Financial Stability Regulation as Indirect Investor/Consumer Protection Regulation: Implications for Regulatory Mandates and Structure

Hilary Allen
American University Washington College of Law, hjallen@wcl.american.edu

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Financial Stability Regulation as Indirect Investor/Consumer Protection Regulation: Implications for Regulatory Mandates and Structure

Hilary J. Allen*

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I. INTRODUCTION

An investor who purchases shares in a corporation, at a price that has been inflated by misleading information, suffers when the truth comes to light and the share price falls. A consumer seeking financing to buy a home suffers if a lender misleads the consumer about the cost and features of a mortgage that the consumer subsequently obtains. In the United States, investor protection regulations, as administered by the United States Securities and Exchange Commission (SEC), aim to address the first scenario by providing remedies for fraud in

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connection with the purchase or sale of a security. To address the latter scenario, a slew of federal consumer protection legislation exists that seeks to protect the consumer from unfair, deceptive, abusive, and discriminatory practices. Since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), these consumer protection statutes largely have been administered by the Consumer Financial Protection Bureau (CFPB). In both of the prior examples, the primary focus is on the harm that individual investors and consumers can suffer at the hands of unscrupulous actors. However, both investors and consumers are—collectively—hurt more by the economic disruptions that follow a financial crisis than they are by individual instances of misconduct.

Despite this, a shared characteristic of the SEC and CFPB is that both agencies typically discharge their protector functions from a direct perspective. Unfortunately, such an approach neglects the indirect harm that consumers and investors suffer as a result of financial instability. That is not to say that the SEC and the CFPB are currently discharging their functions in identical ways: there are certainly striking differences in culture and approach that are evident when we compare the agencies and when we compare investor- and consumer-targeted laws more generally. A more detailed analysis of such distinctions, and the design and purpose of the SEC and CFPB, can be found in the other contributions to this Symposium. The aim of this Article, however, is to illustrate the depth of harm that can befall both investors and consumers in the aftermath of a financial crisis and,


2. For a list of the “enumerated” consumer laws, see Dodd-Frank Wall Street Reform and Consumer Protection Act § 1002(12), 12 U.S.C. § 5481(12) (2012). These include the statutes mentioned infra text accompanying notes 136-139.


4. It should be noted that the CFPB’s jurisdiction to administer consumer financial protection legislation is not complete: while it generally has the power to make rules pursuant to the enumerated consumer laws, it has limited authority to supervise and enforce compliance with those laws/rules for depository institutions and credit unions with total assets of $10 billion or less. See 12 U.S.C. § 5516(c)-(d). Instead, the primary banking regulators supervise and enforce the consumer laws with respect to smaller banks.

5. As other contributors to this Symposium have discussed far more eloquently and in far greater detail, investor protection regulation is more concerned with protecting suppliers of capital to the financial system, and consumer regulation is more concerned with protecting users of capital.
in so doing, make the case that financial stability regulation—which aims to prevent such crises—should be conceptualized as a vitally important, albeit indirect, form of consumer protection and investor protection regulation.6

Viewing financial stability in this way suggests a critique of the existing financial regulatory architecture in the United States, which has a council of regulators, but no dedicated agency charged with protecting consumers and investors from the indirect harms they suffer in the wake of financial crises.7 Instead, the structures in place in the United Kingdom and Australia offer a better alternative: both countries have adopted the so-called “twin peaks” model, which entails having only two financial regulatory agencies, rather than dividing up regulatory jurisdiction by financial industry sector, as is generally the case in the United States.8 Although not often described as such, the twin peaks structure can be conceptualized as designating one market conduct and consumer protection regulator to address direct harms to investors and other consumers of financial products and charging another, a prudential regulator, with preventing indirect harms in the form of externalities that flow from institutional and systemic failure.

The focus of this Article is on the latter, prudential “peak” and on indirect consumer and investor protection; other contributions to this Symposium will consider whether it is advisable to implement the other “peak” in the United States (i.e., to create a single, unified market conduct and consumer protection regulator). This Article argues that the creation of a single prudential regulator, with an express financial stability mandate and jurisdiction over all financial institutions, would be the best regulatory design for promoting financial stability. However, recognizing that it is unlikely that there will ever be sufficient political will for such a restructuring in the United States, this Article also stresses that both the SEC and the CFPB, in their current forms, should strive to prevent crises and protect investors and consumers in so doing.

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6. I have previously argued that efforts to pursue the policy goal of “financial stability” should be oriented towards avoiding externalization of the consequences of financial system failure to people who are outside of the financial system and who have not agreed to bear such risks. See Hilary J. Allen, Putting the “Financial Stability” in Financial Stability Oversight Council, 76 Ohio St. L.J. 1087, 1098 (2015).

7. 12 U.S.C. § 5321 established the Financial Stability Oversight Council (FSOC). For further discussion of the FSOC, its mandate, and its limitations, see infra text accompanying notes 74-76.

8. See infra text accompanying notes 85-94.
The remainder of this Article will proceed as follows: Part II will provide a theoretical sketch of how financial crises indirectly harm investors and consumers, before providing some more concrete data from the financial crisis of 2007-2008 (Financial Crisis or Crisis) and its impact in the United States, the United Kingdom, and Australia. Part III will then discuss how financial stability regulation, which seeks to prevent such indirect harms, is administered in the United States, the United Kingdom, and Australia. After concluding that the regulatory architecture in the United States is suboptimal when compared with the British and Australian alternatives, this Article considers in Part IV how the U.S. regulatory structure might be reformed to better address issues of financial stability. Part V offers second-best, but perhaps more feasible, suggestions as to how the SEC and the CFPB, in their current forms, might nonetheless make valuable contributions to financial stability regulation.

II. INDIRECT HARM TO INVESTORS AND CONSUMERS

This Part will give a brief account of the magnitude of the indirect harm that can flow from financial crises, justifying the active engagement of the SEC and CFPB in financial stability regulation. As a preliminary matter, this requires a brief discussion of the indirect harms that can befall investors and consumers and how they fit within the statutory mandates of the SEC and CFPB.

In both the Securities Act of 19339 and the Securities Exchange Act of 193410 (Exchange Act), the SEC is mandated, in discharging its functions, to “consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”11 The SEC has interpreted this statutory mandate as a tripartite mission that requires it to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”12 While there are a myriad of ways in which investors can be harmed, the prototypical loss suffered by investors is the drop in value of shares in which they have invested. While the SEC has always eschewed merit regulation in the sense that it will not protect investors from

losing money as a result of bad investments, the SEC is also charged with regulating the markets in which shares are traded; therefore, it is appropriate for the SEC to protect investors in the stock market from losses that arise not from idiosyncratic business decisions made by the issuers of shares, but from the failure of the markets generally to operate in an orderly and efficient way. As such, in discharging its investor protection mandate, the SEC should seek to avoid financial crises that can cause the stock market as a whole to fall: in the aggregate, investors holding a diversified portfolio of stocks are impacted much more by systemic events that reduce returns market-wide than they are by the movement of the price of any individual stock.

