Lane Drifting: Remarks at the Hoover Monetary Policy Conference

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I am honored—but frankly surprised—to be here. After all, monetary policy sits in my brain's closet in a dusty box labeled "Save for Later . . . A Lot Later." In college, when economics rocked my world, it was not macro-economics, but micro-economics. I was fascinated to see the push and pull of incentives on individuals' decisions about how to spend their time and money. To remind me of the life-changing lessons I learned in my college micro courses, I often sport a T-shirt I got back then: "I saw the invisible hand at CWRU [Case Western Reserve University]." In contrast to micro-economics, macro-economics, with its focus on the aggregate and abstract theories, did not help me understand the world in which I lived. That macro-economic models, rickety assumptions and all, were forming the gospel basis for government policy did not hit me until later. My periodic attempts to peer into the world of monetary policy are almost always unsettling, unless guided by scholars—many of them in this room—who view monetary policy with humility and an appreciation for the frightening consequences of getting it wrong. But I was not invited here to speak about monetary policy. I am here to speak about staying in one's lane. So—apart from remarking on the profound importance of sound monetary policy to the markets I regulate—staying in my lane is what I will attempt to do. To that end, I remind you that my views are my own as a Commissioner at the Securities and Exchange Commission ("Commission" or "SEC") and not necessarily those of the SEC or my fellow Commissioners.

Government agencies often wander out of their lanes. My own agency, for example, has been on a mission over recent years to slap the securities label on just about everything. For example, last year we charged the creators of the Stoner Cats web series with securities violations for selling digital cats as part of an effort to create a buzz for the series.[1] My colleague Commissioner Uyeda and I observed at the time that a similarly jurisdiction-hungry SEC would have laid claim to Star Wars collectibles in the 1970s.[2] Also, last year, the Commission charged a company $35 million for, among other things, failing to collect and review employee complaints about workplace misconduct.[3] As one observer noted, "Historically, companies have expected scrutiny from the U.S. Equal Employment Opportunity Commission (EEOC) and other civil rights regulators and have understood the risk of private litigation related to workplace misconduct but have not expected the SEC to involve itself."[4] The SEC also is involving itself in cybersecurity and climate. Recent rules, although styled as disclosure rules for public companies, will change how companies approach these risks. The Commission, however, is not the only jurisdictional glutton in D.C. and often finds itself on the receiving end of other agencies' territory grabs. Any defense of SEC jurisdiction coming from an SEC Commissioner is going to be suspect, but the vibrancy, flexibility, and resilience of the American economy is at issue, so please hear me out.

The United States is remarkable for many reasons, including its large, efficient, and liquid capital markets. In contrast to many countries in which banks are the most important funding source, the securities markets are critically important in financing the American economy.[5] Unlike banks, which, by their nature, tend to be risk-averse and conservative, the capital markets are a good match for an innovative, flexible, dynamic, and competitive economy.[6] Well-functioning capital markets reflect the broader society. As Ludwig von Mises explained,

> A stock market is crucial to the existence of capitalism and private property. For it means that there is a functioning market in the exchange of private titles to the means of production. There can be no genuine private ownership of capital without a stock market: there can be no true socialism if such a market is allowed to exist.[7]

Capital markets give individual investors a place to express with their cold, hard cash their views about which companies, technologies, and products will succeed. Based on their own knowledge, experience, and expectations, they take risks on other people's ideas. For an investor, "nothing ventured nothing gained" encapsulates the understanding that we place our money at risk when we hand it over to an asset manager or instruct a broker-dealer to buy shares in a public company. We hold very different expectations when we deposit our bi-weekly paycheck in a bank.

Bank financing is important to the economy, but it allocates capital differently than the securities markets do. Among other differences is the greater effect of government regulations on bank lending decisions. The government's interest in managing bank risk-taking derives in part from its provision of federally backstopped deposit insurance and the government's propensity to bail out even uninsured depositors. Since the government ultimately is on the hook if banks mismanage themselves into insolvency, the government wants a say in how they manage themselves. Banks are accustomed to the assertive presence of their regulators, some of whom literally take up residence in bank headquarters.[8] Regulation—sometimes in pursuit of non-financial objectives—circumscribes some activities by banks[9] and encourages other activities.[10] Economist Henry Simons understood the importance of "minimiz[ing] . . . political influence in the allocation of investment funds," which is why he argued for limiting the role of banks in "mobilizing funds for investment."[11] In taking on credit risk, banks respond to market signals, but the regulatory signals—both stated and hinted—to which they necessarily are very attuned shape their decisions. Equity and debt financing, by contrast, responds more directly to the market because its availability and cost is reliant on the decisions of a wide range of people whose money is on the line.

Core to the success of the securities markets is the idea that failure is a possibility. Without a government insurance program or constantly hovering supervisors, unforgiving market discipline hems in participants in the capital markets. Investors face the consequences of their own decision-making—wise or foolish. If the government will not make good on your losses, you think hard about the decision to hand over your money. Investors can lose their entire investment when a company fails, which makes pre-investment due diligence a must. Likewise, fund investors have a strong incentive to vet and monitor fund activities because funds can and do fail, often without much regulatory interest.[12]

The differences between capital markets and bank financing are reflected in regulation. The former is subject primarily to disclosure and attendant antifraud regulation, and the latter to prudential regulation.[13] Bank regulation is prescriptive to achieve stability and continuity,[14] but capital markets regulation relies heavily on disruptive competition and innovation to keep the markets healthy. The SEC is at its best as a disclosure regulator: through our rules, we seek to ensure that investors obtain the material, accurate information they need to make an informed decision and then we get out of the way so the competitive game can play out. Yes, one-third of the SEC's mission is to protect investors, but we accomplish that objective by ensuring that truthful and accurate material information is easily available so they can be well-informed about investment opportunities, not by limiting investment opportunities. Bank regulators, by contrast, sometimes view less transparency as helpful in fostering stability.[15] One could argue that a full transparency approach would be more effective for bank regulation too,[16] but rumble strips are warning me to stay in my lane.

