BETTER MARKETS
TRANSPARENCY · ACCOUNTABILITY · OVERSIGHT

October 6, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Retrospective Review of Existing Regulations; File Number S7-36-11

Dear Ms. Murphy:

Better Markets, Inc.[1] appreciates the opportunity to comment on the above-captioned release ("Release") of the Securities and Exchange Commission ("Commission"), which seeks input from the public that will assist the Commission in developing a plan for the retrospective review of its regulations.

The Release was prompted by Executive Order 13579, which President Obama signed on July 11, 2011 ("Executive Order"). The Executive Order provides that independent regulatory agencies like the Commission should (1) consider how best to promote retrospective analysis of rules, and (2) develop a plan for periodically reviewing significant existing regulations. The operative language is as follows:

> (a) To facilitate the periodic review of existing significant regulations, independent regulatory agencies should consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned. Such retrospective analyses, including supporting data and evaluations, should be released online whenever possible.
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> (b) Within 120 days of the date of this order, each independent regulatory agency should develop and release to the public a plan, consistent with law and reflecting its resources and regulatory priorities and processes, under which the agency will periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency's regulatory program more effective or less burdensome in achieving the regulatory objectives.

The Release seeks general input regarding any information that the Commission should consider when developing and implementing a plan for the retrospective review of its

[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

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regulations. The Release also seeks comment on a variety of specific issues, including the factors that the Commission should consider when deciding which rules it should select for review. We offer comments in response to both types of questions.

INTRODUCTION

The costs and consequences of the Wall Street meltdown of 2008 and the following financial and economic crises are extraordinary because they have been so profound, so widespread, and so enduring. The terrible impact on American families and the public treasury can be seen in the persistently high unemployment figures, the unprecedented home foreclosure numbers, the strained local, state, and federal budgets, and, frankly, in almost all walks of life. As retirement savings, college funds, homes, jobs, and dreams have disappeared, the damage of the crisis has seeped into every corner of our nation.

The effects of the crisis also extend well beyond our borders, as Europe experiences economic and financial turmoil, and domestic and international stock markets witness dramatic daily swings. Moreover, the crisis is far from over. The toll in financial losses and human suffering continues to mount, and those costs will continue to accrue for years to come.

And yet, more than 3 years after the investment bank Lehman Brothers collapsed and ushered in the largest global financial catastrophe since the Great Depression, very little has changed in the regulation of the financial industry. Part of that is understandable in a democracy and part of that arises from appropriate due diligence before a major change is made in the law.

However, there is no denying that the slow pace of reform is due in large measure to a well-funded, tightly organized, and relentless assault by the financial industry and its allies on absolutely essential and perfectly reasonable regulation. This is unconscionable given that those regulations are designed to protect the American people from having to bear the costs of another crisis, including the massive costs of bailing out that very same financial industry.

In addition to the frontal assault on any proposed regulations, opponents of regulatory reform have also sought to underfund the agencies so that they are incapable of doing what the Dodd-Frank financial reform law requires them to do: put in place a set of regulations that will prevent that American people and the public treasury from being at the mercy of the financial industry.

This is the context that must guide every aspect of the Commission's response to the Executive Order. The Commission has no higher duty than the protection of the American people, the financial system, and the American economy. It is indisputable that the biggest threat to them is another financial crisis.

This leads to two profoundly important conclusions. First, the Commission must prioritize the implementation of all regulations called for by the Dodd-Frank financial reform law before it allocates any time and resources to a retrospective review of prior regulations. Second, when that essential task of implementing Dodd-Frank is complete and the Commission does engage in the rule review process, it must use that process not to dilute but to strengthen its regulations wherever necessary to protect the public and the integrity of the markets.

Just as the Commission has had to announce that some of those essential regulations required by Dodd-Frank have had to be delayed, the Commission should announce that the rule review called for by the Executive Order will have to be delayed. The justification for this step is unassailable: to make sure that effective financial reform is implemented as expeditiously as possible so that the American people can finally get the protection they deserve.

COMMENTS

Any plan for rule review must reflect the Commission's resources and regulatory priorities, and must be subordinated to the more pressing challenges now facing the already strained Commission and its staff.

