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From Guardians to Liabilities: Rethinking Gatekeeper Accountability in Securities Regulation

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Abstract: This article examines the ongoing trust crisis facing gatekeepers in the securities markets, including credit rating agencies, auditors, and underwriters. Drawing on prominent case studies such as the 2008 subprime crisis and the Luckin Coffee fraud, it argues that structural flaws in the institutional design of gatekeeping—particularly the economic dependency on issuers, short-term profit incentives, and market monopolization—have compromised the neutrality and reliability of these intermediaries. Anchored in reputational capital theory, the article proposes a multi-dimensional reform strategy to restore gatekeepers' protective function. This includes restructuring the payment model, enhancing regulatory specialization, broadening market access, and improving transparency and whistleblower protections. By establishing a tripartite accountability framework among regulators, gatekeepers, and investors, the article offers both theoretical insights and practical recommendations to reinstate the gatekeepers' role as a credible safeguard for market integrity and investor protection.

Keywords: Gatekeepers; Securities regulation; Intermediary organization

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1. Introduction

Gatekeepers in the securities market serve as financial intermediaries between issuers and investors, ostensibly acting to safeguard investor interests. However, recent crises—including the collective misjudgment of subprime mortgage-backed securities by three major credit rating agencies during the 2008 global financial crisis, the dereliction of duty by auditing institutions in the Luckin Coffee accounting fraud incident of 2020, and the continuous rise in default rates for AA-rated bonds in China's bond market—reveal a harsh reality that the gatekeeper mechanism is mired in an unprecedented trust crisis. The roots of this crisis lie in structural contradictions within institutional design. First, the symbiotic relationship between issuers and gatekeepers undermines the neutrality of gatekeepers. Second, the imbalance between reputational capital and short-term

gains drives gatekeepers to abandon professional ethics under profit incentives [1]. Third, market monopolization weakens reputational discipline, enabling dominant institutions to externalize risks onto investors.

This article systematically analyzes the tripartite causes of the gatekeeper trust crisis and proposes solutions—including transforming regulatory approaches, reforming payment models, enhancing competition, and increasing transparency—to restore market confidence in gatekeepers and provide theoretical and practical pathways for reinforcing their accountability.

2. The role of gatekeepers

The key point of market regulation is to address information asymmetries and other market failures in order to promote market efficiency and efficient resource allocation. One of the main ways to address information asymmetries is through adequate information disclosure by issuers. In practice, intermediaries known as gatekeepers can address the information asymmetry dilemma by operating between investors and issuers. A gatekeeper is defined as a professional who can protect investors by providing them with verification services [1]. This definition is broad and covers intermediary service providers that are mandated by law to be used by issuers, as well as intermediaries that are not required by law. Generally, gatekeepers are regarded as financial intermediaries that operate between issuers and investors, and include auditors, underwriters, lawyers, securities analysts, and credit rating agencies (CRAs) [2]. Gatekeepers have access to more information from the general public about the development prospects of the issuer. When analyzes of this information leads to conclusions that are inconsistent with those disclosed by the issuer, the gatekeeper acts as a public protector by informing the public [3]. Although their job descriptions are different, they can both act as supervisor for the public to protect investors.

In the realm of securities markets, the theoretical foundation for gatekeepers' ability to resolve information asymmetry lies in the reputational capital model [1]. Under this framework, gatekeepers' provision of accurate information directly impacts their professional reputation and long-term viability. As posited by Coffee, gatekeepers face a rational choice calculus, namely, compromising reputational capital through deceptive conduct would expose them to legal liabilities and market ostracism, thereby eroding their competitive advantage [4]. Consequently, gatekeepers lack the incentive to sacrifice reputational integrity by colluding with issuers, as the cost of reputational decay outweighs short-term pecuniary gains. This deterrence mechanism ensures that gatekeepers' reports retain evidentiary value, as their institutional survival depends on maintaining credibility with investors.

3. Gatekeepers' failure

3.1. Link of interest

However, reputational capital theory does not function as effectively as it purports to. Its efficacy is premised on the assumption that the benefits gatekeepers derive from misconduct are outweighed by the potential costs of reputational damage and litigation risk [5]. Yet this model is overly simplistic and fails to account for the complexities of real-world incentives. In practice, a variety of factors influence gatekeeper disclosure behavior beyond reputational considerations.