As yet another symptom of an increasingly risk averse society, the mindset and sensibilities of federal banking agencies are leaching into the SEC. The attitudinal shift is partly of our own making. We have forgotten that capital markets are not about the safety, soundness, and survival of individual firms, but about resilience and growth through rough-and-tumble competition. Though Congress did not make the SEC a systemic risk regulator, we now routinely invoke systemic risk to justify everything from regulating private funds, to reining in artificial intelligence, to outsourcing of certain functions by investment advisers.[17] Congress empowered the SEC to regulate the activities of mutual funds, broker-dealers, and market intermediaries, but the Commission is wielding this authority in new and more interventionist ways. Prescriptions about the handling of equity market orders, increasingly granular cybersecurity mandates, and strategy-altering liquidity rules for mutual funds are some examples of a trend toward a greater willingness to replace private decision-making with our own. And increasingly, our regulations reach into the operations of firms over which we do not have authority, such as service providers to securities firms. Each of these measures will stand or fall on its own merits, but the general trend is toward greater control of all the participants we regulate and even some we do not regulate.

One notable example of the move toward a more prudential and prescriptive approach to regulation is the recently adopted rules for private fund advisers. Traditionally, advisers to private funds, which are not retail-oriented, operated with great regulatory leeway. Closer oversight began when Congress, in Dodd-Frank, mandated SEC registration of private fund advisers and directed the SEC to collect private fund data to support the Financial Stability Oversight Council ("FSOC"). Recent expansions of this data collection are fodder for future prudential regulatory interventions. The real change, however, came with the adoption last year of a semi-prudential regulatory framework—albeit in a disclosure wrapper and not as interventionist as the proposal—for private fund advisers.[18] Before this rulemaking, fund investors and advisers shaped their relationships through contracts that were the product of each party weighing must-have features against less important ones. Competition, not regulatory prescriptions, kept fund managers in check.[19] Now the Commission has assumed the Tribune's mantle to protect downtrodden private fund investors—such as pension funds and endowments represented by well-compensated investment professionals. Investors looking to increase their negotiating leverage with large managers invited the new rules, but pressure from the prudential regulators also factors into the SEC's increased focus on private funds.[20]

Prudential regulators view private funds as a threat to financial stability. Among other concerns, some funds are highly leveraged, rely on short-term funding, and sell during times of stress, which may "transmit material stress" to banks.[21] As large players in the markets, hedge funds' actions *do* affect the financial system and other participants in it. Bank regulators know about these interconnections, which is why they work with banks to limit their counterparty exposures to hedge funds.[22] On balance, however, they contribute to the resilience of the financial system by being nimble sources of liquidity, even during times of stress, albeit perhaps at prices that sellers would prefer to be higher. The diversity of hedge fund managers and strategies means that when some are selling, others likely are buying. Sometimes, of course, an overly generous Uncle Sam distorts the dynamic by suggesting he might buy at a better price. The best way to ensure that hedge funds continue to contribute to the resilience of the financial markets is to keep barriers to entry and exit low and to avoid regulation that homogenizes fund strategies. Even during times of market stress, the focus should be on the well-being of the markets, not of particular funds.

As the experience with private funds illustrates, prudential regulators have nudged the Commission in the prescriptive and prudential direction. Much of this pressure comes through the FSOC. Most notably, FSOC has been instrumental in the changes to money-market fund regulation over the past decade. In 2012, two years after the SEC adopted post-financial crisis money-market fund reforms to enhance liquidity, FSOC proposed to use its authority under Dodd-Frank to recommend that the SEC adopt additional money-market fund reforms.[23] FSOC called for additional "structural reforms" to "reduce the risk of runs and significant problems spreading through the financial system."[24] In 2014, the Commission complied by, among other things, mandating a floating net asset value ("NAV") for institutional prime funds.[25] The Commission also adopted threshold-triggered discretionary redemption gates and fees. Fear of those thresholds being hit affected investor and fund behavior during the COVID crisis of March 2020.[26] The Federal Reserve, with Treasury's sign-off, responded with the liquidity facilities to support money-market funds and short-term funding markets generally.[27] These facilities inevitably led to calls for further money-market fund reforms.[28] The Commission responded in 2023 by sensibly getting rid of the fees and gates threshold and unwisely adding a new mandatory liquidity fee, which seems to be killing off the handful of prime institutional money-market funds that survived the last set of reforms.[29] These funds' absence will be felt by investors and the issuers of short-term commercial paper,[30] but private issuers' loss is Treasury's gain. A better result would have been to quash any expectations of government support for money-market funds in a future crisis and encourage money-market fund sponsors to devise appropriate, tailored solutions that would work for their funds, even during times of stress.[31] A heterogeneous approach might be better at fostering stability than a uniform approach designed by regulators.

Not content to encourage the SEC's prudential efforts, prudential regulators are eyeing more direct control over capital markets participants. Just as the Commission sees in everything a security, prudential regulators see in every financial institution a bank . . . or at least something lurking in the shadows that should be regulated as one. So-called shadow banking—now less ominously known as "non-bank financial intermediation"—features prominently in the workstreams, task forces, and reports of FSOC and its international sister, the Financial Stability Board ("FSB"). Money market funds, open-end mutual funds, private funds, and their advisers fall within the broad category of nonbank financial institutions that prudential regulators are eyeing.

