Selling Hope, Selling Risk
Corporations, Wall Street, and the Dilemmas of Investor Protection

Donald C. Langevoort
Contents

Acknowledgments xi

Introduction 1

1. Myths and Skepticism 7
   The Human Dimension of Investing 10
   Investor Diversity 13
   Why Regulate? 15
   The Imaginary World of No Regulation 15
   Human Behavior and the Lemons Problem 16
      Publicness 17
      Disclosure 19
      Efficient Markets 20
      Algorithms 24
      (Over)confidence 26
   Deception, Self-Deception, and Honesty 27
   Regulatory Boundaries 28
   The Federal Government and the States 30

2. Making Sense of Corporate Fraud 33
   What Motivates Corporate Fraud? 35
   Cognitive Distortions and Slippery Slopes 35
   Scandals and Loss Aversion 37
   Confidence, Risk-Taking, and the Pathways to Power 38
   Strong Beliefs and Distorted Perceptions 38
   Testosterone and Risky Behavior 38
   Culture and Fraud 40
   Sue the Bastards 42
   The Awareness Conundrum 43
   Enron in the Courtroom 43
   Filtration and Deterrence 44
   Detection and Enforcement 45
   The SEC's Enforcement Record 45
   Madoff 46
   The SEC as Robo-Cop 47
   Fraud-on-the-Market Class Actions 48
The Class Action Debate 48
Who's Hurt and Why? 50
The Dilemma of Compensation 52
Deterrence 53
Half-Truths, Puffery, and Protective Disclosure 56
The Discourse of Disclosure 57
Puffery 57
Bespeaking Caution 60

3. The Insider’s Edge 62
Deception and Harm 63
Insiders, Thieves, and Knaves 66
Tips 70
Hedge Funds 73
Inside the Insider’s Brain 77
Fair Disclosure and the Race for Speed 82
The Political Economy of Insider Trading Regulation 85

4. The Partial Disinfectant of Sunlight 87
The Partiality of “Full Disclosure” 89
Directors, Lawyers, and Disclosure 90
Auditors 92
Psychologists’ Warnings 93
Reform 94
Internal Surveillance 96
Internal Controls: From Watergate to Enron 96
See All, Know All? 97
Whistle-Blowers 99
Analysts: Credibility, Bias, and Opportunism 100
Spitzer’s Crusade 101
Reform 102
Sunlight, Executive Pay, and Short-Termism 103
Self-Dealing 104
Executive Pay 104
Short-Termism 105
Shareholder Activism 107
Social Responsibility 108
Going (or Staying) Dark 111

5. Selling and Swindling 114
Internet Frauds and Ponzi Schemes 114
New Age Scams 114
Ponzi Schemes 116
Boiler Rooms 118