UNEQUAL INVESTMENT: A REGULATORY CASE STUDY

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Growing economic inequality in the United States has reduced social mobility, placing financial security farther out of reach for a growing number of Americans. During the COVID-19 pandemic, U.S. stock prices have grown simultaneously with unemployment and food insecurity, highlighting the fact that prosperity is unequally distributed in the U.S. economy.

Many Americans do not benefit when the stock market soars because they do not have the means to invest. However, even ordinary American families who do have wealth to invest in the capital markets will face enormous obstacles in narrowing the wealth divide through investment. This is because ordinary American investors regularly earn a lower rate of return from investing than their wealthy counterparts. Wealthy investors are growing a larger mass of wealth at a faster rate of return. This makes it virtually impossible for ordinary investors to catch up.

The disparity in rate of return is the result of both regulation and practicalities that limit the investment options of ordinary investors. Scholars have long acknowledged this disparity in investment opportunities, and many have proposed lifting regulatory barriers to expand investment access for ordinary investors. This Article offers a new perspective focusing on the other side of the wealth divide. That is, perhaps wealthy investors have too many investment opportunities.

Examining the regulation of short selling as a case study, this Article demonstrates that when regulating exclusive investments like short selling, regulators focus on investment products' impact on the markets with a strong presumption that more products make for better markets.

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This Article argues that regulators should reexamine the "more is better" presumption in capital markets regulation in light of the fact that additional exclusive investment opportunities fuel the wealth divide.

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> *[T]here is nothing in financial theory that specifies that control of capital should be confined to a few "fat cats." . . . Further perfecting financial institutions and instruments . . . will enable society to enlarge the scope of this prosperity and reverse the growing trend toward social inequality.*[1]
>
> — Robert Shiller, Nobel Laureate in Economics

INTRODUCTION

The average U.S. family in the top 1% of the wealth distribution has 274 times the wealth of the median American family.[2] Meanwhile, millions of American families have no wealth at all or even negative wealth.[3] This wealth gap has been growing persistently since the 1980s, and Black and Hispanic families are disproportionately represented on the losing side of the wealth gap.[4] The social consequences of this gap have come into sharp relief during the COVID-19 pandemic as economic inequality has proven to be an indicator of COVID-19 deaths.[5] This trend is deeply troubling not only for those Americans who must make do with very little today, but also because of what it suggests about the future. Persistent and increasing economic inequality can lead to diminished social mobility. Indeed, it has become increasingly difficult in the last several decades for Americans born into less wealthy families to climb into better economic circumstances.[6]

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1 ROBERT J. SHILLER, FINANCE AND THE GOOD SOCIETY 9 (2012).

2 *See* Edward N. Wolff, *Household Wealth Trends in the United States, 1962 to 2019: Median Wealth Rebounds . . . But Not Enough* 47–50 (Nat'l Bureau of Econ. Rsch., Working Paper No. 28383, 2021).

3 *See id.* at 48.

4 Data on other racial or ethnic groups, including Native American and Asian American families, is often unavailable due to inadequate data. *See id.* at 30.

5 *See infra* note 30; Catherine Thorbecke & Arielle Mitropoulos, *'Extreme Inequality Was the Preexisting Condition': How COVID-19 Widened America's Wealth Gap*, ABC NEWS (June 28, 2020), https://abcnews.go.com/Business/extreme-inequality-preexisting-condition-covid-19-widened-americas/story?id=71401975 [https://perma.cc/BY3S-S9NF].

6 *See infra* note 52.

A fundamental component of economic inequality is the wealth distribution. As used herein, "wealth" refers to the total value of all the assets a household owns at a particular time, less their debts.[7] The distribution of wealth across U.S. families is an important component of economic inequality because many forms of wealth—like shares of stock or rental properties—generate income. Families that own income-generating wealth can therefore turn their existing wealth into more wealth without spending additional time working. Because of this ability for wealth to beget more wealth, large disparities in the distribution of wealth today can have important impacts on the distribution of economic opportunity in the future.[8] Thus, understanding economic inequality requires an understanding of wealth disparities. Today, most wealth is held in the form of financial assets.[9] Given that fact, this Article embarks upon an exploration of whether and how the regulation of financial assets impacts inequality trends.

Wealthy households in the United States not only own *more* wealth than other households, but they also own a wider array of *types* of wealth.[10] Ordinary American families may own their homes and some retirement savings, but other types of wealth are scarce. Wealthy households, on the other hand, often own additional real estate and a broad array of other financial assets. Retirement savings is the predominant form of financial wealth held by middle class households. Wealthy households have retirement savings, but also have access to many other financial practices that are largely unavailable to ordinary Americans. This wider array of investment options allows wealthy investors to earn a higher rate of return on their investments than ordinary American families, accelerating the mathematical forces that drive the wealth divide.[11] Wealthy Americans are not only earning investment income on a larger pool of wealth; they are earning it at a higher rate of return.[12]

Short selling is an example of a financial practice that is rarely available to ordinary investors.[13] Retirement savings, on the other hand, are the primary way in which ordinary inves-

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7 *See infra* note 34.

8 *Infra* section I.A.2.

9 Defined herein as: unincorporated business equity, pension accounts, financial securities, corporate stock, and mutual funds. *See infra* note 55.

10 Unless otherwise indicated, "wealthy" as used herein refers to the top quintile of the wealth distribution.

11 *Infra* section I.B.4.

12 *See infra* note 123.

13 *See infra* section II.B.2.

tors participate in the capital markets.[14] Examining the regulation of these two practices illuminates how well-intended variations in their regulation can accelerate the growth of wealth inequality.

Short selling is a financial strategy used when an investor wants to bet on the decline of a company. A short seller borrows shares of a company if she thinks the price of those shares is too high today and will fall in the future. She sells the shares and buys them back in the future so she can return them to the person from whom she borrowed them. If, as she hoped, the price of the shares falls, she is able to buy them back a lower price than the price at which she sold them. The difference between the (high) price at which she sold the shares and the (low) price at which she bought them is her profit from short selling.

Short sellers need to borrow shares in order to sell them short, and they often borrow those shares from retirement savings accounts. Thus, the ability to engage in short selling, in a sense, depends upon the retirement savings of ordinary Americans. Some of the fees that short sellers pay to borrow shares are passed back to the retirement savers.[15] So, the financial relationship between retirement savings and short selling is symbiotic, and when viewed in isolation appears to be good for wealthy and ordinary Americans alike. Though, as this Article will argue, when viewed through the lens of the growing wealth gap, it becomes evident that short selling is the type of financial practice that can also contribute to the entrenchment of economic inequality, notwithstanding any benefits to savers from share lending fees. This is because a disproportionate share of the benefits from this symbiotic relationship flow to the already wealthy.[16]

A look at the regulatory approaches the United States has taken to retirement savings and short selling illustrates how regulatory priorities differ depending on the expected financial resilience of the investors involved. The regulation of retirement savings is aimed at protecting investors who have retirement accounts.[17] Given the importance of retirement savings for creating financial security, this approach makes sense. It shields retirement savers from many risky investments, which protects ordinary investors from unwittingly losing their lim-

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14 *See infra* section II.B.1.
15 *See infra* section I.B.3.
16 *See infra* section III.A.2.
17 *Infra* subpart II.C.

ited wealth. The regulation of short selling, on the other hand, is largely aimed at protecting and expanding the capital markets themselves. Short selling is an extremely risky practice. However, for a combination of legal and practical reasons, it is largely only available to wealthy investors. Freed from concerns about middle class investors losing their meager savings, the Securities and Exchange Commission's rulemaking around short selling securities focuses on maximizing the practice's contributions to market price efficiency while minimizing its contributions to market volatility.[18]

This bifurcated approach to regulation exists throughout the capital markets.[19] Regulators regularly step in to protect "main street" investors while trusting wealthier investors to understand the greater risks presented by more exclusive financial practices. Absent the specter of growing wealth inequality, this bifurcated approach seems quite appropriate. But research on growing wealth inequality illuminates how the division between ordinary and exclusive investment opportunities adds fuel to the mathematical forces that already perpetuate the wealth divide.

An axiom of finance is that greater risk brings greater reward. A riskier investment comes with a greater chance that you lose your investment, but if you win, the payout is greater. It is this promise of greater reward that attracts wealthy investors to risky investments. These greater rewards for taking on risk also contribute to wealthy households' higher average rate of return on investment, accelerating the growth of the wealth divide. A regulatory approach that focuses on the market impact of risky financial practices cannot account for this unfortunate effect of exclusive investments.

Given the potential for exclusive investment practices to exacerbate the growth of wealth inequality, this Article argues that the regulation of financial markets in the United States often operates on a faulty assumption that what is good for the financial markets is good for the economy. An exclusive financial practice may make a net positive contribution to the health of the markets while simultaneously growing the wealth divide. Healthy financial markets are not a policy end in and of themselves. Rather, they are a means to facilitate prosperity across the real economy. Entrenched inequality is inconsistent with broad economic prosperity. So, financial regulators in pursuit of broad economic prosperity need to account for the ways in

18 *Infra* subpart II.D.

19 *See infra* section III.A.3.

which even well-functioning capital markets can fuel wealth inequality.

Regulators and scholars have noted the way in which the current regulatory impetus to shield ordinary investors from risk inhibits their investment options and potentially their return on investment. To date, most proposed solutions have focused on increasing ordinary investors' access to more investment opportunities.[20] This Article offers an alternative perspective that regulators and scholars also need to consider whether wealthy investors have access to too many capital markets investment opportunities.[21]

The SEC's revisions to the regulation of short selling between 2005 and 2010 exemplify the way in which the market focus expands the availability of exclusive investment opportunities. Before 2005, short selling regulation had not changed since restrictions were first placed on the practice in 1938. In 2007, the SEC lifted most of those restrictions, making short selling available much more often. That decision was founded primarily on a finding that allowing short selling more often would not have *adverse* effects on the markets. Importantly, lifting the restrictions was also not expected to *improve* market health. The expected impact was neutral. The SEC's reasoning appears guided by a principle that more financial opportunities are better so long as the markets are not harmed.[22] Had the practice's contributions to inequality been under consideration, it would have weighed against an expansion of permissible short selling. That would have meant not creating more opportunities for wealthy investors to earn a higher rate of return. Indeed, by 2010 the SEC realized that even from a market-focused perspective, the 2007 repeal had gone too far. Nevertheless, they were unwilling to revert to the original level of restriction, opting instead for a compromise.

Short selling is but one of many financial practices that is disproportionately available to wealthy individuals and also subject to regulation that determines how much of the practice should be permitted. In any such case, contributions to wealth inequality should count among regulatory considerations. Many such practices may present harder cases than the short selling case study discussed herein. When an exclusive financial practice really does improve market health, weighing that benefit against the inequality harm will present a challenge.

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20 *See infra* subpart III.B.
21 *See infra* subpart III.C.
22 *See infra* subpart II.D.

However, the difficulty of that calculation does not mean it can be ignored. Rather, it requires further study because capital markets that entrench the extraordinary wealth of a few are failing in their purpose.

The remainder of this Article proceeds as follows: Part I describes the troubling growth of economic inequality in the United States over the last several decades. It identifies wealthy families' disproportionate access to many financial products as a driver of those trends and the role of law in perpetuating them. Part II examines the regulation of retirement savings and short selling. It points to the divergent policy priorities that motivate the regulation of each and explains how this bifurcated regulatory approach is applied throughout the capital markets. Part III argues that this bifurcated policy focus, while appearing mildly redistributive, obscures exclusive financial practices' contribution to growing economic inequality. It argues that this perspective is based on a faulty assumption that more robust financial markets always serve the real economy. It then returns to the regulation of short selling, demonstrating how the broader policy perspective advocated herein would have altered the SEC's rulemaking on short selling.

I
Economic Inequality and Wealth

A. Wealth Disparities as a Driver of Economic Inequality

1. *Economic Inequality Trends in the United States*

In recent years, news outlets, policymakers, academics, and other members of the public have expressed mounting concern about economic inequality in the United States.[23] Statistics on these trends abound. In the aftermath of the 2008

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[23] News stories dedicated to the topic are innumerable and persistent. To highlight but a few: Lindsay Maizland, *Income Inequality in China Is Bad, but It's Worse in the US*, VOX (Feb. 16, 2017), https://www.vox.com/world/2017/2/16/14636472/income-wealth-inequality-gap-china-bad-us-worse [https://perma.cc/QDZ3-B46S]; Pedro Nicolaci da Costa, *America's Humongous Wealth Gap Is Widening Further*, FORBES (May 29, 2019), https://www.forbes.com/sites/pedrodacosta/2019/05/29/americas-humungous-wealth-gap-is-widening-further/#2a328cfe42ee, [https://perma.cc/T2WX-GM8P]; Thorbecke & Mitropoulos, *supra* note 5. Academics and thinktanks have likewise dedicated extensive attention to the issue. Again, to highlight but a few examples: Isabel V. Sawhill & Christopher Pulliam, *Six Facts About Wealth in the United States*, BROOKINGS UP FRONT BLOG (June 25, 2019), https://www.brookings.edu/blog/up-front/2019/06/25/six-facts-about-wealth-in-the-united-states/ [https://perma.cc/ZDD7-XNBM]; ORG. FOR ECON. COOP. & DEV., *United States Tackling High Inequalities Creating Opportunities For All*, (June 2014), https://

financial crisis, the Occupy Wall Street movement drew public attention to "the one percent"—the top one percent of the wealth distribution in the United States.[24] Economist Joseph Stiglitz wrote in *Vanity Fair* in 2011 that the "top 1 percent" held forty percent of all the wealth in the United States and had seen their incomes increase eighteen percent over the prior decade.[25] During the same time period middle class wages had fallen, suggesting that the United States economy was working for the benefit of a few.[26] The economic pie has grown in the United States in recent decades, but 97.4% of the gains have gone to the wealthiest 20% of American households.[27] Meanwhile, the bottom 40% of U.S. households have seen their average wealth go from positive to negative during the same period.[28] This growth in the economic pie has clearly not resulted in greater prosperity for all.

Economic outcomes cannot be separated from social ones; indeed, economic outcomes *are* social outcomes. In 2016, the median White household had ten times the wealth of the median Black household and eight times the wealth of the median Hispanic household.[29] The COVID-19 pandemic has highlighted how economic disparities translate into health outcomes. A recent study identified income inequality as the second strongest predictor (after population density) of COVID-19 deaths in U.S. states.[30]

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www.oecd.org/unitedstates/Tackling-high-inequalities.pdf [https://perma.cc/HS29-24JN]; Wolff, *supra* note 2.

24 JOSEPH E. STIGLITZ, THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE xxxix (2013).

25 Joseph E. Stiglitz, *Of the 1%, By the 1%, For the 1%*, VANITY FAIR, (May 2011), https://www.vanityfair.com/news/2011/05/top-one-percent-201105 [https://perma.cc/S24D-S9AC].

26 *See id.*

27 Wolff, *supra* note 2, at 50 (comparing data from 1983 to 2019).

28 *Id.* (showing that in 1983, the average family in the bottom 40% of the wealth distribution had $7,000 of net worth in 2019 dollars, and by 2019 that had fallen to negative $7,200).

29 Other racial groups are not separately identified in this data. Median wealth was $171,000 for white households, $17,100 for Black households, and $20,600 for Hispanic households. Rakesh Kochhar & Anthony Cilluffo, *How Wealth Inequality Has Changed in the U.S. Since the Great Recession, by Race, Ethnicity and Income*, PEW RSCH. CTR. (Nov. 1, 2017), https://www.pewresearch.org/fact-tank/2017/11/01/how-wealth-inequality-has-changed-in-the-u-s-since-the-great-recession-by-race-ethnicity-and-income/ [https://perma.cc/E4SV-XPE6]. For a thorough examination of the historical origins of Black Americans' challenges accumulating wealth, see generally MEHRSA BARADARAN, THE COLOR OF MONEY: BLACK BANKS AND THE RACIAL WEALTH GAP 1–11 (2017).

30 Harold Clarke & Paul Whiteley, *Economic Inequality Can Help Predict COVID-19 Deaths in the US*, LSE PHELAN U.S. CTR. (May 6, 2020), https://

Growing economic inequality in the United States has garnered an extraordinary amount of attention not simply because some families have more money than others, but because of the social implications of those disparities. While some economic inequality is probably inevitable,[31] and possibly desirable,[32] too much inequality can reduce social mobility.[33] Without social mobility, those born less well-off will lack opportunities to improve their quality of life. A growing number of economists believe the United States has passed the point at which inequality serves the economy and that instead our current level of inequality is contributing to troubling social and political problems.[34]

Disparities in the quantity of money families have at their disposal can be measured as disparities in income or disparities in wealth. While both are relevant to analyzing economic inequality, this paper focuses on the accumulation of wealth as a determinant of persistent economic inequality.

2. *The Importance of Wealth in Understanding Inequality*

Economic inequality is usually measured in one of two ways: inequality of wealth or inequality of income.[35] Wealth

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blogs.lse.ac.uk/usappblog/2020/05/06/economic-inequality-can-help-predict-covid-19-deaths-in-the-us/ [https://perma.cc/AT4J-ZN2B].

31 FACUNDO ALVAREDO, LUCAS CHANCEL, THOMAS PIKETTY, EMANNUEL SAEZ & GABRIEL ZUCMAN, WORLD INEQUALITY LAB, WORLD INEQUALITY REPORT 2018, at 8 (2018).

32 *True Progressivism*, ECONOMIST (Oct. 13, 2012), https://www.economist.com/leaders/2012/10/13/true-progressivisim [https://perma.cc/F3UU-S8CC] ("[S]ome measure of inequality is good for an economy. It sharpens incentives to work hard and take risks; it rewards the talented innovators who drive economic progress.").

33 *Id.* ("If income gaps get wide enough, they can lead to less equality of opportunity . . . .").

34 *See, e.g.*, Olivier Blanchard & Dani Rodrik, *We Have the Tools to Reverse the Rise in Inequality*, PETERSON INST. FOR INT'L ECON. (Nov. 20, 2019), https://www.piie.com/commentary/speeches-papers/we-have-tools-reverse-rise-inequality [https://perma.cc/6LZ6-23F2] ("Inequality is widening, posing major moral, social, and political challenges to which policymakers must react."); Emmanuel Saez & Gabriel Zucman, *The Explosion in U.S. Wealth Inequality Has Been Fueled by Stagnant Wages, Increasing Debt, and a Collapse in Asset Values for the Middle Classes*, LSE PHELAN U.S. CTR. (Oct. 29, 2014), https://blogs.lse.ac.uk/usappblog/2014/10/29/the-explosion-in-u-s-wealth-inequality-has-been-fuelled-by-stagnant-wages-increasing-debt-and-a-collapse-in-asset-values-for-the-middle-classes/ [https://perma.cc/2VEF-MWL4]; Torsten Persson & Guido Tabellini, *Is Inequality Harmful for Growth?*, 84 AM. ECON. REV. 600, 617–18 (1994); Alberto Alesina & Dani Rodrik, *Distributive Politics and Economic Growth*, 109 Q.J. ECON. 465, 474-78 (1994).

