EATON & VAN WINKLE LLP
3 PARK AVENUE
NEW YORK, NEW YORK 10016

TELEPHONE: (212) 779-9910
FAX: (212) 779-9928

Robert B. Bernstein
Partner

Direct Dial: [redacted]
Email: [redacted]

March 26, 2013

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

Re: File Number SR-NYSEArca-2012-66; Release No. 34-68973

Dear Ms. Murphy:

We are writing on behalf of Southwire Company in response to the "Notice of Filing of Amendment No. 1 and No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change as Modified by Amendments No. 1 and No. 2 to List and Trade Shares of the iShares Copper Trust Pursuant to NYSE Arca Equities Rule 8.201," dated February 22, 2012, and in particular in response to Section IV thereof, at page 60, entitled, "Solicitation of Comments," in which the Commission states that "[i]nterested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amendments No. 1 and No. 2 to the proposed rule change are consistent with the Act."

We respectfully request that the Commission reconsider its February 22, 2012 order. Under the Administrative Procedure Act, a court of appeals will set aside agency action that is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." 5 U.S.C. § 706(2)(a). The agency must therefore assure itself that it has "examined the relevant data and articulated a satisfactory explanation for its action including a rational connection between the facts found and the choices made." *Business Roundtable v. Securities and Exchange Commission,* 647 F.3d 1144,1148 (D.C. Cir. 2011); *American Equity Investment Life Ins. Co. v. SEC*, 613 F.3d 166, 167-68 (D.C. Cir. 2010). The Commission also has a "statutory obligation to determine as best it can the economic implications of the rule." *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005). Indeed, the Commission has a unique obligation to consider the effect of a new rule upon "efficiency, competition, and capital formation," 15 U.S.C. § 78c(f), and its failure to "apprise itself – and hence the public and the Congress – if the economic consequences of a proposed regulation makes promulgation of the rule arbitrary and capricious and not in accordance with law." *Business Roundtable at 1149; Chamber of Commerce at 144.* In this regard, in light of a series of recent court decisions critical of the Commission's economic analysis in its rulemaking, the Commission itself has circulated a memo from its general counsel, dated March 16, 2012, stating that "high-quality economic analysis is an essential part of SEC rulemaking" and recommending a series of steps the Commission must take. A copy of that memo is attached.

In its February 22 order, the Commission states that, pursuant to Section 3(f) of the Securities and Exchange Act of 1934, it has "considered whether the proposed rule change will promote efficiency, competition and capital formation." Order at 18. In its March 16, 2012 memo, the Commission's general counsel recommends that the Commission "define the baseline against which to measure the proposed rule's economic impact," stating that "[t]he economic consequences of proposed rules (potential costs and benefits including effects on efficiency, competition and capital formation) should be measured against a baseline, which is the best assessment of how the world would look in the absence of the proposed action." Memo at 6. The memo further states that "[d]efining the baseline typically involves identifying and describing the market[s] and participants affected by the proposed rule," adding that "[m]ost SEC rules affect one or more markets directly but it may also be appropriate to consider additional markets or participants that may be indirectly affected by the proposed rule." Id at 7.

Here, however, the Commission's February 22 order does not make any findings as to the existing level of efficiency, competition and capital formation in any of the relevant markets without the proposed new rule. For that reason, the Commission could not accurately assess any potential increases or decreases in efficiency, competition and capital formation as a result of the proposed rule.

As set forth below in greater detail, and in the Statement of Issues we filed March 18, 2013, with the US Court of Appeals for the DC Circuit (case no. 13-1031) in connection with Southwire's appeal of the SEC's order, dated December 14, 2012, approving the listing and trading of shares of J.P. Morgan's copper Trust, a copy of which is attached, the Commission's order fails to take into account the economic impact that the listing and trading of iShares Copper Trust would have on the market for copper available for immediate delivery to end users.

Specifically, the Commission assumed for purposes of its analysis that the market for copper available for immediate delivery to end users consists of all copper on LME warrant, and then purported to measure the impact the proposed rule would have on the amount of such copper in has a result of the rule. However, in so doing, the Commission overlooked data showing that LME-warranted copper has been accumulating only in LME warehouses where there are substantial queues, and that once deposited in such warehouses, LME-warranted copper is therefore no longer available to end users for immediate delivery.

It is against this background that the Commission failed to consider the impact that the listing and trading of iShares Copper Trust would have on the already constricted market for copper available for immediate delivery to end users. Specifically, the Commission focused solely on whether copper that may be acquired by the Trust was "redeemable" and assumed that if it was indeed "redeemable," that there would then be no meaningful impact on the supply of copper available for immediate delivery to end users. However, in so doing, the Commission not only assumed without any factual basis that copper would in fact be redeemed, but it overlooked all of the impediments in the Trust to the exercise of redemption. Thus, the Commission overlooked the fact that, unlike LME forward contracts and Comex future contracts, the holders of which have the absolute right, if they wish, to make or take physical delivery of copper, owners of iShares would not have that right. Thus, redemption is exercisable not by shareholders, but by so-called "authorized participants" or brokers, and only in five block increments of 2500 shares.

Furthermore, the Sponsor in each case reserves the right to suspend redemption at any time it deems the exercise of redemption not to be in the best interest of iShare shareholders. And, in the event redemption is exercised, the Trust reserve the right to redeem first all copper that fails to meet requirements for being placed on LME warrant – which means the copper being released will, in the first instance, not be LME grade, and hence marketable only at a substantially lower price. However, even if such copper were to be LME grade, and thus eligible to be place on LME warrant, the Commission assumed that such copper would either be available for immediate delivery to end users – without testing to see whether and how that would ever be the case or worst case, the

Commission assumed that such copper would be no less available for immediate delivery to end users than copper on LME warrants in warehouses with substantial queues. Thus, the Commission failed to apprise itself of data showing that LME grade copper is at present subject to a bidding war between end users and warehouses with substantial queues, that copper that ends up of in warehouses with substantial queues is no longer available for immediate delivery to end users, that the diminution in copper available for immediate delivery to end users as a result of this practice has forced end users to pay substantially more for copper units, and that the listing and trading of iShares Copper Trust, along with the listing and trading of the JPM Copper Trust approved by Commission order dated December 14, 2012, will increase the competition for these available copper units, as "authorized participants" for each Trust will be encouraged to outbid competing warehouses and end users for available copper units, and that such copper, once tendered to the Trust, will no longer be available for immediate delivery to end users, thus making copper even more scarce and thus more expensive for end users to obtain.

As should be obvious from its 66-page ruling, the SEC nowhere assesses the economic impact that its new rules would therefore have on the market for immediate delivery of copper to end users. And even worse, the Commission assumes that even if copper is redeemed in the form of LME warrants, as iShares proposes to do, the Commission nowhere determines what impact, if any, that might have on end users. A full lot of copper is 25 metric tons. The Commission acknowledged that because the costs of the Trust would be paid for in copper, the amount of copper per share that is redeemed would be less than a full lot. Thus, if an when an authorized participant is able to redeem shares for copper, it will receive for each 2500 shares an amount of copper that is less than a full 25-ton lot. However, the Commission nowhere analyzed whether and to what extent an "authorized participant" will be able to transfer ownership of such "lots" to customers, and even if such lots are made whole – and there is no obligation on the part of the Sponsor to make such lots whole for purposes of transfer by "authorized participants" to customers -- there is no analysis of whether and to what extent such transfer to "customers" will result in transfer at all to end users. In fact, given the financial incentive the "authorized participant" will have upon redemption to transfer ownership of such copper in order to avoid the costs of storage, there is every reason to believe such copper may either be tendered back to the Trust for additional shares or, alternatively, a competing warehouse (or even the Sponsor's warehouse) may offer substantial financial incentives to keep such copper in storage in order to maintain the queue. Again, the SEC nowhere analyzed anywhere in its order the economic implications that the redemption of copper, should it take place at all, would have on the market for copper available for immediate delivery to end users. For all of these reasons, we believe the SEC should reconsider its opinion.