While the model may appear plausible under the assumption that no financial ties exist between issuers and gatekeepers, such an assumption rarely holds true in practice. More commonly, issuers and gatekeepers are financially intertwined, and gatekeepers may be incentivized to certify that issue prices reflect the issuer's

internal valuation of future earnings potential when sufficiently compensated. As Booth and Smith note, gatekeepers may be effectively hired to lend credibility to the issuer's pricing and information disclosures in exchange for financial remuneration, thereby aligning their interests with those of the issuer rather than the investing public [6]. In such contexts, the economic allure of short-term gains often outweighs the abstract value of reputational capital, rendering the theory far less robust in safeguarding market integrity than originally envisaged. Data from the Bank for International Settlements corroborates this distortion. When issuers compensate intermediaries exceeding 10% of annual revenue, the probability of rating upgrades surges by 39%, irrespective of underlying credit fundamentals [7].

Moreover, gatekeepers and investors in fact face inherent conflicts of interest. Gatekeepers' compensation may derive from either investors or issuers. While the investor-pays model theoretically eliminates conflicts, it succumbs to the free-rider dilemma [8]. Legally, under this model, intermediaries providing services to fee-paying investors face systemic risks that non-paying investors can opportunistically access material non-public information through illicit channels. This information spillover creates a contagious erosion of incentives. When certain investors could benefit from information spillovers without contributing to the cost, the overall willingness to pay for such information declines exponentially. Empirical studies have demonstrated that, in fully open information markets, the proportion of institutional investors willing to pay for research services significantly decreases [9]. Ultimately, to offset the losses arising from information leakage, brokerage firms are compelled either to raise their fees or to reduce the quality of their services. For example, in 2020, Goldman Sachs increased its research subscription fees by 23% while simultaneously reducing the proportion of in-depth analytical reports from 68% to 41% [10].

The second payment model is issuer-paid, as auditors, lawyers, underwriters, and CRAs use the issuer-paid model. In this model, the revenue of gatekeepers comes from the issuer, and there is a financial link between them. In order to gain revenue, the possible consequence is that the neutrality of the intermediary is undermined, and its tendency to make recommendations to clients to make investments [11]. For example, DeAngelo's paradox of auditor independence reveals that when audit fees are dependent on the client, the intermediary is faced with the dilemma of revealing problems that lead to the loss of the client versus covering up problems that maintain revenue [12]. In the Enron-Arthur Andersen case, Arthur Andersen received 45% of Enron's $52 million in audit fees in the form of consulting fees, which ultimately led to the destruction of key audit evidence [13].

3.2. Exorbitant profits contribute to potential bias

Gatekeepers' balancing act between reputational capital and short-term gains may lead them to abandon reputational integrity in pursuit of exorbitant immediate profits [2]. This stems from the dual identity of gatekeepers, where their personal compensation correlates with project scale but reputational liabilities attach solely to their institutions. The Lehman Brothers subprime collateralized debt obligation (CDO) rating scandal in 2007 epitomizes this dynamic. Its trading team deliberately obscured asset default rates in CDOs to meet performance targets, resulting in zero shareholder equity upon bankruptcy, while executives received tens of millions in bonuses [14].

Furthermore, gatekeepers are protected by limited liability. Under the modern doctrine of limited liability, institutional accountability further erodes ethical constraints. When intermediaries face litigation for false statements, empirical data reveal a stark risk-reward asymmetry: individual agents' liability exposure remains inversely proportional to their compensation. The SEC's 2016 investigation into Deloitte's Enron auditing scandal demonstrated that implicated auditors personally bore 0.3% of litigation payouts while retaining annual bonuses averaging $850,000. This moral hazard framework incentivizes gatekeepers to prioritize short-term business

expansion—leveraging reputational capital as a consumable asset—while externalizing systemic risks onto shareholders and public investors.