The SEC should also remain mindful of the broader economic ramifications of the failure of the securities markets. In this context, certain portions of section 2 of the Exchange Act bear repeating:

For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto . . . .

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce . . . and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal

13. For a discussion of the arguments against merit regulation at the federal level, see Wendy Gerwick Couture, Price Fraud, 63 BAYLOR L. REV. 1, 76-77 (2011).

Government is put to such great expense as to burden the national credit.\textsuperscript{15}

This section 2 of the Exchange Act provides legislative direction for the SEC to proactively regulate to avoid the widespread economic consequences of securities market failure.

Similarly far-reaching ramifications can result from the failure of the consumer credit markets. In the law review article that precipitated the CFPB, Professors Elizabeth Warren and Oren Bar-Gill framed the harm to consumers to be avoided in terms of unnecessary costs paid by consumers for financial services.\textsuperscript{16} In particular, they focused on the unnecessary "transfer from consumers to sellers of credit."\textsuperscript{17} The CFPB's statutory mandate, as set out in section 1021(a) of Dodd-Frank, reflects this intellectual heritage and requires the CFPB to act for the purpose of ensuring "that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."\textsuperscript{18} The CFPB is seeking to preserve access to credit that is, in the aggregate, most vulnerable during crisis conditions, when banks are failing and even solvent banks are nervous about the continuing availability of funding.\textsuperscript{19} In this type of environment, even reliably creditworthy consumers and small businesses can lose their access to credit,\textsuperscript{20} and credit is needed both for individual economic advancement and collective economic growth.\textsuperscript{21} Indeed, it is precisely the choking off of credit that translates financial crises into broader economic recessions (often with significant increases in

\begin{itemize}
\item \textsuperscript{15} 15 U.S.C. § 78b.
\item \textsuperscript{17} Id. at 58.
\item \textsuperscript{18} Dodd-Frank Wall Street Reform and Consumer Protection Act § 1021(a), 12 U.S.C. § 5511(a).
\item \textsuperscript{19} Markus Brunnermeier refers to this as "precautionary hoarding": Precautionary hoarding arises if lenders are afraid that they might suffer from interim shocks and that they will need funds for their own projects and trading strategies. Precautionary hoarding therefore increases when 1) the likelihood of interim shocks increases, and 2) outside funds are expected to be difficult to obtain. The troubles in the interbank lending market in 2007-08 are a textbook example of precautionary hoarding by individual banks.
\item \textsuperscript{20} Markus K. Brunnermeier, \textit{Deciphering the Liquidity and Credit Crunch 2007-2008}, J. Econ. Persp., Winter 2009, at 77, 95.
\end{itemize}
unemployment levels). Thus, the consumer protection that Warren and Bar-Gill were promoting, and that the CFPB is trying to achieve, has the end goal of fostering broad economic well-being and is best preserved by avoiding financial crises and maintaining a stable financial system.

In their analysis of data from This Time Is Different: Eight Centuries of Financial Folly, economists Carmen Reinhart and Kenneth Rogoff found that “[o]n average, unemployment rises for almost five years [following a crisis], with an increase in the unemployment rate of about 7 percentage points.” They also found that the average decline in per capita GDP resulting from financial crises is 9.3% from peak to trough; that “the recessions surrounding financial crises are unusually long compared to normal recessions, which typically last less than a year”, and that real government debt increases on average 86% in the three years following a crisis. Importantly, as Federal Reserve Chair Janet Yellen has stressed: “These are not just statistics …. The toll [of unemployment] is simply terrible on the mental and physical health of workers, on their marriages, and on their children.” And the consequences of financial crises are not evenly distributed—they can have particularly dire consequences for young people first seeking to enter the workforce during a recession and (at the other end of the spectrum) those who have retired or are seeking to retire and whose retirement investments shrink as a result of a crisis.

The magnitude of this type of harm justifies (well-designed) regulatory intervention. The remainder of this Part will look more particularly at the consequences of the Financial Crisis in the United States, the United Kingdom, and Australia in terms of employment, access to credit, economic growth, and the stock markets.

22. See Brunnermeier, supra note 19, at 90.
24. See id. at 229-30.
25. Id. at 230.
26. See id. at 231.
28. Allen, supra note 6, at 1094.
A. United States

The causes of the Financial Crisis were manifold, but in its report on the origins of the Crisis, the Financial Crisis Inquiry Commission (FCIC) summarized them as follows:

Trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world. When the bubble burst, hundreds of billions of dollars in losses in mortgages and mortgage-related securities shook markets as well as financial institutions that had significant exposures to those mortgages and had borrowed heavily against them. This happened not just in the United States but around the world. The losses were magnified by derivatives such as synthetic securities.

The crisis reached seismic proportions in September 2008 with the failure of Lehman Brothers and the impending collapse of the insurance giant American International Group (AIG). Panic fanned by a lack of transparency of the balance sheets of major financial institutions, coupled with a tangle of interconnections among institutions perceived to be “too big to fail,” caused the credit markets to seize up. Trading ground to a halt. The stock market plummeted. The economy plunged into a deep recession.

Risky mortgages were thus the building blocks of the Financial Crisis, and complex financial innovations and short-term interbank funding were the transmission belts. The suboptimal regulatory structure in place in the United States was ill-suited to address the proliferation of these problems. Notably, competition amongst the United States’ various banking regulators to attract institutions to their jurisdictions resulted in laxer regulation, which allowed the nonconforming mortgage market to flourish. More generally, as the United States Department of the Treasury noted in 2009:

While this crisis had many causes, it is clear now that the government could have done more to prevent many of these problems from growing out of control and threatening the stability of our financial system. Gaps and weaknesses in the supervision and regulation of financial firms presented challenges to our government’s ability to monitor,

30. FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT, at xvi (2011) [hereinafter FCIC REPORT].

prevent, or address risks as they built up in the system. No regulator saw its job as protecting the economy and financial system as a whole.\textsuperscript{32} Complex financial instruments in particular fell through the regulatory cracks.\textsuperscript{33} The Financial Crisis proved disastrous for the United States. Notwithstanding unprecedented government intervention (in the form of direct bailouts and liquidity support), banks tightened lending standards, reduced lines of credit on credit cards, and increased fees and interest rates. In the third quarter of 2008, 67% of banks imposed standards on credit cards that were tighter than those in place in the previous quarter. In the fourth quarter, 59% did so, meaning that many banks tightened again. In fact, a significant number of banks tightened credit card standards quarter after quarter until the summer of 2009.\textsuperscript{34} This lack of credit constricted economic growth: "[T]he US economy contracted by 3.5 percent in the immediately following year 2009, down from growth of 2.8 percent in 2007—a loss equivalent to approximately $9 trillion . . . .\textsuperscript{35} Unemployment in the United States peaked in October 2009 at 10% (with underemployment estimated at 17.4%)—\textsuperscript{36} a significant rise from the rate of 4.6% that pertained in June 2007.\textsuperscript{37} And this situation was not remedied quickly: the unemployment rate did not drop below 6% until the last quarter of 2014. Several economists from the Federal Reserve Bank of Dallas have attempted to estimate "\textit{what it cost}—the value of what society gave up" as a result of the Financial Crisis.\textsuperscript{38} They conclude, with what they describe as a conservative estimate, that every household in the United States was between $50,000 and $120,000 worse off as a result


\textsuperscript{33} One particularly important financial innovation—the credit default swap—had been expressly exempted from all regulatory oversight by the Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, app. E, 114 Stat. 2763, 2763A-365 to -461 (codified as amended in scattered sections of 7, 11, 12, 15 U.S.C. (2012)).

\textsuperscript{34} FCIC REPORT, \textit{supra} note 30, at 393-94.

\textsuperscript{35} Armour & Gordon, \textit{supra} note 14, at 43 (citation omitted).

\textsuperscript{36} FCIC REPORT, \textit{supra} note 30, at 390. This underemployment rate includes part-time workers who would prefer to be fully employed and those who are too discouraged to look for work, in addition to those who are unemployed and actively searching for work. \textit{Id}.

\textsuperscript{37} All statistics relating to unemployment levels are drawn from the United States Department of Labor, Labor Force Statistics from the Current Population Survey, \textsc{Bureau Lab. Stat.}, \url{http://data.bls.gov/timeseries/LNS14000000} (last visited Mar. 8, 2016).

of the Financial Crisis (and that the country as a whole was between $6-$14 trillion worse off). Obviously, the Financial Crisis hurt shares in financial institutions, but the general economic malaise that the Crisis unleashed ensured that even nonfinancial stocks fell: the S&P 500 and the Dow Jones Industrial Average did not recover from their Crisis-related losses until March 2013.

B. United Kingdom

"As a leading centre for the trading activity (whether by UK or foreign owned banks), which underpinned the securitised credit model, and as the home country of several leading global banks, the UK was bound to be affected" by the turmoil in the global markets that radiated out from the United States in the latter half of 2008. The United Kingdom was also adversely affected by the failure of its own securitized mortgage financing market, which had developed in parallel to the equivalent market in the United States. The British bank Northern Rock was particularly reliant on the smooth functioning of this securitization market and the short-term interbank funding it used to finance its participation therein, and thus it failed when these markets collapsed. In the end, the United Kingdom was forced to nationalize Northern Rock, as well as the Royal Bank of Scotland, Lloyds TSB, and Halifax Bank of Scotland (HBOS),

39. "The Standard and Poor's 500 Index fell by a third in 2008—the largest single-year decline since 1974—as big institutional investors moved to Treasury securities and other investments that they perceived as safe." FCIC REPORT, supra note 30, at 393.


42. [A]n increasing supply of mortgages was available at very high initial loan-to-value ratios as borrowers and lenders assumed that debt burdens were likely to fall with continuous property price appreciation which delivered large increases in the value of household assets. Though not to the same extent as in the US subprime market, mortgage credit was extended to social categories which would not previously have enjoyed access.

Id.

43. Id.

44. Id. at 35.

45. Elizabeth F. Brown, A Comparison of the Handling of the Financial Crisis in the United States, the United Kingdom, and Australia, 55 VILL. L. REV. 509, 527 (2010).
functioning of the financial system. As in the United States, these failures were facilitated by the regulatory structure then in place: "[A] long period of reduced economic volatility, which was attributed by many informed observers to the positive benefits of the securitised credit model, helped foster inadequate [regulatory] focus on system-wide prudential risks."

The United Kingdom suffered deeply as a result of the Financial Crisis. The Crisis sparked a recession, and unemployment started to rise sharply in 2008, peaking at 8.1% in late 2011. The rate only started to recover in 2013. The United Kingdom only emerged from recession in the fourth quarter of 2009; then, buffeted by the headwinds of the eurozone sovereign debt crisis (which itself was triggered by the Financial Crisis), it returned to recession in early 2012. In terms of stock market performance, the FTSE 100 Index dropped precipitously from its June 2007 peak and did not return to that peak level until November 2013. Finally, as the Bank of England reported in its survey of credit conditions for the fourth quarter of 2008:

Lenders reported that they had reduced the availability of secured credit to households in the three months to mid-December 2008. As in the Q3 survey, expectations for house prices and concerns about the economic outlook were reported to have been factors contributing to this tightening. A further decline was expected over the next three months.

Unsecured credit availability to households was reported to have been reduced in line with expectations. A further fall was expected.

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46. _Turner Review, supra_ note 41, at 87; _see also infra_ text accompanying notes 78-81 (discussing Australia's response to the Financial Crisis). For a brief discussion of the U.S. analogue, see _supra_ text accompanying notes 31-32.


49. "The UK economy comes out of recession, after figures show it grew by 0.1% in the last quarter of 2009, following six consecutive quarters of economic contraction—the longest such period since quarterly figures were first recorded in 1955." _United Kingdom Profile—Timeline_, _BBC NEWS_ (Feb. 29, 2016), http://www.bbc.com/news/world-europe-18028620.


51. _United Kingdom Profile—Timeline, supra_ note 49.

Overall spreads on secured lending to households were reported to have widened over the past three months . . .

Reductions in the availability of credit, and increases in the cost of credit, continued into 2009.

C. Australia

Australia, on the other hand, emerged relatively unscathed from the Financial Crisis. The country did not fall into recession, and its employment rate remained substantially below the Organisation for Economic Co-operation and Development (OECD) average. The OECD commented in 2010 that the Australian economy was “one of the most resilient in the OECD during the global economic and financial crisis.” Australian banks continued to function relatively well throughout 2008 and 2009: although they saw their profits decline somewhat over that period, no government bailouts were required. As a result, the availability of consumer financial services was not interrupted in Australia in the same way that it was in the United States and the United Kingdom.