35 *See generally* ALVAREDO, CHANCEL, PIKETTY, SAEZ & ZUCMAN, *supra* note 31, at 38, 196 (reporting separately on income inequality and wealth inequality for each studied country).

refers to the total value of all the assets a household owns at a particular time less their debts.[36] The assets include cash savings, investments, and possibly a home, and the debts include any outstanding balances on money the household has borrowed.[37] Income, on the other hand, refers to the money received by a household over a period of time.[38] While wealth and income are distinctive measures of economic inequality, they are not unrelated concepts. This is because unspent income becomes wealth, and wealth, in turn, can be a source of income. An individual or a family can derive income from labor (wages) or wealth (returns on investment).[39] Wages are very unequally distributed in the United States.[40] This disparity in wages has contributed to and continues to contribute to income inequality, and thereby economic inequality in the United States.[41] However, recent research suggests that since 2000, wages have ceased to be the primary driver of income inequality. Instead, the returns earned from investing wealth are driving U.S. inequality trends.[42]

In his widely popular book, *Capital in the Twenty-First Century*, Thomas Piketty drew worldwide attention to the role of wealth—as opposed to wages—in entrenching economic inequality.[43] Income-producing wealth reproduces itself and grows. If a family has enough disposable income to spare that they can invest it, they can increase their income without increasing how much they work. The number of hours an individual can work is finite, but the quantity of investment wealth a person can accumulate is virtually unlimited.[44] Conse-

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36 *See* BRIAN KEELEY, INCOME INEQUALITY: THE GAP BETWEEN RICH AND POOR 17–29 (2015).

37 *See id.* at 20.

38 *See id.* at 19.

39 *See id.*

40 *See, e.g.*, ELISE GOULD, STATE OF WORKING AMERICA WAGES 2018, at 3–6, 9 (2019) (illustrating wage gaps between genders, races, education, and earning potential).

41 *See generally* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 298 (2013) (illustrating differences in labor income and capital income and connecting such differences to inequality of total income).

42 ALVAREDO, CHANCEL, PIKETTY, SAEZ & ZUCMAN, *supra* note 31, at 78 ("While the upsurge of top incomes was first a labor-income phenomenon in 1980s and 1990s, it has mostly been a capital-income phenomenon since 2000.").

43 PIKETTY, *supra* note 41, at 30 ("[T]he process of accumulation and concentration of wealth when growth is weak and the return on capital is high . . . . no doubt represents the principal threat to an equal distribution of wealth over the long run.").

44 The salary a worker can take home does not have a theoretical limit. However, once a person or family has met their day-to-day needs, any excess wages become wealth. Unless that wealth is held solely in cash or in another form

quently, income from wealth is capable of reproducing and growing much faster than income from labor, and wealth can be passed on to future generations.[45] In this way, wealth's durability and capacity to multiply can make it all but certain that those who have only, or predominantly labor income will be left behind.[46]

Piketty's central claim in *Capital* was that so long as the rate of return on private wealth exceeds the rate of growth in the economy, inequality will tend to increase.[47] While Piketty's conclusions remain the topic of much debate, there is widespread praise for the enormous quantity of historical data he compiled and the trends that he identified in that data.[48] His research shows that current trends in the distribution of wealth look very similar to past eras of extreme and persistent inequality.[49] He warns that without intervention, we may again enter a period of extreme and persistent inequality, resulting in diminished or nonexistent social mobility.[50] A number of other prominent economists have voiced similar concerns about the entrenchment of wealth disparities.[51] The

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that generates no income, these extraordinary wages will contribute additional income in the form of returns on investing their wealth.

45 *See* Benjamin Means, *Wealth Inequality and Family Businesses*, 65 EMORY L. J. 937, 943 (2016) ("Inheritance practices contribute substantially to wealth inequality.").

46 Assuming some people have substantial wealth. EDWARD N. WOLFF, A CENTURY OF WEALTH IN AMERICA xv (2017) ("[T]here is direct survey evidence that intergenerational transfers of wealth may explain upwards of 40 percent of the total household lifetime accumulation of wealth.").

47 PIKETTY, *supra* note 41, at 25–27. He warned that if this imbalance persisted over years and decades, the already wealthy will multiply their wealth such that others will be unable to catch up. Eventually, wealth will be determined by inheritance and social mobility will be lost. *See id.*

48 Marshall Steinbaum, *Why AAre Economists Giving Piketty the Cold Shoulder?*, BOS. REV. (May 12, 2017), http://bostonreview.net/class-inequality/marshall-steinbaum-why-are-economists-giving-piketty-cold-shoulder [https://perma.cc/E8AD-LH4E] ("[D]espite Piketty's resonance with public experience and apparent applicability to the economic environment of global finance, his book was mostly greeted with hostility by the academic economics profession."). Steinbaum goes on to note that Piketty's collection of historical data and statistics garners widespread praise even among his critics. *Id.* He attributes Piketty's hostile reception to inertia in the economics academy. *Id.*

49 PIKETTY, *supra* note 41, at 440 (comparing U.S. inequality in 2010 to "the Gilded Age, when some US industrialists and financiers . . . accumulated unprecedented wealth").

50 *Id.* at 26.

51 *See* WOLFF, *supra* note 46, at xiii (discussing wealth trends: "[t]here is clear evidence of a growing bifurcation in the United States between the 'favored fifth' and almost all the rest"); Joseph E. Stiglitz, *Inequality and Economic Growth*, *in* RETHINKING CAPITALISM: ECONOMICS AND POLICY FOR SUSTAINABLE AND INCLUSIVE GROWTH 134, 136 (Michael Jacobs & Mariana Mazzucato eds., 2016) (noting that the wealthiest Americans temporarily lost a great deal of wealth during the reces-

problem with wealth inequality is that the larger it gets, the more entrenched it becomes. Entrenched inequality means those born into families with little or no wealth will have scant hope of changing their circumstances. And indeed, social mobility has been declining in the United States as wealth inequality has been growing.[52]

While the distribution of wealth today is approaching that of prior very unequal eras, today's wealth takes a much different form from the wealth of the past.

3. *The Role of Law in Determining the Value of Modern Wealth*

Piketty's work is remarkable, in part, because of the historical reach of his data. His data for some European countries reaches back to the eighteenth century and for the United States to the start of the twentieth century.[53] Until the early twentieth century, rural land was the most important source of wealth globally.[54] Today, financial assets have become the predominant component of personal wealth in the United States.[55] Financial assets differ from land in that how they create income is far less tangible.

Land is a physical asset. It creates income when it is leased to another person or used to grow crops or produce other goods for sale. The crops for sale or the property for lease are physical assets that a purchaser consumes.[56] So, the amount of income generated by land, to a substantial extent, is determined by what a consumer is willing to pay for these tangible products the land generates. Even with these tangible sources of income, the laws and legal structures that apply still meaningfully affect the value and income-producing capacity of

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sion, but they regained this lost wealth during the recovery while ordinary Americans did not).

52 *See* Michael Hout, *Social Mobility*, PATHWAYS, special Issue 2019, at 29, 29 ("American men and women born since 1980—the millennials—have been less upwardly mobile than previous generations of Americans."); Raj Chetty et al., *The Fading American Dream: Trends in Absolute Income Mobility Since 1940*, at ii (Nat'l Bureau of Econ. Rsch., Working Paper No. 22910, Dec. 2016), http://www.nber.org/papers/w22910 [https://perma.cc/6SBJ-YAQ3] (finding that rates of income mobility "have fallen from approximately 90% for children born in 1940 to 50% for children born in the 1980s.").

53 PIKETTY, *supra* note 41, at vii.

54 KATHARINA PISTOR, THE CODE OF CAPITAL: HOW THE LAW CREATES WEALTH AND INEQUALITY 24 (2019).

55 Wolff, *supra* note 2, at 51 tbl.5 (showing that, as of 2019, unincorporated business equity, pension accounts, financial securities, corporate stock, and mutual funds constituted 51.9% of all household wealth in the United States).

56 PISTOR, *supra* note 54, at 3.

that land.[57] Financial assets lack the tangibility of land. Consequently, as Professor Katharina Pistor has described, law is even more determinative of the value of financial assets.[58]

Financial assets don't exist in physical form. For example, a share of stock in a corporation is not a tangible thing that can produce anything of value absent a collection of contracts.[59] A corporation itself is nothing more than a legal fiction created by statute to facilitate the pooling of resources for joint production.[60] A corporation exists as a consequence of a statute allowing for its creation and its formative documents which describe how it will operate.[61] Those same documents will define the rights of shareholders (investors) in the corporation.[62] The formative documents will also determine the liquidity of the shares and whether and how shareholders will be paid dividends. All of these rights contribute to the value that a given investor is willing to place on the share of stock, and all exist in legal documents alone. While many of these contracts are agreements involving only private parties, the contracts the parties enter into would be of little value absent a legal system that recognizes and enforces those contracts and a market where stocks can be traded.[63]

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57 *Id.* at 24 (noting that in order to increase the value of land, "[l]andowners . . . found lawyers who set up a trust or corporate entity to which assets could be transferred, and thereby protected from various groups of creditors"); *see also id.* at 38 (describing how an English law adopted in 1880, which empowered creditors to enforce against family estates, affected wealthy families' ability to maintain their wealth in perpetuity).

58 *Id.* at 3; *see also* Katharina Pistor, *A Legal Theory of Finance*, 41 J. COMP. ECON. 315, 315 (2013).

59 *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) ("Since the specification of rights is generally effected through contracting (implicit as well as explicit), individual behavior in organizations, including the behavior of managers, will depend upon the nature of these contracts.").

60 Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 269 (1999).

61 *See, e.g.*, DEL. CODE ANN. tit. 8, § 101 (2021); *see* PISTOR, *supra* note 54, at 48 (describing corporations as a combination of contracts and public laws that protect the firm's assets).

62 *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 211–212, 220, 251(c), 327 (2021). These rights most commonly include the rights to elect directors to the board, vote on major transactions, inspect corporate books and records, and file derivative suits. *See* Emily Winston, *Benefit Corporations and the Separation of Benefit and Control*, 39 CARDOZO L. REV. 1783, 1809 (2018).

63 PISTOR, *supra* note 54, at 17 ("[L]aw that is backed by the threat of coercive enforcement increases the likelihood that the commitments that private parties made to one another and the privileges they obtained will be recognized and enforced . . . .").

Thus, financial assets—whether shares of corporate stock or investments in a short-selling hedge fund—owe their existence and value to the legal structures that create and apply to them.[64] This legal "coding" includes any regulatory restrictions placed on creating or investing in a particular financial asset. If regulators allow a financial asset to exist, then the value of a financial asset is determined by the contracts entered into by private parties that create the asset and the public legal system that recognizes and enforces those contracts.[65] But the existence of a financial asset is dependent on law and regulation. Regulators can eliminate short selling and the ability to profit from it. Indeed, they have done so, briefly, in the past.[66]

Given the centrality of law in determining the value of financial wealth, this paper will begin to explore how our regulatory approach to financial investments affects the value of investments held by wealthy and less wealthy investors. To do so, it examines the regulation of retirement savings and short selling. These financial practices, perhaps surprisingly, are closely linked. Shares held by retirement savers are an important source of the loaned shares required for short selling. Despite this connection, these financial practices are not equally available to all Americans.[67]

B. The Composition and Distribution of Wealth in the United States

As discussed above, in the last several decades, wealth in the U.S. economy has come to be overwhelmingly held in the hands of a small number of households. The wealth of the wealthiest Americans and that of "ordinary" Americans are not only distinguishable in terms of quantity.[68] Households at different points on the wealth distribution also tend to hold very different *types* of wealth. This section explores those distinctions and their implications for the accumulation of wealth over time.

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64 *Id.* at 3.

65 *Id.* at 217.

66 *See infra* note 230.

67 Short selling is but one of many examples of a financial practice that is disproportionately available to the already wealthy. Discussing all such practices would be impossible. This particular set of financial practices was chosen as a starting point for the reasons described in subpart II.B herein.

68 "Ordinary" Americans as used herein refers to roughly the bottom 80–90% of the wealth distribution in the United States. The intent of this term is to capture the vast majority of Americans who are not exceptionally wealthy.

1. *The Wealth of "Ordinary" Americans*

Many American families have no wealth at all. By some estimates, nearly 20% of U.S. households have zero or negative wealth,[69] and non-White families are much more likely to fall into this category than White families.[70] This means that the assets these households own are not worth more than the debt they owe.[71] These families have few or no opportunities to earn income from wealth and are therefore largely limited to their labor as a source of income. This is deeply problematic. If these families' income is insufficient to allow them to save and therefore accumulate wealth, they are likely living "paycheck to paycheck," a very precarious financial situation.[72]

While a distressingly large number of U.S. households have zero or negative wealth, most American families do have some positive wealth. In 2016, the median U.S. household had positive wealth of $100,800.[73] For American households in the middle 60% of the wealth distribution,[74] the majority of their wealth—61.9%—is held in the form of their home.[75] The next greatest component of middle-class wealth is defined contribution retirement savings ("retirement savings"), which constitute 16.6% of these households' wealth.[76]

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69 Edward Wolff estimates that as of 2019, 19.6% of U.S. households had zero or negative wealth. Wolff, *supra* note 2, at 47 tbl.1. *But see* Giacomo De Giorgi, Olivier Armantier, Luis Armona & Wilbert van der Klaauw, *What is Negative Wealth and Who Does It Affect?*, WORLD ECON. F. (Aug. 5, 2016), https://www.weforum.org/agenda/2016/08/what-is-negative-wealth-and-who-does-it-affect [https://perma.cc/AEK2-AFG4] (estimating that 15.1% of U.S. households have zero or negative wealth but noting that this figure varies across studies due to variances in survey methodology).

70 Lisa J. Dettling et al., *Recent Trends in Wealth-Holding by Race and Ethnicity: Evidence from the Survey of Consumer Finances*, FEDS NOTES (Sept. 27, 2017), https://www.federalreserve.gov/econres/notes/feds-notes/recent-trends-in-wealth-holding-by-race-and-ethnicity-evidence-from-the-survey-of-consumer-finances-20170927.htm [https://perma.cc/N5WW-G3XG] (showing that in 2016, 9% of White families had zero or negative wealth, as compared to 19% of Black families, 13% of Hispanic families, and 14% of families in other non-White groups).

71 *See* Di Giorgi, Armantier, Armona & van der Klaauw, *supra* note 69 ("[A] household's total debt may exceed its total assets, in which case it has "negative wealth.'").

72 *Id.* ("[Negative wealth] may affect the household's ability to save for durable goods, restrict access to further credit, and may require living in a state of limited consumption.").

73 Wolff, *supra* note 2, at 42 tbl.1.

74 Meaning all households *except* the 20% wealthiest households and the 20% least wealthy households.

75 *Id.* at 49 tbl.6. Sixty-seven percent of households in this group owns a primary residence. *Id.*

76 *Id.* at 6, 49 tbl.6 (explaining that "pension accounts" as used in this study does not include defined benefit pension plans).

A principal residence is an important form of wealth for economic security.[77] A principal residence provides a family with a home, reducing housing insecurity. Ideally, a principal residence will also appreciate in value over time, increasing the owner's wealth. Homeowners can borrow against the equity in their home, and that access to credit is an additional source of economic security. Moreover, primary residences can be passed on to heirs, which allows these benefits to persist across generations.[78] Thus, ownership of a primary residence can undoubtedly be an important source of wealth for American households.

Nonetheless, these benefits are not universally available to all homeowners; many of the benefits of homeownership are less often enjoyed by minority homeowners.[79] Moreover, homes, unlike financial assets, are highly illiquid.[80] It is not easy for a family to turn the value of their principal residence into cash that can be spent on consumption, if needed. And, other than appreciation in value, a principal residence does not usually generate income.[81]

Retirement savings—the second most prevalent type of wealth among ordinary Americans—can, and should, generate income in the short and medium term. Retirement savings are generally invested, through mutual funds, in publicly traded stocks and bonds.[82] We invest our retirement savings so that the amount we invest today grows by the time we retire. Retire-

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77 *See* James Herbert Williams, *Economic Security and Home Ownership*, 38 SOC. WORK RSCH. , 3 (2014) ("Home ownership and savings are primary avenues for low-income families and individuals to build wealth, economic assets, and security."). *But see* Jenny Schuetz, *Renting the American Dream: Why Homeownership Shouldn't Be a Prerequisite for Middle-Class Financial Security*, BROOKINGS: UP FRONT (Feb. 13, 2019), https://www.brookings.edu/blog/up-front/2019/02/13/renting-the-american-dream-why-homeownership-shouldnt-be-a-pre-requisite-for-middle-class-financial-security/ [https://perma.cc/9UTF-VDUE] (arguing that homeownership is not a fundamental need due to the financial risks and costs associated with maintaining a home).

78 *See* BARADARAN, *supra* note 29, at 9 ("Especially for families on the bottom rung, owning a home provides a substantial buffer against the harshest edges of poverty, a stable foundation that can be passed down to the next generation.").

79 WILLIAM DARITY JR. ET AL., SAMUEL DUBOIS COOK CTR. ON SOC. EQUITY, WHAT WE GET WRONG ABOUT CLOSING THE RACIAL WEALTH GAP 29–30 (2018), https://socialequity.duke.edu/wp-content/uploads/2020/01/what-we-get-wrong.pdf [https://perma.cc/JE6W-V2B8] (citing racial disparities in access to mortgages, quality of mortgages, appreciation of equity and intergenerational transfers).

80 Wolff, *supra* note 2, at 6 ("[O]ne's home is difficult to convert into cash in the short term.").

81 There are, of course, exceptions. For example, an owner could rent out a room in their principal residence.

82 *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 960 (2013).

ment savings are crucial to economic security since social security benefits are currently inadequate to maintain a person's standard of living post-retirement.[83] Retirement savings earn income because they are invested in financial assets.[84] So, those middle-class households who have retirement savings—roughly half—own financial assets.[85] Very few middle-class families own any financial assets other than their retirement accounts.[86]

Retirement savings differ in important ways from financial assets that are held outside of retirement accounts. Retirement savings are meant to spread out consumption over our lifetimes, and the goal is to maintain the investor's standard of living post-retirement.[87] Even when retirement savings earn income and grow as hoped, they do not make a person "richer" in the colloquial sense of the term; this income does not make its owner capable of buying more things today.[88] And while unused retirement savings will be passed on to the saver's heirs, this is not the usual or primary function of retirement savings.