There are a number of critically important regulatory priorities that must take precedence over the process of retrospective rule review, and any plan for rule review devised by the Commission should reflect this hierarchy. The Executive Order makes very clear that any retrospective rule review should be "consistent with law and reflect [the agency's] resources and regulatory priorities and processes."[2] The President clearly recognized that, although important, the rule review process must be realistically incorporated into each agency's ongoing responsibilities and tailored to each agency's staffing and funding resources.

This is an appropriate limitation on the obligation to establish a rule review plan and it is particularly important with respect to the Commission, which is already struggling to discharge a wide range of regulatory responsibilities without adequate funding.

The duty to conduct a retrospective rule review should be subordinated to several higher priorities. Specifically, the rule review process must not interfere with the Commission's effort to promulgate rules implementing the Dodd-Frank Act. Opponents of regulatory reform undoubtedly will seize upon the Executive Order as a justification for slowing the Commission's progress in implementing those vitally important reforms, arguing that before proceeding with additional rulemaking, it must first take stock of existing rules in accordance with the Executive Order.

However, the Order was clearly not written or intended to have this effect, and the Commission must oppose such tactics. As noted above, the Order provides that the rule review must be consistent with law and with the agency's other regulatory priorities. Under this standard, the statutorily mandated rulemakings under the Dodd-Frank Act clearly supersede any obligation under the Executive Order to conduct a general review of existing rules.

In addition, any rule review must not detract from the Commission's ongoing responsibility to take aggressive action—whether it be rulemaking, surveillance, or enforcement—in areas where we already know that serious abuses are occurring. An important example is the disjointed and opaque market structure we currently have in place, where high frequency traders engage in questionable, inequitable, and quite possibly illegal

[2] Executive Order at 1.

trading practices every day. The fact that so little is known about these trading activities proves the immediate and critical need to devote considerable investigative, data processing, and enforcement resources to the problem. If necessary, the Commission should also conduct additional rulemaking so that it has adequate tools to address whatever abuses it uncovers.

The rule review process must not impede these efforts to address existing and pressing problems in our markets.

The Commission must use the rule review process to identify areas where regulation should be stronger, not only areas where it may be appropriate to streamline or repeal certain rules.

Those who seek to weaken the regulation of our financial markets may suggest that the essential mandate in the Executive Order is to eliminate rules and lighten regulatory burdens on the financial industry. In reality, this interpretation of the Order has no basis. Instead, the Order makes perfectly clear that its intended purpose is as much to make regulation more effective as it is to make regulation less burdensome.

For example, the Order tasks each agency with identifying rules that "may be **outmoded, ineffective, insufficient**, or excessively burdensome."[3] If anything, this language reflects an appropriate emphasis on the need to ensure that sufficiently **strong and effective** regulations are in place.

Elsewhere, the Order lists possible steps that agencies are expected take in accordance with their rule review, including steps "to **modify**, streamline, **expand**, or repeal" rules. Here again, the Order requires each agency to focus its attention on areas where rules must be strengthened, not only on areas where regulation should be scaled back or simplified.

This aspect of the Executive Order, which requires that the rule review identify areas where rules should be stronger, must serve as the guiding principle as the Commission plans and implements its rule review process—at the appropriate time in the future.

The Executive Order does not require independent agencies to conduct cost-benefit analysis.

The Executive Order does not require independent agencies to apply a cost-benefit analysis as part of the rule review process. The Order was clearly written to promote the establishment of rule review mechanisms that would lead to more effective and more efficient regulation, **without** burdening independent agencies with additional obligations to conduct yet more cost-benefit analysis. Indeed, the thrust of the Order is that each agency should devise its own plan, "consistent with law and reflecting its resources and regulatory priorities and processes." Specific protocols are left to the discretion of each agency.

It is true that in the statement of policy, the Executive Order generally acknowledges the value of basing regulatory decisions on a consideration of costs and benefits. But the Order scrupulously avoids any language suggesting that cost-benefit analysis must be part of the rule review process. This is as it should be, since the obligation to perform cost-benefit

3 Executive Order at 1.

analysis can so easily be used as a weapon to challenge and ultimately dismantle beneficial rules and regulations.