One contributing factor to the lack of systemic failure in Australia during the Financial Crisis was the Australian Prudential Regulation Authority’s (APRA) requirement that banks hold higher levels of regulatory capital against nonconforming residential mortgages, ensuring that—unlike in the United States and United Kingdom—very few of such loans were made. APRA, of course, has its own unique history, which no doubt contributed to its strong stance on regulatory capital requirements. In particular, APRA received significant public criticism with regard to its supervision of the Australian insurance giant HIH, which failed in 2001—institutional memory of this episode

55. Brown, supra note 45, at 519.
58. Brown, supra note 45, at 521-22, 524.
59. Id at 539. "The [nonperforming loan] ratio for housing loans of U.S. banks was 5.7% in 2009 and of U.K. banks was 2.4% in 2009. In contrast, the aggregate nonperforming loan ratio for mortgages held by Australian banks was only 0.69% in June 2009." Id at 544.
may partially explain APRA's firm approach to mortgages in later years. However, as this Article will explore, APRA's structure was (and continues to be) calculated to produce a desirable culture. At the very least, having a consolidated prudential regulator avoids the regulatory competition that plagued banking regulators in the United States, leading to increased deregulation as each regulator sought to attract financial institutions to charter with it.

That is not to say that APRA was entirely responsible for the Australian economy's resilience—there were a number of contributing factors, not least of which was Australia's strong trade relationship with China. Furthermore, this Article does not mean to suggest that no Australian firms failed as a result of the Financial Crisis:

Between 2007 and 2009, there were also collapses, totaling A$66 billion, of a number of highly leveraged organizations, including ABC Learning, Allco Finance and Babcock & Brown. Finally, another string of collapses, including those of the Westpoint Group and Opes Prime Stockbroking Ltd (Opes Prime), resulted in massive retail consumer losses.

The key thing to note, however, is that these failures were more notable for the direct harm they caused to investors and consumers—they did not have the indirect systemic impact that the failure of institutions like Lehman Brothers and Northern Rock had. Instead, the Australian economy remained generally robust in the wake of the Crisis (although, interestingly, the ASX 200 stock market index has yet to recover the pre-Crisis high of 6748.90 points reached on October 12, 2007).

III. FINANCIAL STABILITY REGULATION IN THE UNITED STATES, UNITED KINGDOM, AND AUSTRALIA

The potentially dire consequences of financial crises justify the implementation of precautionary financial stability regulation. As a preliminary matter, this Part will first give some color on what

60. Hill, supra note 56, at 220-23.
61. See discussion infra Parts III-IV.
62. See Wilmarth, supra note 31, at 915.
63. Hill, supra note 56, at 276-77.
64. Id. at 214-15.
“financial stability regulation” is. I have previously argued that the proper aim of financial stability regulation is to maintain the smooth functioning of the financial system, so as to prevent the externalization of the consequences of risks taken within the system to people who have not agreed to bear such risks.\textsuperscript{67} However, prior to the Financial Crisis, financial regulation tended to be focused on the solvency of individual financial institutions (especially banks), rather than considering the stability of the system as a whole.\textsuperscript{68} Unfortunately, the Crisis vividly illustrated that when stressed financial institutions try to preserve their individual stability, their collective efforts can undermine the stability of the system.\textsuperscript{69} Since the Financial Crisis, regulators have become more open to a “macroprudential” approach to financial regulation, which scrutinizes interactions and linkages between financial institutions and markets, rather than focusing solely on the institutions themselves.\textsuperscript{70} As a result, there has been a move towards deploying traditional regulatory tools like institutional leverage limits and capital requirements in new ways, such as adjusting the requirements countercyclically “to tamp down an incipient boom . . . and to loosen restrictions in a slump.”\textsuperscript{71} Other types of post-Crisis regulation aimed at promoting financial stability include activities restrictions for financial institutions (such as the Volcker Rule) and clearing requirements.\textsuperscript{72}

Such measures are designed to avoid, or at least mitigate, the indirect harm that a financial crisis can inflict on investors and consumers, as explored in Part II. Notwithstanding the potential harm to their investor and consumer constituencies, however, neither the SEC nor the CFPB has an express statutory mandate to pursue financial stability or to minimize the likelihood of future crises. (Importantly, though, there is also no law that prevents the SEC or CFPB from seeking to discharge their mandates by promoting

\textsuperscript{67} See id. at 182.
\textsuperscript{68} Samuel G. Hanson et al., \textit{A Macroprudential Approach to Financial Regulation}, J. ECON. PERSP., Winter 2011, at 3, 3.
\textsuperscript{70} Hanson et al., supra note 68, at 3.
\textsuperscript{71} Allen, supra note 6, at 1100. For example, “[T]he regulator can lower leverage and/or credit-extension ceilings, and/or boost reserve and/or capital buffer requirements, and/or raise liquidity minima and/or lower maturity mismatch maxima during boom phases, while doing the contrary during slump phases.” Robert Hockett, \textit{The Macroprudential Turn: From Institutional ‘Safety and Soundness’ to Systematic ‘Financial Stability’ in Financial Supervision}, 9 VA. L. & BUS. REV. 201, 225 (2015).
\textsuperscript{72} Allen, supra note 6, at 1099-1100.
financial stability.) Indeed, prior to the Financial Crisis, no regulatory body in the United States had an explicit financial stability mandate, and this was an important contributing factor to the severity of that Crisis.\textsuperscript{73}

In response to the Crisis, Dodd-Frank created a new council of regulators named the Financial Stability Oversight Council (FSOC) and conferred upon it a mandate to "identify risks to the financial stability of the United States" and "to respond to emerging threats to the stability of the United States financial system."\textsuperscript{74} The FSOC has a fundamental flaw, though. It is expected to leverage the expertise of its member agencies in its quest to promote financial stability, and thus it does not have a substantial staff or resources of its own.\textsuperscript{75} However, those member agencies, including the SEC and the CFPB, have no express statutory mandate to pursue financial stability themselves. Therefore, the pre-Crisis status quo prevails to some extent, in that there is no large, well-funded U.S. agency dedicated to protecting the financial system as a whole.\textsuperscript{76}

Instead, the approach to financial stability regulation taken in Australia (and now in the United Kingdom) is better calculated to protect investors and consumers from indirect harm. To be clear, this Article is not recommending the pre-Crisis approach to financial regulation taken in the United Kingdom, which serves more as a cautionary tale of what \textit{not} to do.

