Speech

Mochas, Mariners, and Morality -- Remarks before the National Economists Club

Commissioner Hester M. Peirce

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Thank you, Cliff [Waldman] for that kind introduction. It is an honor to be among economists today. I am not sure why, but every time I speak to economists, I feel compelled to tell a joke. Maybe it is because the securities lawyers of which I am one and with whom I routinely surround myself can be a rather serious bunch. Instead of starting with jokes, they insist that we start our talks with the following disclaimer: The views I represent are my own and not necessarily those of the Securities and Exchange Commission or my fellow Commissioners. That duty done, I am going to tell my joke.

A beekeeper, an economist, and a plaintiff walk into a coffee shop. "What can I get you?" the barista asks the beekeeper. "I'll have a latte with honey," replies the beekeeper. "Done," says the barista, as he serves up a steaming cup of deliciousness. The barista then prepares a mocha with soy milk for the economist. "That will be $5.75, Ma'am," says the barista. "Wait, you didn't even ask me what I wanted," says the economist. "Doesn't matter" replies the barista, "You can assume it's whatever you want." The barista next quickly prepares the plaintiff's drink: a large coffee cup with just enough coffee to cover the bottom of the cup. "What happened to the rest?" demands the angry plaintiff. "Sorry, man, the class action lawyers already drank the rest."

We often tell corny jokes at the expense of lawyers, and rightly so, but I have a special fondness for jokes that take aim at both lawyers and economists, and not just because they are more efficient. I like that they juxtapose the unique characteristics of the two professions. The truth is that economists and attorneys have distinct skills and analytical tools that make it important for them to work hand-in-glove with each other. At the SEC, we have a large team of economists under the capable leadership

of S.P. Kothari who support our rulemaking and enforcement functions. They have been extremely helpful in honing our thinking in both realms. Economists are also important partners in analyzing difficult questions of a more fundamental nature—questions that are not specific to any particular rule or enforcement action. I want to raise three of these questions with you today. In soliciting your input, I am looking for thoughtful approaches that balance competing considerations with an eye toward achieving the *right* outcome, not necessarily the most expedient or convenient one.

My first question is: How much data is enough? One thing I have noticed about the economists with whom I work at the SEC is that they love data. I understand why. Economists can use data to finger fraudsters, determine where a regulatory threshold should be set, or assess the effect of a regulatory obligation. It is quite impressive to see the work our economists produce from the data they have more readily at their fingertips than ever before. Economists are not the only ones who find the data interesting; regulatory lawyers and examiners like it too because it can give them a better handle on the industry they oversee. As you might expect, then, our rulewriters and examiners ask for a lot of data.

The temptation to collect more data only grows with the sophistication of our analytical techniques and tools. Collecting data, however, is not free—not for us, not for the industry from which we collect it, and not for investors. Registrants that provide the data often incur very large direct costs to produce the data in the timeframe and at the frequency we require. They also may experience other kinds of costs if the data fall into the wrong hands. Form PF, for example, is the form that collects information as part of a post-crisis effort to get better insight into the activity of hedge funds and other private funds. The form takes a long time to complete. The data collected on that form are commercially sensitive, so concerns about the security of the data are real. There is also a question about how useful the data we collect on Form PF actually are to the SEC. Because filling out the form requires each firm doing the reporting to make judgment calls about what data are responsive to each field, data collected from one fund may not actually correspond to the data collected from other funds, which makes it difficult (or misleading) to conduct cross-industry analyses of the data. There are also inconsistencies between what funds have to supply to the Commodity Futures Trading Commission and what they have to supply to the SEC. It is also unclear whether the data are fit for purpose; Form PF is supposed to focus on the risk a fund poses to the financial system, but it collects a lot of data points that lack any real nexus to systemic stability.

Another example of the no-holds-barred drive for data is the Consolidated Audit Trail. The so-called CAT, which is not yet up and running, will collect data from brokers across the country and aggregate it in a data pool in which the SEC and other regulators can fish. The data pool will contain all transactions in our equity and options markets. As you can imagine, regulators and enforcement staff love such a rich

reservoir, but it is not cheap—the exchanges and brokers have already incurred huge expenses to get the CAT almost ready to launch and will continue to incur costs throughout the CAT's life; if cyberthieves break in, there will be additional costs to the investors' whose data are compromised; and, not least, there is the cost of eroded liberty, as the government monitors Americans' financial transactions.