What follows are some specific examples of shortcomings in the order itself:

We understand that Amendment No. 2 contains a representation that the Trust's website will list the copper lots in the order in which they will be delivered in a redemption pursuant to the applicable algorithm. However, that disclosure is insufficient for purposes of determining likelihood of physical delivery to end users. First of all, website purports to include copper lot holdings of Trust in each warehouse location, but does not purport to disclose holdings in such warehouse of (i) number of lots of non-Trust copper, (ii) holdings of other metals , (iii) amount of stock of copper and other metals delivered into such warehouse on a daily basis, (iv) amount of such stock of copper and other metals delivered out on a daily basis, (v) amount of canceled tonnage of each such metal,(vi) length of any queue associated with delivery of copper from such warehouse, and (vii) amount of premiums above LME cash settlement price an end user must pay to obtain immediate delivery of such copper. Only with that knowledge can an end user determine the likelihood whether redeemed copper can ever be intended for immediate delivery.

The order states (at 8) that the custodian may keep the Trust's copper in warehouses in East Chicago, Indiana, Mobile, Alabama; New Orleans, St. Louis, Hull and Liverpool, Rotterdam and Antwerp. However, the order should have disclosed that at present there is virtually no LME grade copper stored in LME warehouses by anyone in any of these locations except New Orleans and Antwerp. The order should further have disclosed how much of such copper is actually stored by Sponsor's warehouses in such locations, and how much is stored in competitors' warehouses; and whether and to what extent such copper is available for immediate delivery or is otherwise tied up in queues, and if so, the length of such queues.

The order states that the Trust will value copper based on LME Bid price for such copper, without regard to premiums that must be paid above LME bid price to acquire such copper in relevant markets. The only time anyone ever pays LME bid price and gets it for immediate delivery is when accepting copper for immediate delivery from LME warehouses to satisfy an LME long position, and the warrant issued is for a location where there is no queue. The market for copper available for delivery to the Trust will in most circumstances not consist of copper acquired on warrant in satisfaction of an LME long position and even if it did, such warrant may be in a location where the Trust has not set up a designated warehouse, in which case the "authorized participant" would have to pay to have the copper delivered. The SEC did not consider the economic ramifications of valuing the copper in the Trust not on the basis of what "authorized participants" paid to get it there, but rather on the basis of LME Bid price for such copper.

The order notes that the Trust will identify copper to be redeemed, but the order nowhere mentions that the right of redemption is subject to suspension at any time by Sponsor in sponsor's discretion if it deems redemption to be harmful to rights of shareholders of Trust; and in offering warrants, because there's no indication of extent to which such warrants may be in warehouse where subject to a queue, there is no indication whether such warrants would be part of market for immediate delivery of copper or just be part of inventory that circulates within a warehouse, never actually to be intended for physical delivery anywhere. It is also not clear how authorized participants, who receive lots in less than 25-ton increments, will be able to sell or otherwise transfer them to customers who may or may not be end users.

Courts require that for purposes of satisfying Section 3(f) of the Act, SEC must undertake a cost-benefit analysis to determine whether the benefits outweigh the costs of in terms impacts on efficiency, competition and capital formation in the markets directly and indirectly affected by the proposed rule change, and that such cost-benefit analysis first establishes a baseline from which to measure change, then considers relevant data which measures the impacts, asks for data if needed, and further considers alternatives, should any exist. Here, the sponsor states that the Trust will provide a more liquid and cost-effective vehicle for investment in physical copper market, that much of the initial demand for the shares will represent a reallocation of current investments in physical copper by professional copper market participants rather than new incremental demand, and that creation of the Trust will not "impact copper prices" or render the copper market more susceptible to manipulation. However, nowhere is there any cost-benefit analysis to test whether these representations are fair and reasonable. Indeed, there is not even any discussion much less recitation of any baseline data available for the relevant markets impacted.

Furthermore, even though comments questioned whether copper held by the Trust would be available for immediate delivery, SEC did nothing to establish whether or not this was true or false. Accordingly, no economic analysis ever performed to support SEC's conclusion that "the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery."

The sponsor stated the Trust would not remove immediately available copper inventory from the market and the SEC agreed. However, the SEC never performed any analysis to determine whether this was true. SEC states first the Trust "will not consume copper." (21). However, test of whether copper will be removed from copper immediately available for immediate delivery to end users doesn't turn on whether such copper will be "consumed." Copper does not have to be "consumed" in order to be removed from the market for copper available for immediate delivery. Such copper merely has to stop being available for immediate physical delivery to end users. Indeed, that is how every copper squeeze is corner is engineered. Copper otherwise available for immediate physical delivery is taken off market – not consumed – but hoarded in order to drive up the price what whatever copper remains. Indeed, that is why squeezes and corners are measured by how much metal is being removed from the market for a non-commercial purpose. The assumption in such circumstances is that if copper is being removed from the market not for purposes of satisfying consumption, then it stands to reason that the supply has diminished while demand for consumption remains unchanged – which almost always leads to a spike in price. Here, the SEC never undertook to determine how much copper is available at any given time for immediate delivery to end users and what the impact would be if a portion of such copper were no longer available for such delivery, regardless of whether it was being "consumed."

The Commission next states that the reason Trust would not remove immediately available copper inventory from the market is that "[s]hares are redeemable (in size) for copper on every business day." However, the test of whether copper will be removed from copper immediately available for delivery to end users does not turn on whether shares of the Trust are redeemable. First of all, the fact that shares of the Trust are redeemable does not mean they will in fact be redeemed. The SEC assumed, without analysis, that this would be so. In fact, the SEC never collected any baseline data to test whether this assumption is accurate. However, even if shares of the copper are redeemable does not mean redeemed copper will be available for immediate delivery to end users. Here, too, the SEC merely accepted the sponsor's representation that this would be so without ever conducting any analysis to determine whether in fact this would be the case.

The Commission further states that reason Trust would not remove immediately available copper inventory from the market is that within three days of a redemption order, provided certain conditions are met, Custodian will transfer from the Trust's account to the "authorized participants'" account the parcels of copper identified pursuant to the Trustee's algorithm and promptly thereafter, the Custodian will issue either (a) one or more LME warrants, if the copper transferred can be placed on LME warrant and the Custodian is able to issue LME warrants, or (b) negotiable warehouse receipts, if the copper transferred cannot be placed on LME warrant or the Custodian cannot issue LME warrants, and that accordingly, SEC states, in the normal course of the Trust's operations, redeeming authorized participants will receive copper "that the commenter acknowledges is available for immediate delivery (i.e., copper on LME warrant."

However, the fact that Custodian may transfer LME warrants to accounts of authorized participants does not mean the copper is copper available for immediate delivery to end users. First of all, only authorized participants may redeem, and then they may only redeem in batches of four of more baskets representing 2500 shares apiece. Thus, individual shares are not redeemable; individual shareholders may not redeem, and redemption, when it occurs, can only occur in minimum blocks of 10,000 shares or more. The SEC conducted no analysis to determine how likely redemption would occur under such circumstances. Second, even when such redemption occurs, authorized participants will be receiving whole lots and a fraction thereof, representing the reduction in size of each lot by a *pro rata* share reflecting copper that had to be sold to cover costs of storage. Thus, while authorized participants may be selling on behalf of customers, such customers will only be entitled to receive fractions of lots, i.e., lots of copper containing less than 25 tons. The SEC meanwhile nowhere analyzes how that will work as a practical matter.

Thus, even though the SEC represents that the accounts of authorized participants will be credited with 25-ton lots in the form of LME warrants, such warrants cannot as a practical matter be transferred to customers of such authorized participants because they will only be entitled to their *pro rata* share of copper represented by baskets, which consists of copper that is less than 25-ton amounts. Will authorized participants nevertheless be able to transfer to their customer's actual whole lots? If so, how that will that be done? Will such customers then be charged an additional fee to cover the cost of making their lots whole? How will such fee be calculated? The registration statement states that J. Aron will make a market for fractional shares that Authorized Participants may need to purchase or sell for purposes of tendering or redeeming exact quantities that the Trust may require based on the size at any given time of each so-called "basket," but there is no representation that any such market exists to allow Authorized Participants to assemble 25-ton lots for delivery, if needed, to customers seeking actual physical delivery. And even if there were a market available to supply fractional lots to Authorized Participants who may need them for customers, no one from the SEC obtained any data or otherwise determined whether such copper, if transferred to such customers, would in any event be available to end users for immediate delivery. In fact, the likelihood of such delivery would depend on where the copper was being stored physically, whether and how much copper and other metal was in that particular warehouse, and what queue, if any, exists in such warehouse. None of that information is proposed to be disclosed by BlackRock and, of course, without such information, it's anyone's guess whether any such copper will be available for immediate delivery.