By way of background, the Financial Services and Markets Act of 2000\textsuperscript{77} created the Financial Services Authority (FSA), which had supervisory jurisdiction over the entire British financial industry until 2012. The FSA was responsible for both market conduct (direct) and financial stability (indirect) regulation.\textsuperscript{78} Although much praised in the lead-up to the Financial Crisis,\textsuperscript{79} it became clear after the fact that financial stability had lagged behind other regulatory objectives in the FSA: "[T]he FSA favored efficiency over stability as a regulatory philosophy, and ... that preference manifested itself in a \textit{laissez-faire}, market discipline-based approach that often eschewed the

\textsuperscript{73} Financial Regulatory Reform: A New Foundation, supra note 32, at 2.
\textsuperscript{74} 12 U.S.C. § 5322(a)(1)(A), (C) (2012).
\textsuperscript{75} Allen, supra note 6, at 1090-91.
\textsuperscript{76} See id. at 1150-52.
\textsuperscript{77} Financial Services and Markets Act 2000, c. 8 (UK).
\textsuperscript{78} Turner Review, supra note 41, at 92.
\textsuperscript{79} Hill, supra note 56, at 222-23.
interventionist regulation necessary as a prudential supervisor.\textsuperscript{80} The result was that the FSA was not aggressive enough in demanding adjustments to business models which even at level of the individual institution were excessively risky and which pursued simultaneously by several banks, contributed to the build-up of system-wide risks. In addition . . . it is clear that in the specific case of Northern Rock, the FSA also fell short of high professional standards in the execution of its supervisory approach . . .\textsuperscript{81}

This result is perhaps not surprising given the FSA's structure. The pursuit of efficiency and financial stability can require the implementation of diametrically opposite policies,\textsuperscript{82} therefore, asking the FSA to serve two masters without directing it to clearly pursue one over the other was fraught from the start. The political realities of financial regulation are such that the public has very little interest in financial stability regulation as long as the economy is healthy, making it very difficult for regulators to resist pressure from the financial industry to prioritize efficiency in good times.\textsuperscript{83} It is therefore unsurprising that efficiency trumped stability as an objective in the pre-Crisis FSA (and the same would likely be true if the United States were to implement a single, monolithic financial regulator). Post-Crisis, the United Kingdom recognized the flaws in the design of the FSA and abolished it with the enactment of the Financial Services Act of 2012.\textsuperscript{84} In place of the FSA, the United Kingdom adopted the twin peaks model by creating two new bodies: the Prudential Regulation Authority and the Financial Conduct Authority.\textsuperscript{85} Because the Prudential Regulation Authority has not been given a primary charge to promote efficiency or focus on individual investor and consumer welfare, its mandate and identity are more tied to promoting the public good of financial stability, and this structure is more likely to produce

\textsuperscript{80} Allen, supra note 6, at 1139 (citing Turner Review, supra note 41, at 87).
\textsuperscript{81} Turner Review, supra note 41, at 88.
\textsuperscript{82} "[C]ombing prudential and conduct of business regulation and supervision clearly creates the danger that there will be inadequate specialist focus on either, and in particular that a focus on conduct issues may crowd out prudential, particularly in good economic times when financial instability risks may appear less pressing." Id. at 92.
\textsuperscript{84} Financial Services Act 2012, c. 21 (UK).
\textsuperscript{85} History of the FCA, FIN. CONDUCT AUTHORITY, http://www.fca.org.uk/about/history (last modified Jan. 5, 2016).
a regulatory culture in which the collective (albeit indirect) interests of investors and consumers are prioritized over industry demands.\textsuperscript{86}

Perhaps the most-cited example of a successful implementation of the twin peaks model is in Australia. Financial regulatory reform usually arises as a response to a crisis, but the restructuring of the Australian financial regulatory architecture in 1999 was instead a response to a deliberative "peacetime" study of financial system regulation known as the "Wallis Inquiry." The Wallis Inquiry had been "asked to analyse the forces driving change in the financial system and recommend ways to improve current regulatory arrangements,"\textsuperscript{87} and one of its key recommendations was the creation of an "Australian Prudential Regulation Commission" (which later became APRA) that would regulate the entire financial industry from a prudential perspective.\textsuperscript{88} Admittedly, when the Wallis Inquiry's report was written, the authors took the view that financial stability "must be addressed by the monetary authorities," rather than the prudential regulator,\textsuperscript{89} but there has since been a global shift in understanding about how financial stability regulation should be carried out.\textsuperscript{90} And so, while the Wallis Inquiry recommended that "the systemic stability of the financial system should remain the responsibility of the central bank," rather than the prudential regulator,\textsuperscript{91} the regulatory structure in Australia has evolved such that now "[t]he Reserve Bank of Australia (RBA) and APRA each have responsibility for financial stability."\textsuperscript{92}

APRA's mandate to pursue financial stability was made explicit in 2006 when section 8(2) of the Australian Prudential Regulation Authority Act of 1998\textsuperscript{93} was amended to direct it, in balancing its objectives, "to promote financial system stability in Australia."\textsuperscript{94} The

\textsuperscript{86} Michael W. Taylor, The Road from "Twin Peaks"—And the Way Back, 16. CONN. INS. L.J. 61, 81-82 (2009).
\textsuperscript{88} Id. at 42.
\textsuperscript{89} Id. at 24.
\textsuperscript{91} Wallis Inquiry, supra note 87, at 23.
\textsuperscript{92} Fin. Sys. Inquiry Comm., supra note 29, at 233.
\textsuperscript{93} Australian Prudential Regulation Authority Act 1998 (Cth) (Austl.).
\textsuperscript{94} Id. s 8(2). The full mandate, as set out in section 8(2), directs APRA "to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, . . . to promote financial system stability in Australia." Id.
United Kingdom's Prudential Regulation Authority now has a similar mandate to APRA: Section 2B of the Financial Services and Markets Act of 2000, which was added by the Financial Services Act of 2012, provides that while the Prudential Regulation Authority's *general* objective is to promote the safety and soundness of individual regulated institutions,

[that objective is to be advanced primarily by—

(a) seeking to ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system, and

(b) seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

IV. SUGGESTIONS FOR REFORM

A. *Creating a Peak Prudential Regulator in the United States*

The U.S. regulatory structure, as it currently stands, is not optimally designed to implement financial stability regulation. The best way to protect both investors and consumers from the fallout of financial crises seems to be to follow the Australian (and now the British) model and create a new, unified prudential regulator with jurisdiction over the entire financial industry. Like APRA, the new prudential regulator should be clearly directed to prioritize financial stability as its ultimate end and, in so doing, should work closely with the Board of Governors of the Federal Reserve System (Federal Reserve) (which should retain control over monetary policy and its powers to serve as the lender of last resort/market-maker of last resort

95. Financial Services Act 2012, c. 21, § 2B(3) (UK).

96. The fractured architecture of the U.S. financial regulatory system facilitates arbitrage and capture, making all regulation (not just financial stability regulation) less effective. Looking more specifically at financial stability regulation, the FSOC, in addition to lacking substantial funding and staff, is chaired by the Treasury Secretary and is thus more susceptible to political pressures from the Executive than is desirable. Allen, *supra* note 6, at 1091.

