulatory frameworks.").

83 Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of U.S.C.). For the purpose of clarity, this Note cites to the sections of Dodd-Frank, rather than the U.S. Code.

84 Dodd-Frank Act § 913.

85 U.S. SEC. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEAL-

that the SEC engage in rulemaking to harmonize the standards of care between investment advisers and brokers.[86] The SEC disregarded this advice, instead implementing a lower standard of care in the form of Reg BI.[87] This discrepancy is the subject of much debate and attack, including from state attorneys general,[88] consumer advocates,[89] and democratic Commissioner Robert J. Jackson, Jr.[90]

Drawing much less attention is the fact that The Section 913 Study recommended the SEC review the current supervisory requirements and "focus on whether any harmonization would facilitate the examination and oversight" of the regulated entities.[91] Specifically, The Section 913 Study states that the SEC should consider setting specific supervisory requirements across the board or scaling the supervisory requirements based on the size of the brokerage firm.[92] The SEC, however, through its promulgation and interpretation of Reg BI, did not do either of these things.

### *B. Regulation Best Interest*

In June of 2019, the SEC allegedly accomplished the task The Section 913 Study gave them in the form of Reg BI.[93] The new stan-

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ERS, at i (2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf [https://perma.cc/N3WD-VMK2].

86 *See id.* at viii. Investment advisers, while also advising customers on financial instruments to buy, are different from broker-dealers in that they are subject to a different regulatory regime under the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to -21. *See* Guernsey, *supra* note 38, at 1030–31.

87 *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 26.

88 *See, e.g.*, New York v. SEC, No. 19 Civ. 8365, 2019 WL 5203751 (S.D.N.Y. Sept. 27, 2019) (listing attorneys general from New York, California, Connecticut, Delaware, Maine, New Mexico, Oregon, and District of Columbia as plaintiffs in a challenge against Reg BI). The complaint was dismissed for lack of subject-matter jurisdiction, with directions to petition for review in the U.S. Court of Appeals for the Second Circuit. *Id.* at *1.

89 *See, e.g.*, CFA Institute, Comment Letter on Proposed Regulation Best Interest 2, 13 (Aug. 7, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4604861-176355.pdf [https://perma.cc/CZ59-SX56]; William F. Galvin, Comment Letter on Proposed Regulation Best Interest 2 (Aug. 7, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4177382-172364.pdf [https://perma.cc/3GBR-V9UG]; North American Securities Administrators Association, Inc., Comment Letter on Proposed Regulation Best Interest 2 (Aug. 7, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4184398-172577.pdf [https://perma.cc/BD2V-PUR2]; Bernard, *supra* note 1.

90 Public Statement, Robert J. Jackson, Jr., Comm'r, U.S. Sec. & Exch. Comm'n, Statement on Final Rules Governing Investment Advice (June 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd [https://perma.cc/883B-BHL2] ("Today's actions fail to arm Americans with the tools they need to survive the Nation's retirement crisis.").

91 U.S. SEC. & EXCH. COMM'N, *supra* note 85, at ix.

92 *See id.* at 135–36.

93 *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 26.

dard claims to be heightened from the former suitability rule, which required brokers to only suggest "investments that are 'suitable' based on the customer's characteristics, including age, goals and stomach for risk."[94] The new standard requires brokers, when making a recommendation, to "act in the retail customer's best interest" and not place their own interests before the clients.[95]

Under Reg BI's Compliance Obligation, "broker-dealers must establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with Regulation Best Interest as a whole."[96] This creates an "affirmative obligation under the Exchange Act."[97] To determine whether a broker has complied with Reg BI and acted in the investor's best interest, the SEC states that "an objective assessment of the facts and circumstances" existing at the time the recommendation in question is made will be employed to see if all the components of the rule are followed.[98]

Embedded in the Conflict of Interest prong is another compliance requirement.[99] The Conflict of Interest Obligation states that broker-dealers "must establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose or eliminate conflicts of interest."[100] Although this compliance obligation lists more specific elements than the general compliance prong—enumerating which general activities call for mitigation, prevention, and elimination, respectively—the specificities are largely about compliance practices that theoretically *should* be done rather than requirements as to how they *must* be done.[101] As a result, the Conflict of Interest prong's compliance obligation is, albeit wordier, comparably as weak as the general Compliance Obligation.

In response to critical comments received during the rulemaking period,[102] the SEC tried to justify the broad discretion given to broker-

94 Bernard, *supra* note 1.

95 *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 26.

96 *Id.*

97 Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,397 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

98 *Id.* at 33,325.

99 *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 26.