FSOC's induction into the financial regulatory pantheon laid the groundwork for a new regulatory approach to nonbanks. Congress created FSOC, among other reasons, "to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of . . . nonbank financial companies."[32] FSOC can make recommendations to the primary regulator "to apply new or heightened standards and safeguards for financial activities or practices,"[33] as it proposed to do with money-market funds. Alternatively, FSOC can "require supervision by the Board of Governors for nonbank financial companies that may pose risks to the financial stability of the United States."[34] FSOC has experimented with different approaches to exercising its designation authority and has run headlong into the courts in the process.[35] Last year, FSOC rejected with palpable vehemence the approach the prior FSOC had embraced after its court loss; no longer would designating individual entities be a last resort, no longer would a cost-benefit analysis be performed, and no longer would an assessment of the "company's likelihood of material financial distress" happen.[36] Where an activities-based approach leaves responsibility for addressing any potential risk with the primary financial regulators, an entity-based approach supplements the non-bank financial institution's primary regulator with the Federal Reserve. Commenters highlighted that application of a prudential regulatory framework "focused on safety and soundness for banking institutions is fundamentally incompatible with the capital markets where investors knowingly put their capital at risk."[37] Though it acknowledged the costs, FSOC shifted its designation hammer back to the top of the tool box.[38] Federal Reserve supervision and the attendant prudential regulatory framework that includes measures such as risk-based capital requirements, liquidity minimums, and leverage limits may be coming for funds and their managers.

The pivot back toward designating entities as systemic is reflective of a misplaced focus by prudential regulators on funds . . . not just money market funds and private funds, but open-end funds as a risk to financial stability. Prudential regulators point with alarm to the sector's large size, open-end fund characteristics such as daily redemption and lack of a government insurance scheme, funds' interconnections, and fund performance during times of stress.[39] In addition to FSOC's new designation approach, prudential regulators have pushed measures such as the liquidity requirements we proposed in 2022 for open-end funds, which included a swing-pricing requirement.[40]

Prudential regulation for open-end funds is unnecessary and would undermine their contribution to the resilience of the financial system. Funds that offer daily redemption and a portfolio composed of assets of different liquidity levels have long existed. Their track record is good, even in times of stress.[41] FSB and FSOC blame these funds for aggravating market stress during periods like March 2020, but laying the blame for the COVID-related stress at the feet of open-end funds is a stretch, given the widespread economic uncertainty around the virus and government's response to it.[42] Heavy selling during that time was not limited to funds.[43] The transparency of fund holdings, the heterogeneity of funds, the widespread ownership of funds by investors with a wide range of preferences,[44] and fund sponsors' deep experience in managing redemptions mitigate systemic risk concerns. Prudential regulation would undermine these strengths and, by extension, the resilience and efficacy of the financial system.

Regulating funds in a bank-like way will sap these entities of the characteristics that enable them to nimbly and flexibly serve the economy. Bank-like regulations that focus on mitigating risk, even if imposed by the historically non-prudential SEC, would be a poor match for an industry that is designed to finance entrepreneurial risk-taking. Designating funds and asset managers as systemically important and adding them to the growing ambit of the Federal Reserve would lessen their own incentives to manage risk. A designation likely carries with it a market expectation of future bailouts, which would dull the now keen risk sensitivity of asset managers.[45] To protect its own reputation as a supervisor, the Federal Reserve might be tempted to rescue a failing designated entity. The prudential regulation that would follow designation could subject funds to the same types of constraints and non-market pressures that banks face when making decisions about where to allocate capital.

Finally, the hoped for benefits of a prudential fund regulator are not achievable because prudential regulators are people too. I am reminded of Hayek's takedown of the "economic man" who is "supposed to know automatically all that is relevant for [his] decisions."[46] So too must we reject the model regulator who is supposed to know automatically all that is relevant for her decisions. To again riff on Hayek, that "quasi-omniscient" government regulator is "the skeleton in our cupboard"[47] that keeps popping out to promise that next time will be different if we just give her a little more control. Regulators have neither the knowledge nor the will to make better decisions than the participants in our capital markets.

To the fastidious and well-ordered mind of a bank regulator, the capital markets are messy things. That messiness is beautiful to me, so I dread the day when my old college T-shirt's invisible hand slogan is replaced with: "The invisible hand is dead, long live the Fed." Centralizing decision-making at the Federal Reserve is not the way to bring stability. To quote Simons again, "Centralization [of power] is a product of disorder. In advanced societies, it is retrogression induced by disasters."[48] Prudential regulatory encroachment on the capital markets erodes the decentralized decision-making that is so critical to their proper functioning.

Capital markets are not perfect. We see bubbles, bad behavior, begging for bailouts, big bailouts, and bankruptcies. Some of these problems are the result of poor decision-making by market participants, regulators, or monetary policymakers. We will never eliminate bad decisions, but keeping people in their lanes will enable them to make better decisions. The SEC should focus on getting investors the information they need. Bank regulators should focus on regulating banks. Central bankers should focus on monetary policy. All of these are big and important jobs on their own without moonlighting in someone else's lane. Finally, to focus investors' minds on their task at hand and keep them out of the bailout begging business, we need to remind them with our actions as much as with our words that, in the capital markets, failure is a possibility, but government bailouts are not.

You have been a gracious audience. Having to listen over lunch to me—a non-economist whose field would not have been monetary policy even if I had had the guts to try for an econ PhD and who comes bringing a "stay in your lanes" message—just goes to show that there is no such thing as a free lunch.

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[1] *See* Press Release, SEC Charges Creator of Stoner Cats Web Series for Unregistered Offerings of NFTs (Sept. 13, 2023), available at https://www.sec.gov/news/press-release/2023-178; see also Securities Exchange Act Release No. 11233 (Sept. 13, 2023), available at https://www.sec.gov/files/litigation/admin/2023/33-11233.pdf.

[2] *See* Hester M. Peirce and Mark T. Uyeda, Collecting Enforcement Actions: Statement on Stoner Cats 2, LLC (Sept. 13, 2023), available at https://www.sec.gov/news/statement/peirce-uyeda-statement-stonercats-091323.

