



U.S. Securities and Exchange Commission
Office of Inspector General
Office of Audits

Implementation of the Current Guidance on Economic Analysis in SEC Rulemakings



June 6, 2013
Report No. 516



OFFICE OF
INSPECTOR GENERAL

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MEMORANDUM

June 6, 2013

To: Mary Jo White, Chair

From: Carl W. Hoecker, Inspector General, Office of Inspector General 

Subject: *Implementation of the Current Guidance on Economic Analysis in SEC Rulemakings, Report No. 516*

This memorandum transmits the U.S. Securities and Exchange Commission (SEC) Office of Inspector General's (OIG) final report detailing the results of our audit of the SEC's implementation of the current guidance on economic analysis in its rulemakings. We conducted this audit in response to a Congressional request.

The final report contains one recommendation that, if fully implemented, should strengthen the SEC's economic analysis process. The Office of the Chair concurred with the recommendation. Your written response to the draft report is included in Appendix V.

Within the next 45 days, please provide the OIG with a written corrective action plan that addresses the recommendation. The corrective action plan should include information such as the responsible official/point of contact, timeframe for completing required actions, and milestones identifying how your office will address the recommendation.

If you have any questions about this report, please do not hesitate to contact me.

We appreciate the courtesy and cooperation that you and your staff extended to our staff during this audit.

Attachment

cc: Erica Y. Williams, Deputy Chief of Staff, Office of the Chair
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Implementation of the Current Guidance on Economic Analysis in SEC Rulemakings

Executive Summary

Background. On July 24, 2012, the U.S. Securities and Exchange Commission's (SEC or Commission) Office of Inspector General (OIG) received a letter from the Chairman of the U.S. House of Representatives Committee on Oversight and Government Reform (House Oversight Committee) and the Chairman of the U.S. House of Representative's Subcommittee on TARP (Troubled Assets Relief Program), Financial Services and Bailouts of Public and Private Programs (Subcommittee on TARP) requesting that the OIG evaluate the SEC's implementation of the *Current Guidance on Economic Analysis in SEC Rulemakings* (Current Guidance), issued on March 16, 2012. The letter requested that we assess and report on the degree to which the SEC has incorporated the principles and policies of the Current Guidance into economic analyses supporting proposed and final Commission rules. The OIG was also asked to evaluate the degree to which the SEC has ensured that the principles and policies of the Current Guidance have been incorporated into the economic analyses of rulemakings of the Financial Industry Regulatory Authority, other self-regulatory organizations under the Commission's jurisdiction, and the Public Company Accounting Oversight Board.

The Current Guidance, dated March 16, 2012, is an internal memorandum that the Division of Risk, Strategy, and Financial Innovation (RSFI) and the Office of the General Counsel (OGC) developed. RSFI and OGC sent the memorandum by email to SEC staff in the rulewriting divisions and offices on that same date. The Current Guidance is based on and references recent court decisions, reports from the SEC OIG and the Government Accountability Office (GAO), and Congressional inquiries that have raised questions about or recommended improvements (or both) to the Commission's economic analysis in rulemaking. The Current Guidance, in Sections A and B, contains four substantive requirements and one process requirement.

The SEC derives its rulemaking authority from Federal securities laws. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act gave the SEC additional rulemaking authority and required the SEC to adopt specific rules. Rulemaking at the SEC has three stages: pre-proposal stage, proposal stage, and adopting stage.

Congressional Request. On December 21, 2012, the Interim Inspector General sent letters to the Chairman of the House Oversight Committee and the Chairman of the Subcommittee on TARP outlining the OIG's approach for responding to their request. The OIG's letters stated that it would:

- conduct “an audit to confirm that procedures have been established and are being used in accordance with the Current Guidance and that the Current Guidance incorporates recommendations offered by others on rulemaking [Phase 1];” and
- direct “an experienced contractor with expertise in economic analysis, the securities industry, and SEC operations to perform the more extensive rulemaking analyses [Phase 2].”

This audit report covers Phase 1 of the OIG's response to the Congressional request.

Objectives. The objectives of the audit were to determine whether:

- the SEC has established and implemented procedures for a methodical economic analysis process in accordance with its Current Guidance;
- the SEC developed and uses procedures to improve the economic analysis process such as hiring additional economists and implementing a systematic review process; and
- the Current Guidance incorporates the SEC OIG's and other commenters' recommendations issued to the SEC on economic analysis.

Results. The OIG found that the Commission has used the Current Guidance since its issuance in March 2012 to develop the economic analyses for rulemakings. However, the SEC has not issued written operating procedures implementing the Current Guidance. Not having documented operating procedures poses a risk that the SEC may inconsistently apply the Current Guidance's requirements throughout the rulemaking process.