97. At the very least, this consolidation would limit the scope for financial institutions to arbitrage regulations by picking and choosing the regulators who will have jurisdiction over them. See Richard Scott Carnell, Jonathan R. Macey & Geoffrey P. Miller, *The Law of Banking and Financial Institutions* 26 (4th ed. 2009).

98. APRA is directed "to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, . . . to promote financial system stability in Australia." *Australian Prudential Regulation Authority Act 1998* s 8(2) (Cth) (Austl.).
Granting a strong, statutory financial stability mandate to the new regulator could help forge a regulatory identity that prioritizes the goal of avoiding indirect harms to consumers and investors over the profitability of the financial sector. As James Kwak has stated, “Someone who identifies as an economically sophisticated steward of efficient financial markets will adopt different policy positions than someone who identifies as a defender of the ‘little guy’ . . . .”

In addition to giving the new regulator a statutory financial stability mandate, it is important to structure the agency in a way that makes it robust to deregulatory pressures. Similar to APRA (and some of the existing U.S. financial regulatory agencies), the new agency should be funded by industry fees and headed by a commission, the members of which are presidential appointees who can only be removed for cause. In this instance, a commission is preferable to an individual director because commissioners could be selected who hold different types of expertise; having five commissioners—each with a different background in, say, banking, securities, insurance, derivatives, and funds—would help ensure that no one industry segment would be the dominant focus or model for prudential regulation. In a similar vein, each commissioner should be required to testify before the United States Congress on a regular basis so as to keep all of their viewpoints salient, rather than leaving the agency’s messaging to one single commissioner. Ideally, rather than operating under the aegis of the United States Senate Committee on Banking, Housing, and Urban Affairs, “a public-minded subcommittee on financial stability would be established within the [United States Senate] Committee [on Finance] for the purpose of overseeing financial stability and the new agency, so that the agency’s political overseers are less likely to focus

99. The prudential regulator and the central bank would have to work in close proximity and share information in order to effectively discharge their respective obligations.

100. James Kwak, Cultural Capture and the Financial Crisis, in PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 71, 83 (Daniel Carpenter & David A. Moss eds., 2014).


102. Allen, supra note 6, at 1144.

103. Id.
solely on appeasing financial industry interests." This type of restructuring would provide the best possible environment to engender financial stability regulation that can withstand the inevitable deregulatory pressures that will arise when the economy is doing well and, in so doing, minimize the chance of indirect harm to investors and consumers.

Such investors and consumers will, of course, still require protection from direct harms as well. While the optimal design of regulatory architecture for direct investor and consumer protection is beyond the scope of this Article, it is worth noting that by separating prudential issues from direct consumer and investor protection issues, we are more likely to avoid the pre-Crisis fate of financial consumer protection regulation in the United States—which was often neglected by banking regulators, who instead prioritized prudential issues.

Unfortunately, previous attempts to radically restructure the U.S. federal financial regulatory architecture have all failed. There may never be sufficient political will for a move to create a single, unified prudential regulator, which would entail abolishing the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA); denuding the Federal Reserve of its bank-regulation authority; federalizing insurance regulation; and reshuffling some of the powers of remaining agencies like the SEC and the CFPB. If we are indeed stuck with our current structure, then the FSOC will remain the only entity in the United States with a statutorily mandated focus on protecting financial stability, and the FSOC, which is only a council, lacks the staff and resources of a substantial agency like APRA or the Prudential Regulation Authority. Thus, the FSOC can only succeed in its efforts to promote financial stability if agencies like the SEC and the CFPB are committed to assisting the FSOC with these efforts.

104. Id.
105. As other contributors to this Symposium have noted, it may not be ideal in the United States to unify all direct consumer and investor protection in one agency (as Australia and the United Kingdom have done).
B. Working Within Existing Structures and Mandates

While neither the SEC nor the CFPB has an express mandate to consider financial stability, this Article has made the case that both agencies are open to interpret their statutory mandates as authorizing them to pursue financial stability as a means of indirect investor and consumer protection. Dodd-Frank, enacted in 2010, would lend a degree of legislative support to such efforts because several of its provisions confer something of an implicit financial stability mandate upon the SEC and the CFPB. For example, section 112(b) of Dodd-Frank requires each voting member of the FSOC (including the Chair of the SEC and the Director of the CFPB) to submit an annual statement to Congress regarding the threats they perceive to financial stability; this requirement gives these voting members (and their agencies) an implicit direction to monitor such threats. Sections 113 and 804 of Dodd-Frank give the voting members of the FSOC the power to designate nonbank financial institutions and market utilities as systemically important and thus requiring heightened supervision; this grant of power serves as an implicit direction to monitor such institutions to determine whether designation is necessary. Finally, section 120 of Dodd-Frank authorizes the FSOC to recommend to individual regulatory agencies that heightened regulatory standards or safeguards be applied to activities or practices that pose a threat to financial stability. This provision serves as an implicit direction for the agencies headed by the voting members of the FSOC to monitor the activities of the financial industry. Taken together, these provisions provide further support for efforts by the SEC and CFPB to promote financial stability.

To be clear, urging the SEC and CFPB to promote financial stability is inferior to creating a stand-alone prudential regulator. Because the legal foundations of the SEC’s and CFPB’s financial stability mandates are not unequivocal, regulatory actions taken by the SEC or CFPB in reliance on such mandates may be subject to legal challenges.108 Furthermore, attempts by the SEC and CFPB to protect investors and consumers indirectly by pursuing financial stability will at times conflict with the types of measures best calculated to provide direct protection to investors and consumers. The SEC, for example, will face pressures (similar to those faced by the FSA in the United Kingdom in the lead-up to the Crisis) if it attempts to balance its

108. For a discussion of legal challenges to financial stability regulation, see Allen, supra note 66, at 185-86.
mission to promote "efficient markets ... and facilitate capital formation" against a mission to promote financial stability. Given the lack of political support for financial stability regulation when the economy is performing normally, and given the SEC's history, it would not be at all surprising if the SEC were to ignore financial stability concerns in the absence of a direct mandate to pursue them, notwithstanding that pursuing financial stability might be the best way to fulfill the "investor protection" part of its mandate (as well as promote the orderly and efficient operation of the securities markets in the long run).