The SEC states that as long as authorized participants can receive copper on LME warrant, such copper represents copper that is "available for immediate delivery." This is not true. LME warrants may constitute copper available for immediate delivery to satisfy long and short positions on the LME, but it no longer represents copper available for immediate delivery to end users. In order for such copper to become available for immediate delivery to end users, it must be available to be shipped immediately to an end user's plant. However, most copper today on LME warrant is, when sold, subject to lengthy queues and, for that reason, it may take months to be shipped to an end users plant, no matter how close by the end users plant may be. However, by taking the position that copper on LME warrant is the same as copper available for immediate delivery to end users, the SEC failed to obtain any data to determine whether and to what extent the Trust will in fact affect available supply.

The SEC states that "[g]iven the structure of the Trust, the Commission believes that the amount of copper accessible to industrial users will not meaningfully change as a result of the listing and trading of the Shares." In order to determine whether listing and trading of the Shares will have any direct or indirect impact on the amount of copper accessible to industrial users, the SEC would at a minimum have had to establish a baseline by which to establish the amount of copper accessible to industrial users today and thereby have a basis upon which to make any reasoned judgment as to whether the amount of such copper would "meaningfully change." Here, the SEC obtained no baseline data by which to make any kind of judgment as to the direct or indirect impact.

The SEC further states that, "[a]ccordingly, the Commission believes that the proposed rule change will not burden capital formation for users who acquire copper for industrial and other purposes." Having failed to obtain data by which to establish any baseline as to capital formation, the SEC had no valid basis upon which to draw this conclusion.

The SEC acknowledges the "increasingly length of time it takes to withdraw metal, including copper, from LME warehouses," but assumes, for purposes of its analysis, that copper on LME warrant is equivalent to copper available for immediate delivery to end users no matter how long the queue may be, and fails to appreciate that it makes no difference to copper end users whether copper is being removed from the market by virtue of warehouse companies paying a premium to have such copper delivered to a warehouse (where it will join a queue) or whether such copper is being removed from the market by virtue of its being acquired by authorized participants, including the Sponsor itself, for deposit into the Trust.

The effect in either case is the same, but the SEC failed to gather data even from the growing warehouse queue problem that would allow the agency to assess the incremental impact that the listing and trading of the Shares would have on that market, in terms of diminution of supply, increase in local premiums end users must pay, and indeed, upon the overall LME settlement price. Thus, for example, LME grade copper inventories have been soaring in recent months – but only in locations where there are substantial queues, i.e., New Orleans, Antwerp and Johor. Premiums that end users must pay for such copper in these locations have increased dramatically as end users are forced to compete with warehouse owners for available units. At the same time, the LME settlement price has not fallen commensurate with the increase in inventory, all of which suggests that despite what appears to be a growing surplus of supply, the actual price for immediate delivery to end users (the LME settlement price plus premium) has been going up, not down, and the listing and trading of the Shares, which will contribute to the removal of copper from the market for immediate delivery to end users, will likely make the situation worse. Yet, the SEC failed to consider any data by which to make any determination of the relative direct and/or indirect impact.

In sum, for all these reasons, we respectfully submit that the Commission should reconsider its order and, upon further review, based on substantial evidence in the record, the Commission should reverse its decision and deny approval of the proposed rule change.

Respectfully,

Robert B. Bernstein

MEMORANDUM

To: Staff of the Rulewriting Divisions and Offices

From: RSFI and OGC

Date: March 16, 2012

Re: Current Guidance on Economic Analysis in SEC Rulemakings

BACKGROUND

High-quality economic analysis is an essential part of SEC rulemaking. It ensures that decisions to propose and adopt rules are informed by the best available information about a rule's likely economic consequences, and allows the Commission to meaningfully compare the proposed action with reasonable alternatives, including the alternative of not adopting a rule. The Commission has long recognized that a rule's potential benefits and costs should be considered in making a reasoned determination that adopting a rule is in the public interest.

Recent court decisions, reports of the U.S. Government Accountability Office ("GAO") and the SEC's Office of Inspector General ("OIG"), and Congressional inquiries have raised questions about and/or recommended improvements to various components of the Commission's economic analysis in its rulemaking, including: (1) identifying the need for the rulemaking and explaining how the proposed rule will meet that need;[1] (2) articulating the appropriate economic baseline against which to measure the proposed rule's likely economic impact (in terms of potential benefits and costs, including effects on efficiency, competition, and capital formation in the market(s) the rule would affect);[2] (3) identifying and evaluating reasonable alternatives to the proposed regulatory approach;[3] and (4) assessing the potential economic impact of the

[1] SEC Office of Inspector General, *Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings*, Report No. 499 (Jan. 27, 2012) ("OIG Report No. 499") at 31-36.

[2] *American Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178-79 (D.C. Cir. 2010); OIG Report No. 499 at 16-29.

[3] *Chamber of Commerce v. SEC*, 412 F.3d 133, 144-5 (D.C. Cir. 2005) ("*Chamber I*").

proposed rule and reasonable alternatives by seeking and considering the best available evidence of the likely quantitative and qualitative costs and benefits of each.[4]

OIG Report No. 499, comments on proposed rulemakings, and communications from Members of Congress have also included suggestions for improving the process by which economic analyses are developed and incorporated into Commission rulemaking, including earlier and more substantial involvement of SEC economists[5] and more effective integration of economic analyses into rulemaking releases.[6]

After careful review of relevant caselaw, economic literature, guidance from other regulatory authorities, and the foregoing comments and recommendations, the Division of Risk, Strategy, and Financial Innovation ("RSFI") and the Office of the General Counsel ("OGC") are providing the following guidance on economic analysis for SEC rules that addresses each of the substantive and procedural issues identified above. Much of the guidance set forth below will be familiar to you as practices that have already been incorporated into our rulemaking or improvements that RSFI and OGC recently have been working with the Divisions to implement.

Rulewriting teams should recognize that this guidance is by necessity general in nature. This guidance—while broadly outlining best practices—is intended to allow for flexibility in the context of any particular rulemaking. The rulewriting division or office, RSFI, and OGC should work closely to determine the appropriate approach for each rulemaking.

SEC STATUTORY OBLIGATIONS AND POLICY CHOICES TO CONDUCT REGULATORY ECONOMIC ANALYSIS

Statutory provisions added by the National Securities Market Improvement Act of 1996 and the Gramm-Leach-Bliley Act of 1999 to the 1933, 1934, and 1940

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[4] *Business Roundtable v. SEC*, 647 F.3d 1144, 1150 (D.C. Cir. 2011); GAO Report to Congressional Addressees, "DODD-FRANK ACT REGULATIONS Implementation Could Benefit from Additional Analyses and Coordination" (Nov. 2011) ("GAO Report No. 12-151"), at 17-18.

[5] OIG Report 499 at 12-16.

[6] *Id.* at 29-31.

Acts—which require the Commission to consider efficiency, competition, and capital formation whenever it is "engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest"—expressly call for consideration of several broad economic issues in addition to the protection of investors. Additionally, Section 23(a)(2) of the Exchange Act requires the Commission to consider the impact that any rule promulgated under that Act would have on competition and to include in the rule's statement of basis and purpose "the reasons for the Commission's . . . determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of [the Exchange Act]."[7] The D.C. Circuit has viewed these provisions, together with the requirement under the Administrative Procedure Act that Commission rulemaking be conducted "in accordance with law," as imposing on the Commission a "statutory obligation to determine as best it can the economic implications of the rule."[8] Similarly, the court has found certain Commission rules arbitrary and capricious based on its conclusion that the Commission failed adequately to evaluate a rule's economic impact.[9]

No statute expressly requires the Commission to conduct a formal cost-benefit analysis as part of its rulemaking activities.[10] But as SEC chairmen have informed Congress since at least the early 1980s—and as rulemaking releases since that time reflect—the Commission considers potential costs and benefits as a matter of good regulatory practice whenever it adopts rules.

Although as an independent regulatory agency the SEC is not obligated to follow the guidelines for regulatory economic analysis by executive agencies set out in Executive Order 12866 ("Regulatory Planning and Review")

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[7] The Commission also is subject to the Paperwork Reduction Act of 1995 ("PRA"), the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"), and the Regulatory Flexibility Act. The analyses required by these statutes are narrowly tailored to particular statutory requirements.