Thus, the kind of financial wealth that ordinary Americans are most likely to hold is largely wealth that creates important economic security but will not produce income that improves a family's standard of living. If all goes according to plan, these savings will merely maintain the saver's existing standard of

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83 *See* JENNIFER ERIN BROWN, JOELLE SAAD-LESSLER & DIANE OAKLEY, NAT'L INST. ON RET. SEC., RETIREMENT IN AMERICA: OUT OF REACH FOR WORKING AMERICANS? 2 (2018), https://www.nirsonline.org/wp-content/uploads/2018/09/FINAL-Report-.pdf [perma.cc/Q54F-99U9] ("To maintain their standard of living in retirement, the typical working American needs to replace roughly 85 percent of pre-retirement income. . . . Social Security, under the current benefit formula, provides a replacement rate of roughly 35 percent for a typical household.").

84 *See infra* note 168.

85 Approximately 50% of U.S. households have retirement savings. *See* MONIQUE MORRISSEY, ECON. POL'Y INST., THE STATE OF AMERICAN RETIREMENT SAVINGS: HOW THE SHIFT TO 401(K)S HAS INCREASED GAPS IN RETIREMENT PREPAREDNESS BASED ON INCOME, RACE, ETHNICITY, EDUCATION, AND MARITAL STATUS 12 fig.8 (2019), https://files.epi.org/pdf/136219.pdf [perma.cc/5QNC-7N93]; BROWN, SAAD-LESSLER & OAKLEY, *supra* note 83, at 7 fig.4. Defined benefit plans are another form of retirement savings that are not the focus of this discussion. This is in part because they are excluded from retirement savings in some sources. Moreover, participation in defined benefit plans is decreasing. *See infra* section II.A.1.

86 Wolff, *supra* note 2, at 49 tbl.6 (showing that only 15.3% of middle-class families own "[c]orporate stock, financial securities, mutual funds, and personal trusts" and only 7.8% own unincorporated business equity).

87 *See* BROWN, SAAD-LESSLER & OAKLEY, *supra* note 83, at 2.

88 Except with a substantial tax penalty. *Topic No. 558 Additional Tax on Early Distributions from Retirement Plans Other than IRAs*, IRS, https://www.irs.gov/taxtopics/tc558 [perma.cc/P4XN-5M53] (last updated Mar. 1717, 2021).

living. Moreover, even though retirement savings are the second greatest component of wealth for middle-class households, the retirement savings that Americans do hold are largely inadequate to allow their owners to retire with the economic security these savings are meant to create.[89]

By some estimations, approximately half of Americans have no retirement savings,[90] and Black and Hispanic families are disproportionately represented among those with no retirement savings at all.[91] Across all working Americans, over seventy percent have insufficient wealth to support retirement, even using a very low benchmark savings goal.[92] And again, Black and Hispanic families endure a disproportionate share of the burden, with median retirement account balances substantially below those of non-Hispanic White families.[93] Seventy percent of the balance of retirement savings held by Americans is held by the top 20% of the income distribution.[94] So, retirement savings are decidedly inadequate for all but the wealthiest Americans.

Notwithstanding their inadequacies, retirement savings remain the predominant way in which ordinary Americans participate in the markets for financial products. They are therefore the primary way in which ordinary Americans' money is subject to capital market regulation. At the same time, it is a clear example of the immediate effects of wealth inequality in the United States. The inadequacy of wealth accumulation puts an economically secure retirement out of reach for most Americans. Therefore, retirement savings are a useful starting point for exploring the relationship between financial regulation and economic inequality.

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89 MORRISSEY, *supra* note <*CITE* _Ref83247395“>, at 8 fig.5 (“Most families—even those approaching retirement—have little or no retirement savings.”).

90 Exact percentages vary by study based on survey methodology. *See, e.g.*, *id.* at 6 (estimating that 58% of “prime-age” families in the U.S. had retirement account savings in 2016); BROWN, SAAD-LESSLER & OAKLEY, *supra* note 83, at 7 fig.4 (“Almost 60 [p]ercent of all [w]orking [a]ge [i]ndividuals [d]o [n]ot [o]wn [a]ssets in a [r]etirement [a]ccount.”).

91 MORRISSEY, *supra* note 85, at 14 fig.10 (“Most black and Hispanic families have no retirement account savings.”).

92 BROWN, SAAD-LESSLER & OAKLEY, *supra* note 83, at 15.

93 MORRISSEY, *supra* note 85, at 15 (“In 2016, the median white non-Hispanic family with retirement savings had over three times as much saved in a retirement account ($79,500) as the median Hispanic family with savings ($23,000) and nearly three times as much as the median black family with savings ($29,200).”).

94 *Id.* at 23.

2. *The Wealth of the Wealthy*

Households in the upper echelons of the U.S. wealth distribution also count primary residences and retirement savings among their sources of wealth, though with much greater frequency. Over 94% of households in the top quintile of the wealth distribution own a principal residence, and over 80% have defined contribution retirement savings.[95] In addition to their homes and retirement savings, these wealthy households also own other types of assets with much greater frequency than less wealthy households.[96]

Nearly one half of the top quintile of the wealth distribution owns real estate other than their primary residence.[97] Nearly one third own equity in non-corporate businesses.[98] Nearly two thirds own corporate stock, financial securities, mutual funds, and personal trusts.[99] These additional sources of wealth notably have the ability to grow these households' wealth without additional labor. Real estate other than one's primary residence can be rented out to generate income. Unincorporated business equity, corporate stock, financial securities, and mutual funds are all financial assets that are purchased virtually exclusively for their financial returns. These types of assets that are predominantly owned by the wealthy contribute to the tendency of wealth to beget more wealth and thereby entrench economic inequality.[100]

3. *Explaining the Division*

A number of factors converge to explain why wealthy Americans' wealth is so much more diverse than that of ordinary Americans. Perhaps the most obvious factor is the simple fact that wealthy households have more money to invest. Owning a home and saving for retirement are foundations of economic security.[101] It is logical that until those two basic needs have been met, most families will not invest their money in other forms of wealth. The number of working-age Americans with insufficient retirement savings demonstrates that, for most

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95 Wolff, *supra* note 2, at 52 tbl.6.
96 *See id.*
97 *Id.*
98 *Id.*
99 Other than that which comprises their retirement savings. *Id.*
100 Notably, intergenerational wealth transfers have not been a major contributor to the recent growth of inequality in the United States. Rather, it is life-cycle wealth accumulation that has been the driving force in the recent increase in wealth inequality. Wolff, supra note 46, at 304-10.
101 *See* Williams, *supra* note 77, at 3.

American families, these basic financial needs are not met.[102] Wealthy families, on the other hand, have surplus wealth to invest beyond retirement savings, potentially increasing their consumption in the short run or passing on wealth to descendants in the long run. Ordinary Americans often do not have adequate money to invest for these purposes.[103]

A regulatory factor contributing to the different composition of wealth among wealthy and ordinary Americans is the Securities Exchange Commission's ("SEC") rule known as the accredited investor standard.[104] The accredited investor standard limits who can purchase securities that have not been registered with the SEC.[105] When a company registers its securities with the SEC, it is subject to extensive reporting requirements and oversight.[106] The regulation of registered securities is designed to make comprehensive and accurate information widely available to investors to facilitate informed investment choices.[107] A company that has not registered with the SEC, and is therefore "private," is subject to less extensive regulation.[108] Thus, if a company does not want to incur the costs of registering with the SEC, it can remain a private company, and it will be largely restricted to seeking investments from "accredited investors."[109] As currently formulated, the accredited investor standard largely limits unregistered investments to individuals with a net worth of at least one million dollars or an annual income over $200,000.[110] A recent

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102 *See* MORRISSEY, *supra* note 85, at 6.

103 *See* Wolff, *supra* note 2, at 52 tbl.6.

104 17 C.F.R. § 230.501(a) (2020).

105 SEC, *Updated Investor Bulletin: Accredited Investors*, INVESTOR.GOV (Apr. 14, 2021), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3 [perma.cc/82SK-TEMY] [hereinafter SEC, *Updated Investor Bulletin*].

106 *See, e.g.*, Securities Act of 1933, 15 U.S.C. §§ 77f–g (requiring a registration statement for publicly offered securities); *id.* § 77g(c) (prescribing disclosure requirements for registered securities); Exchange Act of 1934, 15 U.S.C. § 78 (same).

107 *See* SEC, *Registration Under the Securities Act of 1933*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/registration-under-securities-act-1933 [perma.cc/E4MH-SL6A] (last visited Feb. 22, 2021) ("The Securities Act of 1933 has two basic objectives: [t]o require that investors receive financial and other significant information concerning securities being offered for public sale; and [t]o prohibit deceit, misrepresentations, and other fraud in the sale of securities.").

108 *See, e.g.*, Securities Act of 1933, 15 U.S.C. § 77d-1 (exempting transactions not involving any public offering from registration).

109 *See* Regulation D, 17 C.F.R. §§ 230.504, 230.506.

110 17 C.F.R. § 230.501(a)(5)–(6) ("Accredited investor shall mean . . . [a]ny natural person whose individual net worth, or joint net worth with that person's spouse or spousal equivalent, exceeds $1,000,000 . . . [or] [a]ny natural person

amendment to the rule expanded the definition of an accredited investor to include certain financial professionals who are deemed financially sophisticated, even if they do not meet the net worth requirement.[111]

The types of investments that the accredited investor standard largely restricts to wealthy investors include: direct investments in stock or other securities offered by companies that haven't "gone public," venture capital funds that pool money to invest in promising startup ventures, and the class of investment funds colloquially referred to as "hedge funds."[112] While the term "hedge fund" has no formal legal definition, it generally refers to lightly regulated investment funds that often pursue riskier investment strategies than those available to ordinary investors.[113] One such investment strategy commonly used by hedge funds is short selling.[114]

The policy justification for the accredited investor standard is to protect vulnerable investors from less regulated and thus presumably riskier investments. The accredited investor standard aims to filter out investors who (1) lack the financial know-how to understand the risks involved and (2) lack the wealth to weather potential losses.[115] But, as currently formulated, the wealth requirement is the predominant determinant

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who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse or spousal equivalent in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.").

111 The relevant changes appear in 17 C.F.R. § 230.501(a)(10), which adds to the definition of accredited investor "[a]ny natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status," and 17 C.F.R. § 230.501(a)(11), which adds "[a]ny natural person who is a 'knowledgeable employee[ ]' . . . of the issuer of the securities being offered or sold."

112 *See* SEC, *Updated Investor Bulletin*, *supra* note 105.

113 *See* SEC, *Hedge Funds*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/hedge-funds [perma.cc/2V6Y-3FPB] (last visited Feb. 22, 2021).

114 *See* Peter Molk & Frank Partnoy, *Institutional Investors as Short Sellers?*, 99 B.U. L. REV. 837, 844 (2019) (pointing out that other, less exclusive institutional investors could engage in short selling, but in practice it is largely only a subset of hedge funds that do so).

115 *See* SEC, *Updated Investor Bulletin*, *supra* note 105. For most of its existence, the accredited investor standard did not in any way screen for investor sophistication. Rather, it made an implicit assumption that those whose wealth or income meets the threshold have the requisite sophistication to understand the risks of investment. This assumption has long been widely criticized. *See, e.g.*, Manning Gilbert Warren III, *A Review of Regulation D: The Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933*, 33 AM. U. L. REV. 355, 381–82 (1984) (criticizing the accreditation of investors based on their wealth, income, or amount of purchase); Donald C. Langevoort & Robert B.

of whether an individual or household is deemed an accredited investor. The recent amendments expanding the definition to include other financially sophisticated investors have added a very small number of households to the definition.[116] So, in its current form, the accredited investor standard draws a regulatory divide between the investments of the wealthy and those of ordinary Americans.[117]

A final factor that contributes to the distinctions in the composition of wealth of wealthy and ordinary Americans is access. Regardless of whether regulatory obstacles exist that would formally exclude ordinary investors, wealthy individuals have access to social networks and investment advisors that can connect them to investment opportunities that ordinary Americans do not have.[118] Hedge fund managers have complete discretion over to whom they grant access to their funds.[119] Consequently, it can be very difficult for those without a personal connection to the fund to invest.[120] Private funds also have "minimum buy-ins," meaning that you can only invest if you are willing and able to invest a minimum amount.[121] Those minimums are almost always over $100,000 and can go well into the millions.[122] Without elite investment advisors or networks of wealthy contacts, many unaccredited investors would have difficulty locating these exclusive investments even absent the accredited investor standard. And, even if they could find these investments, they would often lack the wealth necessary to invest.

Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 362–63 (2013) (same).

116 *See* Amending the "Accredited Investor" Definition, Release Nos. 33-10824, 34-89669 (Aug. 26, 2020), https://www.sec.gov/rules/final/2020/33-10824.pdf [https://perma.cc/R8PD-GWFY] (noting that "the upper bound estimate" for how many new individuals will become accredited investors under the new definition is a 4% increase, representing 0.2% of the overall investing population).

117 This effect of the accredited investor standard has led Professor Usha Rodrigues to conclude that "government intervention has created an investing climate that lets the rich get richer, while the poor get left behind." Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389, 3389–90 (2013).

118 *See* Coryanne Hicks, *How to Find a Financial Advisor if You're Not Rich*, U.S. NEWS & WORLD REP. (Apr. 8, 2021), https://money.usnews.com/investing/investing-101/articles/how-to-find-a-financial-advisor-if-youre-not-rich [perma.cc/6UX8-MQAF]. The author of this Article worked as a bank teller in college and was instructed in that role to offer the bank's financial advisory services only to customers with sufficiently high account balances.

119 Joshua Kennon, *Investing in a Hedge Fund Can Be Difficult*, THE BALANCE, https://www.thebalance.com/investing-in-a-hedge-fund-can-be-difficult-357523 [perma.cc/8DUR-4QMC] (last updated Oct. 25, 2020).

120 *Id.*

121 *See id.*

122 *See id.*

While the accredited investor standard creates regulatory barriers to many investments for ordinary Americans, other more fundamental factors also explain why ordinary Americans' wealth is less diverse than that of wealthy families. Foremost, many American households simply lack adequate money to invest beyond the relatively fundamental necessities of purchasing a home and saving for retirement. Beyond that, even if they had adequate money, many Americans likely lack the personal connections, familiarity with investment options, and time to find other investment opportunities.

4. *Implications of Wealth Composition: Unequal Returns*

Wealthy and ordinary Americans differ in the quantity of wealth they own and the composition of that wealth. They also differ in the rate at which their wealth grows. Wealthy investors earn a greater per-dollar rate of return on their investments than less wealthy investors.[123]

This disparity in rate of return is tied to the different forms of wealth to which wealthy investors have access.[124] Wealthy households are much more broadly and deeply invested in the financial markets than ordinary American households.[125] Financial assets outside of retirement savings consistently earn a higher rate of return than other forms of wealth,[126] but for the

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123 *See* Wolff, *supra* note 2, at 57 tbl.11 (showing that the average annual rates of return on gross assets were greater for the top 20% than the middle three quintiles of the wealth distribution for all periods from 1983–2019). The same table shows the trend reversing for the rates of return on *net worth*, with middle class rates of return consistently exceeding those of the top 20%. This is attributable to the much higher relative debt load of the middle class. *See id.* at 25; *see also* PIKETTY, *supra* note 41, at 545 ("[A]round the world, the largest fortunes (including inherited ones) have grown at very high rates in recent decades . . . significantly higher than the average growth rate of wealth.").

124 *See* Wolff, *supra* note 2, at 20–21 ("The differences [in rate of return among wealth groups] reflected the greater share of high yield investment assets like stocks in the portfolios of the rich and the greater share of housing in the portfolio of the middle class."); *see also* Robert M. Solow, *Thomas Piketty is Right*, *in* AFTER PIKETTY: THE AGENDA FOR ECONOMICS AND INEQUALITY 48, 56 (Heather Boushey, J. Bradford DeLong & Marshall Steinbaum eds., 2017) ("Income from wealth is probably even more concentrated than wealth itself because, as Piketty notes, large blocks of wealth tend to earn a higher return than small ones. Some of this advantage comes from economies of scale, but more may come from the fact that very big investors have access to a wider range of investment opportunities than smaller investors.").

125 *See* Wolff, *supra* note 46, at 91 (showing that 85% of the top 20% of U.S. households (by wealth) owned stocks directly or indirectly in 2013, while only 41% of the middle three quintiles owned stock).

126 *Id.* at 65 tbl.1 (showing that from 1983–2019 the rate of return on financial assets exceeded the rate of return on pension accounts and residential real estate in all periods except the financially turbulent decade from 2001–2010).

reasons described above, ordinary Americans rarely own financial assets besides their retirement savings.[127] Additionally, wealthy investors have access to financial advisors who may provide investment advice that allows them to invest more profitably than ordinary Americans.[128] So, the fact that wealthy Americans have access to a larger menu of income-producing assets makes them capable of growing their wealth at a faster pace than Americans of more modest means. And they can do so in a way that can make them "richer." That is, they are growing wealth that is not serving the basic needs of providing a home or a secure retirement. It is surplus wealth that can increase consumption in the short term and can be passed on to heirs in the long term.

This disparity in rate of return and wealth composition has important implications for inequality trends. It means there are two distinct but simultaneous mathematical forces that are preventing ordinary Americans from catching up with their wealthy counterparts: both the quantity of wealth held by the wealthy and their ability to grow that wealth at a faster rate than ordinary Americans.

For example, from 2016 to 2019, the average annual rate of return on defined contribution pension accounts in the United States was 7.45%, while the average annual rate of return on other financial assets was 9.34%.[129] The chart below compares how that disparity in rate of return would affect the total return, over twenty years, of a modest $100 monthly investment versus a more extravagant $10,000 monthly investment. At either rate of return, it is quite evident how invested wealth grows the wealth divide. But with the wealthy investor earning a higher rate of return, it grows much faster. At the higher rate of return, the wealthy investor's investment is 27% greater than it would be at the lower rate of return available for defined contribution retirement accounts.

127 *Id.* at 52 tbl.6 (showing that only 15.3% of the middle three quintiles of the wealth distribution own "[c]orporate stock, financial securities, mutual funds, and personal trusts").