[3] *See* Press Release, "Activision Blizzard to Pay $35 Million for Failing to Maintain Disclosure Controls Related to Complaints of Workplace Misconduct and Violating Whistleblower Protection Rule" (Feb. 3, 2023), available at https://www.sec.gov/news/press-release/2023-22.

[4] Akin, Alerts: "The SEC Reminds Companies Not to Forget the 'S' in ESG: Activision Blizzard Reaches $35 Million Settlement over Disclosure Controls Related to Workplace Complaints and Violation of Whistleblower Protection Rule" (Feb. 15, 2023), available at https://www.akingump.com/en/insights/alerts/the-sec-reminds-companies-not-to-forget-the-s-in-esg-activision-blizzard-reaches-dollar35-million-settlement-over-disclosure-controls-related-to-workplace-complaints.

[5] *See*, *e.g.*, Securities Industry and Financial Markets Association ("SIFMA"), Our Markets, https://www.sifma.org/about/our-markets/ (explaining that, in contrast to "[o]ther countries [in which] "bank lending dominates corporate borrowing," in the United States, "the inverse is true: bank lending accounts for just 26% of corporate borrowing, while corporate bonds are 74%."); William C. Dudley and R. Glenn Hubbard, "How Capital Markets Enhance Economic Performance and Facilitate Job Creation," Goldman Sachs Global Markets Institute White Paper (Nov. 2004), (comparing the United States and United Kingdom, which have well-developed capital markets, with other countries that rely more heavily on bank financing), available at https://www0.gsb.columbia.edu/faculty/ghubbard/Articles%20for%20Web%20Site/How%20Capital%20Markets%20Enhance%20Economic%20Performance%20and%20Facilit.pdf. *See also* IMF Background Note on CMU for

Eurogroup (June 15, 2023) at 2 ("Banks account for a much larger part of the financial system in Europe than in the US []. . . . European firms rely much less on market sources of financing, with less than 30 percent of their funding coming from tradable equity and debt, compared to nearly 70 percent for US firms []. And firms with fewer tangible assets to pledge as collateral are particularly constrained in a bank dominated system, which can impair their growth performance."), available at https://www.imf.org/-/media/Files/News/Speech/2023/imf-background-note-on-cmu-for-eurogroup.ashx.

[6] *See*, *e.g.*, Mark T. Uyeda, Remarks at the ICI Global Asset Management Asia Forum (Nov. 30, 2023) (explaining that the capital markets offer investors the prospect of greater returns in exchange for taking risk), available at https://www.sec.gov/news/speech/speech-uyeda-iciglobal-asset-management-asia-forum-113022.

[7] Murray Newton Rothbard, MAKING ECONOMIC SENSE 426 (1995) (quoting Ludwig von Mises), available at https://cdn.mises.org/Making%20Economic%20Sense_3.pdf.

[8] *See*, *e.g.*, Careers at the OCC – Large Bank Locations, available at https://careers.occ.gov/locations/locations-list-view.html?category=lbs.

[9] In the name of guarding against reputational risk, bank regulators sometimes dissuade banks from working with certain types of customers. *See*, *e.g.*, Julie Andersen Hill, *Regulating Bank Reputation Risk*, 54 GEO. L. REV. 523 (2020), available at https://scholarship.law.ua.edu/cgi/viewcontent.cgi?article=1513&context=fac_working_papers. *See also* Letter from American Fintech Council to FDIC Chairman Martin J. Gruenberg (Apr. 19, 2024) (suggesting that the FDIC discourages banks from entering into fintech partnerships), available at https://www.fintechcouncil.org/advocacy/federal-advocacy-letter-to-fdic-on-regulating-innovation; Remarks by FDIC Vice Chairman Travis Hill at the Cato Institute on "Insights on the FDIC's Agenda" (Sept. 21, 2023) ("In 2022, the FDIC proposed principles for managing climate-related risks and discussed plans to issue further guidance in the future. . . . To the extent the principles are meaningful and more than a check-the-box compliance burden, the inevitable result will be that banks offer less credit, or charge more for credit, to consumers and businesses in communities that are most vulnerable to climate events, including those in low- and moderate-income areas. As a general matter, when bank regulators declare something a safety and soundness concern, the expected result should be that banks will do less of it or charge more for it.") (internal citation removed), available at https://www.fdic.gov/news/speeches/2023/spsept2123.html.

[10] *See*, *e.g.*, John Cochrane, *Don't Let Financial Regulators Dream Up Climate Solutions*, CITY JOURNAL (Mar. 24, 2021) (pointing out regulatory pressure "to defund the fossil fuel industry before alternatives are in place and to steer funds to fashionable but unprofitable investments," and giving as an example "the [Network for Greening the Financial System] club of financial regulators [which] states plainly that it seeks to 'mobilize mainstream finance to support the transition toward a sustainable economy'") (citing Network for Greening the Financial System, "NGFS publishes Conceptual Framework for Nature-related Financial Risks at launch event in Paris" (Sept, 7, 2023), available at https://www.ngfs.net/sites/default/files/medias/documents/press-release_2023-09-07_ngfs-publishes-conceptual-framework-on-nature-related-risks.pdf), available at https://static1.squarespace.com/static/5e6033a4ea02d801f37e15bb/t/605cc6ed6a961148266b2978/1616692973960/Cochrane_city_journal_climate.pdf; Office of the Comptroller of the Currency website ("The Community Reinvestment Act of 1977 (CRA) *encourages* certain insured depository institutions to help meet the credit needs of the communities in which they are chartered, including low- and moderate-income (LMI) neighborhoods, consistent with the safe and sound operation of such institutions.") (emphasis added), available at https://www.occ.gov/topics/consumers-and-communities/cra/index-cra.html; Stephen Matteo Miller, "The Recourse Rule Regulatory Arbitrage, and the Financial Crisis," Journal of Regulatory Economics 54, no. 2 (October 2018) ("[B]y lowering capital requirements on the very assets that lay at the heart of the crisis, the Recourse Rule could have created incentives for the largest securitizing BHCs to gradually hold more of those assets. Even though regulators may have finalized the Recourse Rule to encourage securitization but not risk taking, an unintended consequence was that it created incentives for the largest securitizing BHCs to expose themselves to what turned out to be riskier assets."), available at miller-recourse-rule-crisis-sum-mercatus-v1.pdf.