100 *Id.*

101 *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. at 33,386 ("[W]hile *not required* components . . . broker-dealers *should consider* including in their supervisory and compliance programs the components listed in the Proposing Release, which *may* be relevant in considering whether policies and procedures are reasonably designed." (emphasis added)).

102 *See, e.g.*, Better Markets, Comment Letter on Proposed Regulation Best Interest 20

dealers by stating that it is necessary for the wide range of business models broker-dealers use, allowing them to take into account "the structure and characteristics of their relationships with retail customers, including the varying levels and frequency of recommendations provided and the types of conflicts that may be presented."[103] As such, the final rule explicitly states that "a risk-based compliance and supervisory system" will be considered reasonable, rather than a more comprehensive and robust set of required guidelines.[104]

All of these reforms brought internal compliance regimes and the role of top-down enforcement to the forefront. None of them, however, prescriptively specified how this compliance must be done, instead using permissive language and vague standards of reasonableness. The distrust of Reg BI's weak standards and insistence that federal regulators do more to manage the reckless, self-interested tendencies of those in the financial industry is widespread and commonplace.[105]

## III. The Current Compliance Regime Has Proven Ineffective

The current laws and regulations regarding the way public companies must implement compliance systems to ensure brokers are not succumbing to conflicts of interest are too weak to be effective.[106] In particular, when brokerage institutions internally implement compliance programs that are purportedly comprehensive enough to be effective, the officers tasked with doing so are unlikely to be objective.[107] This is because they are under pressure to increase profits, either for themselves in the form of commission or for the company in the form of shareholder value.[108] The management failures at

(Aug. 7, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4185206-172621.pdf [https://perma.cc/2B8Z-VHM4] ("Another defect in the Proposal is the enormous amount of discretion that it affords to advisers in determining how to comply with the Conflict of Interest requirements.").

103 Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. at 33,386.

104 *Id.* at 33,385.

105 *See, e.g.*, Public Statement, Jackson, *supra* note 90. Corporate law scholars have expressed distrust in the systems companies choose to implement themselves. *See* John C. Coffee Jr., Gatekeepers: The Professions and Corporate Governance 146 (2006); Gadinis & Miazad, *supra* note 39, at 2155; Maurice E. Stucke, *In Search of Effective Ethics & Compliance Programs*, 39 J. Corp. L. 769, 794 (2014).

106 *See, e.g.*, Stucke, *supra* note 105, at 770–71 (discussing the persistence of ineffective compliance and corporate crime despite efforts to incentivize internal corporate compliance).

107 *See* Gadinis & Miazad, *supra* note 39, at 2155.

108 *See* John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J.

Wells Fargo illustrate the ineffectiveness of the current compliance regime.

Wells Fargo emerged relatively unscathed from the financial crisis.[109] Its lack of compliance with basic securities laws, however, imploded in 2016 when it was exposed that broker employees of the bank opened over 3.5 million fictitious accounts under pressure from management to meet sales goals and rack up fees.[110] Brokers who opened more accounts got bonuses, fueling the perverse incentive for those around them to do the same and inferring a tone of approval from senior management.[111]

The widespread opening of sham accounts occurred despite the bank's own compliance analysis indicating that steps taken to reduce the risk of this occurring were effective.[112] Wells Fargo had ethics training programs and dedicated teams for compliance.[113] Behind the scenes was a different story, with payouts from the accounts increasing for those higher up in the company.[114] Ironically, the CEO who got rich from his own company's lack of oversight blamed the scandal on the employees who were faced with unrealistic sales goals and wrongheaded financial incentives.[115]

After the scandal unfolded, Wells Fargo executives justified the rampant fraudulence by saying they had controls in place to avoid it

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LEGAL ANALYSIS 35, 38 (2014) (stating that shareholder value maximization "pushes managers hard to undermine regulation"); Donald C. Langevoort, *Cultures of Compliance*, 54 AM. CRIM. L. REV. 933, 949–50 (2017) (discussing "[s]elf-[s]erving [b]iases at [w]ork" in the form of an agent personally serving herself or seeking to benefit the firm).

109 *See What Kind of Bank Will Wells Fargo Be?*, ECONOMIST (Oct. 26, 2019), https://www.economist.com/finance-and-economics/2019/10/26/what-kind-of-bank-will-wells-fargo-be [https://perma.cc/XLX3-C4R3]; Gadinis & Miazad, *supra* note 39, at 2203 ("While Wells Fargo was one of the few major banks to have emerged from the financial crisis on a white horse, its currently unfolding fake account scandal reflects some of the darkest days in banking history.").

110 *See* Stacy Cowley, *Wells Fargo Review Finds 1.4 Million More Suspect Accounts*, N.Y. TIMES (Aug. 31, 2017), https://www.nytimes.com/2017/08/31/business/dealbook/wells-fargo-accounts.html [https://perma.cc/VCC2-KT56].