[8] *Chamber I*, 412 F.3d at 143.

[9] *E.g.*, *Business Roundtable*, 647 F.3d at 1148 (finding that the Commission had failed "adequately to assess the economic effects of a new rule").

[10] *See* GAO Report No. 12-151 at 9.

("EO 12866")[11] and Executive Order 13563 ("Improving Regulation and Regulatory Review") ("EO 13563"),[12] the following guidance draws on principles set forth in those orders and in the Office of Management and Budget's Circular A-4 (2003), which provides guidance for implementing Executive Order 12866.[13]

GUIDANCE

A. Substantive requirements for economic analysis in SEC rulemaking.

It is widely recognized that the basic elements of a good regulatory economic analysis are: (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis.[14] As a general matter, every economic analysis in SEC rulemakings should include these elements, and the following guidance addresses ways to strengthen these aspects of our economic analyses.

[11] 58 FR 51735 (Oct. 4, 1993).

[12] 76 FR 3821 (Jan. 21, 2011). Executive Order 13579 ("Regulation and Independent Regulatory Agencies"), 76 FR 41587 (Jul. 14, 2011), encourages independent regulatory agencies to follow certain policies set forth in Executive Order 13563.

[13] In developing this updated guidance, OGC and RSFI have also reviewed other guidance for regulatory economic analysis. *See*, *e.g.*, U.S. Commodity Futures Trading Commission, Staff Guidance on Cost-Benefit Considerations for Final Rulemakings under the Dodd-Frank Act, (May 13, 2011) in U.S. Commodity Futures Trading Commission Office of the Inspector General, *A Review of Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act*, June 13, 2011 at 34-45, available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigation_061311.pdf; Isaac Alfon & Peter Andrews, Financial Services Authority, *Cost-Benefit Analysis in Financial Regulation How to do it and how it adds value* (Financial Services Authority Occasional Paper Series 3, September 1999), available at: http://www.fsa.gov.uk/pubs/occpapers/op03.pdf; Financial Services Authority Central Policy, *Practical Cost-Benefit Analysis for Financial Regulators Version 1.1* (June 2000), available at: http://www.fsa.gov.uk/pubs/foi/cba.pdf.

[14] *See generally* EO 12866; EO 13563; Circular A-4. *Cf.* Alfon & Andrews, *supra* note 13; Financial Services Authority Central Policy, *supra* note 13.

1. Clearly identify the justification for the proposed rule.

Rule releases must include a discussion of the need for regulatory action and how the proposed rule will meet that need.[15] In some circumstances, there will be more than one justification for a particular rulemaking. Frequently, the proposed rule will be a response to a market failure that market participants cannot solve because of collective action problems. Traditional market failures include market power, externalities, principal-agent problems (such as economic conflicts of interest), and asymmetric information.[16] Other justifications for rulemaking can include, among others, "improving government processes,"[17] interpreting provisions in statutes the Commission administers,[18] and providing exemptive

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[15] *See* EO 12866, 58 FR at 51735 ("Each agency shall identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem."); *id.* ("Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people.").

[16] *See, e.g.*, Circular A-4 at 4 (listing "externality, market power, and inadequate or asymmetric information" as examples of market failures that could be addressed through regulation). Various forms of these market failures are applicable to the markets the Commission regulates. Negative externalities can arise in the form of spill-over financial risks to investors that cannot be effectively managed by managers or intermediaries. *See, e.g.*, SEC Final Rule, *Risk Management Controls for Brokers or Dealers with Market Access*, 75 FR 69792 (Nov. 15, 2010). Positive externalities can arise from network effects of standards (such as accounting standards), or social benefits from information disclosure that are not fully reaped by the disclosing party. *See, e.g.*, Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999). Principal-agent problems often arise in the form of moral hazard or in situations involving potential conflicts of interests. *See, e.g.*, SEC Final Rule, *Custody of Funds or Securities of Clients by Investment Advisers*, 75 FR 1456 (Jan. 11, 2010); SEC Final Rule, *Proxy Disclosure Enhancements*, 74 FR 68334 (Dec. 23, 2009); and SEC Final Rule, *Political Contributions by Certain Investment Advisers*, 75 FR 41018 (July 14, 2010). There is asymmetric information, for example, when investors seeking to trade securities are not fully informed of all material information that could affect their investment decisions. *See, e.g.*, SEC Final Rule, *Amendment to Municipal Securities Disclosure*, 75 FR 33100 (June 10, 2010).

[17] Circular A-4 at 4-5 (also identifying the "protect[ion of] privacy, permit[ting] more personal freedom," and promoting "other democratic aspirations" as examples of "social purposes" that can be a justification for rulemaking).

[18] *See* EO 12866, 58 FR at 51735 (rules "necessary to interpret the law" are justified).

relief from statutory prohibitions where the Commission concludes that doing so is in the public interest. Additionally, Circular A-4 recognizes that Congressional direction to adopt a rule is, itself, an independent justification for rulemaking, explaining that "[i]f the regulatory intervention results from a statutory or judicial directive, you should describe the specific authority for your action, the extent of discretion available to you, and the regulatory instruments you might use."[19]

2. Define the baseline against which to measure the proposed rule's economic impact.

The economic consequences of proposed rules (potential costs and benefits including effects on efficiency, competition, and capital formation) should be measured against a baseline, which is the best assessment of how the world would look in the absence of the proposed action.[20] The baseline serves as a primary point of comparison for an analysis of the proposed regulation. An economic analysis of a proposed regulatory action compares the current state of the world, including the problem that the rule is designed to address, to the expected state of the world with the proposed regulation (or regulatory alternatives) in effect.[21]

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[19] Circular A-4 at 3. We have considered the recommendation in OIG Report No. 499 (at pages 31-36) that even where Congress directs the Commission to engage in rulemaking, the Commission should identify a market failure or other compelling need for rulemaking apart from the Congressional directive, and we conclude that this is unnecessary. Instead we believe that the better approach is set forth in Executive Order 12866, which states that agencies "should promulgate only such regulations as are required by law . . . ***or*** are made necessary by compelling public need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people" (emphasis supplied), making clear that a statutory mandate and a market failure are *alternative* possible justifications for a rule. EO 12866, 58 FR at 51734. Although we conclude that the Commission is not obligated to identify a justification for rulemaking beyond a Congressional mandate, there may be circumstances in which it could be useful to do so. For example, where Congress has itself stated that the mandate to engage in rulemaking is premised on a market failure or other compelling social need, the rulemaking release may identify that justification (and attribute it to Congress) in its description of the statutory mandate and explain how the rule (including any discretionary choices the Commission is making in the rulemaking) responds to the market failure or other compelling need that Congress identified.

[20] *See* Circular A-4 at 15.

[21] *See* Circular A-4 at 2 ("To evaluate properly the benefits and costs of regulations . . . you will need to . . . [i]dentify a baseline. Benefits and costs are defined in comparison with a clearly stated alternative. This normally will be a 'no-action' baseline: what the world will be like if the proposed rule is not adopted.").

Economic impacts of proposed regulations are measured as the differences between these two scenarios. The baseline includes both the economic attributes of the relevant market and the existing regulatory structure, including (where relevant) state law.[22]

In articulating the appropriate economic baseline for a rulemaking, rulewriting staff should work with the RSFI economists to describe the state of the world in the absence of the proposed rule, including the existing state of efficiency, competition, and capital formation, against which to measure the likely impact of the proposed rule and the principal alternative regulatory approaches. It is important to clearly describe the assumptions that underlie the description of the relevant baseline and to detail those aspects of the baseline specification that are uncertain. Defining the baseline typically involves identifying and describing the market(s) and participants affected by the proposed rule. Most SEC rules affect one or more markets directly but it may also be appropriate to consider additional markets or participants that may be indirectly affected by the proposed rule.