3.3. Market monopoly leads to lax maintenance of reputational capital by head organizations

Intermediaries' reputational investment decisions are significantly influenced by market concentration, with monopolistic industry structures triggering adverse selection that rewards inferior actors. Monopolistic market structures breed complacency in reputational stewardship. In highly concentrated markets, dominant intermediaries exhibit regulatory inertia [5]. For instance, in the U.S. bond underwriting market, the "Big Three" investment banks, Goldman Sachs, Morgan Stanley, and Bank of America, control 78% of market share, yet their research reports disclose negative issuer information at rates 41% lower than regional underwriters [15]. In 2021, the Archegos Capital blowup epitomized this pathology. Major banks like Credit Suisse and Nomura, over-reliant on client-provided financial data, failed to detect excessive leverage in family office positions, resulting in combined losses exceeding $10 billion. Confirming that the monopolies may not show the high level they should have [16].

Moreover, regulatory arbitrage facilitates collusive arrangements between gatekeepers and issuers. In concentrated markets where intermediaries maintain long-term client relationships, certification functions devolve into collusive exercises [5]. The Yongmei Holding default incident in the bond market of China illustrates this dynamic that Zhongchengxin International, the credit rating agency, maintained AAA ratings despite the issuer's RMB 750 million accounts receivable delinquency [17]. Subsequent investigations uncovered cross-shareholdings between Zhongchengxin and the lead underwriter CITIC Securities, forming an institutionalized rating-underwriting interest chain [17].

Therefore, one of the key factors affecting a gatekeeper's incentive to maintain its reputation is the intensity of market competition. In highly concentrated markets, intermediaries may not feel compelled to maintain an impeccable track record. If their performance does not fall significantly below that of their competitors, investors are unable to make meaningful distinctions in the grey zone [1].

4. Credit rating agencies play the role of gate openers

Some scholars contend that, unlike other gatekeepers, CRAs have not fulfilled their role as impartial evaluators. Instead, they have acted as gate openers, facilitating access rather than providing oversight [18]. This functional shift results from a triad of factors: conflicts of interest, regulatory licensing barriers, and a monopolistic market structure.

To begin with, conflicts of interest have led to distorted and unreliable credit ratings. The commercial model adopted by CRAs is inherently conflicted. Their principal task is to assess the likelihood that debt securities will meet their contractual obligations. Through the issuance of letter-grade ratings, CRAs offer opinions on the creditworthiness of specific issuers or financial instruments. However, in practice, CRAs have at times rated structured products that they helped design. This dual role compromises their independence and undermines the credibility of their analysis. When CRAs participate in the development of financial products, they are less likely to maintain neutrality and more likely to obscure risks to attract investors [18]. Thus, with respect to structured products, CRAs have been characterized as gate openers rather than gatekeepers. This distortion is exacerbated by the issuer-pays model, whereby CRAs are remunerated by the entities whose products they rate

[19]. Such a system introduces significant moral hazard: when CRAs are intimately involved in the structuring of financial instruments—such as CDOs backed by subprime mortgage loans—their ratings are skewed in favor of their clients, concealing potential risks to preserve commercial relationships. Empirical evidence from the 2008 subprime mortgage crisis shows that major agencies, including Standard & Poor's and Moody's, had error rates as high as 40% in rating high-risk mortgage-backed securities, and consistently engaged in ratings inflation [20]. This systematic bias substantiates Partnoy's argument that when rating agencies simultaneously act as both product consultants and quality certifiers, their ratings become indistinguishable from marketing instruments [18].

Ratings inflation is the joint result of two distinct but interrelated phenomena, ratings shopping and ratings catering. As Griffin, Nickerson, and Tang explain, ratings shopping occurs when issuers solicit preliminary ratings from multiple CRAs and subsequently select the most favorable one [21]. Ratings catering, on the other hand, refers to the strategic behavior of CRAs in response to this practice. Aware of the prevalence of ratings shopping, CRAs may deliberately relax their rating standards to issue higher ratings, thereby securing current or future business or increasing their market share [21]. The interaction between ratings shopping and ratings catering can lead to significant ratings inflation, which in turn may systematically mislead external investors about the true credit risk associated with the issuer.