111 *See id.*; Michael Corkery & Stacy Cowley, *Wells Fargo Warned Workers Against Sham Accounts, but 'They Needed a Paycheck,'* N.Y. TIMES (Sept. 16, 2016), https://www.nytimes.com/2016/09/17/business/dealbook/wells-fargo-warned-workers-against-fake-accounts-but-they-needed-a-paycheck.html [https://perma.cc/G9GN-TRKD].

112 *See* Corkery & Cowley, *supra* note 111 ("The bank analyzed potentially questionable accounts and employee terminations from 2011 through much of 2015 and concluded that it had made progress in cleaning up its act. . . . In interviews, former employees say the fact that the behavior has continued to occur—even if less frequently—shows that the bank has not been doing enough to stop it.").

113 *See id.*

114 *See id.*

115 *See id.*

and that they are continuing to do more.[116] Left to implement and supervise their own compliance regimes, banks will formally put some controls in place and then leave lower level employees to exploit the system and in turn provide large payouts to the individuals at the top, who then shirk responsibility.[117] The method of using compliance controls as a façade to get away with malfeasance behind the scenes is not novel and is all too similar to the methods preceding the financial crisis.

## IV. While Reg BI's Compliance Obligation Promotes Risk-Focused Supervision, SM&CR Promotes Accountability and Denotes Specific Conduct

By telling brokers to implement compliance systems that reasonably conform to its rules and regulations, the SEC is endorsing the deferential risk-focused supervision that was implemented in the years leading up to the financial crisis. Rather than checking to ensure large, complex financial conglomerates have sufficient compliance procedures in place to mitigate risk, regulators simply check to see that compliance systems exist.[118] If broker entities have systems and controls in place that a reasonable person would consider sufficient to address conflicts of interest, then the Compliance Obligation is satisfied.[119]

Compliance experts recognize that the wide grant of discretion to brokers is an area ripe for improvement.[120] In an attempt to close this gap and implement a more comprehensive system of compliance, the United Kingdom's Financial Conduct Authority ("FCA") has taken a different approach to regulatory oversight than the United States. Senior Management and Certification Regime ("SM&CR"), also known as the "Accountability Regime," is a regulatory regime emphasizing senior-level accountability and raising the standards for internal compliance within financial services firms and big banks.[121] Like Dodd-

116 *See id.*

117 *See, e.g.*, *id.*

118 *See* Wilmarth, *supra* note 32, at 213–14.

119 *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,397–98 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

120 *See* Wilmarth, *supra* note 21, at 964 ("Current regulatory policies—which rely on 'market discipline' and LCFIs' internal 'risk models'—are plainly inadequate to control the proclivities in universal banks toward destructive conflicts of interest and excessive risk-taking."); Gadinis & Miazad, *supra* note 39, at 2208 ("For those interested in boosting board accountability, this is a fertile ground for further intervention.").

121 *See* Fin. Conduct Auth., The Senior Managers and Certification Regime:

Frank and Reg BI, SM&CR is a response to the financial crisis caused by the same exploitation of conflicts of interest by brokers and their bosses in the United Kingdom.[122]

SM&CR contrasts from Reg BI in that its mandates for compliance are not permissive but prescriptive. By requiring tangible, traceable steps for senior managers—designated persons to hold accountable for malfeasance—SM&CR tells brokers and their associated entities *how* to comply, rather than to merely create a reasonable compliance system.[123] As the following Sections illustrate, this framework has many advantages.

### *A. Responsibility Placed at the Top*

Comparable to Reg BI, SM&CR applies to brokers along with other financial actors such as asset managers and investment advisers.[124] The regime has different requirements for different "tiers" of regulated entities—"Limited," "Core," and "Enhanced."[125] Most regulated firms fall into the Core tier.[126] A firm falls into the Enhanced tier, and is subject to stricter requirements, if it manages assets of £50 billion or more.[127] LCFIs would fall into this category. The Limited tier is reserved for those who were formally authorized to be subject to a reduced set of requirements under the prior rule regarding compliance enforcement.[128]

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GUIDE FOR FCA SOLO-REGULATED FIRMS 6 (2019), https://www.fca.org.uk/publication/policy/guide-for-fca-solo-regulated-firms.pdf [https://perma.cc/3VKT-7FFM].

122 *See* Wilmarth, *supra* note 21, at 1004; William Yonge & Matthew Howse, *New UK Regime to Strengthen Senior Management Accountability*, NAT'L L. REV. (Nov. 17, 2015), https://www.natlawreview.com/article/new-uk-regime-to-strengthen-senior-management-accountability [https://perma.cc/V6VW-NS9E]; *Senior Managers and Certification Regime (SMCR)*, GOODACRE, https://www.goodacreuk.com/smcr [https://perma.cc/7DAW-Q4RA].

