

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 economists⁵ 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

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”)

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

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

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

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. Identify and discuss reasonable alternatives to the proposed rule.

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

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. Analyze the economic consequences of the proposed rule and the principal regulatory alternatives.

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

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

Benefits 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):

- 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

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.