Further, the OIG found that the Commission has taken steps to improve its process for economic analysis by: (1) requiring RSFI economists to be involved in the three stages of the rulemaking process; (2) hiring economists with financial industry knowledge; and (3) formalizing the Chief Economist's review and concurrence process.

Finally, we found that the Commission incorporated recommendations it received from the SEC OIG and other commenters into its Current Guidance. Specifically,

the SEC addressed in the Current Guidance: (1) recommendations from the SEC
OIG followup review of Dodd-Frank rulemaking; (2) a GAO report on Dodd-Frank
rulemaking; and (3) a U.S. Court of Appeals opinion that vacated an SEC rule
about proxy access.

Summary of Recommendation. This report contains one recommendation
designed to ensure that the SEC develops written operating procedures for
economic analysis to implement the requirements in the Current Guidance.

Management's Response to the Report's Recommendation. The OIG
provided the Chairman's Office with the formal draft report on May 24, 2013. The
Chairman's Office concurred with the recommendation in this report. The OIG
considers the report recommendation resolved. However, the recommendation
will remain open until documentation showing the recommendation has been fully
implemented is provided to the OIG. The Chairman's Office's response to the
recommendation and OIG's analysis of that response is presented after the
recommendation in the body of this report.

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Background and Objectives

Background

Congressional Request

On July 24, 2012, the U.S. Securities and Exchange Commission's (SEC or Commission) Office of Inspector General (OIG) received a letter from the Chairman of the U.S. House of Representatives Committee on Oversight and Government Reform (House Oversight Committee) and the Chairman of the U.S. House of Representative's Subcommittee on TARP (Troubled Assets Relief Program), Financial Services and Bailouts of Public and Private Programs (Subcommittee on TARP) requesting that the OIG evaluate the SEC's implementation of the *Current Guidance on Economic Analysis in SEC Rulemakings* (Current Guidance), issued on March 16, 2012. The letter requested that we assess and report on the degree to which the SEC has incorporated the principles and policies of the Current Guidance into economic analyses supporting proposed and final Commission rules. The OIG was also asked to evaluate the degree to which the SEC has ensured that the principles and policies of the Current Guidance have been incorporated into the economic analyses of rulemakings of the Financial Industry Regulatory Authority, other self-regulatory organizations under the Commission's jurisdiction, and the Public Company Accounting Oversight Board.

Interim Inspector General's Response

On December 21, 2012, the Interim Inspector General sent letters to the Chairman of the House Oversight Committee and the Chairman of the Subcommittee on TARP outlining the OIG's approach for responding to their request. The OIG's letters¹ stated that it would:

- conduct "an audit to confirm that procedures have been established and are being used in accordance with the Current Guidance and that the Current Guidance incorporates recommendations offered by others on rulemaking [Phase 1];" and
- direct "an experienced contractor with expertise in economic analysis, the securities industry, and the SEC operations to perform more extensive rulemaking analyses [Phase 2]."

¹Jon T. Rymer, Interim SEC Inspector General, letters to Darrell Issa, Chairman, House Committee on Oversight and Government Reform (December 21, 2012), and to Patrick McHenry, Chairman, House Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs (December 21, 2012).

This audit report covers Phase 1 of the OIG's response to the Congressional request.

Current Guidance. The Current Guidance, dated March 16, 2012, is an internal memorandum that the Division of Risk, Strategy, and Financial Innovation (RSFI) and the Office of the General Counsel (OGC) developed. RSFI and OGC sent the memorandum by email to SEC staff in the rulewriting divisions and offices on that same date. The Current Guidance is based on and references recent court decisions, reports of the SEC OIG and the Government Accountability Office (GAO), and Congressional inquiries that have raised questions about or recommended improvements (or both) to the Commission's economic analysis in rulemaking. The Current Guidance, in Sections A and B, contains four substantive requirements² and one process requirement.

Section A of the Current Guidance discusses four substantive requirements to be used when conducting economic analysis in SEC rulemaking. Those requirements are to:

1. clearly identify the justification for the proposed rule;
2. define the baseline³ against which to measure the proposed rule's economic impact;
3. identify and discuss reasonable alternatives to the proposed rule; and
4. analyze the economic consequences of the proposed rule and the principal regulatory alternatives.

Section B of the Current Guidance covers the process requirement for "enhanced integration of economic analysis into the rulemaking process and rule releases."⁴

Rulemaking at the SEC. The SEC derives its rulemaking authority from Federal securities laws.⁵ The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)⁶ and the Jumpstart Our Business Startups Act⁷ gave the

² SEC, *Current Guidance on Economic Analysis in SEC Rulemakings* (March 16, 2012), p. 4.