123 Comparing the language used in SM&CR with Reg BI elucidates the stronger level of regulation within SM&CR. For example, the SM&CR guide lists out "*required* functions" that regulated firms *must* denote to *specific* executives, who *must* create a document describing those functions and their responsibility over them. FIN. CONDUCT AUTH., *supra* note 121, at 23–25 (emphasis added). In contrast, the SEC's final rule explanation used in Reg BI's Compliance Prong repeatedly uses suggestions for compliance, stating that it is "not mandating specific requirements pursuant to the Compliance Obligation." Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. at 33,397.

124 *See The UK's Expanded Senior Managers and Certification Regime: Key Issues and Action Plan for Brokers, Advisers and Asset Managers*, SHEARMAN & STERLING (July 8, 2019), https://www.shearman.com/perspectives/2019/07/the-uks-expanded-senior-managers-and-certification-regime-key-issues-and-action-plan [https://perma.cc/XLG5-M2WB].

125 *See id.*

126 *See id.*

127 *See id.*

128 *See id.*

As indicated from its name, SM&CR's main focus is on holding senior executives accountable for the misconduct of those they are required to supervise.[129] Its key obligations land on the senior managers responsible for implementing change in the firm—those who "are the most senior people in a firm with the greatest potential to cause harm or impact upon market integrity."[130] SM&CR enumerates roles, referred to as "Senior Management Functions" ("SMFs"), that qualify someone as a senior manager.[131] SMFs vary across tiers, and at least ten roles in Enhanced firms qualify individuals as senior managers.[132]

Another obligation includes "Prescribed Responsibilities," which require firms to designate senior managers with certain responsibilities, including, but not limited to, taking accountability for compliance with the regime, implementing "financial crime risk management procedures," and training and reporting on company compliance with those procedures.[133] These responsibilities are defined in a handbook that the FCA requires firms to give to its senior managers.[134]

SM&CR also requires firms to designate each business area to a senior manager to ensure that someone is accountable for compliance with necessary procedures.[135] These individuals must create "Statements of Responsibilities" ("SoRs"), which are documents that enumerate in detail every function they are responsible for within the firm.[136] Firms subject to the Enhanced requirements must create "Responsibilities Maps," which "give a collective view of the allocation of responsibilities across a firm" by mapping the structure of management and oversight.[137] Any individual who performs audit functions

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129 *See* Yonge & Howse, *supra* note 122 ("[T]he SMCR[] was designed to replace the current Approved Persons Regime (APR) and strengthen the regulation of individuals at the top of relevant firms.").

130 Fin. Conduct Auth., *supra* note 121, at 13.

131 *Id.* at 18–19 (enumerating SMFs for Core firms); *id.* at 21–22 (enumerating SMFs for Limited Scope firms); *id.* at 23–25 (enumerating SMFs for Enhanced firms).

132 *See id.* at 23–25 (enumerating the roles, including being a chair of any governing body or having oversight capabilities).

133 *See The UK's Expanded Senior Managers and Certification Regime: Key Issues and Action Plan for Brokers, Advisers and Asset Managers*, *supra* note 124.

134 Fin. Conduct Auth., *supra* note 121, at 16.

135 *See* Barnabas Reynolds & Reena Agrawal Sahni, *Individual Accountability: Sr. Managers & Beyond*, Clearing House: Bank Pol'y Inst., https://www.theclearinghouse.org/banking-perspectives/2015/2015-q4-banking-perspectives/articles/individual-accountability-uk-us [https://perma.cc/334R-TJWK].

136 *Id.*

137 Fin. Conduct Auth., *supra* note 121, at 26–27.

must be independent from individuals involved in the performance of services.[138]

Finally, every senior manager must have a "Duty of Responsibility."[139] In the event that an agent of the regulated entity breaches any FCA requirement, the senior manager who is predetermined to be responsible for the activity causing this breach will "be held accountable if they didn't take reasonable steps to prevent or stop the breach."[140] This contrasts with section 15(b)(4)(e) of the Exchange Act, which allows an affirmative defense of having a reasonable system in place, thus creating the opportunity for a manager to use a façade of compliance to skirt liability.[141] SM&CR does not allow the existence of a "reasonable system" to bar liability.[142] Senior managers have a statutory duty of responsibility and will be held liable if the FCA can show they did not take specific steps to prevent a specific breach for which that person is already responsible.[143]

## B. *The Active Role of Regulators*

Another key aspect of SM&CR is its emphasis on certification by the FCA. The regime calls for frequent communication between the FCA and senior managers. Individuals in senior manager roles must be approved by the FCA before assuming any responsibilities over the firm.[144] When applying for their senior manager role, individuals must submit SoRs to the FCA.[145] They must keep SoRs up to date and resubmit them when there is a "significant change" in their responsibilities.[146]

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138 *Id.* at 25.