Because the CFPB is such a new agency, there is little publicly available information or institutional history to indicate its attitude toward financial stability regulation. A number of speeches by CFPB officials have briefly touched on the contribution that the agency can make to financial stability, but there has been little substantive public discussion of the issue. Instead, public statements from the CFPB to date suggest that the agency is focusing on direct consumer harms, fulfilling its self-described mission to "help[] consumer financial markets work" for Americans. However, this silence does not necessarily mean that financial-stability-related issues are not being considered behind the scenes at the CFPB—it is even theoretically possible that the CFPB could focus on financial stability to the extent that it neglects its direct consumer protection mandate (just as banking

109. See supra text accompanying notes 11-12.
110. See infra text accompanying notes 119-124.
111. While the SEC has certainly suggested it will assist the FSOC, it may be that it sees financial stability as the FSOC's, rather than its own, concern. In a recent speech, SEC Chair Mary Jo White stated that the "FSOC's current review of the potential risks to the stability of U.S. financial system of asset managers is a complement to the work we are now undertaking." Mary Jo White, Chair, SEC, Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry, Speech at the New York Times DealBook Opportunities for Tomorrow Conference (Dec. 11, 2014), https://www.sec.gov/News/Speech/Detail/Speech/1370543677722#.VKy78Slu61UQ.
regulators did prior to the Financial Crisis). However, early indications are that the CFPB’s identity has been sufficiently forged as a protector of direct consumer rights and that it will focus on these over and above the indirect protection afforded to consumers by financial stability.

It would therefore be preferable to have a dedicated prudential regulator to pursue financial stability in the United States, as in Australia and the United Kingdom. Nonetheless, because such reform is unlikely in the United States and the FSOC is likely to be hamstrung in its efforts to promote financial stability without meaningful support from the SEC and the CFPB, these agencies should be urged regularly to do their best to promote financial stability. The following Part will give just a few examples of the unique contributions that the SEC and CFPB can make in promoting financial stability and, in so doing, protecting investors and consumers, respectively, from indirect harms.

V. POSSIBLE CONTRIBUTIONS OF THE SEC AND CFPB TO FINANCIAL STABILITY

A. The SEC

Notwithstanding that it is the primary regulator of many institutions that are integral to the proper functioning of the financial system, the SEC has rarely approached the regulation of financial intermediaries from a prudential perspective (with its “consolidated supervised entities program” being a rare and disastrous exception). At best, “prudential supervision has been only a secondary responsibility” for the SEC, which seems to have little affinity or aptitude for this type of regulation. There are therefore open questions about whether the SEC should continue to be responsible for setting capital requirements for broker-dealers or regulating money market mutual funds, given that both responsibilities involve prudential concerns. However, this Article does not purport to
answer these questions; instead, it emphasizes that financial stability regulation concerns more than just the safety and soundness of individual financial institutions. In particular, the integrity of the capital markets within which financial institutions operate is also vital to the proper functioning of the financial system, and the integrity of the capital markets is clearly within the SEC’s purview.

The SEC has, in the past, intervened in the capital markets during crises to shore up financial stability. However, regulatory responses formulated under crisis conditions are often less than ideal. Thus, the SEC’s focus on financial stability should not be limited to times of severe market distress: financial stability should also be concerned with ensuring that the financial system is robust to shocks, particularly because financial stability measures that are thought out well in advance are less likely to be accompanied by unintended negative consequences. Investor protection may be best achieved indirectly by proactively regulating market structure to minimize the market disruptions that, in the aggregate, can be most harmful to investors.


The SEC should also be cognizant that the existence of destabilizing asset bubbles undermines its ability to carry out its more traditional methods of direct investor protection.

The rising stock prices and mass psychology of bubbles cause the deterioration of compliance by securities issuers and market intermediaries with securities laws in three ways. First, bubbles alter the rational calculus of compliance with securities
Part of the motivation for creating the SEC in 1934 was concern about "unnecessary, unwise and destructive speculation" in the securities markets. As a result, the SEC is—and has been since its creation—mandated to "maintain orderly markets," which it does in part by providing "a constitution-like structure for the markets, providing rules that private parties might themselves provide in the absence of government, while also shaping those rules in a way that the private parties might not." While it is true that, at some points over the course of its history, the SEC has proved hesitant to intervene to shape market structure—preferring instead to focus on its simpler, more visible role of direct investor protection—this lack of interference can only be justified by a belief that markets are efficient and that markets will order themselves to generate the best possible outcome for investors as long as a level informational playing field is created. However, the intellectual foundations of such belief have been called into question by the Financial Crisis: "[A] strong case can be made that the events of [the Financial Crisis] suggest that in some ways market prices and market pressures may have played positively harmful roles." Furthermore, seismic changes have occurred over the last decade in the way that the capital markets function (particularly in light of the emergence of dark pools and algorithmic trading), and these changes are eroding long-espoused theories about the best ways to regulate markets for securities. The SEC must therefore decide how it will approach market regulation in this new environment: in the interests of financial stability, the SEC should approach market structure reform from the perspective that broad and

laws, such that securities issuers and market intermediaries, such as gatekeepers, are under-detemned by antifraud rules. Second, bubbles exacerbate the behavioral biases of issuers and intermediaries, causing them to over-discount their expected liability under the securities laws. Finally, bubbles raise the costs of compliance with securities laws for market participants by increasing agency and information costs.


124. Thompson, supra note 118, at 571.

125. Werner, supra note 123, at 755, 759-60.

126. For a discussion of how the federal securities laws are underpinned by the efficient market hypothesis, see Yesha Yadav, Beyond Efficiency in Securities Regulation 14-21 (Vanderbilt Univ. Law Sch., Law & Econ. Working Paper No. 14-8, 2014).

127. Turner Review, supra note 41, at 45.

128. Yadav, supra note 126, at 5.
sustainable economic growth should be prioritized over short-term gains for traders within those markets.

In particular, high-frequency trading should be addressed from a financial stability perspective. High-frequency trading is executed automatically by computers according to preset algorithms; it generates profits by trading at high volume and high speed. While proponents of high-frequency trading contend that such risks are justified by the increased liquidity and efficiency that such trading provides to the markets, as economist Andrew Haldane has noted: "Speed increases the risk of feasts and famines in market liquidity. . . . [High-frequency traders] contribute to the feast through lower bid-ask spreads. But they also contribute to the famine if their liquidity provision is fickle in situations of stress." Liquidity is most valuable in times of distress, and high-frequency trading makes no promise of liquidity at such times. The algorithms on which high-frequency trading is based are designed to react to market events—often in a correlated manner—and thus have the potential to magnify market response to shocks and cause liquidity to seize up more quickly as a result. A recent report by the Senior Supervisors Group (a group comprised of senior financial supervisors from ten countries) concluded, "The complexity of market interactions among [high-frequency trading] firms and other market participants increases the potential for systemic risk to propagate across venues and asset classes over very short periods of time." Importantly, the speed at which such trading operates leaves it "largely impervious to real-time human

129. **Id. at 25-26.**

130. **Telis Demos & Norma Cohen, High-Frequency Trading Adding Risk, Haldane Says, FIN. TIMES (July 8, 2011, 12:09 AM), http://www.ft.com/intl/cms/s/0/b77f05ec-a8ec-11e0-ab62-00144feabdc0.html (alteration in original) (quoting Haldane).**

