

# Economic Research and Analysis

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*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.*

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## What We Did

- Assessed the costs and benefits of all new Commission rules and rule proposals.
- Monitored the economic effects of recent policy initiatives, such as decimalization, the new execution quality disclosure rule, and Regulation FD.
- Prepared reports on recent market developments, such as the growth of exchange-traded funds (ETFs) and intensified competition in the market for trading listed options.
- Provided technical assistance to IOSCO Working Party 3 on topics such as the cross-border marketing of financial services, capital adequacy standard for financial service firms, and methodologies for assessing operational risks.
- Provided advice and technical assistance to the SEC's inspections and examinations staff on issues such as market pre-opening practices, payment-for-order-flow arrangements, and order execution practices.

- 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.
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## **Economic Analysis and Technical Assistance**

Our economic analysis staff provided substantial quantitative economic evidence on approximately 45 regulatory and market initiatives impacting the securities industry and markets. Some of the more significant initiatives are discussed below.

### **Market Structure and Trading Practices**

- Assessed the costs and benefits of Commission rules impacting the securities industry, such as the proposed amendments to broker-dealer books and records requirements.
- Monitored the implementation of decimal pricing on Nasdaq and exchanges and provided empirical analysis of related issues. For example, the staff prepared studies of decimalization's effects on quoted spreads, trading costs, quotation depth, limit orders, price volatility, bid flickering, quote jumping, and short selling.
- Analyzed the trading costs on electronic communications networks (ECNs) relative to those of comparable orders executed by market makers and reported the findings to the Commission.

- Monitored the implementation of the new execution quality disclosures and provided the Commission with analyses of the effective spreads and certain other execution quality metrics reported by various market centers.
- Provided economic advice and empirical analysis on the economic effects of rules governing market operations and trading structures and self-regulatory organization initiatives such as Nasdaq's SuperMontage.
- Analyzed the impact of short sale rules and rules governing options' markets quotations, electronic linkages, and trade-throughs.
- Assessed the likely effects of the single stock futures trading rules and evaluated proposed customer margin requirements.

## Disclosure and Accounting Standards

- Monitored the economic effects of new Regulation FD and evaluated related surveys and empirical studies.
- Provided advice and technical assistance to the Division of Corporation Finance in conjunction with a Division study of compliance with the new audit committee requirements.
- Prepared a report analyzing the economic issues and related empirical research on the use of the pooling and purchase methods in preparing financial statements for mergers.

- Provided economic advice and technical assistance on issues pertaining to road show communications and the delivery of proxy statements to households.

## Mutual Funds

- Analyzed the costs and benefits of rule changes impacting mutual funds and investment advisers, such as rules governing custody of fund assets, mergers of affiliated funds, and disclosure requirements pertaining to fund investment objectives and performance.
- Prepared reports on issues related to the economic effects of ETFs. For example, the staff analyzed the effects of trading in ETFs on the liquidity and volatility of markets for the underlying securities.
- Provided assistance to the Division of Investment Management and Office of Investor Education and Assistance on technical issues, such as the use of the Commission's mutual fund fee calculator and the computation of a mutual fund's after-tax returns.

## International and Cross-Border Issues

- Provided technical assistance to IOSCO Working Party 3 on topics such as the cross-border marketing of financial services, capital adequacy standard for financial service firms, and methodologies for assessing operational risks.

## Inspections and Examinations

Our economic analysis staff provided advice and technical assistance to the SEC's Office of Compliance Inspections and Examinations in reviewing the first phase of the new Combined Options Audit Trail,

Nasdaq market maker's pre-opening practices, the extent of payment-for-order-flow arrangements and their impact on the options markets, and broker-dealer and exchange order execution practices in the equity and option markets.

## **Enforcement Issues**

Our economic analysis staff provided assistance in 65 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.