139 *Id.* at 14.

140 *Id.* The handbook also states:

> The burden of proof lies with the FCA to show that the Senior Manager didn't take the steps a person in their position could reasonably be expected to take to avoid the firm's breach occurring.
>
> . . .
>
> Sometimes it will be appropriate to take action against a Senior Manager, sometimes against a firm, and sometimes against both. These decisions will be made on a case by case basis . . . .

*Id.*

141 *See* 15 U.S.C. § 78o(b)(4)(E).

142 *See* FIN. CONDUCT AUTH., *supra* note 121, at 14.

143 *See id.*; Reynolds & Sahni, *supra* note 135.

144 *See The UK's Expanded Senior Managers and Certification Regime: Key Issues and Action Plan for Brokers, Advisers and Asset Managers*, *supra* note 124; FIN. CONDUCT AUTH., *supra* note 121, at 13.

145 FIN. CONDUCT AUTH., *supra* note 121, at 14.

146 *Id.*

SM&CR also has "fitness and propriety" requirements, which mandate firms assess whether staff in key roles are fit and proper to maintain their roles.[147] These apply to senior managers as well as those in "Certification Function[s]," which are functions "performed by employees who could pose a risk of significant harm to the firm or its customers," but who do not need to be approved by the FCA.[148] The fit and proper test requires firms to perform criminal record and disciplinary checks, acquire references, and judge personal characteristics such as integrity, reputation, and competence.[149] These checks must be done annually.[150]

The FCA's active role in firm compliance ensures that it is always apprised of who is making decisions that have the potential to affect the wellbeing of the economy. The intent behind these comprehensive checks is to catch mistakes before they result in severe damage to consumers and the financial system.[151] With its emphasis on individuals in influential roles that impact the culture of the entire firm, SM&CR has the capability to prevent another national financial crisis. The SEC should issue an amendment to the Reg BI Compliance Obligation, incorporating these more specific and prescriptive compliance mandates.

## V. Implementation: Prevention as an Alternative to Crisis Management

Some of the factors contributing to the financial crisis are equally as present today as they were in the early 2000s. LCFIs still hold vast amounts of financial assets and consolidate lending and securitization activities, as seen by the recent merger of Morgan Stanley, one of Wall Street's biggest names, and E*Trade, the online trading platform.[152]

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147 *Id.* at 40 ("A key feature of the SM&CR is to reinforce that firms need to take responsibility for their staff being fit and proper to do their jobs.").

148 *Id.* at 10.

149 *Id.* at 40–41. For a list of the fit and proper requirements for each role, see *id.* at 43.

150 *Id.* at 40.

151 *See id.* at 6.

152 *See* Michael J. de la Merced, Kate Kelly & Emily Flitter, *Morgan Stanley to Buy E-Trade, Linking Wall Street and Main Street*, N.Y. Times (June 16, 2020), https://www.nytimes.com/2020/02/20/business/morgan-stanley-etrade.html [https://perma.cc/6W22-H4W7]; *Why Morgan Stanley Wants to Buy E*Trade*, Economist (Feb. 20, 2020), https://www.economist.com/finance-and-economics/2020/02/20/why-morgan-stanley-wants-to-buy-etrade?utm_campaign=the-economist-today&utm_medium=newsletter&utm_source=salesforce-marketing-cloud&utm_term=2020-02-20&utm_content=article-image-1 [https://perma.cc/YM57-E6RX]. This is not a novel merger. In November of 2019, investment bank Charles Schwab announced plans to acquire online broker TD Ameritrade. *See Charles Schwab Agrees to Buy TD Ameritrade for $26bn*, Economist (Nov. 25, 2019), https://www.economist.com/fi-

This is notably "the biggest takeover by a major American lender since the 2008 global financial crisis."[153] LCFIs' persistent participation in both lending and securitizing activities means that the inherent conflicts of interest and originate-to-distribute model still operate within our economy.[154]

Considering the similarities between the current situation and the situation preceding the 2007–2009 financial crisis, it is urgent for the SEC to take action immediately. Section V.A discusses how the SEC should implement SM&CR, and Sections V.B and V.C apply its requirements to Senior Management failures enabled by the current regulatory regime.