128 PIKETTY, *supra* note 41, at 431.

129 Wolff, *supra* note 2, at 68 app. tbl.1.

	Monthly Investment	**20 Years at 7.45%**	**20 Years at 9.34%**
Ordinary Investor:	$100	$55,476	*Not available*
Wealthy Investor:	$10,000	$5,547,584	$7,039,025[130]

Given these dual forces affecting wealth accumulation, it is unsurprising that the bottom 80% of U.S. households have seen their share of wealth decrease consistently over the last forty years.[131] If wealthy investors are earning a higher rate of return on a larger stock of wealth, the gap between the wealthiest Americans and everyone else can only grow. As was discussed above, the bigger that gap grows, the harder it is to undo. And while disparate rates of return are only part of the story, they act as an accelerant to the growth of wealth inequality via invested wealth.

This section has described the differences in the composition of wealth owned by wealthy and ordinary Americans, the regulatory and extra-regulatory structures that create that divide, and the way those distinctions allow wealthy investors to grow their wealth faster than ordinary Americans. The following Part examines how the regulatory strategies applied to financial investments differ for exclusive and ordinary investments. To do so, it takes a closer look at two financial practices that exemplify this divide: retirement savings and short selling. It describes how these two practices, while not equally available to all Americans, are intertwined, and it explores the regulatory approaches applied to each.

II
REGULATING FINANCIAL WEALTH

A. Goals of Capital Markets and their Regulation

Before examining specific instances of regulating financial investment, it is worth examining the role that financial mar-

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130 Calculations made by compounding interest monthly on consistent monthly contributions over twenty years. U.S. Securities and Exchange Commission, *Compound Interest Calculator*, INVESTOR.GOV https://www.investor.gov/financial-tools-calculators/calculators/compound-interest-calculator [https://perma.cc/Q2NG-8FQ9]. The formula for this calculation is: Total = [P(1®/n)^(nt)] + [PMT × (((1 + r/n)^(nt) - 1) / (r/n))], where P = the principal investment amount (here, $100 or $10,000), r = the annual interest rate (here, .0745 or .0934), t = the time the money is invested (here, 20 years), n = the number of times that interest is compounded per unit t (here, 12 for monthly compounding), and PMT = the monthly investment (here, $100 or $10,000).

131 *See* Wolff, *supra* note 2, at 48 tbl.2.

kets play in the economy and the motivation for their regulation. The term "financial markets" refers to the markets where an array of financial products are traded.[132] The practices studied in this paper—retirement savings and short selling stocks—are largely confined to the capital markets, where stocks and bonds issued by companies are traded. In the United States, primary responsibility for regulating the capital markets lies with the SEC.[133] The SEC's tripartite mission is: "to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."[134] With this mission as a starting point, this Part explores what public benefit we hope to attain when regulating financial markets and, more specifically the capital markets.

1. *Function of Financial Markets*

The financial markets in the United States are large and complex.[135] They are an important part of the economy; however, the financial markets do not alone constitute the economy. The financial markets are separate from both the "real" economy where goods and services are made and sold and the personal sector of the economy comprised of individuals and households who make wages, buy things, and hopefully save for the future.[136] In a sense, the part of the financial markets known as the capital markets stands between companies and individuals, mobilizing the savings of individuals to fund business ventures so those businesses can provide jobs and products to individual participants in the economy.[137]

Ideally, this function of the capital markets should make all individuals in the economy better off because the businesses funded by the markets produce goods, services, and

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132 *See* JOHN ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION 23 (2016) ("[F]inancial *markets* [are markets] such as equity markets, bond markets, derivative and options markets, futures and commodity markets, and ancillary actors which facilitate the production and dissemination of information that enable markets to operate.").

133 The SEC was given this function by the Exchange Act of 1934. *See* Exchange Act of 1934, 15 U.S.C. § 78.

134 *About the SEC*, SEC, https://www.sec.gov/about.shtml [perma.cc/42JM-C6MR] (last updated Nov. 22, 2016).

135 Ben Winck, *Here are the 10 Biggest Stock Exchanges in the World, Ranked by Market Cap*, INSIDER: MARKETS INSIDER (June 19, 2020), https://markets.businessinsider.com/news/stocks/biggest-stock-exchanges-world-ranked-market-cap-nyse-nasdaq-trading-2020-6-1029325478 [perma.cc/P7MZ-67WG] (showing that the two largest stock exchanges in the world are the New York Stock Exchange and the NASDAQ, both of which are located in the United States).

136 ARMOUR ET AL., *supra* note 132, at 22.

137 *See id.* at 23.

jobs that can improve everyone's standard of living.[138] On top of that, individuals can save for the future by investing in stocks and bonds. If widespread benefits to individuals and households were not the ultimate goal, it would be difficult or impossible to make a normative argument in favor of capital markets. Surely, we should not as a society actively support markets if they only serve to multiply the benefits of a few. Rather, capital markets are deemed important because of their potential to spread prosperity broadly across the economy.[139]

Notwithstanding this broad, economy-wide goal of capital markets, the functions of these markets are often described more narrowly, with a focus on the efficient functioning of the market itself, rather than on the "real" economy outside the bounds of the capital markets. This narrower perspective often focuses on the concept of efficient capital allocation. That is, the idea that when there is money available in the economy to be invested, we want it to be invested in something productive.[140] Capital markets can facilitate efficient capital allocation by: (1) mobilizing capital from savers who have wealth available to invest; (2) allowing those savers to choose among possible projects in which to invest their savings; and (3) creating mechanisms to allow investors to monitor the performance of the businesses in which they are invested or may invest.[141] Monitoring allows investors to make informed decisions about where to spend their money. The hope is that if the capital markets succeed in doing these three things, available savings will flow to productive business ventures.

The implicit assumption underlying these market-focused goals is that if the capital markets achieve them, they will do a better job of providing widespread benefits to the broader economy. That is, good businesses will be funded, resulting in innovation and job creation that benefit all or most participants

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138 *See* E. GORDON & K. NATARAJAN, FINANCIAL MARKETS AND SERVICES 3 (10th rev. ed. 2016) ("It is the financial system which supplies the necessary financial inputs for the production of goods and services which in turn promote the well-being and standard of living of the people of a country."); EMILIOS AVGOULEAS, GOVERNANCE OF GLOBAL FINANCIAL MARKETS: THE LAW, THE ECONOMICS, THE POLITICS 4 (2012) ("The financial system provides a large number of critical functions . . . which are inextricably linked with the welfare of modern economies and day-to-day life.").

139 *See* SHILLER, *supra* note 1, at 8–9.

140 Jeffrey Wurgler, *Financial Markets and the Allocation of Capital*, 58 J. FIN. ECON. 187, 188 (2000) ("A fundamental job of the economy is to allocate capital efficiently. To achieve this, capital is supposed to be invested in the sectors that are expected to have high returns and be withdrawn from sectors with poor prospects.").

141 *See* ARMOUR ET AL., *supra* note 132, at 22.

in the economy. If and when this is true, efficient markets become a means by which the ends of widespread economic prosperity can be achieved. However, as will be discussed below, the relationship between efficient markets and widespread prosperity is complicated by growing wealth inequality. Nonetheless, financial market *regulation* most often takes aim at these narrower, intermediate goals of improving the capital markets' allocative efficiency.

2. *Goals of Capital Market Regulation*

The SEC is not the only entity whose regulatory reach impacts the capital markets. However, its mission reflects widely acknowledged goals of financial and capital markets regulation.[142] The latter two parts of the SEC's mission—"maintaining fair, orderly and efficient capital markets" and "facilitating capital formation"[143]—directly reflect the market-focused goals discussed above. The first part of its mission, protecting investors, deviates from this focus on the market itself and acknowledges the potential vulnerabilities of individual investors. However, regulations aimed at protecting invest*or*s are usually really aimed at protecting invest*ments*, which limits the reach of any such protection for those with scarce resources to invest. Each of these regulatory goals is discussed in turn below.

a. *Protecting the Markets*

In the context of the capital markets, market efficiency (or, price efficiency) refers to investors' ability to accurately value a particular company and its plans for using capital raised in the markets.[144] This ability of the market to determine the price of a security is deemed a prerequisite for efficient capital allocation.[145]

In the capital markets, the price of a security is determined by the price investors are willing to pay for it. If investors have access to information about a company, they can make a good

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142 *See id.* at 52; MARC LABONTE, CONG. RSCH. SERV., R44918, WHO REGULATES WHOM? AN OVERVIEW OF THE U.S. FINANCIAL REGULATORY FRAMEWORK 3–5 (2020), https://fas.org/sgp/crs/misc/R44918.pdf [perma.cc/H964-HNKW]. There are a number of other oft-cited goals, such as fraud prevention and consumer protection, but these are less relevant to the capital markets-focused analysis herein.

143 *About the SEC*, *supra* note 134.

144 Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 383 (1970) ("A market in which prices always 'fully reflect' all available information is called 'efficient.'").

145 *Id.* ("In general terms, the ideal is a market in which prices provide accurate signals for resource allocation . . . .").

estimation of what to pay for that company's securities. This will create demand among investors for the securities of valuable companies, pushing the prices of their securities up. Fewer investors will want to buy the securities of less valuable companies, pushing the prices of those companies' securities down. If markets are efficient, investors are able to accurately decide how much they are willing to pay for a security based on the information they have. Because this will make the price of valuable companies go up, it means more money will flow to more valuable companies while less money flows to less valuable companies.[146] In this way, we hope capital is allocated efficiently; that is, we hope that our capital markets fund promising, quality-of-life-enhancing businesses and innovations.[147]

When regulation focuses on market efficiency, it is attempting to protect the functioning of the market, which should serve as a means to achieve the ultimate goal of widespread prosperity. Rules aimed at improving market efficiency seek to ensure that investors can monitor company performance and make informed decisions about what to pay for financial assets, as well as ensure that money flows to the correct companies and the markets are liquid. A great deal of market-focused regulation is directed at ensuring that investors have the information they need to set this capital allocation mechanism in motion.[148] Indeed, some scholars argue that this is the only desirable function of capital market regulation.[149] A regulatory focus on maximizing market efficiency implies a belief that if the financial markets function well, they will provide greater benefits to the broader economy.

b. *Protecting Investors*

Investor protection was a fundamental motivation for adopting the securities law framework that governs many aspects of the U.S. capital markets today.[150] When regulation focuses on investor protection, it strays somewhat from a straightforward focus on ensuring that the market is function-

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146 *See* Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 721 (2006).

147 Once a company has raised money, and its securities are trading only in the secondary market, market efficiency can serve to facilitate trading and allow investors to monitor company managers. *See id.*; Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 1013 (1992).

148 *See* ARMOUR ET AL., *supra* note 132, at 62.

149 *See* Goshen & Parchomovsky, *supra* note 146, at 713.

150 *See* Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1, 9 (1983).

ing efficiently and instead considers whether the individuals participating in the market are treated fairly.[151] Investor protection is not unrelated to optimizing market functioning. If there were no rules to protect investors, they might not invest their money, and then there would be less capital to allocate.[152] However, investor protection is also motivated by a desire to protect the investors' investments by reducing the likelihood that they are exploited when participating in the markets.[153] This is particularly true when the investors are deemed to be unsophisticated or of limited financial means.

Investor-protective regulation relies heavily on disclosure as a regulatory tool.[154] The idea underlying this strategy is to ensure that investors have all the information they need to evaluate and understand their investments. In this way, this type of regulation aims to ensure that participants in the market do not take on risks they do not understand. To improve the reliability of these disclosures, the U.S. capital markets regulatory regime also provides for public and private enforcement when disclosure is false or misleading.[155] Another tool of investor-protective regulation is placing legal duties on those who provide advice to investors and threatening liability to those who lead investors astray.[156] These regulatory strategies seek to ensure investors understand the risks they are taking to prevent vulnerable investors from unwittingly losing their investments. Thus, this type of investor protective regulation is primarily directed at investors who have limited knowledge of or familiarity with the capital markets. This more often describes ordinary investors than wealthy ones. With less

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151 *See* ARMOUR ET AL., *supra* note 132, at 55.

152 Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, Public Statement by Commissioner: Investor Protection is Needed for True Capital Formation: Views on the JOBS Act (Mar. 16, 2012), https://www.sec.gov/news/public-statement/2012-spch031612laahtm [perma.cc/6GNX-QBLD] ("True capital formation and economic growth require investors to have both confidence in the capital markets and access to the information needed to make good investment decisions.").

153 *See* ARMOUR ET AL., *supra* note 132, at 55.

154 *Id.* at 62.

155 *See* Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (2021); Securities Act of 1933 § 11, 15 U.S.C. § 77k.

156 *See* Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 736–39 (2010) (discussing the history of debate on the fiduciary duties of investment advisers); *see also* Robert J. Jackson Jr., Comm'r, U.S. Sec. & Exch. Comm'n, Statement on Final Rules Governing Investment Advice (June 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd [perma.cc/WPY8-6YMU] (discussing the SEC's most recent rulemaking with respect to the fiduciary duties of investment advisers).

wealth, ordinary investors have less experience investing, and they lack the means to pay for specialized investment advice.

In a way, a regulatory focus on protecting unsophisticated investors' investments relates to the distribution of wealth. Given the little wealth that most Americans have to invest in the capital markets, and the centrality of savings to economic security, effective investor protection reduces the likelihood that investors of modest means lose what wealth they do have. If we think that absent investor protection the wealthy would more often exploit the less wealthy, investor protection may even be mildly redistributive in that it prevents one potential flow of wealth from the less wealthy to the wealthier. However, as will be discussed in more detail below, the extent of this distributive function is limited because it does not protect ordinary investors from market and regulatory structures that maintain and grow the wealth divide.

The motivations of protecting investors and protecting markets are not entirely distinct concepts. If investors stood a substantial chance of being exploited in the capital markets, fewer people would invest. A lack of capital is not good for the markets. Similarly, investors benefit from the opportunity to participate in liquid, efficient and well-functioning markets. Investing in securities would be a much riskier proposition if investors were not confident that they could easily sell them when they wanted to, or that the price they paid reflected the value of the security. So, the line between these two categories of regulatory motivations is penetrable.

The following section describes two financial practices that are not equally available to wealthy and ordinary investors: retirement saving and short selling stock. The subsequent sections will explore how the regulatory priorities described above are applied to each practice.

B. Case Study: Retirement Savings and Short Selling

Wealthy American households and ordinary American households participate in the financial markets in very different ways. These differences in investment portfolios create differences in returns on investment, which accelerate the growth of economic inequality in the United States.[157] This Article begins to explore the role financial regulation plays in advancing these troubling trends. To do so, it examines the regulation of two specific financial practices: retirement savings and short

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157 *See supra* section I.B.3.

selling. This pair of financial practices is but one of many examples of the divide between the financial wealth of the wealthy and that of ordinary Americans.[158] A close examination of any such practice would likely illuminate the relationship between financial regulation and inequality. This Article takes a first step into this inquiry by focusing on short selling and retirement savings because they provide a unique example of where the financial wealth of ordinary Americans and that of wealthy Americans intersect.

1. *Retirement Savings*

As discussed above, retirement saving is the primary avenue through which middle class Americans invest in the financial markets. Employer-sponsored retirement plans are the most important means for providing income for retired Americans given that social security benefits only replace 35% of a household's pre-retirement income.[159]

There are two primary categories of employer-sponsored retirement plans: defined benefit plans and defined contribution plans. Defined benefit plans are the types of retirement plans most often referred to as "pensions." Employers offering defined benefit plans pay their retired employees a predetermined payment while the former employee is retired.[160] Because the amount of the payments is guaranteed, employers are the investors for these plans and the employers therefore bear the investment risk.[161] The employer sets aside funds to make pension payments, invests that money, and is responsible for making up the difference if available funds are inadequate to make all promised pension payments.[162] While

[158] An underinclusive list of financial practices that are disproportionately available to wealthy investors includes: private equity, venture capital, and any number of hedge funds. *See* SEC, *Updated Investor Bulletin*, *supra* note 105.

[159] BROWN, SAAD-LESSLER & OAKLEY, *supra* note 83, at 2, 4. Approximately one-third of American households have non-employee-sponsored individual retirement accounts. However, these households overwhelmingly also have employee-sponsored defined contribution or defined benefit savings. They are also wealthier than the households without IRAs. Thus, employee-sponsored retirement savings remain the first line of defense (after social security) for retirement security for most American households. U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2011, at 360 tbls.552 & 553 (2011), https://www2.census.gov/library/publications/2010/compendia/statab/130ed/tables/11s0552.pdf [https://perma.cc/S74V-R37M].

[160] PATRICK PURCELL & JENNIFER STAMAN, CONG. RSCH. SERV., RL34443, SUMMARY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA) 3 (2009).

[161] *Id.*

[162] *Id.*

widespread before the 1980s, defined benefit plans have been declining in number since then.[163]

Today, the most prevalent type of employer-sponsored retirement plan is a defined contribution plan.[164] A defined contribution plan provides an individual account for each participating employee. Employers that choose to provide this type of plan will offer some portion of their employees the right to participate in a defined contribution retirement plan.[165] (These plans are often colloquially referred to as 401(k) plans in reference to the section of the tax code that grants many defined contribution plans special tax status.[166]) If the employee chooses to participate, she will contribute a portion of her salary to the plan, and in some cases the employer may provide additional contributions. The employee then has a menu of options for where she can invest the money.[167] Generally, the options consist of a limited variety of mutual funds invested in bonds and equity.[168] The benefits available to be paid out at retirement are a function of the amount of money contributed to the account and any investment gains or losses on the balance in the account. So, for defined contribution plans, the individual employees are the investors, and they bear the risk of loss.[169]

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163 *Id.* at 3–4. Several reasons are cited for the increasing popularity of defined contribution plans and the declining popularity of defined benefit plans: (1) global competition makes companies more cost-conscious; (2) a mobile work force prefers the portability of defined contribution plans; (3) ERISA funding requirements made defined benefit plans more expensive; (4) I.R.C. § 401(k) made defined contribution plans more appealing. *Id.* at 4.

164 In 2018, 46,869 employer-sponsored retirement plans were defined benefit and 675,007 were defined contribution. EMP. BENEFITS SEC. ADMIN., PRIVATE PENSION PLAN BULLETIN HISTORICAL TABLES AND GRAPHS 1975–2018, at 1 tbl.E1 (Jan. 2021), https://www.dol.gov/sites/dolgov/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf [https://perma.cc/NYR5-9GMB].

165 *See* Matt Bell, *9 Steps to Make the Most of Your 401(k)*, SOUND MIND INVESTING (March 26, 2021), https://soundmindinvesting.com/articles/view/9-steps-to-make-the-most-of-your-401k [https://perma.cc/8UUS-UVWV] (observing that only 27% of workers eligible for a 401(k) participate).

166 *See* I.R.C. § 401(k).