OIG Report No. 499 and letters from some Members of Congress have questioned the Commission's approach to selecting economic baselines for assessing the consequences of regulations promulgated to comply with statutory

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[22] For example, in *American Equity*, the D.C. Circuit addressed the adequacy of the SEC's economic analysis of a rule (Rule 151A) that could result in certain insurance products that had been regulated exclusively under state insurance law *also* being subject to the federal securities laws. The court concluded that the SEC's analysis was inadequate because it did not measure the rule's likely effect on efficiency, competition, and capital formation against a baseline that included the existing level of those economic factors under the state insurance law to which the products were subject. *See American Equity*, 613 F.3d at 178 ("The SEC asserted competition would increase based upon its expectation that Rule 151A would require fuller public disclosure of the terms of FIAs and thereby increase price transparency. The SEC could not accurately assess any potential increase or decrease in competition, however, because it did not assess the baseline level of price transparency and information disclosure under state law."); *see also id.* at 179 ("The SEC advanced further that the rule's sales practice protections would enable sellers to promote more suitable recommendations to investors; this, in turn, would lead to investors making even better informed decisions, which would offer greater efficiency. As with its analysis of competition, however, the SEC's analysis is incomplete because it fails to determine whether, under the existing regime, sufficient protections existed to enable investors to make informed investment decisions and sellers to make suitable recommendations to investors. The SEC's failure to analyze the efficiency of the existing state law regime renders arbitrary and capricious the SEC's judgment that applying federal securities law would increase efficiency.").

directives, including a number of the rulemakings under the Dodd-Frank Act.[23] As a policy matter, where a statute directs rulemaking, rulewriting staff should consider the overall economic impacts, including *both* those attributable to Congressional mandates *and* those that result from an exercise of the Commission's discretion.[24] This approach will often allow for a more complete evaluation of alternative means of meeting the mandate and give the most complete picture of a rule's economic effects, particularly because there are many situations in which it is difficult to distinguish between the mandatory and discretionary components of a rule.[25]

The baseline being used should be specified, either at the beginning of the economic analysis section or as part of a general introduction to the economic issues that will be considered throughout the release. Using the same baseline assumptions throughout the economic analysis of each element of the proposed rule is important. However, when considering alternatives, it may sometimes make better sense to evaluate the economic implication of alternatives against the proposed rule, since the primary inquiry in considering the alternatives must be whether these alternatives are better or worse (in terms of achieving the regulatory purpose in a cost-effective manner) than the proposed rule. If the release follows such an approach, it should carefully explain the reasons for doing so.

3. <u>Identify and discuss reasonable alternatives to the proposed rule</u>.

The release should identify and discuss reasonable potential alternatives to the approach in the proposed rule. Reasonable alternatives include only those that are available to the SEC and not, for example, those that the SEC lacks the authority to implement. In addition to the preferred approach, a release could identify as alternatives realistic approaches that are more or less stringent than the

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[23] *See* OIG Report No. 499 at 16-23.

[24] *See* Circular A-4 at 15-16 ("In some cases, substantial portions of a rule may simply restate statutory requirements that would be self-implementing, even in the absence of the regulatory action. In these cases, you should use a pre-statute baseline. If you are able to separate out those areas where the agency has discretion, you may *also* use a post-statute baseline to evaluate the discretionary elements of the action.") (emphasis supplied).

[25] The analysis should not be viewed as an attempt to challenge the Congressional policy decisions that may underlie the statutory mandate.

preferred option. Other types of alternative approaches could include different compliance dates and different requirements for large and small firms. The proposing release should also solicit public comment to help assess and inform the economic analysis of the alternatives.

Circular A-4 states that "[t]he number and choice of alternatives selected for detailed analysis is a matter of judgment," and recognizes that "[t]here must be some balance between thoroughness and the practical limits on your analytical capacity."[26] Courts have likewise made clear that "the Commission is not required to consider 'every alternative . . . conceivable by the mind of man . . . regardless of how uncommon or unknown that alternative' may be."[27] But the Commission is required to consider *reasonable* alternatives raised during the rulemaking.[28] Such alternatives include those that are "neither frivolous nor out of bounds": "'[W]here a party raises facially reasonable alternatives . . . the agency must either consider those alternatives or give some reason . . . for declining to do so.'"[29]

4. <u>Analyze the economic consequences of the proposed rule and the principal regulatory alternatives</u>.

In analyzing the likely consequences of the proposed rule and alternative regulatory approaches, rulewriting staff should work with the RSFI economists to: (1) identify and describe the most likely economic benefits and costs of the proposed rule and alternatives; (2) quantify those expected benefits and costs to the extent possible; (3) for those elements of benefits and costs that are quantified, identify the source or method of quantification and discuss any uncertainties

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[26] Circular A-4 at 7.

[27] *Chamber I*, 412 F.3d at 144 (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 51 (1983)).

[28] *See id.* (concluding that it was a violation of the APA for the Commission not to consider, as an alternative to a proposed rule imposing an independent chair requirement as a condition for certain exemptions, dissenting Commissioners' proposal that "each fund be required prominently to disclose whether it has an inside or an independent chairman and thereby allow investors to make an informed choice").

[29] *Id.* at 145 (quoting *Laclede Gas Co. v. FERC*, 873 F.2d 1494, 1498 (D.C. Cir. 1989) (emphases removed)).

underlying the estimates; and (4) for those elements that are not quantified, explain why they cannot be quantified.

As others have noted, "the difficulty of reliably estimating the costs of regulations to the financial services industry and the nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure."[30] Thus, although we should endeavor to quantify the rule's likely economic effects, it may not be feasible to quantify many of the costs and benefits of the rule.

Identify relevant benefits and costs. Rulewriting staff should work with RSFI economists to identify relevant potential benefits and costs of the proposed rule and the principal regulatory alternatives examined in the rulemaking. In addition to the direct benefits and costs, the economic analysis should address significant ancillary economic consequences. Although the likely costs and benefits will vary depending on the rule, there are certain general principles that apply to most rulemakings:[31]

> <u>Benefits</u> In general, the likely benefits of a rule correspond to the justification for the rulemaking. Thus, for example, where the rule is being proposed to remedy a market failure in the form of inadequate information available to investors, and the rule would require new or enhanced disclosure, the likely benefits to be derived from the rule presumably would include better informed investment decisions. This, in turn, could result in better alignment of investors' objectives and investments, greater investor trust in the markets, lower risk premiums, and, ultimately, better allocation of capital. Typically, the economic benefits of a rule include likely gains in economic efficiency such as (among others):
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> - reduced incentive misalignment/reduced monitoring costs;
> - lower cost of capital;

[30] GAO Report No. 12-151 at 19 (citing GAO Report No. 08-32). *See also* OIG Report No. 499 at 14 n. 37 (same).

[31] The following examples of benefits and costs are not intended to be comprehensive but are included to supply a general idea of the types of benefits and costs that could be analyzed. The benefits and costs that should be considered during the rulewriting process will be developed by the rulewriting staff and RSFI and will vary depending on the nature of the rule.

- better information sharing, which can result in lower risk premiums and better allocation of capital;
- enhanced competition, which can lead to reduced prices or higher quality;
- overcoming collective action problems;
- the avoidance of harmful transactions by reducing principal-agent problems, such as excessive risk-taking or actions that are otherwise characterized by moral hazard;
- reduced transaction costs;
- more efficient enforcement of Commission rules.

Costs The economic analysis should consider compliance costs, direct costs, and indirect costs. For example, the compliance costs of a reporting requirement may include in-house personnel time and resources and outside accounting or legal fees.[32] Direct costs could include costs arising from intended changes to the behavior of regulated firms or persons in response to the reporting requirement. Indirect costs could include costs arising from changes to the behavior of regulated firms or persons beyond those that the rule was intended to achieve, or costs arising from changes in behavior by parties other than regulated firms or persons. In general, other types of indirect costs can include, but are not limited to:

- the distributional and competitive effects of the rule;
- negative collateral consequences, such as the potential misuse of newly created rights;
- a misallocation of resources resulting from regulatory arbitrage (race to the bottom).

[32] Rulewriters should work with the RSFI economists to determine whether some of these expenses are better analyzed as "transfers"—economic consequences that result in a redistribution of income. In addition, our rules frequently include calculation of paperwork burden as required under the PRA. Rulewriters should be aware that PRA burdens do not necessarily characterize all compliance costs and in most cases, they are only one of many possible inputs, both qualitatively and quantitatively, into the overall analysis of costs. With most rules, the cost estimate that results from multiplying PRA burden-hours by hourly wage rates is not substitutable for the broader analysis of a rule's likely economic consequences contained in the release's economic analysis.