Once we start down the road of collecting data, it is hard to rein ourselves in. So Form PF marches along unchanged, and the CAT wobbles to life without much change, aside from the potential elimination of some personally identifiable information. In the Rime of the Ancient Mariner, the poet Samuel Taylor Coleridge writes of the sea surrounding a ship full of thirsty sailors, "Water, water, every where, Nor any drop to drink."[1] In our world of data-hungry economists, this phrase becomes "Data, data everywhere, Nor any stops to think." Lest our quest for data haunt us as the hunt of the albatross did the mariner in Coleridge's poem, we ought to think carefully about how much data is enough.

My second question is somewhat related and is perhaps the flip side of the last: Given that better data are easier to come by, are there ways that we can look to academics and market participants to assist us in regulating markets? There already are natural incentives for market participants to monitor one another's actions. Think of the role that short sellers and other activist investors can play. One way we can enlist the help of others is to do a better job at making data available for people outside the agency to analyze. Whether it is improving the data about municipal issuers, increasing transparency about transactions in the fixed income markets, giving investors greater insight into financial institutions' balance sheets, or ensuring that brokers' customers can get information about how their orders have been executed, more data can be a powerful tool for market participants. Armed with the data, market participants are able to make better decisions. Even for some functions that are often found in regulatory hands, outside help can be beneficial.[2]

I have been a critic of post-financial crisis regulation that looks to regulators alone to identify and solve problems; no offense to any government economists in the audience, but lots of people working independently are better at identifying problems and generating solutions than a small group of regulators holed up in musty regulatory agencies in Washington, D.C. An important question for both lawyers and economists working in regulatory agencies is: How can we enlist the help of people outside of government in regulating the activities we are responsible for overseeing?

My third question relates to the advertised title of this talk, "Sustainable Morality." One of the big topics of conversation in the financial regulatory world these days is the role that regulators should play in fostering "sustainable finance." The motivating force behind this trend seems to be that finance has been too focused on raw dollars, and insufficiently focused on building a financial system that fosters a better, more sustainable society. Regulators are thinking about how they can force

financial firms to take into account environmental and social considerations as they allocate capital. I share the desire to build an economy that serves this generation and future generations well, but I disagree that such an economy will result from regulators taking on the role of stewards of morality. In fact, I think the opposite is true. Well-functioning financial markets are key to efficient resource allocation, which is key to economic growth, which is key to improving people's lives. The greatest beneficiaries of free financial markets are people whose lives are difficult. Sustainable morality is not morality dictated by a few powerful financial regulators, but morality that reflects the decisions and preferences of individuals throughout society. Free markets give expression to those decisions and preferences. My question for you is how can economists (and those of us who love them) do a better job of explaining the role that a free economy can play in improving people's lives, particularly the people who face the greatest deprivation and despair? In short, how can we best explain that sustainable morality does not require more government control of economic decision-making, but less?

Thank you all for listening to my questions. Now I am interested in hearing your answers to the questions I have asked or ones you think I ought to have asked. Economists are essential partners to lawyers not only in answering specific questions about rules and enforcement actions, but in asking and answering the big questions about how government should work. You can throw in a few jokes too.

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[1] Text of 1834 available at: https://www.poetryfoundation.org/poems/43997/the-rime-of-the-ancient-mariner-text-of-1834.

[2] Our whistleblower program is an example of how important such outside help can be. *See, e.g.*, Report Suspected Securities Fraud or Wrongdoing, https://www.sec.gov/tcr (last visited Dec. 12, 2019). *See also* Marcos López de Prado, Testimony before the Task Force on Artificial Intelligence of the House Committee on Financial Services (Dec. 6, 2019), https://financialservices.house.gov/uploadedfiles/hhrg-116-ba00-wstate-lopezdepradom-20191206.pdf (suggesting that outside data scientists could be enlisted to unravel discrete events like the Flash Crash).