[11] Henry C. Simons, "The Requisites of Free Competition," in Economic Policy for a Free Society p. 80 (1948) (reprinted from the American Economic Review, Supplement, XXVI, No. 1 (Mar. 1936), 68-76.) ("If we could separate sharply between the function of issuing money, the function of warehousing and transferring funds, and the function of mobilizing funds for investment, then government control over enterprises performing the latter function (or the latter two functions) might easily be confined to the provision of ordinary safeguards against fraud, and the threat of political influence in the allocation of investment funds minimized.").

[12] *See*, *e.g.*, Michael Malquarti, "Commentary: The Hedge Fund Bermuda Triangle," 37 The Hedge Fund Journal (May 2008) (advising hedge fund investors to "[a]void[] managers who combine leverage, illiquidity and concentration," because managers "who attempt to sail through the 'Hedge Fund Bermuda Triangle' . . . run the risk of following their predecessors into failure."), available at https://thehedgefundjournal.com/the-hedge-fund-bermuda-triangle/.
[13] *See*, *e.g.*, Mark T. Uyeda, Remarks at the ICI Global Asset Management Asia Forum (Nov. 30, 2022) (contrasting securities regulation, which provides the disclosure necessary to enable investors to choose their risk level, with bank regulation, which aims to limit risk), available at https://www.sec.gov/news/speech/speech-uyeda-iciglobal-asset-management-asia-forum-113022.
[14] Governor Michelle W. Bowman, Essay, Starling Insights (Feb. 13, 2024) (Bank regulation need not "replace a bank's management and board of directors in adopting a banking strategy and risk appetite," but can instead be limited "to apply[ing] appropriate, targeted regulation and supervision, to assess whether a bank is operating in compliance with applicable laws and in a safe and sound manner."), available at https://www.federalreserve.gov/newsevents/bowman-starling-insights-20240213.htm#:~:text=Being%20transparent%20does%20not%20dilute,efficiently%20work%20to%20meet%20them. As Governor Bowman notes, "[t]his can be a difficult balance to strike." *Id*.
[15] For example, Bank regulators' ratings of banks are strictly confidential. *See*, *e.g.*, the Federal Reserve Bank of St. Louis, "The ABCs of CAMELS" (July 23, 2018) ("Each bank's CAMELS ratings and examination report are confidential and may not be shared with the public, even on a lagged basis. In fact, it is a violation of federal law to disclose CAMELS ratings to unauthorized individuals. Outsiders may monitor bank health through private-sector firms that use publicly available financial data to produce their own analysis of bank health, sometimes even using their own rating system."), available at https://www.stlouisfed.org/on-the-economy/2018/july/abcs-camels (internal citation removed).
[16] *See*, *e.g.*, Comment Letter of Aaron Klein, Brookings Institution (Feb. 28, 2020) (arguing for greater transparency of CAMELS ratings), available at https://www.brookings.edu/wp-content/uploads/2020/02/CAMEL-Comment-letter-Final-Klein.pdf.
[17] *See* U.S. Securities and Exchange Commission, Outsourcing by Investment Advisers, 87 Fed. Reg. 68816, at 68818 (Nov. 16, 2022) ("The use of service providers could create broader market-wide effects or systemic risks as well, particularly where the failure of a single service provider would cause operational failures at multiple advisers."), available at https://www.govinfo.gov/content/pkg/FR-2022-11-16/pdf/2022-23694.pdf.
[18] *See* U.S. Securities and Exchange Commission, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63,206 (Sept. 14, 2023) (to be codified at 17 C.F.R. 275), available at https://www.federalregister.gov/documents/2023/09/14/2023-18660/private-fund-advisers-documentation-of-registered-investment-adviser-compliance-reviews.
[19] Commenters on the private fund adviser rule noted the competition. *See*, *e.g.*, Comment Letter from Jay Clayton, et al, (April 25, 2022) at 6 ("The Proposing Release identifies more than 5,000 registered investment advisers with private fund clients. This figure does not include private funds managed by exempt reporting advisers or advisers that are not eligible for SEC registration. Investors are free to choose the terms they are willing to accept, including cost and liability allocation provisions, when investing in a private fund."), available at s70322-20126482-287124.pdf (sec.gov); *see also* Committee on Capital Markets Regulation "A COMPETITIVE ANALYSIS OF THE U.S. PRIVATE EQUITY FUND MARKET" (April 2023) at 6-7 (applying well-tested competition metrics to find that not only were private equity funds and advisers well below the threshold for an unconcentrated market, but the concentration for registered investment companies was *four times higher*), available at https://capmktsreg.org/wp-content/uploads/2023/04/CCMR-Private-Equity-Funds-Competition-Analysis-04.11.20231.pdf.
[20] *See*, *e.g.*, Financial Stability Oversight Council, 2023 Annual Report (2024) at 12 ("The Council supports the initiatives by the SEC and other agencies to address risks in hedge funds, including data collection improvements for Form PF. The Council will continue to review the findings of the Hedge Fund Working Group (HFWG) as they are developed and recommends that the SEC and other relevant regulators consider whether additional steps should be taken to address vulnerabilities related to these funds."), available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf ("FSOC 2023 Annual Report"); Financial Stability Oversight Council, 2022 Annual Report (2023), at 44 (FSOC's Hedge Fund Working Group "also identified gaps in the availability of data related to hedge funds, and Council member agencies are taking steps to address these gaps. For example, the SEC and the CFTC proposed amendments to Form PF, the primary regulatory

data source on the private fund industry. The SEC also proposed a new requirement that certain advisers to hedge funds report timely information about events that indicate significant distress at a fund."), available at https://home.treasury.gov/system/files/261/FSOC2022AnnualReport.pdf ("FSOC 2022 Annual Report").