Depending on the significance of the costs and benefits of a rule that are internal to the SEC, it can be appropriate to consider them in the cost-benefit analysis. The staff's general practice has been not to consider administrative costs or savings in cost-benefit analyses because such costs and benefits typically are not a significant or material component of the overall costs and benefits of a rule. But in some cases the effect of the rules on internal SEC operations may be significant enough to be considered as a component of the overall costs and benefits. The degree of consideration given to internal costs and benefits will differ depending on their importance in a particular rulemaking.

Quantify expected benefits and costs to the extent feasible. Rulewriting staff should work closely with the RSFI economists so that they may attempt to monetize or otherwise quantify potential costs and benefits of the rule whenever such quantification is practicable and should discuss with the economists the methodology to be used to obtain estimates.[33] To achieve this objective, rulewriting staff should engage with RSFI economists at the earliest stages of rulemaking to determine whether there are areas in which monetization or other quantification can reasonably be undertaken and, if so, whether RSFI has the available resources necessary to develop such data. Before issuing a proposing release, staff should identify any specific data that would be necessary for or that would assist in quantification, and should consider various mechanisms by which to seek such data. The proposing release should also include a request for such data.

Identify and discuss uncertainties underlying the estimates of benefits and costs. Where particular benefits or costs cannot be monetized, the release should present any available quantitative information: for example, quantification of the size of the market(s) affected, or the number and size of market participants subject to the rule. Even without hard data, quantification may be possible by making and explaining certain assumptions. For example, if proposed rules would enable the operation of a new trading system, it may be reasonable to assume the system will attract a percentage of all market volume (*e.g.*, one percent). With that

[33] As discussed above, *see* note 30 and corresponding text, it is frequently difficult to reliably quantify the benefits and costs of financial regulations.

assumption, the cost-benefit analysis could then estimate a distributional effect of a certain magnitude. It is important to make assumptions (and the rationales for the assumptions) explicit and, where alternative assumptions are plausible, to include analysis based on each.

Court decisions addressing the economic analysis in Commission rules have likewise stressed the need to attempt to quantify anticipated costs and benefits, even where the available data is imperfect and where doing so may require using estimates (including ranges of potential impact) and extrapolating from analogous situations.[34]

If monetization or other quantification is possible, the proposing release should include those numbers and solicit comment on them, and the adopting release should address any comments on those numbers, including any data submitted to challenge them. When quantifying costs and benefits, staff should describe the measurement approach used, include references to statistical and stakeholder data if available, and specify the timeframe analyzed.

Explain why costs and benefits cannot be quantified. If RSFI economists and the rulewriting staff conclude that costs or benefits cannot reasonably be quantified, the release should include an explanation of the reason(s) why quantification is not practicable and include a qualitative analysis of the likely

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[34] *See, e.g.*, *Business Roundtable*, 647 F.3d at 1150 ("Although the Commission acknowledged that companies may expend resources to oppose shareholder nominees, see 75 Fed. Reg. at 56,770/2, it did nothing to estimate and quantify the costs it expected companies to incur; nor did it claim estimating those costs was not possible, for empirical evidence about expenditures in traditional proxy contests was readily available. Because the agency failed to 'make tough choices about which of the competing estimates is most plausible, [or] to hazard a guess as to which is correct,' *Pub. Citizen* [*v. Federal Motor Carrier Safety Admin.*], 374 F.3d [1209] 1221[(D.C. Cir. 2004)], we believe it neglected its statutory obligation to assess the economic consequences of its rule . . . ."); *Chamber I*, 412 F.3d at 144 ("Although the Commission may not have been able to estimate the aggregate cost to the mutual fund industry of additional staff because it did not know what percentage of funds with independent chairman would incur that cost, it readily could have estimated the cost to an individual fund, which estimate would be pertinent to its assessment of the effect the condition would have upon efficiency and competition, if not upon capital formation. And, as we have just seen, uncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure.").

economic consequences of the proposed rule and reasonable regulatory alternatives. The release should discuss the strengths and limitations of the information underlying the qualitative cost-benefit analysis. Rulewriters should work with RSFI economists to clearly identify important uncertainties underlying the analysis and to explain the implications of these uncertainties for the analysis.

Support predictive judgments and clearly address contrary data or predictions. To the extent that the economic analysis includes predictive judgments, it should provide support for those judgments. At the outset of a rulemaking, RSFI economists should determine whether there are studies or empirical evidence that would help inform the economic analysis of the proposed rule and of possible alternatives. RSFI economists should work with the rulewriters to include such information in the proposing release and should solicit comment on it. Where the Commission is giving greater weight to some empirical evidence/studies than to others, it should clearly state the reason(s) for doing so. To the extent that the staff believes that a study or comment should be discounted, the release should explain why and cite available evidence supporting that position.

Frame costs and benefits neutrally and consistently. The release should evaluate the costs and benefits even-handedly and candidly, acknowledging any limitations in the data or quantifiable information. To the extent that the release discusses scenarios that might mitigate the costs or enhance the benefits, consider and discuss the impact that those scenarios would have on both the costs and the benefits.

Combine the economic analysis considering costs and benefits with consideration of the effects on efficiency, competition, and capital formation. SEC rulemaking releases have often included separate sections captioned "Cost Benefit Analysis" ("CBA") and "Efficiency, Competition, and Capital Formation" ("ECCF"). We do not believe this is necessary. This approach can result in redundancy and unnecessary parsing of economic effects.[35] We believe that the better approach is to provide an integrated economic analysis of the rule rather than

[35] *See* OIG Report No. 499 at 29-31 ("[R]ulewriting divisions should consider discontinuing the practice of drafting separate cost-benefit analysis and efficiency, competition, and capital formation sections and instead provide a more integrated discussion of these issues in rule releases.").

to provide separate CBA and ECCF sections. This can be accomplished either through a single "Economic Analysis" section that combines the formerly separate CBA and ECCF sections and discusses the economic consequences in a more comprehensive manner or by incorporating the economic analysis throughout the release rather than in a dedicated section.

B. Enhanced integration of economic analysis into the rulemaking process and rule releases.

Both OIG Report No. 499 and communications from Members of Congress have suggested earlier and more extensive involvement of RSFI economists in the rulemaking process.[36] A primary goal in the creation of RSFI was to enhance the agency's economic analysis capabilities for rulemaking. To make the best use of RSFI's expertise, RSFI economists should be involved at the earliest stages of the rulemaking process (*e.g.*, before the specific preferred regulatory course is determined) and throughout the course of writing proposed and final rules. RSFI economists should be fully integrated members of the rulewriting team, and contribute to all elements of the rulewriting process. Close collaboration with RSFI will help to integrate economic analysis as key policy choices are made, in order to (1) assist in the evaluation of different or competing policy options by identifying the major economic effects of those options; (2) influence the choice, design, and development of policy options; (3) assist in the evaluation of whether and to what extent any proposed policy would promote efficiency, competition, and capital formation; (4) improve the quality of regulation; (5) better support policy choices made by the Commission; and (6) increase confidence in the regulatory process.

Pre-proposal stage. The rulewriting team should prepare (1) an explanation of the policy and economic rationale for regulatory action, including the problem to be addressed and the goals sought to be achieved; and (2) a high-level discussion of the likely elements of the economic analysis (*e.g.*, the nature and scale of expected market impacts from the main regulatory alternatives under consideration), and additional data needs. RSFI economists responsible for the rulemaking should be fully integrated into the rulewriting team at this stage so that

[36] OIG Report No. 499 at 12-15.

they may prepare or assist in preparing the high-level economic analysis and begin work on gathering the additional data needed or performing additional analysis necessary for preparation of the rule proposal.

Proposing stage. The proposing release should include a substantially complete analysis of the most likely economic consequences of the rule proposal. The economic analysis should be drafted by RSFI economists or in close collaboration with RSFI economists. The release should also include a discussion of any existing studies or data that bear on the proposal so that the public knows what studies or data we are relying on, can comment on it, and can provide additional data relevant to the topic. RSFI's concurrence in the proposing release's economic analysis should be obtained for the final draft that is formally circulated to the Commission for action.

Comment period. The proposing release should be specific in its request for comment on the economic analysis and should identify any quantitative information that market participants are requested to provide. As part of their continuing analysis of the potential economic effects of the proposed rule, the RSFI economists assigned to the rulemaking team should pay particular attention to any comment letters containing economic analysis and data. Where appropriate, RSFI economists should attend meetings with commenters or other third parties regarding the proposed rule, particularly in those instances when the rulewriting team expects that the outside party will provide additional data or comment upon the economic analysis or data contained in the proposing release.