167 Sometimes the employer will match a portion of that contribution. *See* Bell, *supra* note 165.

168 JACK VANDERHEI, SARAH HOLDEN, LUIS ALONSO & STTEVEN BASS, EMP. BENEFIT RSCH. INST., ISSUE BRIEF NO. 436, 401(K) PLAN ASSET ALLOCATION, ACCOUNT BALANCES, AND LOAN ACTIVITY IN 2015, at 24 fig.22 (Aug. 3, 2017), https://www.ebri.org/docs/default-source/ebri-issue-brief/ebri_ib_436_k-update.pdf?sfvrsn=7187292f_0 [https://perma.cc/38CA-3KWT] (showing that most 401(k) plans consist only of "equity, bond, money and/or balanced funds," with a minority of plans providing additional options); Bell, *supra* note 165 (noting that the average 401(k) plan offers 15 investment choices).

169 PURCELL & STAMAN, *supra* note 160, at 3.

The mutual funds available in defined contribution retirement plans are created and managed by an outside investment manager with which the employer contracts. These outside investment managers are in the business of pooling the invested money of many individuals.[170] As defined contribution accounts have increased in popularity, large investment managers that provide the funds in which retirement savers invest have grown in prominence.[171] These companies, such as BlackRock, Vanguard, Fidelity and State Street, manage trillions of dollars of Americans' retirement savings, which are invested through mutual funds, largely in stocks and bonds.[172] As will be discussed below, these large pools of retirement savings are an important resource for short sellers.

2. *Short Selling*

Short selling stock is a practice by which an investor can make money on a company's failure rather than its success. Generally, an investor will short a company's stock if they think the price of that stock is going to fall in the future.[173] While short selling may be relatively unfamiliar to the average retirement saver, short sellers hold billions of dollars of short positions on any given day.[174]

The mechanics of short selling involve selling a share of stock that the investor does not actually own.[175] To do this, a short seller must find someone willing to lend their shares. The

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170 *See* Emily Winston, *Managerial Fixation and the Limitations of Shareholder Oversight*, 71 HASTINGS L.J. 699, 717 (2020).

171 *See id.* at 717–18.

172 *See* BlackRock, Inc., Annual Report (Form 10-K), at 6 (Feb. 28, 2020) ("BlackRock is among the world's largest managers of pension plan assets with $2.6 trillion, or 67%, of long-term institutional AUM managed for defined benefit, defined contribution and other pension plans for corporations, governments and unions at December 31, 2019."); *About Fidelity*, FIDELITY INVS., https://www.fidelity.com/about-fidelity/our-company [https://perma.cc/3VN9-8X5K] (last visited Feb. 22, 2021) (stating that Fidelity manages employee benefit programs for over 22,000 businesses and holds $10.4 trillion in customer assets).

173 Joshua Kennon, *The Basics of Shorting Stock: A Beginner's Guide for How to Short Stocks*, THE BALANCE, https://www.thebalance.com/the-basics-of-shorting-stock-356327 [https://perma.cc/9F5M-3QV5] (last updated May 13, 2021) ("Short stock trades occur because sellers believe a stock's price is headed downward.").

174 *See, e.g.*, *Largest Short Interest Positions on 6/30/2020*, MARKETBEAT https://www.marketbeat.com/short-interest/ [https://perma.cc/YM79-UGED] (last visited July 22, 2020) (showing close to $100 billion in short positions on June 30, 2020).

175 FRANÇOIS-SERGE LHABITANT, HANDBOOK OF HEDGE FUNDS 126–127 (2006). The author describes a direct method for shorting stock. *Id.* Investors can achieve a similar financial result using futures or options contracts—processes known as "synthetic shorts." Although those practices are not the topic of this Article, the

short seller pays a willing lender a fee to borrow shares of stock and agrees to return them at some future date.[176] The short seller then sells the borrowed shares of stock and buys them back at the end of the loan period.[177] If, as the short seller hopes, the price of the stock goes down, they are able to buy the shares back at a lower price than the price at which they had sold them. The difference between the high price at which they sold the shares and the low price at which they bought them back (less the lending fee) is the short seller's profit from this transaction.[178]

There are a number of ways to invest in short selling. Most prominently, hedge funds engage in short selling.[179] Some, known as short-only funds, do so as their primary investment strategy. These funds will actively seek out companies that they believe are overvalued and short their stock in an attempt to profit from the eventual fall in price.[180] Other hedge funds use short selling as part of a more complex investment strategy.[181] As discussed above, ordinary Americans are excluded from investing in hedge funds due to lack of access and the accredited investor standard.[182] However, there are opportunities to invest in short selling for those who do not meet the requirements to be an accredited investor.

A special category of mutual funds, called liquid alternative funds, engage in many financial practices that are usually the province of hedge funds, including short selling.[183] These al-

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way in which the availability of synthetic shorts affects short selling regulation is discussed in section III.D *infra*.

176 LHABITANT, *supra* note 175, at 127.

177 *Id.*

178 Kennon, *supra* note 173.

179 Molk & Partnoy, *supra* note 114, at 846.

180 *See, e.g.*, *Short Only*, TRADEWIND CAP., http://tradewindcapital.eu/index.php/shareclasses/ [https://perma.cc/3FG9-CJUU] (last visited Feb. 22, 2021) ("Stocks are selected on the basis of expected poor relative or negative returns . . . .").

181 *See* Eric Bank, *Hedge Fund Strategies (Part 5)—Hedged Equity Short Selling*, ERIC BANK BLOG (Apr. 24, 2011), https://ericbank.com/hedge-fund-strategies-part-5-hedged-equity-short-selling/ [https://perma.cc/V7C6-Y6YM] (discussing the different hedging strategies involving short selling that hedge funds employ).

182 *See supra* section I.B.3.

183 *See* Anita K. Krug, *Investors' Paradox*, 43 J. CORP. L. 245, 247 (2018) (describing a liquid alternative fund as "a mutual fund that pursues investment and trading strategies that are similar in many respects to the types of strategies pursued by hedge funds, private equity funds, and other types of privately-offered funds") (footnotes omitted); *id.* at 262 (stating that liquid alternative funds can short securities); *see also ProShares UltraShort Consumer Services*, PROSHARES, https://www.proshares.com/funds/scc_index.html [https://perma.cc/3MK6-J8UW] (describing an exchange traded fund that invests in short positions).

ternative funds are structured to meet the legal requirements to be available to all investors, regardless of whether they meet the accredited investor standard.[184] Thus, there are no regulatory barriers to ordinary investors participating in short selling via liquid alternative funds. However, these funds will rarely be among the limited investment options available in an employer-sponsored retirement plan.[185] So, in most cases, investors would need to be investing money other than their retirement savings to participate in these funds and, as was discussed above, very few ordinary Americans have adequate savings to invest in financial assets other than through their retirement accounts.[186]

Finally, ordinary Americans can, in theory, participate in short selling individually. One need not be an accredited investor to do so because short selling is not technically an investment. It is a trading strategy that can be applied to publicly traded securities. An individual wishing to sell securities short must employ a broker that can lend her shares. A number of popular online brokers facilitate short selling for ordinary investors.[187]

Notwithstanding the lack of an accredited investor requirement to short sell, it is unlikely that many ordinary Americans participate in this practice. The constraints of lack of wealth and lack of access to intermediaries create a barrier for many ordinary Americans.

Because short selling securities requires borrowing the securities before selling them short, investors must open margin accounts to engage in short selling.[188] Federal regulations re-

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184 Krug, *supra* note 183, at 251.

185 *Id.* at 276–78 (noting that the lack of advice available to investors when making retirement account investment decisions will inhibit investors' ability to effectively utilize opportunities to invest in liquid alternative funds). In addition to this lack of advice, fiduciary obligations placed on retirement plan managers may make it unlikely that plan managers will make these alternative funds available to investors in a given employer-sponsored plan. *See infra* subpart II.C.

186 *See supra* section I.B.1.

187 *See Trading FAQs: Order Types*, FIDELITY, https://www.fidelity.com/trading/faqs-order-types [https://perma.cc/YW2R-YSRV] (last visited Feb. 22, 2021); Peter Klink, *Shorting a Stock: Seeking the Upside of Downside Markets*, TD AMERITRADE: THE TICKER TAPE (Oct. 15, 2019), https://tickertape.tdameritrade.com/trading/short-selling-basics-shorting-a-stock-17047 [https://perma.cc/3V7G-HUNP]; *Short Selling Explained: Trading Strategies*, ALLY FIN. INC. (Mar. 1, 2017), https://www.ally.com/do-it-right/investing/short-selling-explained-trading-strategies/ [https://perma.cc/HED8-CCWT].

188 *See, e.g.,Margin Investing: A Guide for Vanguard Brokerage Clients*, VANGUARD 13 (2019), http://vanguard.com/pdf/margin.pdf [https://perma.cc/7DQA-2GSS] (describing how an investor must be approved for a margin account before engaging in short selling).

quire that a margin account have a minimum balance of $2,000[189] and that the balance must always equal 150% of the current value of the shorted securities.[190] So, short selling, even small amounts, requires an investor to have a minimum of $2000 cash on hand, plus more if the price of the stock rises before they close out their short position. Even if a non-wealthy investor had adequate cash on hand and found her way to a brokerage firm, she may not be sufficiently familiar with short selling to inquire about the practice.[191]

These days, it is not difficult for ordinary investors to find their way to online brokers. Indeed, the COVID-19 pandemic led to a surge of interest in stock trading among ordinary Americans.[192] However, recent events appear to confirm that short selling remains a practice reserved for wealthy investors. In January 2021, a populist uprising among ordinary retail investors caused a sudden spike in the stock price of the ailing retailer GameStop.[193] The investors driving the unprecedented rally in GameStop stock were inspired by a desire to cause financial losses for short-selling hedge funds.[194]

The exclusion of many ordinary investors from short selling may not be a bad outcome, given the enormous risk involved. When you purchase a share of stock, your potential losses are limited to the price you paid for the share. When you short a share of stock, your losses have no limit because there is no theoretical limit to how high the price of the stock could go once

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189 FINRA Manual, Rule 4210(b) (2021) https://www.finra.org/rules-guidance/rulebooks/finra-rules/4210 [https://perma.cc/9ZLM-CB77].

190 12 C.F.R. § 220.12(c) (2020).

191 *See infra* note 293.

192 *See* Stephanie Yang, *The Pandemic Turned My Parents into Day Traders*, WALL ST. J. (Oct. 23, 2020), https://www.wsj.com/articles/the-pandemic-turned-my-parents-into-day-traders-11603488582 [https://perma.cc/LWV9-HCVH] ("The ranks of amateur day traders have swollen this year, helping to create a record number of new accounts at brokerages like Charles Schwab and TD Ameritrade."); Sydney Ember, *The Boredom Economy*, N.Y. TIMES (Feb. 20, 2021), https://www.nytimes.com/2021/02/20/business/gamestop-investing-economy.html [https://perma.cc/P65F-LBK4] ("Investing as a way of coping with pandemic boredom has also fueled an amateur day-trading boom more broadly. New accounts at online brokers like E-Trade, Charles Schwab, and Robinhood exploded.").

193 *See* Tory Newmyer, Douglas MacMillan, and Hamza Shaban, *Congress Presses Robinhood CEO on Company's Role in GameStop Stock Frenzy*, WASH. POST (Feb. 18, 2021), https://www.washingtonpost.com/business/2021/02/18/gamestop-robinhood-citadel-roaring-kitty-hearing-live-updates/ [https://perma.cc/42B7-GRNF].

194 Matt Phillips & Taylor Lorenz, *'Dumb Money' Is on GameStop, and It's Beating Wall Street at its Own Game*, N.Y. TIMES (Feb. 25, 2021), https://www.nytimes.com/2021/01/27/business/gamestop-wall-street-bets.html [https://perma.cc/3HPN-RBDE].

you have borrowed it and sold it short.[195] If the price of the stock rises instead of falling, the investor must pay the new, higher price to buy back the shares when the lending period is over. If the price rises a lot, the investor can lose a lot, as did a couple of hedge funds that were shorting GameStop in January 2021.[196] Any such extraordinary losses would be difficult or impossible for most Americans to bear.

3. *Connection*

This Article uses short selling as a case study because it is a financial practice disproportionately available to the wealthy that bears an important connection to the retirement savings of ordinary Americans. Large-scale short selling would be much more difficult without the retirement savings of ordinary Americans. Defined contribution retirement savings are among the biggest sources of shares for lending to short sellers.[197]

As was discussed above, large investment managers such as BlackRock, State Street, Fidelity, and Vanguard hold large quantities of shares for defined contribution retirement savers. Retirement savings are invested for the long term[198] and are often invested in index funds, which do not engage in active

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[195] A simplified example: If you buy a share of stock for $50 and the company loses 100% of its value, you lose $50. If you short a stock that is currently trading at $50, you borrow the share and then sell it for $50. You now have $50 of cash. You shorted the stock because you thought the price would go down, but it might instead go up. If the price of the stock goes up, and it is trading at $200 on the day you need to return your borrowed share, you now have to pay that $200 in order to be able to return your borrowed share. You have now lost $150 (the $200 you paid for the share less the $50 you made when you sold it). In this way, losses from short selling can far exceed losses from purchasing a share of stock. In addition, a real-life transaction would involve a lending fee, and the share lender would likely require collateral to ensure the share is returned.

[196] Juliet Chung, *Melvin Capital Lost 53% in January, Hurt by GameStop and Other Bets*, WALL ST. J. (Jan. 31, 2021), https://www.wsj.com/articles/melvin-capital-lost-53-in-january-hurt-by-gamestop-and-other-bets-11612103117 [https://perma.cc/88P2-LC7H].

[197] Viktoria Baklanova, Cecilia Caglio, Frank Keane &&Burt Porter, *A Pilot Survey of Agent Securities Lending Activity*, U.S. SEC. & EXCH. COMM'N 7 tbl.3 (Aug. 2016), https://www.sec.gov/files/Porter_PilotSurveyAgentSecuritiesLendingActivity.pdf [https://perma.cc/5DFK-UBFE] (showing that the group titled "Pension Funds and Endowments" was the largest lender of securities during the studied period in 2015).

[198] LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 123 (2012) ("[M]ost stocks are held either by individuals with long-term investing goals (like saving for retirement . . .), or by institutions like pension funds and mutual funds that run portfolios on behalf of these individuals.").

trading.[199] Thus, retirement account shares that are managed by investment managers are often available for lending.[200] And, indeed, investment managers do lend out these shares. In fact, it is an important aspect of their business model. For example, at the end of 2019, BlackRock had $290 billion of loaned securities outstanding.[201]

Investment managers charge fees for lending shares, and these fees constitute revenues for the investment manager. For example, in 2019, BlackRock reported $617 million in revenue from its securities lending practices.[202] The income from those fees can be passed on to the retirement savers whose shares were lent. The extent to which this revenue is passed on to the saver varies among investment managers, but the percentage that is passed on is almost always over 50% and sometimes close to 100%.[203] When investment managers pass these fees on to retirement savers, it increases the retirement savers' savings, either by reducing the fees the savers pay to the investment managers or by increasing the balance in their retirement accounts.

Thus, these two financial practices, while very different, are intertwined and mutually beneficial. Short sellers rely on the existence of concentrated pools of retirement savings to provide a supply of shares available for lending. Retirement savers, in turn, can save a bit more if they share in the benefit

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[199] Dawn Lim, *Index Funds Are the New Kings of Wall Street*, WALL ST. J. (Sept. 18, 2019), https://www.wsj.com/articles/index-funds-are-the-new-kings-of-wall-street-11568799004 [https://perma.cc/3CQY-FZKG].

[200] Baklanova, Caglio, Keane & Porter, *supra* note 197, at 7 tbl.2 (showing that "Pension Funds and Endowments" had $2.5 trillion of securities available for lending during the studied period in 2015).

[201] BlackRock, Inc., *supra* note 172, at 10; *see also* State Street Corp., Annual Report (Form 10-K), at 123 (Dec. 31, 2020) ("The aggregate amount of indemnified securities on loan totaled $440.88 billion . . . as of December 31, 2020 . . . .").

[202] BlackRock, Inc., *supra* note 172, at 46; *see also* State Street Corp., *supra* note 201, at 128 (showing $356 million in revenue from securities finance for the fiscal year ending December 31, 2020). Note, however, that BlackRock's $617 million in revenue from share lending represents only 4% of their $14.5 billion in total revenue reported in 2019. BlackRock, Inc., *supra* note 172, at 32, 46. BlackRock's revenue from share lending represents a much, much smaller percentage of the $7.4 *trillion* in assets that BlackRock was managing at the end of 2019. *Id.* at 2.

[203] Adam McCullough, *Our Take on Why Securities-Lending Risk is Overblown*, MORNINGSTAR (Jan. 17, 2019), https://www.morningstar.com/insights/2019/01/17/securities-lending [https://perma.cc/6QMC-WU7R] (showing that all studied investment managers pass substantial percentages of their lending fees on to the investors in the funds they manage, that, in particular, Vanguard passes over 90% of the fees onto the investors in its funds, and that BlackRock passes between 69% and 78%, depending on the type of security).

from lending fees.[204] As is discussed further below, this mutual benefit combined with the distinct regulatory approaches applied to these two practices gives the outward appearance that only good comes from these interrelated practices. However, a closer look illuminates how these two practices and their regulation contribute to the growth of wealth inequality.

The remainder of this Part explores the motivations behind the regulation of both retirement savings and short selling. Part III will explore how these regulatory motivations can contribute to the capital markets' role in accelerating wealth inequality.

C. Regulation of Retirement Accounts: Protecting Investors

The primary source of law governing retirement savings in the United States is the Employee Retirement Income Security Act of 1974 ("ERISA").[205] As the title of this law suggests, it focuses on protecting the investments of retirement savers. Specifically, ERISA protects savers in private-sector employee benefit plans, including the defined contribution retirement plans discussed herein.[206] Because of its connection to the employer-employee relationship, ERISA is largely enforced by the United States Department of Labor ("DOL"). The DOL is, of course, guided by a different mission than the SEC. However, in the context of retirement savings, the DOL's mission to "promote . . . the welfare of wage earners . . . and retirees" aligns with the SEC's regulatory goal of protecting investors.[207]

ERISA was passed in response to employee losses from poorly managed pension accounts in the 1950s and 1960s.[208] As employer-sponsored retirement plans grew in popularity in the mid-twentieth century, instances of mismanagement also grew.[209] When employers mismanaged retirement accounts, employees found themselves empty-handed upon retire-

204 However, the additional savings are very minimal. *See infra* section III.A.2.

205 Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001–1461 (2021).