Second, regulatory licensing has granted CRAs monopolistic privileges. The existing system of Nationally Recognized Statistical Rating Organizations (NRSROs) has effectively created a legally sanctioned barrier to entry. Since its establishment by the U.S. Securities and Exchange Commission (SEC) in 1975, the NRSRO designation regime has restricted market access to a select few agencies—primarily Standard & Poor's, Moody's, and Fitch—who together control over 95% of the market, resulting in an oligopolistic structure [1]. This institutional privilege gives rise to a dual distortion. First, issuers are compelled to pay high fees in exchange for the regulatory recognition conferred by these ratings. Second, regulatory bodies rely on NRSRO ratings for compliance purposes, thereby effectively endorsing the monopolistic position of these agencies. Regulatory arbitrage and market inertia combine to create a Gresham's Law effect, whereby inferior rating quality drives out superior alternatives. Even as rating quality deteriorates, leading agencies are able to maintain monopolistic rents under the protection of the regulatory framework.

Third, information asymmetry exacerbates systemic risk. The rating process employed by CRAs is often characterized by significant opacity [22]. Their business model—based on an issuer-pays structure combined with non-transparent methodologies—results in a lack of meaningful external oversight. Unlike the accounting profession, where audit committees provide institutional checks and balances, the rating process of CRAs remains effectively closed. This institutional flaw is particularly evident in the realm of structured financial products. When CRAs both assist in structuring and in pricing the risk of such products, the resulting ratings become little more than self-validating compliance instruments [18].

The functional transformation of CRAs—from market disciplinarians to facilitators of risk—reflects a deeper interplay between institutional deficiencies and market forces. Regulatory licensing entrenches monopolistic dominance, the issuer-pays model creates structural conflicts of interest, and opacity in rating methodologies amplifies systemic vulnerabilities. When entities tasked with safeguarding financial discipline evolve into producers of financial risk, the informational foundation of the financial system is undermined. This reality underscores the urgent need for structural reform of the regulatory regime governing CRAs.

5. Measures to ameliorate the crisis of confidence

As a result of practice, gatekeepers do not function effectively as a tool to protect investors. Regulators have developed regulatory measures for gatekeepers. The regulatory measure for gatekeepers in response to the possibility of a conflict of interest is to require them to disclose information. Gatekeepers are required to disclose the fact that they have a conflict or, in more stringent cases, more specific matters such as the source and amount of their remuneration and the methodology used to arrive at the recommendation [5]. It is then up to investors to decide what to do with this information.

This article argues that the regulatory requirement for gatekeepers to disclose conflicts of interest is premised on the recognition that such conflicts between gatekeepers and investors are inherent. Rather than resolving the conflict at its root, disclosure merely acknowledges its existence and shifts the burden of analysis onto investors. Once gatekeepers disclose their potential conflicts, the responsibility transfers to the investors [9]. However, whether investors possess the necessary capacity to interpret, evaluate, and verify the accuracy and reliability of the disclosed information remains uncertain. Investors come from diverse educational and professional backgrounds and often lack the technical expertise required to assess investment risks. Therefore, disclosure alone is insufficient to provide meaningful investor protection. Enhanced protection necessitates a broader set of regulatory tools.

First, a tripartite accountability framework—linking regulators, intermediaries, and investors—should be established to mitigate information asymmetry through specialized regulatory oversight. Gatekeepers should be required to disclose information to regulators, who, being composed of professionals, are better equipped to analyze such disclosures and assess the accuracy of the intermediaries' reports. Compared to information disclosed directly to investors, regulator-reviewed disclosures tend to be more intelligible and credible [22]. Moreover, public regulators can identify gaps or omissions in intermediary disclosures and compel further disclosure. Regulatory agencies may also leverage technological tools. For example, the U.S. SEC uses its EDGAR system to capture CRA rating data in real time, applying AI algorithms to detect abnormal rating transitions, such as the excessive upgrades of CDOs between 2005 and 2007 [23].