### A. *The SEC Should Amend Reg BI's Compliance Obligation to Reflect the SM&CR Compliance Requirements*

The SEC's fundamental role is to protect investors and ensure the integrity of financial markets.[155] It has the authority to regulate the compliance of brokers via Dodd-Frank, which granted it rulemaking power.[156] Indeed, amending Reg BI would take another period of notice and comment. However, the vast number of comments critical of the initial Reg BI proposal and the SEC's lack of implementing meaningful changes in response have laid the groundwork of exemplifying what improvements must be made. For example, Better Markets, a sophisticated independent public interest group founded in the wake of the financial crisis, stressed that the compliance mandate leaves too much discretion with brokers, called for substantive requirements, and pointed out the flaws in the SEC's economic analysis.[157] Thus, the amendment period should not take as long as the original implemen-

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nance-and-economics/2019/11/25/charles-schwab-agrees-to-buy-td-ameritrade-for-26bn?utm_campaign=the-economist-today&utm_medium=newsletter&utm_source=salesforce-marketing-cloud&utm_term=2020-02-20&utm_content=related-stories-1 [https://perma.cc/65LN-W35X].

153 de la Merced et al., *supra* note 152.

154 Furthermore, the securitization of debt payments has now taken hold in another form: college loans, known as Student Loan Asset-Backed Securities. *See* Eric Reed, *Should You Invest in Student Loan Asset-Backed Securities?*, THESTREET (May 20, 2017, 1:20 PM), https://www.thestreet.com/personal-finance/should-you-invest-in-student-loan-asset-backed-securities-14142296 [https://perma.cc/EV8H-DBS6]. For an example of an interesting way Lambda School is using this concept, see Levine, *supra* note 68.

155 *What We Do*, U.S. SEC. & EXCH. COMM'N (Dec. 18, 2020), https://www.sec.gov/Article/whatwedo.html [https://perma.cc/CNE9-6KBQ].

156 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 209, 124 Stat. 1376, 1460 (codified as amended in scattered sections of U.S.C.).

157 *See* Better Markets, *supra* note 102, at 20–27.

tation for the rule, as the studies and comments naturally point toward more stringent compliance mandates.

Furthermore, one of the issues with Reg BI's compliance prong is that it is permissive, listing out recommended compliance strategies without mandating that brokers implement them.[158] Some of the recommended strategies are comparable to those required by SM&CR, such as "periodic review and testing" and "training."[159] Accordingly, some of the changes to Reg BI could be a matter of replacing recommendations as requirements.

### B. *Placing Compliance Responsibility on Senior Managers Will Influence the Cultures They Create*

Wells Fargo shows that, even after Dodd-Frank tried to implement sweeping reform, management is not doing what it should to address issues with internal compliance.[160] This is because management is only required to implement a reasonable system and does not have to take responsibility when it fails.[161] When regulation does not focus on individuals in key roles, executives and managers are able to create company cultures that favor profit over compliance while hiding behind a veil of ignorance and pointing to systems that are reasonably designed.

SM&CR responds to this accountability problem by placing responsibility and accountability on senior managers, those who have the most power to cause harm as well as mitigate it.[162] By prescribing compliance responsibilities to senior managers and requiring them to write out SoRs to show that they understand their personal duties, SM&CR requires senior managers to take an active role in compliance.[163] This realigns executives' responsibilities and shows that company culture can be a balance between profits and compliance, rather than a trade-off.

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158 *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,397 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

159 *See id.* at 33,386 n.688.

160 *See* William D. Cohan, *Wells Fargo Scandal May Be Sign of a Poisonous Culture*, N.Y. TIMES (Sept. 16, 2016), https://www.nytimes.com/2016/09/17/business/dealbook/wells-fargo-scandal-may-be-sign-of-a-poisonous-culture.html [https://perma.cc/P84C-VAXV].

161 *See supra* text accompanying notes 116–17.

162 *See* FIN. CONDUCT AUTH., *supra* note 121, at 13.

163 *See id.*; *The UK's Expanded Senior Managers and Certification Regime: Key Issues and Action Plan for Brokers, Advisers and Asset Managers*, *supra* note 124.

Furthermore, when there is a breach, there is a specific manager who will be required to answer for it.[164] SM&CR shifts the liability inquiry from reasonableness of a general system, with no prescribed controls or responsible individuals, to reasonableness of a senior manager's actions in response to acts of noncompliance and adherence with explicit mandates.[165] For example, regulators would assess the fact that Wells Fargo senior managers created a culture that rewarded brokers who opened more accounts and set unrealistic sales goals, despite the existence of a formal compliance system that may satisfy standards of reasonableness.[166] The inquiry would also focus on whether the required Senior Management functions and responsibilities were followed by the individual in question.[167] This focus would ensure that senior managers do not blame lower-level employees or claim ignorance over the regulated activities, which must be well-documented and submitted to regulators.