206 ERISA also covers private sector defined benefit plans, *see* PURCELL & STAMAN, *supra* note 160, at 3–4, but these plans are not the subject of this paper for the reasons described in section II.B.1 *supra*.

207 *About Us*, U.S. DEP'T OF LABOR, https://www.dol.gov/general/aboutdol [https://perma.cc/HTP5-AHWM] (last visited July 3, 2021) (stating that the DOL's mission is "[t]o foster, promote, and develop the welfare of the wage earners, job seekers, and retirees of the United States; improve working conditions; advance opportunities for profitable employment; and assure work-related benefits and rights").

208 PURCELL & STAMAN, *supra* note 160, at 2.

209 *Id.*

ment.[210] Consequently, Congress adopted ERISA in 1974. ERISA utilizes an array of tools in its effort to protect employee retirement savers who participate in employer-sponsored retirement plans ("plan participants").[211] This discussion focuses on the aspects of the law that implicate plan participants' interaction with the capital markets.

A primary regulatory tool of ERISA, as is common when unsophisticated investors are potentially involved, is disclosure.[212] The statute attempts to protect the interests of plan participants by requiring several types of disclosure, including a plain language description of how the retirement plan works[213] and periodic statements of the saver's balances and rights under the plan.[214] These are measures designed to increase savers' understanding of their investments and related risks.

ERISA also places fiduciary responsibilities on those who are responsible for the management and operation of retirement plans.[215] The employer adopting the plan must name at least one person to serve as a fiduciary and manage the retirement plan.[216] But anyone who, in practice, exercises control or authority over the plan is also deemed a fiduciary under the law.[217] These fiduciary responsibilities include a duty of loyalty, which is a duty to discharge the fiduciary's responsibilities in the interest of and for the exclusive purpose of providing benefits to plan participants.[218] Part of the duty of loyalty includes defraying the reasonable expenses of administering the plan, which includes assessing the reasonableness of any fees

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210 *Id.* ("After the Studebaker automobile company terminated its underfunded pension plan in 1963, leaving several thousand workers and retirees without the pensions that they had been promised, Congress began considering legislation to ensure the security of pension benefits in the private sector.").

211 For a complete summary of the many employee protections contained in ERISA, see *id.* at 6–57.

212 *See id.* at 7–10.

213 29 U.S.C. §§ 1021(a)(1), 1022(a) (requiring that participants be furnished with a "summary plan . . . written in a manner calculated to be understood by the average plan participant"); Richard J. Link, Annotation, *What Documents Constitute "Summary Plan Descriptions" Under Employment Retirement Income Security Act (29 U.S.C.A. §§ 1001 et seq.)*, 124 A.L.R. Fed. 355 (1995) ("Employers who set up employee-benefit plans governed by [ERISA] . . . are required to provide each participant in the plan with a summary plan description . . . in plain language . . . .").

214 29 U.S.C. § 1025(1)(a) (requiring that the administrator of a plan regularly provide participants with a "pension benefit statement").

215 *See* PURCELL & STAMAN, *supra* note 160, at 24–32.

216 29 U.S.C. § 1102(a)(1).

217 29 U.S.C. § 1002(21)(A).

218 29 U.S.C. § 1104(a)(1).

charged in investing the plan assets.[219] This makes funds that engage in share lending to short sellers more attractive because the lending fees lower the cost of investing.

Fiduciaries are also required to act with prudence in managing the plan assets, meaning that the plan manager must take steps to ensure she is acting with care and not subjecting savers to unnecessary risks.[220] The prudence requirement may lead plan managers to exclude from the plan funds that use risky investment strategies, such as short selling. Plan managers are also statutorily required to diversify the plan assets across investments.[221] This generally means that "fiduciaries should not invest an unreasonably large proportion of a plan's portfolio in a single security, in a single type of security, or in various securities dependent upon the success of a single enterprise or upon conditions in a single locality."[222] As a consequence of these fiduciary rules, plan managers mostly select pooled, diversified investment funds, and in turn that is where retirement savers invest their savings.[223] So, ERISA not only protects retirement investors by requiring disclosure so that savers can understand what they are investing in, but also by imposing fiduciary duties to reduce the baseline risk for all plan participants. Some protection is built in even if savers do not read or understand the disclosure.[224] One result of this investor-protective framework is that retirement savings are funneled into mutual funds that can be sources of share lending for short sellers.

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219 PURCELL & STAMAN, *supra* note 160, at 25.

220 29 U.S.C. § 1104(a)(1)(B); *see* Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1983) (discussing the prudent person test) ("[A]t the time they engaged in the challenged transactions, [the fiduciaries] employed the appropriate methods to investigate the merits of the investment and to structure the investment.").

221 29 U.S.C. § 1104(a)(1)(C).

222 PURCELL & STAMAN, *supra* note 160, at 26.

223 *See* DELOITTE, THE RETIREMENT LANDSCAPE HAS CHANGED—ARE PLAN SPONSORS READY?: 2019 DEFINED CONTRIBUTION BENCHMARKING SURVEY REPORT 16 (2019), https://www2.deloitte.com/us/en/pages/human-capital/articles/annual-defined-contribution-benchmarking-survey.html [https://perma.cc/9GXA-64N8] (listing the "top 10 investment option offerings," many of which include pooled, diversified investment funds); *see also* BRIGHTSCOPE & INV. CO. INST., THE BRIGHTSCOPE/ICI DEFINED CONTRIBUTION PLAN PROFILE: A CLOSE LOOK AT 401(k) PLANS, 2017, at 37 (Aug. 2020), https://www.ici.org/pdf/20_ppr_dcplan_profile_401k.pdf [https://perma.cc/ZS34-TXLN] (showing that equity and bond funds are the most common investment options in 401(k) plans).

224 *See* Intel Corp. Inv. Pol'y Comm. v. Sulyma, 140 S. Ct. 768, 773 (2020) (acknowledging that plan participants do not always read their disclosures by declining to find "actual knowledge" by the plaintiff employee at the time he received disclosure).

The regulation of private retirement savings in the United States—the most commonly-held financial assets among ordinary Americans—falls squarely within the "investor protection" category of financial regulations. And, as discussed above, this can affect the distribution of wealth. If ERISA's protections keep retirement savers from losing their retirement savings, that has a distributional impact in that it keeps the saver from losing their share of the national wealth. That said, the distributional impact of this investor-protective regulation is limited in a number of ways.

First, ERISA does not require that every employer provide any type of benefit plan to its employees.[225] If it did, of course, we would not have approximately 50% of working age Americans without retirement savings.[226] Rather, ERISA requires that if an employer chooses to provide a retirement plan for its employees, it must also comply with ERISA in its administration of the plan. This protective regulation does very little to remedy the fact that most Americans have inadequate retirement savings. And the protections do not reach Americans who lack retirement savings. This is a recurring limitation of any financial regulation, a limitation that is considered again in subpart III.D below.

Second, this investor-protective regulation does not change the fact that earning a return on retirement savings does not create more disposable wealth today. It does not increase the standard of living of the saver. It is not intended to be passed on to heirs and secure family wealth across generations. It is, instead, intended to help the saver maintain their standard of living in retirement.

Finally, this investor-protective regulation does not reduce the disparity in rate of return earned by ordinary versus wealthy investors. In fact, it probably has the opposite effect, for two reasons. First, it creates opportunities for wealthy investors to earn higher average returns by making shares available for short selling. Second, it lowers the risk to which retirement investors are exposed thereby lowering their rate of return. In financial markets, taking on less risk usually means accepting a lower rate of return. That is not to say that reducing the risk to which retirement savers are exposed is bad policy. It is not. Investors with minimal wealth usually should

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225 PURCELL & STAMAN, *supra* note 160, at 1. However, the Internal Revenue Service grants tax deductions and deferrals to encourage employers to provide retirement plans for their employees. *Id.*

226 *See* sources cited *supra* note 87.

not be exposed to a substantial risk that they will lose that limited wealth, at least not unknowingly. But, protecting retirement investors from risky investments will, inevitably, usually have the effect of lowering their average rate of return.

The investor-protective regulation of retirement savings is grounded in a highly defensible policy goal. Nonetheless, its capacity to reduce economic inequality by helping ordinary Americans accumulate wealth is substantially limited.

D. Regulation of Short Selling: Protecting (and Expanding) Markets

An important starting point for a discussion of the regulation of short selling is the application of the accredited investor standard. As discussed in section I.B.3 above, the accredited investor standard creates a regulatory barrier between ordinary investors and the most prominent vehicle for engaging in short selling—hedge funds. The accredited investor standard and its application to short selling aims to protect investors. As was mentioned above, short selling is an extremely risky financial practice because an investor engaging in short selling can potentially lose much more than what they invest in the transaction.[227] Thus, the partial application of the accredited investor standard to short-selling hedge funds serves to shield many ordinary investors from exposure to this risk.[228]

Once past the accredited investor hurdle, the regulation of short selling is largely directed at protecting the markets. The line demarcating when short selling is and is not permissible has shifted over the years, and debates around where that line should be drawn have focused on how short selling affects the health of the capital markets. Specifically, these debates have focused on maximizing short selling's contributions to market efficiency and liquidity while minimizing its contributions to market volatility and manipulation.[229]

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[227] *See supra* note 187 (describing the possibility of significant loss from short selling).

[228] Non-accredited investors can still engage in short selling through liquid alternative funds or as retail investors. *See supra* section II.B.2. Investors in liquid alternative funds are beneficiaries of certain investor protective regulations. *See* Krug, *supra* note 184, at 247 (describing the regulatory constraints on liquid alternative funds).

[229] *See* Douglas M. Branson, *Nibbling at the Edges—Regulation of Short Selling: Policing Fails to Deliver and Restoration of an Uptick Rule*, 65 BUS. LAW. 67, 69–72 (2009).

With the exception of one brief period in 2008,[230] short selling has never been banned outright in the United States because of its perceived—and empirically documented—contribution to market efficiency.[231] Short sellers who primarily engage in short selling as an investment strategy will attempt to find overvalued companies with problems that the rest of the market has not yet identified. This is how these short sellers make money. The market has priced the securities too high because it does not yet know about the problems. Once the market becomes aware of the problems, the price falls, and the short seller profits. If, in seeking these profits, short sellers do uncover previously unknown information about a company, this new information benefits the entire market because it makes the prices of assets in the market more accurate.[232]

A well-documented example is the short seller Fahmi Quadir's bet against the pharmaceutical company Valeant in 2015.[233] Valeant was engaged in a complex scheme of corruption and fraud when Quadir shorted its stock in 2015.[234] At the time she executed the transaction, Valeant's stock was trading at around $257 per share.[235] As its fraud was exposed, the stock price fell to $28 eight months later.[236] The fund for

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230 *SEC Halts Short Selling of Financial Stocks to Protect Investors and Markets*, U.S. SEC. & EXCH. COMM'N (Sept. 19, 2008) https://www.sec.gov/news/press/2008/2008-211.htm [https://perma.cc/SHC4-KW6P].

231 *See, e.g.*, Pedro A.C. Saffi & Kari Sigurdsson, *Price Efficiency and Short Selling*, 24 REV. FIN. STUD. 821, 823–24 (2010) (showing that when stocks are not available to lend out for short sellers, price efficiency is negatively impacted); Ekkehart Boehmer & Juan (Julie) Wu, *Short Selling and the Price Discovery Process*, 26 REV. FIN. STUD. 287, 287 (2013) ("We show that stock prices are more accurate when short sellers are more active."); Gregory J. Clinch, Wei Li & Yunyan Zhang, *Short Selling and Firms' Disclosure of Bad News: Evidence from Regulation SHO*, 4 J. FIN. REPORTING 1, 1 (2019) ("As informed traders, short sellers enhance the informativeness of stock prices . . . ."); Amiyatosh Purnanandam & H. Nejat Seyhun, *Do Short Sellers Trade on Private Information or False Information?*, 53 J. FIN. & QUANTITATIVE ANALYSIS 997, 997 (2018) ("We find that shortselling activities are considerably informative about future stock returns when there is a higher likelihood of private information in stocks . . . .").

232 *See* Letter from Fahmi Quadir, Founder & CIO, Safkhet Cap. Mgmt., to Jean-Pierre Bussalb, Head of Short Selling Section, Bundesanstalt für Finanzdienstleistungsaufsicht [Federal Financial Supervisory Authority] (Mar. 15, 2019), https://img1.wsimg.com/blobby/go/14c124c6-8b4b-4fce-aa5b-4fc04834d 828/downloads/Safkhet%20Capital%20to%20BaFin%20on%20Short %20Sale%20Ban.pdf?ver=1553002904959 [https://perma.cc/QQ4E-8PZD].

233 Safi Thind, *"I Make Money by Finding Companies that Exploit People." The Woman Shaking Up Wall Street*, SQUARE MILE (Feb. 7, 2020), https://squaremile.com/features/fahmi-quadir-dirty-money-interview/[https://perma.cc/7Z2H-JHRN].

234 *Id.*

235 *Id.*

236 *Id.*

which Quadir was working made an enormous amount of money off of this bet. But her research also brought to light the extent of Valeant's wrongdoing, a benefit for the financial markets and beyond.[237]

A primary policy justification for permitting short selling is therefore to reap these efficiency benefits.[238] Short selling is also sometimes believed to contribute to market liquidity because it increases the number of shares being bought and sold in the market.[239] When considering how much short selling should be allowed, the SEC weighs these potential benefits against the potential negative impacts on the market. Foremost among potential negative effects are concerns about volatility in the form of large, disruptive swings in stock prices.[240] When the market becomes aware that short sellers are shorting a company's stock, other investors may sell, accelerating the price decline. The market may overreact to this signal, causing drastic swings in the stock price. Another concern is that opportunities to profit from falling stock prices can create incentives for short sellers to make false claims about problems at a company or engage in other manipulative practices.[241] These bad faith short sellers reduce market efficiency by spreading false information or otherwise manipulating the market. We see these concerns inform the SEC's reasoning when developing its regulatory strategy for short selling.

The first regulation of short selling in the United States was adopted in 1934.[242] It was a reaction to the stock market crash

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237 *Id.; see also Dirty Money: Drug Short* (Netflix documentary series broadcast Jan. 26, 2018) (describing Quadir's short selling of Valeant stock).

238 James S. Chanos, *Short Sellers Keep the Market Honest*, WALL ST. J. (Sept. 22, 2008), https://www.wsj.com/articles/SB122204250955761325 [https://perma.cc/P8KH-YKDD] ("We need the shorts in the market for balance so that we don't have bubbles." (quoting former SEC Chairman Christopher Cox)); Branson, *supra* note 229, at 72 ("Short sellers' transactions help bring prices into line with levels supported by those of the corporate issuers and the market's fundamentals . . . .").

239 Amendments to Regulation SHO,Release No. 34-61595 75 Fed. Reg. 11,232, 11,235 (Mar. 10, 2010) (to be codified at 17 C.F.R. pt. 242)242).

240 Charles R. Schwab, *Restore the Uptick Rule, Restore Confidence*, WALL ST. J. (Dec. 9, 2008), https://www.wsj.com/articles/SB122878208553589809 [https://perma.cc/PGR8-XWPH].

241 *See, e.g.*, Elisabeth Braw, *The Temptation for Cyber Attackers to Become Short—Sellers*, FIN. TIMES (Jan. 5, 2021) https://www.ft.com/content/59949478-65e1-45bd-8c24-873c241cd3f1 [https://perma.cc/ZE5Y-LCYD] (describing how hackers could create a problem within a company and then profit from shorting the company's stock).

242 YANEER BAR-YAM, DION HARMON, VEDANT MISRA & JOE ORNSTEIN, NEW ENGLAND COMPLEX SYS. INST., REGULATION OF SHORT SELLING: THE UPTICK RULE AND MARKET STABILITY 4 (2010), https://static1.squarespace.com/static/5b68a4e4a2772c2a

in 1929 and the ensuing Great Depression, during which time short selling stock appeared to have accelerated the declines in already plummeting stock prices.[243] In response, the newly formed SEC adopted the "uptick rule."[244] The uptick rule mandated that short sales only be made on stocks whose prices were increasing or, if the price was declining, the sale needed to be made at a price higher than the last trading price.[245] This rule was designed to prevent investors from rushing to short stocks that were already crashing, thereby further accelerating the decline and contributing to volatility in the stock market.[246]

The uptick rule remained the only rule applicable to short selling until the SEC promulgated Regulation SHO in 2005.[247] The 2005 version of Regulation SHO did not change the uptick rule, but rather authorized a pilot study of the potential effects of repealing the rule.[248]

The study commissioned by the SEC in 2005 was designed to determine whether the uptick rule benefitted or harmed the functioning of the capital markets.[249] To do so, it temporarily suspended the uptick rule for a defined group of stocks. Suspending the uptick rule meant that short sellers could short these stocks even when their prices were already declining. The study then observed how removing the uptick rule restriction affected several measures of market health, including price efficiency, liquidity, volatility, and market manipulation.[250] Ultimately, the pilot study concluded that the uptick

206180a1/t/5c0849e64fa51af588758070/1544047078449/NECSISECreport Feb2010.pdf [https://perma.cc/V5C3-LQAX].

243 *Id.* at 3.

244 Rules for the Regulation of Short-Selling, 3 Fed. Reg. 213, 213 (Jan. 25, 1938).

245 *Id.*

246 Schwab, *supra* note 240 (describing the uptick rule as designed to "[limit] the ability of short sellers to manipulate stocks lower by piling on, driving the share price quickly down and quickly profiting from the downdraft they created").

247 *Key Points About Regulation SHO*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/investor/pubs/regsho.htm [https://perma.cc/XMR5-BRBF] (last updated Apr. 8, 2015); 17 C.F.R. § 242.200–204 (2020).

248 Order Suspending the Operation of Short Sale Price Provisions for Designated Securities and Time Periods, Release No. 50104 (July 28, 2004), 69 Fed. Reg. 48,032, 48,032 (Aug. 6, 2004). The 2005 regulation also implemented close-out requirements on short sales to address problems that had arisen from short sellers selling shares short before they had located a share to borrow, resulting in a failure to deliver. *See Key Points About Regulation SHO*, *supra* note 247.

249 Short Sales, Release No. 34-48709, 68 Fed. Reg. 62,972, 62,983 (proposed Oct. 28, 2003) (to be codified at 17 C.F.R. pts. 240, 242))("The pilot would enable us to study the effects of relatively unrestricted short selling on, among other things, market volatility, price efficiency, and liquidity.").