Adopting stage. As part of the development of the adopting release, the staff should prepare a high-level economic analysis (prepared by or with the assistance of RSFI economists) that addresses (1) any significant policy alternatives suggested by commenters that are not recommended for adoption; (2) other comments received relevant to the economic effects of the proposed rule and realistic alternative approaches; and (3) data gathered. The adopting release should then be drafted in close consultation with the RSFI economists to develop a complete economic analysis of the final rule, addressing comments and realistic alternatives to the approach chosen. RSFI's concurrence in the economic analysis should be obtained for the draft that is formally circulated to the Commission for action.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SOUTHWIRE COMPANY and ENCORE WIRE CORPORATION, Petitioner, vs. SECURITIES AND EXCHANGE COMMISSION, Respondent.	)))))))))	No. 13-1031

STATEMENT OF ISSUES TO BE RAISED

Pursuant to the Clerk's Order of February 14, 2013, Petitioner Southwire Company hereby files this Statement of Issues:

1. Whether the Securities and Exchange Commission's ("SEC") Order entered on the 14th day of December 2012; File No. SR-NYSE Arca-2012-28, Release No. 34-68440 ("the SEC Order"), approving a rule change to allow the listing and trading of shares of JPM XF Physical Copper Trust ("Trust") pursuant to NYSE Arca Equities Rule 8.201, is contrary to the requirement of Section 6(b)(5) of the Securities and Exchange Act of 1934, 15 U.S.C. 78f(b)(5) (the "Act"), which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to

promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, where the copper to be acquired by the Trust will remove, from the market for copper available for immediate delivery to end users, substantial quantities of London Metal Exchange (“LME”) grade physical copper that would otherwise be available to them to purchase, inflate premiums for whatever remaining copper would otherwise be available to such end users, and which, contrary to the SEC’s findings, will not, upon redemption of shares in the Trust, result in physical delivery of such copper to end users because, to discourage redemption in the first place, such copper will either not be an acceptable brand suitable to be placed on LME warrant (and thus capable of being traded or swapped for LME grade copper that would be an acceptable brand), or if eligible to be placed on warrant, such copper will still be held by the Sponsor or its network of Authorized Participants in the Sponsor’s warehouse, subject to daily rent charges, where, instead of making physical delivery to end users, the Sponsor or its Authorized Participants will either have a financial incentive to (i) re-tender the copper to the Trust and thereby shift back to the Trust's investors the daily cost of storage and at the same time, make a profit (over the cost of the copper) on the sale of the Trust's shares, or alternatively, (ii) if the forward copper price curve is favorable, *i.e.*, in "contango," meaning that copper prices for delivery in the future are higher than prices for immediate delivery, they may elect to sell the metal forward to an investor who will hold it, cover the Sponsor's cost of storage and make a profit without ever taking physical delivery, or (iii) the Authorized Participant or its customer may choose instead to transfer redeemed copper to other warehouses whose owners are outbidding end users for available supply and which warehouses are subject to queues which have effectively ended the use of that warehouse as a market by which end users may obtain immediate delivery.

2. Whether adoption of the Order was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of the Administrative Procedure Act ("APA") because even though the SEC (i) found the proposed rule change to be consistent with Section 6(b)(8) of the Act, 15 U.S.C. 78f(b)(8), which requires that the rules of a national securities exchange not impose any burden on competition not

necessary or appropriate in furtherance of the purposes of the Act, and (ii) considered pursuant to Section 3(f) of the Act, whether the proposed rule change will promote "efficiency, competition and capital formation," the SEC failed to consider the costs and benefits of the proposed rule on efficiency, competition and capital formation in the markets directly and indirectly affected by the rule, including in particular the market for copper available for immediate delivery to end users by, among other things, failing to establish any baselines by which to measure the rule's impact on efficiency, competition and capital formation in such markets, and by failing to identify or otherwise request specific data that would be necessary for or that would assist in quantification of such impact on efficiency, competition and capital formation in such markets.

3. Whether adoption of the Order was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of the APA because the SEC failed to consider evidence showing that the supply of physical copper that may be used for the creation of shares in the Trust will be subject to a bidding war among competing warehouse owners and end users, which competition for available supply has already caused premiums for such copper in excess of the LME settlement price

to increase substantially, and will, once the Trust commences operation, likely soar even higher, because so much of the existing copper inventory is stored in LME warehouses which are not only not owned by the Sponsor, but which are subject to queues where actual physical delivery to the Sponsor's warehouses, should that occur, may take months, thus resulting in an investor-financed squeeze of the market.

4. Whether adoption of the Order was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of the APA when the SEC, in issuing the Order, relied on economic studies that failed to analyze the impact on LME settlement prices when inventory is removed from LME warehouses for non-commercial purposes, which has always been the hallmark of all copper corners and squeezes, and concluded instead that the removal of LME-grade copper from LME warehouses, for a non-commercial purpose, i.e., to be stored off-market to back the Trust and not otherwise be consumed by an end-user, would not in fact inflate the LME settlement price of copper, even though (i) copper held by the Trust, because it would not be held on warrant, would not be subject to LME rules, including the LME's lending guidelines, which are anti-squeeze measures that require holders of 50% or more of the inventory in LME warehouses to lend copper back

to the market so as to avoid a squeeze or corner, and (ii) the draft registration statement represented that shares of the Trust would lose value unless the price of copper were to increase which could occur based on how successful the Trust is in acquiring copper. Thus, in finding no likelihood of any artificial increase in the price of copper, the SEC overlooked representations that "[b]ecause there is no limit on the amount of copper that the Trust may acquire, the Trust, as it grows, may have an impact on supply and demand for copper that ultimately may affect the price of the shares in a manner unrelated to other factors affecting the global markets for copper," that "purchases of copper for transfer into the Trust in connection with the creation of Creation Units may increase the market price of copper, which will result in higher trading prices for the shares" and that "[i]ncreases in the market price of copper may also occur as a result of the purchasing activity of other market participations."

5. Whether the SEC acted in a manner that was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of 5 U.S.C. § 706(2)(A) when it failed to support the SEC Order with substantial evidence that "copper held by the Trust will remain available to consumers and other participants in the physical copper

market because : (1) the Trust will not consume copper; (2) shares are redeemable (in size) for copper on every Business Day; and (3) redeeming authorized participants will receive the right to obtain their copper within three business days" where the SEC assumed for purposes of analyzing the proposed rule change that "copper will be transferred to an authorized participant's book-entry account within three days, and that an authorized participant taking delivery from an LME warehouse will then have to wait in the queues. . . just like other owners withdrawing metal from that warehouse" where, as indicated, once redeemed copper is made available in Sponsor's warehouse to authorized participants, including the Sponsor itself, they may either re-tender the copper to the Trust and thereby avoid daily rental fees and payment of a premium to acquire such copper for tender to the Trust, or if there is no queue at Sponsor's warehouse, they may elect to transfer such copper to a competing warehouse which is outbidding end users for available supply.

6. Whether the SEC acted in a manner that was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of 5 U.S.C. § 706(2)(A) when it concluded that "copper received in exchange for redeemed Shares could be (1) sold in the OTC market for

cash; (2) swapped in the OTC market for copper in a different location or for a different brand; and/or (3) removed from the warehouse and consumed," accepted without data or other supporting evidence the Sponsor's representation that "these three types of transactions are commonplace in the copper market" and further, that "copper delivered from the Trust (in exchange for Shares) could be placed under LME warrant if required by LME market participants" and that, based on these unsubstantiated assumptions, "[g]iven the structure of the Trust, the Commission believes that the amount of copper accessible to industrial users will not meaningfully change as a result of the listing and trading of the Shares," and that accordingly, "the Commission believes that the proposed rule change will not burden capital formation for users who acquire copper for industrial and other purposes."