³ The Commission defines a baseline as the best assessment of how the world would look in the absence of the proposed action.

⁴ *Id.* at p. 15.

⁵ These include, among others, the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940.

⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, July 21, 2010.

⁷ Jumpstart Our Business Startups Act, April 5, 2012.

SEC additional rulemaking authority and required the SEC to adopt specific rules. Rulemaking at the SEC has three stages:

- *Pre-Proposal Stage.* This stage involves internal meetings among the rulewriting divisions, OGC, RSFI, and other SEC divisions and offices to begin to consider the scope and terms of a possible rulemaking and develop a plan of action. The SEC may issue a concept release⁸ if the Commission decides to seek public input before releasing a proposed rule.
- *Proposing Stage.* When approved by the Commission, a proposed rule is published for public notice and comment for a specified period of time, typically between 30 and 60 days. Proposing releases usually contain the text of the proposed new or amended rule, a discussion of the issue or problem the proposal is designed to address, and a detailed economic analysis.
- *Adopting Stage.* When approved by the Commission, a new rule or rule amendment becomes part of the official rules that govern the securities industry. Adopting releases reflect the SEC's consideration of public comments and generally include a detailed economic analysis.⁹

The rulemaking process begins when the rulewriting division's staff formulates a rulemaking recommendation on the basis of either the Commission's discretion or a Congressional mandate. The rulewriting divisions, which include the Division of Corporation Finance (CF), the Division of Investment Management (IM), and the Division of Trading and Markets (TM), have the primary responsibility for rulemaking. These divisions assign staff to the rulemaking and reach out to other SEC divisions and offices to ensure that relevant staffs are involved.

The rulewriting division that is responsible for the rulemaking prepares a term sheet that briefly describes the proposed rule and includes a preliminary economic analysis of the proposal that RSFI prepares. By this stage in the rulemaking process, RSFI economists have become an integral part of the rulemaking teams. The SEC uses a term sheet to facilitate discussion about the proposed rule. The term sheet is circulated among the Commissioners for their review and input.

⁸ A concept release typically outlines the topic of concern, identifies different potential approaches, and raises a series of questions inviting public comment on the matter. The Commission considers the public's feedback as it decides which approach, if any, is appropriate.

⁹ See *Rulemaking, How it Works*, <http://www.sec.gov/answers/rulemaking.htm>.

The responsible rulewriting division drafts a proposing or adopting release (depending on the stage of the rulemaking) and coordinates with OGC and RSFI representatives about their input to the draft. The rulewriting division and RSFI work together to prepare the economic analysis included in the release. At various stages during the drafting process, drafts of the release are circulated to the Commissioners for their review and input. The SEC staff may revise the draft rule and the release on the basis of comments from the Commissioners.