250 *Id.*

rule *had no significant impact on market behavior*, meaning the markets did not function better (or worse) without the uptick rule.[251] The SEC ultimately concluded this lack of effect on the market justified repealing the uptick rule entirely. It did so in July of 2007, creating more opportunities to short sell stock.[252]

In deciding to repeal the uptick rule, the SEC did not require a showing that removing the restriction would benefit the market. Rather, it only required a showing that the market would not be harmed.[253] Beyond citing this largely neutral result, the SEC reasoned that the markets had evolved since the implementation of the uptick rule in 1938 such that this restriction was no longer needed.[254] Further, it noted that investors wishing to take a short position on a stock had other options that were not subject to the uptick rule.[255] An investor can attain the financial result of a short sale without directly borrowing and then selling the share. This can be accomplished using futures contracts. Given this other route by which investors can take a short position, the SEC reasoned that removing the uptick restriction would "level the playing field" for investors seeking short positions.[256] Importantly, this does not refer to leveling the playing field between wealthy and

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[251] *See* Amendments to Regulation SHO, Release No. 34-61595, 75 Fed. Reg. 11,232, 11,236 (Mar. 10, 2010) (to be codified at 17 C.F.R. pt. 242)242)(summarizing the pilot study's findings that the uptick rule did not have significant impact on daily volatility, did not distort a security's price, did not affect liquidity levels, and did not affect price efficiency); *see also* Ekkehart Boehmer, Charles M. Jones & Xiaoyan Zhang, Unshackling Short Sellers: The Repeal of the Uptick Rule 20 (Nov. 11, 2008) (unpublished manuscript) https://www.researchgate.net/publication/265996935_Unshackling_short_sellers_The_repeal_of_the_uptick_rule [https://perma.cc/7FMA-LLTQ] (concluding that "the uptick rule has only modest effects on short selling activity, and in fact may improve liquidity and other market quality measures").

[252] Regulation SHO and Rule 10a-1, Exchange Act Release No. 34-55970, 72 Fed. Reg. 36,348, 36,348 (July 3, 2007) (to be codified at 17 C.F.R. pts. 240, 242) ("removing Rule 10a-1 and adding Rule 201 of Regulation SHO to provide that no price test, including any price test by any SRO, shall apply to short selling in any security").

[253] OFF. ECON. ANALYSIS, U.S. SEC. & EXCH. COMM'N, ECONOMIC ANALYSIS OF THE SHORT SALE PRICE RESTRICTIONS UNDER THE REGULATION SHO PILOT 56 (2007) [hereinafter SHORT SALE PRICE RESTRICTIONS], https://www.sec.gov/news/studies/2007/regshopilot020607.pdf [https://perma.cc/8YFC-WG9L] (concluding that removing restrictions on short selling "on balance has not had a deleterious impact on market quality or liquidity").

[254] Regulation SHO and Rule 10a-1, Release No. 34-55970, 72 Fed. Reg. 36,348, 36,351("[T]oday's markets are characterized by high levels of transparency and regulatory surveillance. These characteristics greatly reduce the risk of undetected manipulation . . . .").

[255] Short Sales, Release No. 34-48709, 68 Fed. Reg. 62,972, 62,984 (proposed Oct. 28, 2003) (to be codified at 17 C.F.R. pts. 240, 242)).

[256] Regulation SHO and Rule 10a-1, 72 Fed. Reg. at 36,350.

ordinary investors. Instead, it refers to leveling the playing field between (presumably wealthy) investors who want to short sell directly and those who use futures contracts to create what are often referred to as synthetic shorts.[257] The SEC reasoned that ensuring similar financial products are not subject to disparate regulation was consistent with its mandate of investor protection.[258] Thus, having failed to identify any market-health justification for expanding access to short selling, the SEC reverted to the investor protection branch of its tripartite mission and concluded that more investment opportunities are better for investors. Of course, because short selling is largely only available to wealthy investors, wealthy investors are the only beneficiaries of this expanded access, creating one more source of wealthy investors' higher rate of return.

Somewhat ironically, this repeal came just over one year before another historic market crash. Following the market crash in 2008, short selling of financial stocks was temporarily banned entirely out of fear that it would exacerbate the crash.[259] The 2008 market crash called into question the SEC's prior conclusion that short selling did not contribute to extreme movements in stock prices and that markets had fundamentally changed since 1938.[260] And so in 2010, the SEC adopted the "circuit breaker" restriction.[261] Inspired by similar concerns as the uptick rule but less restrictive, the circuit breaker restriction allows the short selling of stock whose price is falling unless its price has fallen 10% in one day, at which point short selling is not allowed.[262] The market crash of 2008 appears to have convinced the SEC that short selling could, in fact, harmfully contribute to market volatility.[263] But the SEC was not willing to return to the level of restriction that had been in place from 1938–2007. Instead, it adopted the less-stringent circuit breaker restriction.[264]

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257 LHABITANT, *supra* note 175, at 126–27.

258 Short Sales, 68 Fed. Reg. at 62,983("We believe that to the extent possible, consistent with investor protection, one market should not benefit over another because of regulatory differences.").

259 The ban on short selling lasted less than one month. *See* Louise Story, *A Debate as a Ban on Short-Selling Ends: Did It Make Any Difference?*, N.Y. TIMES (Oct. 7, 2008), https://www.nytimes.com/2008/10/08/business/08short.html [https://perma.cc/P628-SCKH] (noting that the ban, which commenced on September 19, ended on October 8).

260 *See* BAR-YAM, HARMON, MISRA & ORNSTEIN, *supra* note 242, at 3.

261 *See id.* at 10.

262 17 C.F.R. § 242.201 (2020).

263 *See* Amendments to Regulation SHO, Release No. 34-61595, 75 Fed. Reg. 11,232, 11,233 (Mar. 10, 2010).

264 *Id.* at 11,244.

In sum, short selling faced its highest level of restrictions from 1938–2007 via the uptick rule. Those restrictions were removed entirely for most of 2007–2010 (save a brief short selling ban in 2008). Since 2010, short selling has been subject to an intermediate level of restriction via the circuit breaker test. More short-selling opportunities have been available since 2007 than had been available in the prior seven decades because the SEC deemed this expanded access to be consistent with investor protection.

Regulatory motives diverge substantially when regulating ordinary investors' investments as opposed to those of the wealthy and well-connected. Retirement savings—the only way most ordinary Americans participate in the financial markets[265]—are regulated with an eye to reducing the risk to which savers are exposed. Short selling, an exclusive financial practice, is regulated with an eye not only to reducing the risk to which the markets are exposed, but also to expanding market opportunities. The following Part considers the distributive implications of these divergent regulatory motivations.

III
EVALUATION AND ALTERNATIVES

A. The Consequences of a Divergent Regulatory Approach

1. *The View from Within the Capital Markets: Unproblematic*

Capital market regulation focuses on protecting the investments of less-wealthy, less-sophisticated investors and maximizing the functioning of the capital markets. Regulators give scant explicit attention to how a given financial practice may affect the broader economy. The policy focus is instead based on an assumption that what is good for the capital markets is good for the entire economy. Indeed, there is substantial evidence to suggest that what is good for the capital markets can be good for the broader economy.[266] However, that is not al-

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[265] *See, e.g.*, Teresa Ghilarducci, *Most Americans Don't Have a Real Stake in the Stock Market*, FORBES (Aug. 31, 2020), https://www.forbes.com/sites/teresaghilarducci/2020/08/31/most-americans-dont-have-a-real-stake-in-the-stock-market/?sh=4f0a7d7b1154 [https://perma.cc/HR44-3K24] ("The latest available government data, via the Federal Reserve from 2016, shows a relatively small share of American families (14%) are directly invested in individual stocks but a majority (52%) have some market investment mostly from owning retirement accounts such as 401(k)s.").

[266] *See, e.g.*, WILLIAM C. DUDLEY & R. GLENN HUBBARD, HOW CAPITAL MARKETS ENHANCE ECONOMIC PERFORMANCE AND FACILITATE JOB CREATION 2 (2004), https://www0.gsb.columbia.edu/faculty/ghubbard/Articles%20for%20Web%20Site/

ways the case.[267] This means that thriving capital markets are a means that can, in the right circumstances, lead to the ends of a prospering economy. However, the markets are not the ends in and of themselves. A regulatory approach that focuses on the markets as the end regulatory goal will overlook the instances in which growth of the capital markets does not serve the broader economy.

One way in which growing markets could harm the broader economy is by contributing to growing economic inequality. And, indeed, in the United States in recent years, growing financial markets have coincided with growing economic inequality.[268]

Examining the regulation of retirement savings and short selling demonstrates that the well-being of the markets does guide financial regulation in the United States, particularly when regulating exclusive financial practices such as short selling. If the well-being of the markets were the appropriate end goal for capital markets regulation, the existing approach of regulating both retirement savings and short selling would seem to strike an appropriate balance and even address the potential for distributive inequities. The following description summarizes why.

How%20Capital%20Markets%20Enhance%20Economic%20Performance%20and%20Facilit.pdf [https://perma.cc/G4G8-EU4S] ("Our main thesis is that well-developed capital markets generate many economic benefits, including higher productivity growth, greater employment opportunities, and improved macroeconomic stability."); Geert Bekaert & Campbell R. Harvey, *Capital Markets: An Engine for Economic Growth*, 5 BROWN J. WORLD AFFS. 33, 33 (1998) (finding that capital markets are important for economic development); Rodrigo de Rato, Managing Dir., Int'l Monetary Fund, Speech at the 3d International Derivatives and Financial Market Conference: Economic Growth and Financial Market Development (Aug. 22, 2007), https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp082207[https://perma.cc/EB5Z-87YK] (emphasizing the importance of financial markets in emerging economies).

267 *See, e.g.*, Atif R. Mian, Ludwig Straub & Amir Sufi, *The Saving Glut of the Rich* 1 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26941, Apr. 2020), http://www.nber.org/papers/w26941 [https://perma.cc/U66C-RLM8] (finding that the accumulation of financial assets by rich households has not boosted investment, but rather has resulted in dissaving by the government and the rest of the household sector); *see also* Young Soo Lee, Han Sung Kim & Seo Hwan Joo, *Financialization and Innovation Short-termism in OECD Countries*, 52 REV. RADICAL POL. ECONS. 259, 259 (2020) (finding that "as financialization advanced, the radicalness of technological innovation declined"); Christopher Hartwell, *The Coevolution of Finance and Property Rights: Evidence from Transition Economies*, 51 J. ECON. ISSUES 73, 73 (2017) (finding that in economies transitioning from communism to capitalism, larger capital markets and financial sector wages negatively impacted the development of property rights).

268 *See infra* note 274.

Retirement savings are the predominant way in which ordinary Americans participate in the financial markets, and they are a very important factor for financial security after retirement.[269] Financial markets are complex and full of risks that can be difficult to understand, and those investors whose only exposure to the financial markets is their employer—sponsored retirement plan may not fully understand all the risks involved. For an investor of modest means, any losses sustained could have dire consequences for the investor's economic security and quality of life. Thus, we regulate retirement savings in an attempt to ensure: first that savers have all the information they need to make good choices, and second that those who manage retirement savers' money are doing so prudently and in a way that is designed to help the saver.

Short selling, on the other hand, is unavoidably risky. Our financial regulatory scheme largely (although not entirely) limits this practice to investors with adequate resources to cushion the blow from any losses. Despite the risk involved, U.S. regulators do not ban the practice because of the market benefits discussed above—price efficiency and liquidity.[270] Short selling regulation attempts to balance the efficiency and liquidity benefits with the volatility and manipulation costs. When the effect of more short selling on the markets is neutral, regulation favors increasing investment opportunities. Short selling provides a financial benefit to many retirement savers from the fees earned from share lending.[271] This can result in some retirement savers having more money—and therefore more economic security—at retirement than they otherwise would have.

So, viewed from within the borders of the capital markets, the United States' general regulatory approach to these practices seems reasonable. It protects the investments of more

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269 *See supra* section II.B.1.

270 And most regulators around the world do the same. *See, e.g.*, Alessandro Beber & Marco Pagano, *Short-Selling Bans Around the World: Evidence from the 2007–09 Crisis*, 68 J. FIN. 343, 343 (2013) (noting that most stock exchange regulators around the world reacted to the financial crisis by placing temporary bans on short selling, implying that short selling is allowed in these countries in normal market conditions); Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n, Opening Remarks at the UU.S. Securities and Exchange Commission Roundtable to Discuss Short Sale Price Tests and Short Sale Circuit Breakers (May 5, 2009), https://www.sec.gov/spotlight/shortsales/roundtable050509/shortsales-roundtable050509-transcript.txt [https://perma.cc/9ZST-PX9S] ("[L]egitimate short selling can provide tangible benefits such as improved liquidity and pricing efficiency.").

271 *See supra* note 172.

vulnerable investors and allows wealthy investors to engage in the highly risky practice of short selling so long as the markets are not harmed. However, when we step back and consider these practices in light of wealth inequality trends, this market-focused policy perspective appears incomplete; the means have been mistaken for the ends.

2. *The View from the Broader Economy: Problematic*

Economic literature supports the idea that creating more opportunities in the financial sector is good for the broader economy.[272] However, recent studies suggest that there is a point after which further financial development correlates with growing inequality.[273] Indeed, according to the International Monetary Fund's measure of "financial development," the United States' financial development has been growing in lock-step with its economic inequality since the 1980s.[274] What has been deemed good for the financial markets during this time period has therefore not translated into economic opportunity beyond the borders of the financial markets. So, we cannot assume that more opportunities in the financial markets will translate into widespread economic benefits.

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272 *See, e.g.*, *Financial Development*, THE WORLD BANK, https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-development [https://perma.cc/RRC9-P5T5] (last visited Feb. 23, 2021) (explaining that financial sector development fosters economic development); *Local Capital Market Development*, INT'L FIN. CORP., https://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/solutions/products+and§ervices/treasury-client-solutions/local-capital-market-development [https://perma.cc/UY36-S25U] (last visited Feb. 23, 2021) ("Deep, efficient local capital markets create access to long—term, local—currency finance, and are the foundation for a thriving private sector—the key driver of jobs and growth.").

273 Michael Brei, Giovanni Ferri & Leonardo Gambacorta, *Financial Structure and Income Inequality* 5 (Bank for Int'l Settlements, Working Paper No. 756, 2018), https://www.bis.org/publ/work756.pdf [https://perma.cc/2H8J-PSTA] (finding that "more finance . . . reduces income inequality but only up to a point. Beyond that point, income disparity rises if finance is expanded via market-based financing"); Michael Brei, Giovanni Ferri & Leonardo Gambacorta, *How Finance Affects Income Inequality*, VOXEU (Mar. 7, 2019), https://voxeu.org/article/how-finance-affects-income-inequality [https://perma.cc/R63T-L32K], (noting that "market-based financial development has been a driver of inequality in the financial systems of the common law countries").

274 *See* Financial Development Index Database, INT'L MONETARY FUND, https://data.imf.org/?sk=F8032E80-B36C-43B1-AC26-493C5B1CD33B [https://perma.cc/R9B5-9DV7] (last visited Feb. 23, 2021) (explaining the International Monetary Fund measure of financial development and linking to historical data for all countries, including the United States); GINI Index for the United States, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/SIPOVGINIUSA [https://perma.cc/RFW5-YEBS] (last visited Feb. 23, 2021); Chart (on file with author) (showing correlation between financial development and the GINI coefficient (a measure of inequality) in the United States).

Economists anticipate that the growing wealth inequality in the United States will have very adverse effects on future economic prosperity.[275] Most wealth in the United States is held in the form of financial assets, and retirement savings are the financial asset most commonly owned by ordinary Americans.[276] Regulation aimed at protecting investors may have the benevolent aim of protecting the wealth of the less wealthy, but it does not remedy the fact that the financial wealth of the wealthy tends to grow so quickly that ordinary investors may never catch up.

As was discussed in section I.B.3 above, wealthy American households not only have a lot more wealth than their less-wealthy counterparts, they also earn a higher rate of return on their invested wealth.[277] This creates two complimentary mathematical forces that entrench wealth disparities: wealthy investors not only earn returns on a larger pool of money; they also earn more per dollar invested. This Article focuses on the latter force. The higher average rate of return enjoyed by wealthy investors is attributable to the wider variety of financial investments available to wealthy American families.[278] More financial opportunities mean more opportunities to increase returns, and investment opportunities that are disproportionately available to the wealthy consistently earn a higher rate of return than retirement savings. Short selling is among those financial practices to which wealthy Americans have disproportionate access, and therefore it is likely a contributor to this disparity in rate of return and thereby the entrenchment of economic inequality.[279] So, when the SEC acts to allow more short selling (or any other exclusive financial practice) in the market, they are contributing to this disparity in rate of return.

A policy focus that considers only the well-being of the capital markets cannot account for this possibility. It acknowledges the potential market efficiency contributions of short selling and the potential for deeper or broader financial markets to increase the size of the economic pie. However, it ig-

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[275] *See supra* section I.A.2.

[276] *See* Wolff, *supra* note 2,, at 52 tbl. 6. Roughly 50% of working age Americans have no retirement savings. *See* BROWN, SAAD—LESSLER & OAKLEY, *supra* note 83, at 7. Over 70% of Americans have inadequate retirement savings. *See* MORRISSEY, *supra* note 85, at 6.

[277] *See* Wolff, *supra* note 2, at 21.

[278] *Id.*

[279] Importantly, this Article does not seek to prove that short selling specifically contributes to this trend. Rather, it serves as an example of how our current regulatory focus does not take into consideration the fact that it, and other similarly exclusive practices, may contribute to these troubling trends.

nores how pursuit of that efficiency and breadth can provide outsized financial gains to already wealthy investors, increasing disparities in how the pie is distributed. The current regulatory focus on market health creates more opportunities for wealthy investors to secure and grow their economic lead.

The SEC's actions in adopting and revising Regulation SHO demonstrate how this can happen. Between 2003 and 2010, the SEC twice considered the circumstances under which short selling should be prohibited. In both cases, the principle guiding their inquiry was that they should allow as much short selling as possible so long as the markets were not harmed. In both cases, there was little to no evidence that allowing additional short selling would improve the markets.[280] But, so long as the net benefit was not negative, in the eyes of the SEC, the amount of short selling should be maximized. The expanded availability of short selling also means expanded opportunities for wealthy investors to grow their already substantial wealth.

It is highly unlikely that this additional short selling that the SEC took pains to preserve facilitates widespread economic prosperity. Retirement savers will save a bit more from the additional share lending fees, but the economy-wide impact of these savings are minimal.[281] For example, in 2019, BlackRock managed $7.43 trillion in assets and made $617 million in revenue from securities lending.[282] This amounts to one dollar earned for every $12,000 BlackRock manages. BlackRock is estimated to pass approximately seventy cents of each of those dollars back to its investor clients.[283] Clearly, an added annual return of seventy cents per $12,000 invested is inadequate to close the gap in the rate of return earned by ordinary and wealthy investors. This is why the disparity in rate of return persists despite the nominal financial benefit available to ordinary investors.