A careful reading of the Executive Order, in conjunction with a prior executive order to which it refers, removes any doubt that the President intended to exclude cost-benefit analysis from the obligations being imposed on independent agencies. The Executive Order incorporates by reference certain provisions from a prior order, but it conspicuously does **not** incorporate the section from the prior order that calls upon federal agencies to conduct cost-benefit analysis.[4]

Given that cost-benefit analysis was expressly referenced in the statement of policy but not included in the Executive Order itself, and given that the Executive Order explicitly incorporates certain duties listed in a prior order with the **exception** of cost-benefit analysis, the only logical and reasonable conclusion is that such a duty was excluded from the Executive Order by design.

<u>To the extent the Commission decides in its discretion to undertake cost-benefit analysis as a part of its rule review process, it should follow a flexible and holistic approach.</u>

To the extent the Commission determines to exercise its discretion and include some form of cost-benefit analysis in its rule review plan, it must adopt an appropriately flexible and holistic approach. Applying these two principles in any cost-benefit analysis is the only way to ensure that important regulatory protections are not stripped away through the application of a mechanical, narrow, unrealistic, or overly rigid cost-benefit formula.

In this context, **flexibility** means considering the benefits of regulation even where they cannot be measured in purely quantitative dollar terms. The benefits of regulation are significantly more difficult to measure than the costs. Consider, for example, the difficulty in estimating the monetary value of the losses that are **never incurred** by investors as a result of new regulatory protections. Another example would be the harms that are avoided when financial institutions do not collapse due to stronger prudential standards.

What would be the losses avoided if our country were not suffering from unemployment over 9 percent or if foreclosures were not at historic highs? Those and many other hardships are a direct result of the financial meltdown. Preventing another meltdown will avoid similar and, almost assuredly, even worse consequences. While difficult to quantify, the benefits of averting another financial crisis are unquestionably enormous and they must be included in any cost-benefit analysis.

The need to think broadly about costs and benefits is based on more than logic and common sense. The series of prior executive orders issued over the years that help define the required elements of cost-benefit analysis clearly reflect this point of view. For example, President Obama's January 18, 2011 Executive Order on the subject repeatedly calls for an expansive approach to cost-benefit analysis. It instructs agencies to consider qualitative, as well as quantitative, costs and benefits; future, as well as present, costs and benefits; and even

[4] Executive Order at Section 1(c), incorporating enumerated parts of Executive Order 13563 (Jan. 18, 2011).

"values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impact."[5]

If the methodology for conducting cost-benefit analysis ignores these elements and results in an overly rigid, narrow, and incomplete quantitative assessment of such benefits, then many advantages of regulation, no matter how important to society or to properly functioning markets, will be improperly excluded from the calculation.

Viewed in such a narrow, quantitative light, cost-benefit analysis can easily be invoked to justify regulatory inaction, or worse, regulatory regression through the repeal of important rules.

A **holistic** approach to cost-benefit analysis entails considering not only the consequences of a rule in isolation, but also its role as part of a comprehensive regulatory framework—its cumulative impact. For example, the intent of the Dodd-Frank Act was not to repair isolated flaws in our regulatory structure, but to institute a general framework that would create a more stable, transparent, and fair financial market. Each rule must be evaluated in terms of its contribution to this comprehensive new system.

In the context of Dodd-Frank rulemaking, the value of that new regulatory system is huge, and it includes the benefits of sparing our society and our economy the devastating impact—both monetary and otherwise—of another financial crisis. By any measure, the cumulative benefit of the Dodd-Frank regulatory framework promises to be in the trillions of dollars.

Thus, a flexible and holistic analysis of the costs and benefits that accrue from regulation must be considered in any fair and meaningful cost-benefit analysis.

The Commission must consider a wide variety of factors and sources of information when establishing a rule review process.

The Release identifies a variety of sources and factors that the Commission already considers in determining when a review of existing rules is appropriate.[6] These include—

- The requirements of the Regulatory Flexibility Act, pursuant to which each agency must evaluate whether a proposed rule is likely to have a significant economic impact on a substantial number of small entities;[7]
- Broad programmatic reviews that the Commission conducts from time to time in specific areas;
- Formal petitions for rulemaking;
- Informal suggestions from the public, members of Congress, and fellow regulators;
- Input from advisory committees, roundtables, and conferences;
- Compliance examination and enforcement investigations; and
- Formal rule proposals, which often prompt a review of related existing rules.