If an individual is influential enough in an organization to affect its culture, then she should have accountability regarding its compliance. SM&CR places these duties on those individuals and would disallow executives like O'Neal of Merrill Lynch and Prince of Citigroup to claim they were held accountable while simultaneously pocketing millions.[168] Furthermore, SM&CR gives the public what it asked for in response to the last crisis—executive accountability.[169] The regime's certification requirements will transform the current regulatory strategy from deferential and post hoc to engaging and preventive.

### C. *SM&CR Certifications Will Keep Regulators Apprised of Malfeasance*

After the Wells Fargo scandal erupted into the public arena, the board of directors began an effort to bulk up its compliance department, adding over 5,200 compliance employees.[170] This is similar to JP Morgan Chase's addition of 5,000 employees after the financial crisis.[171] The familiar approach of management taking compliance seri-

164 *See* Fin. Conduct Auth., *supra* note 121, at 14.

165 *See id.* ("When deciding whether to take action against someone . . . [FCA] will look at all the circumstances of the case. This includes the seriousness of the breach, the person's position, responsibilities, and the need to use enforcement powers effectively and proportionately.").

166 *See supra* Section III.A.

167 *See* Fin. Conduct Auth., *supra* note 121, at 14.

168 *See supra* note 78.

169 *See supra* notes 78–79 and accompanying text.

170 Gadinis & Miazad, *supra* note 39, at 2206.

171 Langley & Fitzpatrick, *supra* note 15.

ously only after grave financial harms have ensued is inefficient and expensive.[172] The SM&CR offers a solution to this problem by ensuring that the SEC take an active role in firm compliance, rather than engage in the deferential risk-focused supervision that preceded the previous financial crisis.

By requiring senior managers to implement specific formal frameworks and prove the existence of these frameworks to regulators, SM&CR responds to the issue of letting misconduct go on for years without detection and elimination. Pre-approval of individuals in senior manager roles and submissions of SoRs to the SEC will facilitate its supervision over big economic actors and keep the SEC apprised of any changes or problematic conflicts of interest.[173]

For example, SM&CR's requirement that individuals responsible for the auditing and compliance functions be independent from those in other senior manager functions operates to ensure that undue influence does not bleed between roles.[174] Applying this to the U.S. framework, senior managers would be required to document and submit their duties to the SEC, proving that every function is accounted for and there are no problematic overlaps in responsibilities.[175] At LCFIs, this would be in combination with Responsibilities Maps, so regulators would know who is responsible for what at each major bank.[176] Internally, firm compliance teams would already know about problematic conflicts because they must reassess these employees every year for fitness and propriety.[177]

The enhanced awareness that SM&CR requires would help prevent another situation like that of Citigroup, in which the senior risk officer and the head of mortgage-related securities were known friends and influenced each other in ways diametrical to the interests of investors.[178] As a result, traders knew they could get any deal through if their superior simply spoke to the risk officer on a friendly basis.[179] If the individuals in these integral roles were subject to specific compliance obligations mandating independence and certification by the SEC, this problem could have been avoided, and millions in investor money saved.

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172 *See* Better Markets, *supra* note 102, at 18.

173 *See* Fin. Conduct Auth., *supra* note 121, at 13–14.

174 *See id.* at 25.

175 *See id.* at 13–14.

176 *See id.* at 26–27.

177 *See id.* at 40.

178 *See supra* text accompanying notes 69–73.

179 *See* Dash & Creswell, *supra* note 71.

Some critics will argue that this is too inefficient and costly for the SEC to implement and supervise. SM&CR, however, would actually prove that the certifications are more efficient for the SEC because it harmonizes the compliance requirements that regulators assess when determining liability.[180] If firms do not have discretion in how to comply, there will be less variance in their compliance regimes,[181] standards will be more or less uniform across the board, and accountable individuals will be easily identifiable.[182] This should ease the burden on regulators, who will look for the same compliance indicators in like firms and already be apprised of who the actors are.[183] Furthermore, SM&CR's implementation of more uniform standards of conduct accomplishes a goal of Dodd-Frank, which was to "focus on whether any harmonization would facilitate the examination and oversight" of the regulated entities.[184]

SM&CR does not call for absolute harmonization, as the requirements depend on which tier a firm falls into.[185] Yet, this scaled-for-size feature of SM&CR directly responds to attempted justifications for the SEC's weak compliance prong.[186]

### D. *Business Model Concerns*

The SEC's biggest justification for not requiring specific steps in compliance programs is that weaker mandates are necessary in order to allow brokers to "have flexibility to tailor policies and procedures to their specific business models."[187] Rather than make an effort to

180 *See* FIN. CONDUCT AUTH., EXTENDING THE SENIOR MANAGERS & CERTIFICATION REGIME TO FCA FIRMS—FEEDBACK TO CP17/25 AND CP17/40, AND NEAR-FINAL RULES 50 (2018), https://www.fca.org.uk/publication/policy/ps18-14.pdf [https://perma.cc/DP6W-92D2]; DELOITTE, SENIOR MANAGERS REGIME: INDIVIDUAL ACCOUNTABILITY AND REASONABLE STEPS 5 (2016), https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-senior-manager-regime.pdf [https://perma.cc/QM4Y-8SZR].