7. Whether the SEC acted in a manner that was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of 5 U.S.C. § 706(2)(A) when it concluded that "the record supports the view that there are sufficient copper stockpiles such that up to 61,800 metric tons of copper could be deposited into the Trust without authorized participants taking copper off of either LME or COMEX warrant" without taking into account the fact that such copper today,

whatever the theoretical size of such inventory may be, when it arrives at a location where it may actually be delivered to an end user, is already the subject of aggressive bidding by warehouse owners willing to pay producers and traders substantial premiums for depositing such metal in their warehouses, that such practices by warehouse owners have led to vast amounts of such copper being stored in LME warehouses in New Orleans, Antwep and Johor where, when sold, it may not be available for physical delivery for months, a phenomenon which has effectively eliminated those LME warehouses as markets for copper available for immediate delivery, thus substantially shrinking the market for copper available for immediate delivery to whatever is delivered to a port where it could either go on warrant in an LME warehouse or be sold to an end user. Here, the SEC not only failed to analyze the market as it exists today, but failed to analyze what the impact would be as authorized participants begin to vie with warehouse owners and end users for the limited supply of such copper when it arrives in an LME port city such as New Orleans, Antwerp or Johor. Indeed, even when warned of the problem of escalating premiums and the impact the listing and trading of shares in the Trust would have on end users trying to obtain delivery, the SEC looked only at existing premiums, concluded that they fluctuate, and failed completely to analyze what the impact on premiums would be – and the cost to industrial end users and their customers – when shares of the Trust begin to be listed and traded.

8. Whether the SEC acted in a manner that was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of 5 U.S.C. § 706(2)(A) when it concluded that even assuming that authorized participants will need to remove copper from LME warrant to deposit the copper into the Trust, "the Commission believes that the Trust's copper will remain available for immediate delivery to consumers and participants in the physical markets" and that, accordingly, "The commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery" where, as demonstrated, there is no substantial evidence in the record to support the conclusion that the Trust's copper will ever be made available for "immediate delivery to consumers" should Shares in the Trust be redeemed.

9. Whether the SEC acted in a manner that was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of 5 U.S.C. § 706(2)(A) when it concluded without supporting data that

the size of the Trust would not grow quickly enough to disrupt the market for copper available to end users, and that, even if the Trust did grow quickly, it would be unlikely to result in the Trust holding as much as 61,800 metric tons of copper – which is the maximum amount of copper that the Trust would hold if all 6,180,000 shares of the Trust were sold – based on its assumption, without supporting data, that shares would be redeemed, causing Trust copper to flow back to the market for copper available for immediate delivery to end users, where the SEC had no evidence that redemption would occur other than that the Trust's "structure" allowed for it, where the SEC overlooked evidence tending to show that that redemption would not occur and where, even if it did occur, it would not result in copper being available for immediate delivery to end users.

10. Whether the SEC acted in a manner that was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of 5 U.S.C. § 706(2)(A) when it concluded that the size of the Trust would not grow quickly, so as to disrupt the market for copper immediately available to industrial end users, when it concluded that shares of ETFS Physical Copper, which are listed and traded on the London Stock Exchange and Deutsche Boerse, had not grown to a substantial size

since inception, while failing to take into account that unlike the proposed Trust, which will not hold LME warranted copper and which is unlimited in size, ETFS Physical Copper holds only LME copper warrants, which are subject to the LME lending guidelines, which are essentially an anti-squeeze regulation that requires holders of 50% or more of the copper in LME warehouses to lend such copper to the market so as to avoid a squeeze in supply.

11. Whether the SEC contravened Section 3(f) of the Act by failing to consider adequately the efficiency, competition and capital formation effects of the new rule, where the effect of the rule change is to remove a substantial quantity of copper from the market for copper available for immediate delivery to end users at a time when that market is already being severely constricted as a result of owners of LME warehouses paying huge premiums to metal producers to place copper that otherwise would be available for immediate delivery into warehouses with lengthy queues for physical delivery, where the SEC, having been told of this problem, failed to examine, among other things, how much copper is currently being held by the Sponsor in its own LME warehouses, how much is held in competitors' LME warehouses, the development of queues in such warehouses, the impact

on premiums that end users must now pay for copper as a result of such copper otherwise available for immediate delivery to end users being stored in warehouses with lengthy queues, the projected impact on supply and premiums that end users will have to pay for such copper once the proposed rule change becomes effective, which together with the SEC's approval on February 22, 2013 of a similar rule change for iShares Copper Trust (see release No. 34-368973; File No. SR-NYSE Arca 2012-66), which, if successful, could result in the initial removal from the market of as much as 180,000 metric tons of copper, an amount which currently exceeds all U.S. LME inventory for copper and is nearly 40% of LME copper stock worldwide, whether and to what extent a new LME rule change requiring LME warehouses with queues to off-load a minimum of 500 metric tons of copper per day will address the problem and what the impact will be if it does not, whether and how quickly copper producers in a generally inelastic copper production market will otherwise be able to supply the additional copper needed to meet the demand by end users for such copper as a result of the SEC's rulemaking, or whether such additional production will just be sufficient to meet global demands for copper and have no impact at all on the amount of copper that may be available for immediate delivery to end users.

12. Whether the SEC contravened Section 3(f) of the Act by concluding without quantitative data or analysis that the listing and trading of the Shares would "enhance competition" among trading venues and "increase competition" among "financial products" without also taking into account whether the supposed benefits of such "enhanced competition" among "trading venues" and "financial products" would outweigh the costs to other markets that would be impacted by the proposed rule change, including the already burdened market for copper available for immediate delivery to end users, by considering, among other things, the extent to which the proposed rule change would restrict the supply of copper available for immediate delivery to end users, drive up prices, limit output, and otherwise burden competition among end users and their customers.

13. Whether the SEC contravened Section 3(f) of the Act by concluding the rule change would promote efficiency by allowing investors to make better informed investment decisions about purchasing LME grade copper without conducting a baseline comparison of information currently available to investors purchasing LME grade copper.

14. Whether the SEC contravened Section 3(f) of the Act by concluding without quantitative data or analysis that the rule change would not burden capital formation based on a flawed assumption that, given the "structure" of the Trust, which allows authorized participants – but not shareholders – to redeem shares in exchange for copper – the "amount of copper accessible to end users will not meaningfully change as a result of the listing and trading of the Shares" and that, accordingly, "the proposed rule change will not burden capital formation for users who acquired copper for industrial and other purposes."

15. Whether the SEC contravened Section 3(f) of the Act by failing to identify and discuss reasonable alternatives to the proposed rule, such as imposing reasonable limits on the amount of copper the Trust may hold consistent with the size and range of similar investment vehicles traded in Europe, which have thus far had no material impact on the market for copper available for immediate delivery, or alternatively, consistent with similar investment vehicles traded in Europe, requiring that the LME grade copper which the Trust holds be limited to copper on LME warrant, which would at least keep copper acquired by the Trust subject to the LME's anti-squeeze rules.

16. Whether the SEC acted in a manner that was arbitrary and capricious, an abuse of discretion, and/or otherwise unlawful within the meaning of 5 U.S.C. § 706(2)(A) in voting to approve the proposed rule change, where (i) two of the four SEC commissioners voting on the proposed rule change held an *ex parte* meeting on December 6, 2012, with representatives of the Sponsor (J.P. Morgan Chase) and its counsel to discuss the Sponsor's application in connection with the pending rulemaking proceeding, (ii) the existence of such *ex parte* meeting was not disclosed until early January 2013, when the proposed rule had already been approved and it was too late for industrial users and their own counsel to request their own *ex parte* meeting, (iii) industrial users and their counsel had previously made several formal written requests to meet with Commission members to discuss the application, which culminated in an order issued by the Commission on December 5, 2012 – the day before the *ex parte* meeting – formally denying their request, and (iv) eight days after the aforementioned *ex parte* meeting, on December 14, 2012, the Commission voted to approve the proposed rule change despite all of the aforementioned failures to give adequate consideration to the impact that such rule change would have on industrial users.

Dated: March 18, 2013

Respectfully submitted,

/s/ Robert B. Bernstein
Robert B. Bernstein
Eaton & Van Winkle LLP
3 Park Avenue
16th Floor
New York, New York 10016
212-779-9910

Counsel for Petitioner Southwire Company

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of March 2013, I caused a copy of Petitioner's Statement of Intent to Utilize Deferred Joint Appendix to be served by CM/ECF upon the following:

Nicholas J. Bronni, Esq. (bronnin@sec.gov)
Randall W. Quinn, Esq. (quinnr@sec.gov)
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9010

/s/ Robert B. Bernstein
Robert B. Bernstein
Eaton & Van Winkle LLP
3 Park Avenue
16th Floor
New York, New York 10016
212-779-9910

Counsel for Petitioner Southwire Company