[21] *See*, *e.g.*, Remarks by FDIC Chairman Martin J. Gruenberg at the Exchequer Club on the Financial Stability Risks of Nonbank Financial Institutions (Sept. 20, 2023) ("Hedge funds are a type of nonbank that often employ a strategy of high leverage and reliance on short–term funding, which can create risks to financial stability and contribute to a reduction in financial intermediation during periods of market stress. The Financial Stability Oversight Council (FSOC) Hedge Fund Working Group found that hedge funds were among the three largest sellers of Treasury securities by category in March 2020 along with foreign institutions and open–end mutual funds, and that they materially contributed to the Treasury market disruption during this period."), available at https://www.fdic.gov/news/speeches/2023/spsept2023.html (internal citation removed).

[22] *See*, *e.g.*, Board of Governors of the Federal Reserve System, Supervision and Regulation (Nov. 2023) ("[Federal Reserve supervisors] are also conducting work to assess the level and quality of loans to nonbank financial institutions, given a substantial increase in lending to this segment in recent years."), available at https://www.federalreserve.gov/publications/files/202311-supervision-and-regulation-report.pdf.

[23] Financial Stability Oversight Council, Proposed Recommendations Regarding Money Market Mutual Fund Reform, 77 Fed. Reg. 69455 (Nov. 19, 2012), available at. https://www.govinfo.gov/content/pkg/FR-2012-11-19/pdf/2012-28041.pdf.

[24] *Id.* at 69456. *See also id.* at 69455-6 ("But the 2010 reforms did not address the structural vulnerabilities of MMFs that leave them susceptible to destabilizing runs. These vulnerabilities arise from MMFs' maintenance of a stable value per share and other factors as discussed below. MMFs' activities and practices give rise to a structural vulnerability to runs by creating a 'first-mover advantage' that provides an incentive for investors to redeem their shares at the first indication of any perceived threat to an MMF's value or liquidity."). *See also* Daniel Schwarcz and David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem*, *U. CHI. L. REV. VOL. 84 (2017)* at 243 ("In all likelihood, the SEC would have refused to accept FSOC's recommendations on money market funds were it not for the council's designation power. There is, in fact, strong evidence that the council had explicitly threatened the SEC with the prospect of designating large money market funds and their advisors."), available at https://lawreview.uchicago.edu/print-archive/regulation-threat-dodd-frank-and-nonbank-problem.

[25] We rejected most of FSOC's other suggested changes, such as the introduction of a NAV buffer. *See* U.S. Securities and Exchange Commission, Money Market Fund Reform; Amendments to Form PF, 79 Fed. Reg. 47736, at 47924 (Aug. 14, 2014), available at https://www.govinfo.gov/content/pkg/FR-2014-08-14/pdf/2014-17747.pdf.

[26] Funds sold long-term holdings at a rate greater than average presumably to avoid the gates and fees threshold. *See* Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N–CSR and Form N–1A, 88 Fed. Reg. 51404, at 51414 (Aug. 3, 2023) ("[I]n March 2020 institutional prime and institutional tax-exempt money market funds experienced significant outflows, spreads for instruments in which these funds invest widened sharply, and these funds sold significantly more long-term portfolio securities [*i.e*., securities that mature in more than a month] than average."), available at https://www.govinfo.gov/content/pkg/FR-2023-08-03/pdf/2023-15124.pdf.

[27] *See* Report of the President's Working Group on Financial Markets, Overview of Recent Events and Potential Reform Options for Money Market Funds (Dec. 2020) at 3-4, ("While government MMFs saw significant inflows during this time, the prime and tax-exempt MMF sectors faced significant outflows and increasingly illiquid markets for the funds' assets. As a result, prime and tax-exempt MMFs experienced, and began to contribute to, general stress in short-term funding markets in March 2020. For example, as pressures on prime and tax-exempt MMFs worsened, two MMF sponsors intervened to provide support to their funds. It did not appear that these funds had idiosyncratic holdings or were otherwise distinct from similar funds and, accordingly, it was reasonable to conclude that other MMFs could need similar support in the near term. These events occurred despite multiple reform efforts over the past decade to make MMFs more resilient to credit and liquidity stresses and, as a result, less susceptible to redemption-driven runs. When the Federal Reserve quickly took action in mid-March by establishing, with Treasury approval, the Money Market Mutual Fund Liquidity Facility [] and other facilities to support short-term funding markets generally and MMFs specifically, prime and tax-exempt MMF outflows subsided and short-term funding market conditions improved."), available at https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf.

[28] *See*, *e.g.*, Financial Stability Oversight Council Statement on Money Market Fund Reform (June 11, 2021) ("The pandemic-induced market volatility demonstrated that disruptions in short-term funding markets, including at

MMFs, have the potential to create or amplify financial instability. . . . [F]uture reforms should address structural vulnerabilities in MMFs, improve the resilience and functioning of short-term funding markets, and reduce the likelihood that official-sector interventions and taxpayer support will be needed to halt future MMF runs and address stresses in short-term funding markets more generally."), available at https://home.treasury.gov/system/files/261/FSOC_Statement_6-11-21.pdf.

[29] *See*, *e.g.*, Harriet Clarfelt and Brooke Masters, *Managers to Shut or Convert $220bn of US Money Market Funds Before Rule Change*, FIN. TIMES (Apr. 11, 2024), available at https://www.ft.com/content/c0753ee8-3025-445d-ab44-ec957c09079b.