131. **[Algorithmic trades tend to be correlated, suggesting that the HFT strategies used in the market are not as diverse as those used by human traders. In this context, shocks hitting the small number of very active algorithmic traders might affect the entire market. And, because high frequency trading firms are often very lightly capitalised, this could generate failures. Handling the corresponding counterparty risk could be daunting, given that HFT firms turn over their positions many times a day, while clearing systems operate at a much lower frequency. Combined, these elements could generate systemic market disruptions.**


ensuring that regulators may be limited in their ability to stanch any mayhem until a crisis is well underway. The SEC should therefore be urged to prioritize the threats that high-frequency trading poses to financial stability as it considers market structure reform.\textsuperscript{134}

\textbf{B. The CFPB}

In 2011, the newly created CFPB was delegated many of the consumer protection responsibilities that had previously belonged to the existing banking agencies.\textsuperscript{135} Much of the consumer protection legislation now administered by the CFPB pertains to the provision of credit. For example, the Equal Credit Opportunity Act\textsuperscript{136} seeks to prevent discrimination in the provision of credit, the Truth in Lending Act\textsuperscript{137} seeks to promote better disclosure by institutions in the business of providing consumer credit, and the Home Ownership and Equity Protection Act of 1994\textsuperscript{138} includes provisions relating to both disclosure and regulation of potentially abusive practices in connection with high-cost mortgages.\textsuperscript{139} These pieces of legislation all have laudable goals, but—like much of securities regulation—they are primarily focused on individual instances where consumer harm results, or is likely to result, from the complexity of consumer financial products and the consequent scope for deception, misunderstanding, and dispute. However, there are a number of steps that the CFPB can take to reduce the risk of financial crises, thus promoting \textit{collective} economic well-being and protecting consumers from \textit{indirect} harms.

For example, pursuant to section 1034 of Dodd-Frank, the CFPB is specifically authorized to take and respond to complaints regarding financial institutions within its jurisdiction. A pattern of complaints about a particular class of consumer financial products often indicates

\begin{footnotesize}
\bibitem{133} Yadav, \textit{supra} note 126, at 30.
\bibitem{134} The SEC is currently reconsidering equity market structures and how they are regulated, a process that commenced with the issuance of the SEC’s Concept Release on Equity Market Structure in January 2010. \textit{See} Concept Release on Equity Market Structure, Exchange Act Release No. 61,358, 75 Fed. Reg. 3594 (Jan. 21, 2010).
\bibitem{139} \textit{CARNELL, MACEY & MILLER, supra} note 97, at 304, 311, 388.
\end{footnotesize}
that the market for those products has become frothy.\footnote{140} Ideally, the CFPB would coordinate with the Office of Financial Research to mine its complaints data sets for patterns and trends that indicate there is a bubble developing in a particular product. Such data could also be mined for patterns of complaints with respect to a particular financial institution (rather than product category), which might suggest problems in that institution’s approach to risk management.\footnote{141} Importantly, there needs to be some type of “fire alarm” procedure in place for escalating these patterns to the attention of the FSOC and its composite agencies. (All of this also holds true for complaints made to the SEC about fraudulent schemes associated with different types of securities—trends identified in these complaints should also be brought to the FSOC’s attention.) While the CFPB’s Office of Consumer Response does already investigate groups of complaints periodically to survey product- and issue-specific trends,\footnote{142} it is unclear if the analysis of such trends is used only for identifying frauds, scams, and abuses in order to prevent them or whether the growth of these types of frauds, scams, and abuses in relation to a particular institution or product is considered as indicative of a problem with that institution as a whole or the entire market for that financial product. There is certainly nothing in the CFPB’s “Consumer Response Annual Reports” from 2012, 2013, or 2014 to suggest that it is looking for threats to financial stability. The CFPB should be urged to do so.

In addition to gathering and analyzing complaints, the CFPB has embarked upon programs to improve disclosure and educate consumers; for example, as part of its “Know Before You Owe” initiative, the CFPB has developed new mortgage disclosure forms designed to “minimize consumer confusion and enable comparison shopping to produce better functioning mortgage markets.”\footnote{143} Such reforms reflect a market-based approach in that they target market failures with the intention of allowing better-informed consumers to make choices that are better for them.\footnote{144} The CFPB is also authorized

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\footnote{140. See Gerding, supra note 122, at 403.}
\footnote{141. See Daniel Schwarcz, Redesigning Consumer Dispute Resolution: A Case Study of the British and American Approaches to Insurance Claims Conflict, 83 TUL. L. REV. 735, 752-53 (2009).}
\footnote{144. Id. at 1153.}
to take a more interventionist approach in situations where significant consumer harm is unlikely to be addressed by market means: pursuant to section 1031 of Dodd-Frank, the CFPB is authorized to prohibit "unfair, deceptive or abusive" acts or practices in such circumstances.

From the outset, Warren and Bar-Gill conceived the CFPB as a way of preventing or mitigating bubbles in consumer financial products that might otherwise have systemic ramifications when they pop.145 However, it is possible that the CFPB will instead focus solely on the welfare of the individual consumers who participate in the markets for consumer financial products and services. This Article argues strenuously that the CFPB instead consider these types of initiatives in the context of their potential impact on financial stability.146

VI. CONCLUSION

The aggregated fallout from a financial crisis can prove much more devastating to investors and consumers than individually misleading and abusive practices. As a result, the SEC and the CFPB would best serve their constituencies in seeking to prevent these financial crises by committing to pursue financial stability as part of their regulatory efforts, rather than ignoring what are admittedly less-than-concrete mandates to do so. This will not always be easy because financial stability regulation may conflict with the agencies' clearer mandates of direct investor and consumer protection, but the consequences of abdicating all financial stability matters to the FSOC—which does not have the resources necessary to properly implement, supervise, or enforce financial stability regulation—may prove dire. Unless and until the United States is ready to take a leaf out of the Australian and British books and create a single prudential regulator, responsibility for financial stability regulation must necessarily fall on agencies like the SEC and CFPB. To the extent that either agency is currently considering financial stability as part of its regulatory efforts, any dedication to such end may fade with memories of the harrowing experience of the Financial Crisis. This Article therefore urges the SEC and CFPB to expressly commit, and maintain

146. "Consumer financial protection can, and must, serve a role not only in protecting individuals from excessive risk, but also in protecting markets from systemic risk." Erik F. Gерding, The Subprime Crisis and the Link Between Consumer Financial Protection and Systemic Risk, 4 FLA. INT'L U. L. REV 435, 435 (2009).
commitment, to protecting the financial system—even in the absence of an express statutory mandate to do so.