[5] Executive Order 13563 (Jan. 18, 2011), at 1.
[6] Release at 56129.
[7] 5 U.S.C. § 601 *et seq.*

The Commission should also consider a number of additional factors and sources as it establishes its methodology for rule review.

Technological Innovation

The review of existing rules should be guided in part by the pace of technological change that is taking place in a given area. Where technological innovation is facilitating new types of market activity, then rule review should be more frequent. In those areas, rule review should be attuned to the potential for new abuses that will require additional rulemaking.

On the other hand, technological innovation may suggest ways in which rules can be simplified without compromising investor protection or market integrity. For example, it may be possible to make reporting obligations more efficient and less burdensome by amending rules to require the use of new data processing technologies.

Financial Product Innovation

Another important factor to consider in the rule review process is product innovation. The emergence of new financial products may suggest the need to review existing regulations to determine if they establish jurisdiction over those new products and if they provide adequate protection against risks and abuses associated with those new products.

Risk-Based Analysis

Rule review should also be guided by the same type of risk-based analysis that the Commission has increasingly used to establish its examination priorities. Whenever examinations, investor complaints, whistleblowers, or other sources indicate that some form of abuse has become widespread or chronic, then, in addition to any investigative or enforcement response, a review of applicable rules in that area is warranted (consistent with the overall prioritization for implementing financial reform first). This should be an explicit component of any rule review protocol.

The Age of Existing Rules

The rule review process should also take into account a simple, quantitative factor: the time that a given set of rules has been in effect without significant amendment. This factor alone certainly does not necessarily indicate that rule revisions are appropriate, but it is an element that should be considered when identifying rules that warrant review and in what order.

Academic Analysis and Data

The Release specifically seeks comment on the role that empirical data and financial economic literature should play in prioritizing rules for review and in actually reviewing rules.[8] Both of these sources are potentially useful, but they must be incorporated into the

[8] Release at 56129.

rule review process carefully and cautiously for two reasons. First, the author of any study or the proponent of any empirical data must be closely scrutinized to identify potential biases. Seemingly objective and credible academic and other experts in the field of financial regulation are often just the opposite: little more than bought and paid for industry consultants used to advance an anti-regulatory agenda.

When scrutinizing such literature, it is hardly sufficient to ask simply whether or not anyone paid for the research or literature under review. The paymasters have become much more sophisticated than that. To identify bias and conflicts, it is essential that the Commission determine the amount and sources of income an author receives. For example, a recent favorite way to disguise payments is to pay academics and others a very substantial appearance or speaking fee. It must also be determined if such a person is on any corporate or other boards and what compensation they receive for serving in that capacity. The same is true for travel "grants" and similar payments, ostensibly unrelated to any particular research or publication.

Unfortunately, it is difficult to keep up with the many and evolving ways that payments are disguised, labeled, or structured to avoid disclosure and scrutiny. Therefore, reliance on any academic experts or others would be inappropriate without a full examination of all sources and amounts of income those experts have received during the five years prior to the analysis, data, or opinions that the Commission might consider.

Second, any scholarly or empirical analysis regarding the effects of regulation must be tested and balanced by opposing points of view and empirical data. Only with this vetting can the Commission or any other regulator be assured that all relevant factors and analysis have been considered in making important decisions about necessary modifications in financial regulations. One way to achieve this goal is for the Commission to sponsor a roundtable on a given subject where all sides are equally represented and a fair, balanced, and thorough airing of issues would be possible.

Where no counterbalancing analysis is available, it is incumbent upon the Commission and its in-house experts to independently evaluate any proffered data or academic opinions on an issue of regulatory importance.

Advisory Committee

The Commission may consider the benefits of establishing an advisory committee to implement the directives of the Executive Order. This approach has potential merit in that it would enable the Commission to implement the guidance in the Executive Order efficiently by drawing on the expertise of outside experts and by minimizing the drain on the Commission's own scarce resources. Provided that the advisory committee's input is truly and solely advisory, not binding, the risk of undue control or influence over the Commission's authority is minimized.

The success of this approach would depend heavily on the composition of any such advisory committee. To be effective, it must be balanced, drawing on a broad range of representative individuals with experience and expertise. Overall, any such committee must be focused on promoting investor protection and market integrity.

CONCLUSION

We hope these comments are helpful as you develop your rule plan for retrospective rule review.

Sincerely,

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