[30] Michael Piwowar anticipated almost ten years ago in his dissent from the 2014 money fund rulemaking, that institutional assets "would no longer be available for the short-term funding of state and local governments or businesses." Statement of Commissioner Michael Piwowar, "Dissenting Statement at Open Meeting Regarding Money Market Fund Reform," July 23, 2014, available at https://www.sec.gov/news/statement/2014-07-23 ("Piwowar Statement"). *See also* Comment Letter from SIFMA-AMG PWG at 1 (April 12, 2021) ("Money market funds play an important role in the orderly functioning of the short-term funding markets and serve valuable financial and economic functions for a variety of investors (including both retail and institutional investors) and the capital markets more broadly. Policy measures that have the effect of eliminating or significantly decreasing the size of the prime, retail, and tax-exempt money market fund sectors will significantly impair the resilience and orderly functioning of the short-term funding markets."), available at https://www.sec.gov/comments/s7-01-21/s70121-8664048-235345.pdf.

[31] *See*, *e.g.*, Hester Peirce, "Air Dancers and Flies: Statement on the Adoption of the Latest Round of Money Market Fund Reforms" (July 12, 2023), available at https://www.sec.gov/news/statement/peirce-statement-air-dancers-flies-adoption-latest-money-market-fund-reforms and Piwowar Statement (advocating an "investor choice" approach, which "would allow investors to choose whether to invest in a fund that floats its NAV or one that can impose a liquidity fee and gate. The key feature of this approach is that investors, after receiving complete information as to the benefits and risks of each alternative, could choose which alternative best fits their own unique investment objectives, rather than the Commission choosing which to impose on all investor"). Because the government repeatedly has rushed in with rescue programs, eliminating expectations of a future rescue is admittedly difficult. *See*, *e.g.*, Huberto M. Ennis, Jeffrey M. Lacker, and John A. Weinberg, Federal Reserve Bank of Richmond, Working Paper Series "Money Market Fund Reform: Dealing with the Fundamental Problem" at 14 (Aug. 31, 2022) ("While we might be better off in a world in which the relevant authorities can credibly commit ex ante to not providing support ex post, that world may not be available to us. If so, then, MMFs should be required to have contractual commitments in place, in advance, for liquidity support from private third parties in the event of their financial distress. Such requirements would enhance the ability of the official sector to resist intervening and provide market-based incentives for MMFs to mitigate funding risks."), available at https://www.richmondfed.org/-/media/RichmondFedOrg/publications/research/working_papers/2022/wp22-08.pdf.

[32] Dodd-Frank § 112(a)(1)(A).

[33] Dodd-Frank § 112(a)(2)(K).

[34] Dodd-Frank §§ 112(a)(2)(H) and 113.

[35] MetLife Inc. v. Financial Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016).

[36] Financial Stability Oversight Council, "Guidance on Nonbank Financial Company Determinations," 88 Fed. Reg. 80110, at 80111 (Nov. 17, 2023) ("[T]he 2019 Interpretive Guidance stated that before considering a nonbank financial company for potential designation … the Council would exhaust all available alternatives by prioritizing an "activities-based approach," perform a cost-benefit analysis, and assess a company's likelihood of material financial distress. [T]he Council has determined that these steps are not legally required, are not useful or appropriate, and would unduly hamper the Council's ability to use the statutory designation authority in relevant circumstances[.]"), available at https://www.govinfo.gov/content/pkg/FR-2023-11-17/pdf/2023-25053.pdf.

[37] Comment Letter from Fidelity at 3 (July 27, 2023), available at https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/about-fidelity/Fidelity-FSOC-Comment-Letter.pdf ("FSOC 2023").

[38] *See*, *e.g*., FSOC 2023 at 80122 ("Moreover, the purpose of the prudential standards and Federal Reserve supervision applicable to a designated nonbank financial company is to mitigate the threat to financial stability that the company's material financial distress or activities could pose. For example, even if they were costly to implement, risk-based capital requirements, leverage limits, or liquidity requirements reduce risks posed by companies to the financial system. Notwithstanding the potential costs of a Council designation, Congress set out a

process by which companies should be evaluated and, if they meet the statutory standard, subject to prudential standards and Federal Reserve supervision.").

[39] *See*, *e.g*., FSOC 2023 Annual Report at 64-65 ("Open-end funds allow daily redemptions; however, some types of open-end funds may invest in assets that may not be easily liquidated, resulting in a potential structural liquidity mismatch. In times of market this mismatch can contribute to and amplify stress in the U.S. financial system."), available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf; Financial Stability Board, Enhancing the Resilience of Non-Bank Financial Intermediation -- Progress report (Sept. 6, 2023) at 9 ("Unmitigated structural liquidity mismatch may amplify shocks by driving 'excess' redemptions that require managers to engage in asset sales larger than in the absence of liquidity mismatch, especially in times of stress. One particular example is when redeeming OEF investors do not bear the full cost of their redemptions and there is a 'first mover advantage' for those investors. Recent episodes of stress . . . have shown that OEF outflows can be very large, which contributed to selling pressures and led to interventions by public authorities to restore market confidence."), available at https://www.fsb.org/wp-content/uploads/P060923-1.pdf; Financial Stability Board, "Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities" (Jan. 12, 2017) at 4 ("In light of the need to understand and address potential financial stability risks from structural vulnerabilities associated with asset management activities, the Financial Stability Board (FSB) launched in March 2015 work to address such vulnerabilities."), available at Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities (fsb.org); Press Release, Financial Stability Oversight Council Statement on Nonbank Financial Intermediation (Feb 4, 2022), available at https://home.treasury.gov/news/press-releases/jy0587.