181 *See* DELOITTE, *supra* note 180, at 5; *cf.* Better Markets, *supra* note 102, at 24 (discussing that a uniform fiduciary standard for brokers and investment advisers would "promote regulatory efficiency" and "streamlin[e] compliance").

182 *See* FIN. CONDUCT AUTH., *supra* note 180, at 50; DELOITTE, *supra* note 180, at 5.

183 *See* DELOITTE, *supra* note 180, at 5 ("The increased focus on individual accountability will therefore move the regulators away from the time-consuming task of having to determine who is accountable for what, to a position of determining whether the individual(s) responsible took reasonable steps . . . ."). This also addresses a concern that commenters expressed in response to Reg BI's proposal, which was that it did not provide regulators a means with which to assess compliance. *See supra* Section II.B.

184 U.S. SEC. & EXCH. COMM'N, *supra* note 85, at 136.

185 *See The UK's Expanded Senior Managers and Certification Regime: Key Issues and Action Plan for Brokers, Advisers and Asset Managers*, *supra* note 124.

186 *See supra* Section II.B.

187 Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318,

create specifications appropriate for those it is tasked with regulating, the SEC effectively threw up its hands and went with the weakest approach. In contrast, SM&CR directly responds to this problem in the form of its three-tiered system, which imposes different requirements for differently sized firms.[188] For example, the Enhanced firms are those with more time and resources to accomplish the tasks assigned to them, such as drafting and submitting Responsibilities Maps to the FCA.

In the United States, the Enhanced firms would be the LCFIs whose mergers and consolidations enable them to concentrate the vast amount of assets within their own entities.[189] This seems entirely appropriate, as their concentration also subjects the financial market to systemic risk.[190] Furthermore, SM&CR's scaling would accomplish in part what Dodd-Frank originally asked the SEC to do: The Section 913 Study suggested the SEC consider scaling the specific supervisory requirements based on the size of the brokerage firm.[191]

## Conclusion

Although financial markets have become increasingly robust and complex, the securities laws regulating them have lagged behind. LCFIs still dominate the financial industry and engage in the same risky lending strategies that preceded the 2007–2009 financial crisis. The SEC failed to protect financial consumers from these risks in its recent promulgation of Reg BI. Specifically, the compliance prong

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33,385 (July 12, 2019) (codified at 17 C.F.R. pt. 240). This argument was also used by executives who bemoaned the cost of complying with Sarbanes-Oxley. *See* Glater, *supra* note 15; *supra* note 58 and accompanying text. A related argument is that stricter mandates may cause brokers to pass compliance costs onto retail consumers. *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. at 33,385; Guernsey, *supra* note 38, at 1031. The only costs that are saved, however, are in the beginning, with more payments coming later in the form of crisis management, investor harm, and investigation and enforcement by the SEC and other regulatory entities. *See* Better Markets, *supra* note 102, at 18 ("[I]t is inconceivable that the benefits to brokers of this approach would outweigh the costs to investors that will inevitably follow from such a weak solution to the problem of conflicts of interest.").

188 *See The UK's Expanded Senior Managers and Certification Regime: Key Issues and Action Plan for Brokers, Advisers and Asset Managers*, *supra* note 124.

189 *See supra* Section IV.A.

190 *See* Wilmarth, *supra* note 21, at 994.

191 U.S. Sec. & Exch. Comm'n, *supra* note 85, at 135 ("In reviewing these requirements, the Commission could consider whether a single set of universally applicable requirements would be appropriate. Alternatively, the Commission could consider whether supervisory structure requirements should be scaled based on the size (*e.g.*, number of employees) and nature of a broker-dealer or an investment adviser.").

does not add any additional protection than the vague compliance standards in securities laws preceding it.

The United Kingdom's SM&CR assures that compliance systems are not just reasonable, but also effective as they have to meet obligations set out by regulators, rather than by conflicted financial actors. This regime is stronger than Reg BI because it is focused on senior manager accountability and prevention of investor harm, rather than crisis management. By amending Reg BI's Compliance Obligation to reflect these characteristics, the SEC can fulfill its role as a protector of investors, not of the broker business model.