

Economic Research and Analysis

The economic analysis program provides the technical and analytical support necessary to understand and evaluate the economic effects of Commission regulatory policy, including the costs and benefits of rulemaking initiatives. The staff reviews all rule proposals to assess their potential effects on small businesses; competition within the securities industry and competing securities markets; efficiency, competition, and capital formation; and costs, prices, investment, innovation and the economy.

What We Did

- Provided economic advice, analysis, and data in connection with major policy initiatives, such as Decimalization, Regulation FD, the new Execution Quality Disclosure Rule, and revised Auditor Independence Standards.
- Produced and published a study comparing the quality of order executions across equity market structures. The study was a part of the Commission's ongoing inquiry into the impact of order interaction on the quality of executions for customer orders in the National Market System for equity securities.
- Co-produced and published studies with the Office of Compliance Inspections and

Examinations focusing on compliance with the Commission's Limit Order Display Rule and analyzing the extent of payment-for-order-flow arrangements and their impact on the options markets.

- Provided advice and technical assistance in a variety of investigations and enforcement actions, applied financial economics and statistical techniques to examine evidence, and estimated the amount of disgorgement to be sought in insider trading cases.

Economic Analysis and Technical Assistance

Our economic analysis staff provided substantial quantitative economic evidence on a number of rulemaking projects.

Market Structure and Trading Practices

- Provided technical assistance to the Commission in analyzing the likely effects of decimalization on quoted spreads, trading costs, quotation depth, limit orders, specialists' participation rates, and price volatility. Before decimalization, the staff published an empirical analysis of the reduction in markets' in the minimum tick size from an eighth to a sixteenth. The staff also monitored the impact of the initial phases of decimalization.
- Provided technical assistance to the Commission in analyzing the association between the pricing of initial public offering (IPOs) and certain trading practices

employed by investment banking firms and investors. For example, the staff analyzed the effects of short sales and short-covering practices, flipping, and penalty bids to help policymakers in assessing the rules governing trading practices during IPOs.

- Published a report comparing order executions across equity market structures. The staff based the study on matched samples of Nasdaq and NYSE stocks. The study is a part of the Commission's ongoing inquiry into the impact of order interaction on the quality of executions for customer orders.
- Worked with the Division of Market Regulation to provide a report to Congress on the extent and impact of after-hours trading. The economics staff provided data and analysis of ECNs' market shares, quoted spreads, price volatility, and trading costs.
- Analyzed the effects of intensified competition in the options markets on quoted spreads, trading costs and market share.
- Provided economic advice and empirical data regarding the economic effects of rules governing market operations and trading structures, such as the execution quality disclosures and rules governing options' markets quotations, electronic linkages, and trade-throughs.

Disclosure and Accounting Standards

- Evaluated the costs and benefits of policy alternatives considered in conjunction with the revision of the Auditor Independence Standards. Analyzed pertinent research and provided empirical data and analysis pertaining to non-audit revenues of accounting firms.
- Provided economic advice and empirical data regarding the economic effects of new and revised disclosure rules. These included analyses of the impact of new Regulation FD, enhanced audit committee disclosures, equity compensation disclosures, and rules governing the delivery of proxy materials to shareholders.
- Prepared a report analyzing differences in the measures of net income and shareholders equity between US Generally Accepted Accounting Principles (GAAP), home-country GAAP and International Accounting Standards for 92 foreign registrants.

Mutual Funds

- Provided economic advice and empirical data on issues impacting mutual funds. These included analyses of the effects of rules governing mutual funds' purchases of securities from affiliates, the independence of mutual funds' directors, mutual funds' adherence to the investment style that their names imply, and new disclosure requirements that require mutual funds to calculate and present after-tax returns.

- Provided advice and analytical support to the Division of Investment Management on its Study of Mutual Fund Fees. In particular, the economics staff helped develop an econometric model to measure the relationship between mutual fund fees and certain fund attributes.
- Provided economic advice and empirical data on issues impacting investment advisers. These include pay-to-play restrictions on investment advisers and rules that simplify the registration process for investment advisers.

Inspections and Examinations

Our economic analysis staff worked closely with the SEC's Office of Compliance Inspections and Examinations to:

- Analyze compliance with the Commission's Limit Order Display Rule. The staff published its findings in a report issued in April of 2000.
- Analyze the extent of payment-for-order-flow arrangements and their impact on the options markets. The staff published its findings in a report issued in December of 2000.

Enforcement Issues

Our economic analysis staff provided assistance in investigations and enforcement actions involving insider trading, mutual fund trade allocation, market manipulation, fraudulent financial reporting, and other violations of securities laws. The staff applied financial economics and

statistical techniques to determine whether the elements of fraud were present and to estimate the amount of disgorgement to be sought. The economics staff also assisted in evaluating the testimony of experts hired by opposing parties.