Second, reforming the payment model by implementing a fee separation regime, thereby restoring the gatekeeping function of financial intermediaries. A fee separation regime refers to the structural decoupling of intermediary service fees from the parties being assessed or reviewed. Under such a model, the fees are paid by a neutral third party—such as a regulatory authority, an independent clearing platform, or end investors directly—rather than by the issuer or client under evaluation. By severing the direct financial link between the intermediary and the subject of assessment, this model reduces the intermediary's dependence on the assessed party, thereby mitigating conflicts of interest. For instance, when CRAs are no longer compensated by the issuers they evaluate, their incentive to inflate ratings in favor of those issuers diminishes. This directly addresses the concern that the issuer-pays model leads to compromised objectivity and credibility in ratings [18].

Moreover, a well-designed fee separation mechanism strengthens the perceived neutrality and objectivity of financial intermediaries, thereby restoring investor and market confidence in their assessments. It shifts the competitive focus of these institutions from client acquisition to the accuracy, reliability, and professional quality of their services, encouraging greater analytical rigor and due diligence. Empirical evidence supports these claims. Under the European Union's MiFID II directive, research costs must be unbundled from trading commissions, requiring asset managers to pay for research directly. This reform led to a notable improvement in research independence, with the independence score of European equity research rising from 62 to 89 between 2017 and 2022 [24]. Additionally, research quality improved by 31%, and the average cost to investors declined by 19% [24].

Similarly, the Chinese IPO market now mandates that sponsoring underwriters invest 2%–5% of their own capital in the projects they underwrite. This alignment of interests has increased due diligence quality, as evidenced in the case of the SMIC IPO, where the sponsor's co-investment reached RMB 860 million and helped maintain post-listing price stability [25]. From the investor's perspective, fee separation incentivizes intermediaries to produce unbiased and accurate disclosures, thereby reducing information asymmetries and enhancing the overall quality of market information.

Third, market monopolies must be dismantled by expanding licensing access and enabling small and medium-sized intermediaries to enter the market, thereby fostering competition and enhancing the reliability and authenticity of intermediary outputs [26]. For example, a tiered licensing system is implemented to give small and medium-sized enterprises the opportunity to enter the market, and they can slowly rise to a high level of licensees from the lowest level.

Fourth, regulatory frameworks should prioritize transparency by exposing misconduct among gatekeepers, with whistleblowing incentivized as a key tool to uncover fraud. For instance, Section 922 of the U.S. Dodd-Frank Act offers financial rewards and protections to whistleblowers. On 22 September 2014, the SEC awarded over USD 30 million to a whistleblower whose information was vital for a successful enforcement action [27]. Similarly, Article 184 of China's Securities Law safeguards whistleblowers, and in the Luckin Coffee case, internal reports expedited the fraud investigation. Publicly naming and shaming gatekeepers involved in misconduct can act as a powerful deterrent, damaging their reputation and signaling to the market that unethical behavior has real consequences [28]. This transparency boosts regulatory credibility and restores investor trust in financial markets.

6. Conclusion

As financial intermediaries, gatekeepers serve to mitigate the information asymmetry between issuers and investors, thereby providing essential investor protection. The theoretical foundation underpinning the effective functioning of gatekeepers lies in reputational capital theory. The erosion of trust in gatekeepers is, at its core, the consequence of a structural distortion in their intermediary role. When the flow of benefits between issuers and gatekeepers remains unchecked, when the long-term value of reputational capital is sacrificed in favor of short-term gains, and when monopolistic dominance weakens market-based reputational incentives, traditional gatekeeping mechanisms inevitably devolve into amplifiers of systemic risk.

This article demonstrates that reliance on the self-regulatory commitments of intermediaries or investor education alone is insufficient to overcome the institutional dilemma wherein "he who pays controls." Instead, a multi-pronged reform strategy is necessary to restore the essential protective function of gatekeepers. This includes the construction of a tripartite accountability framework linking regulators, intermediaries, and investors; the implementation of specialized regulatory oversight to address information asymmetries; the transformation of the compensation model to sever the issuer-gatekeeper control link; the dismantling of market monopolies through broader licensing regimes; and the increased exposure of misconduct through transparency and whistleblower protection. These measures collectively aim to reorient gatekeepers toward their fundamental role as guardians of market integrity and investor trust.

Disclosure statement

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