Beyond this small direct financial benefit to ordinary investors, short selling can have positive effects on market health, which, in theory, can benefit the economy broadly. However, the SEC's inquiry into the matter suggested diminishing marginal benefits from increased access to short selling: the additional short selling that the SEC permitted via Regulation SHO

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280 *See supra* subpart II.D.

281 And there is no indication this benefit informed SEC decision-making around Regulation SHO.

282 *See* BlackRock, Inc., *supra* note 172, at 2, 46.

283 *See* McCullough, *supra* note 203.

was not shown to have any real effect on market efficiency or liquidity.[284] While having no discernable effect on market health, the additional short selling permitted by SHO did add more options to the wealthy investors' menu of financial practices—the menu that offers a higher rate of return on larger quantities of wealth. This higher rate of return works to entrench economic inequality, at tremendous cost to the economy. Capital markets, and their regulation, should promote broad economic prosperity. When the markets contribute to inequality, they impede broad economic prosperity. As the SEC's decision-making around Regulation SHO demonstrates, the current focus of financial regulation does not account for the ways in which the disparate availability of financial opportunities can accelerate the growth of wealth inequality. This omission comes at great economic cost.

3. *The Prevalence of this Divergence: A Regulatory Puzzle*

The divergence in regulatory objectives that exists between short selling regulation and retirement savings regulation exists throughout the market. The investments of ordinary investors—retirement accounts, mutual funds, publicly traded securities—are regulated with a substantial emphasis on protecting less wealthy, less sophisticated investors who are perceived as more vulnerable. However, these investments of small, unsophisticated investors will usually do little to improve market efficiency or liquidity. Most ordinary investors are well advised to invest in broadly diverse mutual funds that charge low fees.[285] Among the safest of these options are index funds which commit to invest in a diverse group of predetermined securities and do not engage in active trading.[286] Because these funds do not actively trade their securities, their contributions to market efficiency and liquidity are limited.[287] Moreover, if ordinary investors do engage in more active investing, it is usually going to be in small quantities,[288] meaning that extensive research into the value of companies will rarely

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284 *See supra* subpart II.D.

285 BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET: THE TIME-TESTED STRATEGY FOR SUCCESSFUL INVESTING 17 (12th ed. 2019) ("Investors would be far better off buying and holding an index fund than attempting to buy and sell individual securities or actively managed mutual funds.").

286 Winston, *supra* note 170, at 715 n.48.

287 As pointed out by Professor James Tierney, contributions to and withdrawals from index funds and exchange traded funds may, indeed, have market efficiency and liquidity effects.

288 A necessary consequence of the wealth divide.

be cost-efficient and any trades will do little to move the market price. Thus, ordinary investors' investments contribute much less to the market goals of efficiency and liquidity than the larger investments of more sophisticated investors.

Investments that are more exclusive to the wealthy and well connected, on the other hand, contribute more to market efficiency and liquidity. Active trading requires time, resources, expertise, and the financial wherewithal to withstand the increased risk. Wealthy investors are much more likely to have these characteristics, or they can afford to pay someone with these characteristics to manage their money. Because risky investments—hedge funds, derivatives, futures contracts—are largely available only to the already wealthy (and thus, it is presumed, the financially savvy), they are not regulated with an eye to protecting the investor from exploitation or unexpected loss. Instead, they are regulated under the guiding principle that more financial opportunities are better so long as the market is not harmed. Countless examples of such practices exist beyond short selling.

One such example is venture capital investing. Investors in venture capital funds make extraordinary returns a small percentage of the time. So, an investor can make a lot of money investing in these funds, but they have to be willing to lose their entire investment sometimes. Ordinary Americans are therefore largely excluded from venture investing by both the accredited investor requirement and a lack of access.[289] Activist funds are another example. These are hedge funds that take substantial positions in publicly traded companies and attempt to influence management so as to make the target company more profitable. Because they are private funds, ordinary Americans are barred from investing in activist funds by the accredited investor standard.[290] Though, even absent that regulatory barrier, few ordinary investors would have the financial resources to buy a stake in an activist fund.

Many other examples could be added to this list.[291] Besides being predominantly available to wealthy investors, these financial practices also have another important trait in common: they can all be justified on the grounds that they make

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289 *See supra* section I.B.4. *But see* Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 787 TENN. L. REV. 983, 984 (2020) (addressing policies surrounding the exclusion of retail investors from unicorn investments).

290 *See supra* note 105.

291 A few additional examples: high frequency trading, impact investing, private equity, and any securitized investment products.

the financial markets work better. Short sellers contribute to price efficiency, venture investors provide capital to risky ventures to drive innovation, and activist investors monitor corporate managers. These "market improving" practices require investors to take on substantial risk—risk that wealthy investors, by virtue of their wealth, are better positioned to bear. The consequence is a market structure that grants wealthy investors the responsibility to maintain market efficiency, and in turn rewards them with high investment returns, allowing them to multiply and entrench their already substantial wealth.

Thus arises a challenging regulatory puzzle. Protecting less wealthy investors means reducing the risk to which they are exposed. However, doing so leaves all the opportunities for above average returns in the hands of the already wealthy—a phenomenon that can feed the growth of inequality.

This Article focuses on two pieces of this puzzle—retirement savings and short selling—as a starting point for analyzing regulatory decisions on both sides of this divide. However, the broad divergence in regulatory motivations is not unique to these two practices, and further inquiry into other financial practices is warranted.

B. Existing Proposals: Expand Options for Ordinary Investors?

The fact that wealthy American investors have a larger menu of investments available to them, creating more opportunities for higher returns, is a widely recognized phenomenon.[292] To date, most proposals to address this problem have focused on expanding ordinary investors' access to investments. Several recent SEC rules have sought to increase ordinary Americans' access to investing in companies that are not registered with the SEC.[293] Recent changes to the accredited investor standard are motivated by this same concern.[294] A number of scholars have likewise noted, with concern, the disparity in investment opportunity and proposed solutions that would allow ordinary Americans access to more investment

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292 *See supra* note 124.

293 *See* Jay Clayton, Chairman, Sec. & Exch. Comm'n, Remarks to the Economics Club of New York (Sept. 9, 2019) ("Congress and the SEC have long sought to expand Main Street access to our private capital markets while preserving investor protection. Recent initiatives include (i) Regulation Crowdfunding, (ii) expanding Regulation A, and (iii) lifting the ban on general solicitation for Rule 506 offerings under Regulation D.").

294 Amending the "Accredited Investor" Definition, *supra* note 116.

options.[295] While many of these proposals are potentially beneficial, their impact on inequality trends is limited in a number of ways.

The original justification for limiting ordinary investors' access to unregistered investments is based on the fact that these exclusive investments carry additional risk. It is a largely unavoidable axiom of investment that an investor must take on more risk in order to make a greater return.[296] American families that have little wealth to spare and are struggling to save adequately for retirement are well advised to avoid risky investments.[297] To a family with little wealth to spare, a large investment loss could be economically catastrophic. This is an excellent policy motivation to prevent unsophisticated, non-wealthy investors from exposing their limited savings to extraordinary risk. Thus, complete equality of access to investment opportunities is not desirable.

Even with additional legal access to more investment opportunities, ordinary investors' lack of access to financial advisors and well—connected social networks would still work as barriers to many investment opportunities. So, ordinary investors will only be able to partially take advantage of any expanded access. With only partially expanded access, ordinary investors will only partially close the gap in rate of return. Moreover, the existing gap in wealth inequality means that ordinary investors have very little money to invest. So, those who do take advantage of expanded investment access will do so with a relatively small amount of money.[298]

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295 *See, e.g.*, Rodrigues, *supra* note 117, at 3430 (arguing that the general public should have greater access to the private securities market via mutual funds); Krug, *supra* note 183, at 247–48 (arguing that regulation should facilitate greater investment by retail investors in liquid alternative funds); Jasmin Sethi, *Another Role for Securities Regulation: Expanding Investor Opportunity*, 16 FORDHAM J. CORP. & FIN. L. 783,838 (2011) (arguing for expanding opportunities for wealth creation through investment); Houman B. Shadab, *Fending for Themselves: Creating a U.S. Hedge Fund Market for Retail Investors*, 11 N.Y.U. J. LEGIS. & PUB. POL'Y 251, 253 (82008) (proposing expanding access to hedge funds for sophisticated retail investors); So-Yeon Lee, *Why the "Accredited Investor" Standard Fails the Average Investor*, 31 REV. BANKING & FIN. L. 987, 987 (2012) (describing how private placement exemptions restrict investment by ordinary investors).

296 *See* GUY FRASER-SAMPSON, NO FEAR FINANCE: AN INTRODUCTION TO FINANCE AND INVESTMENT FOR THE NON—FINANCE PROFESSIONAL 111 (2011) ("[G]enerally, a higher return can be earned only at the expense of also accepting a higher level of risk.").

297 *See generally* MALKIEL, *supra* note 285 (advising ordinary investors to invest in broadly diversified passively managed mutual funds).

298 When the SEC recently expanded the definition of "accredited investor" to include some sophisticated but not wealthy investors, it noted that this change would have very little effect on the flow of capital to private companies. Amending

In light of these combined forces, even if access to more capital market opportunities could increase the average rate of return for ordinary investors, its impact on ordinary Americans' investments and therefore the wealth gap will be limited. Recall that there are two complimentary forces that work to entrench wealth disparities in the United States: the quantity of wealth held by the wealthy and their greater average rate of return on investments. Expanded access might lead to a slightly higher rate of return for ordinary investors. It could also expose ordinary investors to more risk of loss. Regardless, wealthy investors will still have more wealth and investment opportunities. This suggests that more changes are necessary to reduce the capital markets' contributions to wealth inequality trends. The following subpart describes another channel for addressing this regulatory puzzle.

C. A New Proposal: Fewer Options for Wealthy Investors

Given that limitations exist to the distributive effects of expanding ordinary investors' access to higher risk investments, this Article concludes that academics and policymakers must also take a look at the other side of the divide. That is, we should inquire whether wealthy investors have access to too many financial tools, rather than (or in addition to) asking whether ordinary investors have access to too few.

In February 2021, the SEC's Office of Investor Education and Advocacy tweeted: "Don't understand an investment? Don't invest in it."[299] Surely, that is prudent advice. However, if followed, it will substantially limit the investment options of many or most Americans, without the accredited investor standard. Many, or perhaps most, elite investment practices are not widely understood by those not in the finance profession.[300] In a 2018 survey, the Financial Industry Regulatory Authority (FINRA) found that, among investors with investments other than their retirement accounts, only 22% could correctly identify the definition of short selling in a multiple—choice question.[301] Given that only 15.3% of middle-class

the "Accredited Investor" Definition, *supra* note 116 ("[I]t is unlikely that these newly eligible investors will provide an additional, meaningful source of capital in most private offerings.").

299 @SEC_Investor_Ed, TWITTER (Feb. 13, 2021, 3:01 PM), https://twitter.com/SEC_Investor_Ed/status/1360680449413111811 [https://perma.cc/47P9-YRKT].

300 *See* FINRA INV. EDUC. FOUND., INVESTORS IN THE UNITED STATES: A REPORT OF THE NATIONAL FINANCIAL CAPABILITY STUDY 23 (2019).

301 *Id.*

Americans have financial investments outside their retirement accounts, it seems likely the vast majority of Americans do not know what short selling is.[302] This is not surprising, and the same could likely be said for a large number of "sophisticated" financial products and practices. Investors are well advised not to invest in products they don't understand, but expanding financial markets usually means expanding more complex, less widely understood practices. More elite investment options mean more disparity in rate of return. Fewer elite investment options mean less disparity in rate of return. This fact calls into question the "more is better" approach to capital markets regulation.

If limiting wealthy investors' exclusive investment opportunities is a worthy goal, the next inquiry is what regulators can do to facilitate this change. The history of Regulation SHO suggests a starting point.

1. *Application to Regulation SHO*

Considering whether wealthy investors have too many options is fitting when regulators face decisions about how much of a financial practice should be allowed in the market. That was precisely the type of decision the SEC faced when it considered the uptick rule when establishing and amending Regulation SHO. The SEC was not deciding whether to ban or allow short selling. It was deciding whether to remove a restriction and thereby make more short selling available in the market.

A study of the SEC's reasoning when eliminating the uptick rule and then re-establishing a less restrictive version demonstrates the extent to which it favors creating more financial opportunities. Its decision was guided by a desire to allow as much short selling as possible so long as it did not hurt the market. When the effect on the market appeared neutral, the regulatory impulse was to maximize the availability of this exclusive, risky financial practice by reducing the restrictions placed on it. This decision was in part due to the fact that the economic effect of short selling was available via other financial products.[303] While there is logic to that reasoning, such reasoning also facilitates the proliferation of exclusive, high-return financial practices. If the existence of exclusive practices elsewhere justifies the creation of new exclusive investment opportunities, there is virtually no stopping point.

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302 Wolff, *supra* note 2, at 49 tbl.6.

303 *See supra* note 255.

The broader regulatory perspective advocated herein would have resulted in maintaining the uptick rule. When the SEC's study of the matter concluded that removing the uptick rule would have *no discernable impact on market health*, the conclusion would be to leave the uptick rule intact. There would be no implicit presumption in favor of expanding the number of financial practices in the market. Rather, there would be an acknowledgement that short selling is disproportionately available to wealthy investors, that any increased access would disproportionately benefit wealthy investors, and that this would work to entrench harmful wealth inequality trends. When weighed against no discernable impact on the markets, the clear conclusion under this new perspective would be to maintain the uptick rule and not expand access to short selling.[304]

2. *Application Beyond Regulation SHO*

The decision-making process around Regulation SHO represents the easy case. There was no market benefit expected from expanding access to short selling. The lack of market harm was deemed good enough. When that neutral result is weighed against the dangers of wealth inequality, the analysis is straightforward. There are likely other instances where the SEC or other regulators have made or will make similar decisions guided by an implicit assumption that in the realm of financial markets, more is better.[305]

However, the analysis will be harder when increasing financial opportunities shown or believed to positively impact market health. At that point, under the new perspective, regulators would be faced with weighing the social good created by better functioning markets against the social harm created by perpetuating a driver of wealth inequality. It is likely impossible to precisely make that calculation.[306] And doing so would

[304] Just as implementing the original uptick rule and then partially reinstating it in 2010 erewere consistent with the SEC's mandate under the Exchange Act, maintaining the uptick would be as well. This revised perspective takes into consideration investor protection, market efficiency, and the public interest as required by statute. Exchange Act of 1934 § 13, 15 U.S.C. §§ 3(f), 9(d).

[305] The author did not choose Regulation SHO as a case study knowing in advance that the SEC's analysis showed a neutral impact on the markets. They discovered that during research for the project. This makes it seem more likely that other instances can be found of ties being broken in favor of creating more financial opportunities.

[306] *See* John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 888 (2015) ("[F]inance is at the heart of the economy; it is social and political; and is characterized by non—stationary relationships . . . . These features undermine the ability of science to precisely and reliably estimate the effects of financial regulations, even retrospectively.").

not fit well within the existing parameters of cost-benefit analysis in SEC rulemaking. Thus, obstacles remain before capital market regulation can consistently and effectively account for wealth inequality.[307] But those obstacles should not justify ignoring the inequality impacts of financial market structure and regulation. It simply means there is more learning to be done before we get it right.[308]

A regulatory view that focuses only on market health and market breadth assumes too much in terms of a large and healthy market's ability to foster widespread economic prosperity. Virtually every financial practice that is disproportionately available to already wealthy investors will also have the ability to exacerbate inequality trends. Entrenched economic inequality is inconsistent with the ultimate goals of financial markets and thus cannot be ignored if we are to attain those ultimate goals. The new regulatory perspective proposed herein would allow regulators to explicitly consider how unequal financial opportunities contribute to economic inequality.

D. Scope and Limitations of the Proposal

The new regulatory perspective proposed in the Article will not solve the problem of economic inequality. Economic inequality is a large problem that requires attention from a number of angles.[309] The proposals in this paper are directed at capital market regulation. Therefore, they will have no direct or immediate effects on the wealth of the many Americans who currently do not participate in the capital markets.

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307 As an independent agency, the SEC is not required to engage in formal cost—benefit analysis as part of its rulemaking activities. *See* Memorandum from Sec. & Exch. Comm'n, Div. of Risk, Strategy, & Fin. Innovation, and Sec. & Exch. Comm'n, Off. of the Gen. Couns.,., to Staff,Rulewriting Div. & Offs. 3 (Mar. 16, 2012), https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf [https://perma.cc/9LL7-DM63]. However, the D.C. Circuit, in reviewing SEC rulemaking, has consistently struck down or questioned SEC rules based on inadequate cost-benefit analysis, suggesting thatcost-benefit analysis is often required to withstand judicial scrutiny. *See* Richard L. Revesz, *Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation*, 34 YALE J. ON REG. 545, 565––70 (2017).

308 *See* George A. Akerlof, *Sins of Omission and the Practice of Economics*, 58 J. ECON. LITERATURE 405, 416 (2020) ("The norms regarding how economics should be done should call for flexibility of methodology—instead of insistence on methodological purity that might be perfect for some Important problems but leaves other problems and other approaches outside the domain of economic research.").

309 *See* Matteo Gatti & Chrystin Ondersma, *Can a Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera*, 46 J. CORP. L. 1, 10 n.39 (2020) (explaining that a multifaceted approach is required to address inequality).

Nonetheless, we need to understand the mechanisms of inequality entrenchment before we can hope to reverse it. Moreover, reducing the tendency of the financial markets to perpetuate wealth inequality matters. The financial markets are where most Americans who have savings invest for the future. Other tools may be necessary to achieve a more equitable distribution of wealth in the United States. But, once a family has the means to invest, the markets in which they invest should not work against any distributive gains. An economy that is sustainably fair requires financial markets that do not promote wealth accumulation among a lucky few.

CONCLUSION

A close examination of the regulation of retirement savings and short selling demonstrates how the usual policy framework for considering capital market regulation fails to consider economy-wide distributional effects. A policy perspective that stops at the borders of the capital markets will never be able to account for the fact that additional investment opportunities are also opportunities to entrench economic inequality. The harmful social effects of entrenched economic inequality make it imperative that academics and policymakers acknowledge that financial practices that provide a net benefit to the capital markets may nonetheless harm the economy by entrenching economic inequality. When regulators make decisions about how much of a financial practice to allow, this broader perspective will weigh against expanding access to financial products.