[40] *See*, *e.g*., Janet Yellen, Secretary Statements and Remarks, "Remarks by Secretary of the Treasury Janet L. Yellen at the National Association for Business Economics 39th Annual Economic Policy Conference" (Mar. 30, 2023) ("The structural vulnerabilities at the heart of money market and open-end funds aren't new. In the banking sector, capital and liquidity requirements and federal deposit insurance reduce the likelihood of runs taking place. In case runs occur, access to the discount window helps provide buffers for banks. Yet the financial stability risks posed by money market and open-end funds have not been sufficiently addressed. Over the past two years, the SEC has proposed rules to mitigate the vulnerabilities plaguing these funds. The SEC's proposals would reduce the first-mover advantage, reducing run incentives during times of stress. They would also require new liquidity management tools, while mandating more comprehensive and timely information on these funds for the SEC and investors."), available at https://home.treasury.gov/news/press-releases/jy1376 (internal citations removed); Remarks by FDIC Chairman Martin J. Gruenberg at the Exchequer Club on the Financial Stability Risks of Nonbank Financial Institutions (Sept. 20, 2023) (warning about "potential liquidity mismatch, particularly in times of stress, in some types of open–end funds can give rise to a desire by investors to redeem shares more expeditiously, including taking a 'first mover advantage'"), available at https://www.fdic.gov/news/speeches/2023/spsept2023.html#footnoteref9_p4YjmsaK3hxj. *See also* FSOC 2022 Annual Report at 45 (noting that "[o]pen-end funds continue to pose risks to U.S. financial stability," and noting SEC's rulemaking efforts).

[41] *See*, *e.g.*, Shelly Antoniewicz, Hammad Qureshi, and Matt Thornton, ICI Viewpoints, "The SEC's Liquidity Proposal Is Arbitrary and Harmful to Investors" (Jan. 12, 2024) ("Open-end long-term mutual funds ('funds') have a long history of successfully managing liquidity, enabling them to meet shareholder redemptions in a timely manner while pursuing their investment objectives. Over the past four decades, 99.94% of these funds have met redemptions, including every single fund during the 2008 global financial crisis and the 2020 dash for cash."), available at https://www.ici.org/viewpoints/24-view-liquidity-proposal.

[42] For a discussion of the complexities of the COVID crisis and the nature of the Federal Reserve's response, *see* Michael D. Bordo and John V. Duca, Hoover Institution, Economic Working Paper 21118, "An Overview of The Fed's New Credit Policy Tools and Their Cushioning Effect on the COVID-19 Recession" (September 2021), available at https://www.hoover.org/sites/default/files/research/docs/21118-bordo-duca-2.pdf; Robert L. Hetzel, Mercatus Center at George Mason University, Mercatus Working Paper, "COVID-19 and the Fed's Credit Policy" (July 2020), available at https://www.mercatus.org/media/71856/download.

[43] *See*, *e.g*., Financial Stability Oversight Council Meeting Minutes (Feb. 4, 2022) (reporting that "open-end funds were among the largest recorded sellers of U.S. Treasuries, U.S. municipal bonds, and possibly U.S. corporate debt during March 2020," but that they "were not the sole or primary cause of market stress.") (comments of Kelsey Pristach), available at https://fraser.stlouisfed.org/title/minutes-financial-stability-oversight-council-5160/minutes-meeting-611810/fulltext; Financial Stability Board, "Holistic Review of the March Market Turmoil" at 1 (Nov. 17, 2020) ("On the demand side, non-financial corporates attempted to tap capital markets; demand for US dollar

liquidity increased from foreign borrowers; non-government money market funds (MMFs) experienced significant outflows; and some open-ended funds also experienced redemptions. On the supply side, reductions in risk appetite, regulatory constraints and operational challenges may have reduced dealers' capacity to intermediate larger flows in some core funding markets."), available at https://www.fsb.org/wp-content/uploads/P171120-2.pdf.

[44] *See*, *e.g.*, Comment Letter of The Asset Management Group of the Securities Industry and Financial Markets Associations (July 23, 2023) at 12 ("An asset manager with a large amount of assets under management is effectively a collection of many smaller and diverse accounts, each with its own characteristics, objectives and risk profiles. Investment advisers and funds regularly shut down or have assets migrate from manager to manager with little market impact. It is investors—not the fund or the asset manager—who ultimately own the assets and bear the investment risk in pooled vehicles. Moreover, it is the clients who set the investment strategy, which the manager simply executes. Taken together, this limits the potential threat to financial stability."), available at https://www.sifma.org/wp-content/uploads/2023/07/SIFMA-AMG-Comment-Letter-on-FSOC-Proposals-7.27.23.pdf.

[45] *See*, *e.g*., Letter from Commissioners Mersinger, Pham, Uyeda, and Peirce (July 27, 2023) at 2 ("A systemic risk designation could increase moral hazard in the markets by identifying a particular firm as being too important to fail. With that designation comes an implicit promise of a bailout by U.S. taxpayers to avert failure."), available at https://www.regulations.gov/comment/FSOC-2023-0001-0045.

[46] F.A. Von Hayek, Economics and Knowledge, A presidential address to the London Economic Club, 10 November 1936. First published in Economica (February 1937) ("The assumption of a perfect market then means nothing less than that all the members of the community, even if they are not supposed to be strictly omniscient, are at least supposed to know automatically all that is relevant for their decisions. It seems that that skeleton in our cupboard, the 'economic man', whom we have exorcised with prayer and fasting, has returned through the back door in the form of a quasi-omniscient individual."), available at https://oll.libertyfund.org/pages/hayek-economics-and-knowledge-1936.

[47] Perhaps in league with Jeremy Bentham's skeleton? *See* University College of London Website, Auto-Icon ("On the ground floor of UCL's Student Centre stands a glass case, containing a figure which has been a source of curiosity and perplexity to visitors. The cabinet contains Bentham's preserved skeleton, dressed in his own clothes, and surmounted by a wax head. Bentham requested that his body be preserved in this way in his will made shortly before his death on 6 June 1832."), available at: https://www.ucl.ac.uk/bentham-project/about-jeremy-bentham/auto-icon.

[48] Henry C. Simons, Economic Policy for a Free Society, at 22 (1948).