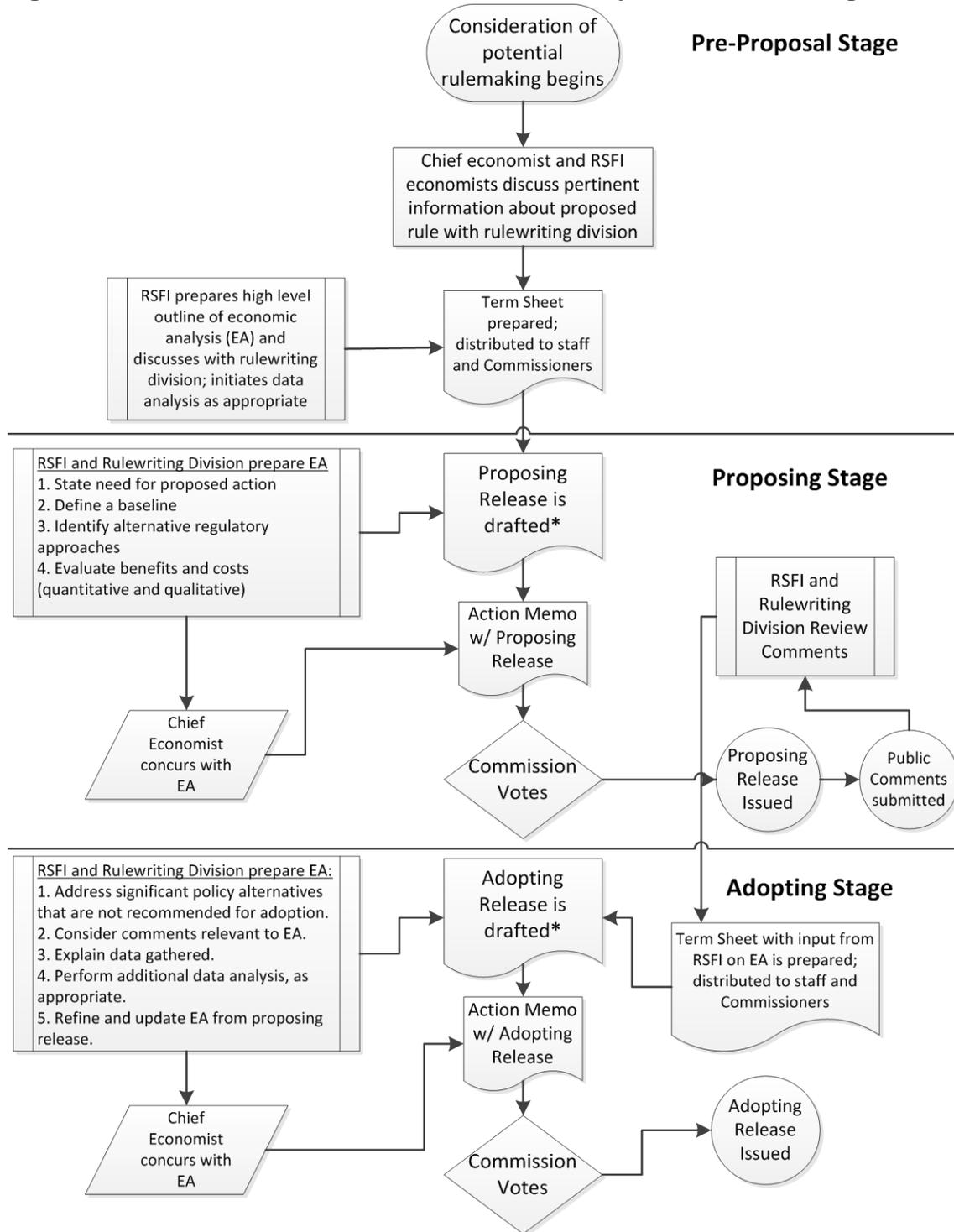
OGC reviews the proposed rulemaking to verify that the SEC has legal authority to adopt the rule and the release complies with the Administrative Procedure Act¹⁰ and other Federal administrative law requirements.¹¹ OGC also looks at the entire rule to determine whether it is consistent with applicable laws and other requirements. RSFI is responsible for the content of the economic analysis in the rulemaking release and the Chief Economist must concur with the economic analysis. Once a draft of the proposing or adopting release is completed, the responsible rulewriting division formally submits to the Commission, through the Office of the Secretary (OS), an action memorandum recommending Commission approval and issuance of the release. OS ensures that the rule complies with the formatting requirements of the Office of the Federal Register and coordinates the Commissioners' voting on the rule. If a majority of the Commissioners vote to issue the release, it is posted on the SEC's public website and published in the *Federal Register*. In the case of an adopting release, the final rule is also published in the *Code of Federal Regulations*.

Economic Analysis in the SEC's Rulemaking Process. The Current Guidance specifies that economic analysis at the SEC includes several important evaluations and high-level controls such as defining a baseline, quantifying costs and benefits where possible, and RSFI Chief Economist concurring with a rule's economic analysis. Figure 1 illustrates the SEC's process for economic analysis in the three rulemaking stages.

¹⁰ The Administrative Procedure Act (APA) of 1946, 5 U.S.C. §§ 501 et. seq., provides procedural standards that Federal administrative agencies must follow. With respect to rulemaking, the APA requires agencies to give the public advance notice of the contents of a proposed rule and to offer members of the public an opportunity to express their views on the proposed rule. 5 U.S.C. § 553. The APA also provides that courts may set aside any rule found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." 5 U.S.C. § 706.

¹¹ These include the Paperwork Reduction Act, the Regulatory Flexibility Act, and the Small Business Regulatory Enforcement Fairness Act.

Figure 1: The SEC’s Process for Economic Analysis in Rulemakings



*Preliminary drafts of the Proposing Release and Adopting Release are circulated informally to the Commissioners for their input.

Source: OIG generated

Objectives

The objectives of the audit were to determine whether:

- the SEC has established and implemented procedures for a methodical economic analysis process in accordance with its Current Guidance.
- the SEC developed and uses procedures to improve the economic analysis process such as hiring additional economists and implementing a systematic review process.
- the Current Guidance incorporates the SEC OIG's and other commenters' recommendations issued to the SEC on economic analysis.

Findings and Recommendation

Finding 1: The Commission Has Used the Current Guidance in its Rulemakings, but Does Not Have Documented Procedures Implementing the Current Guidance

The SEC has used the Current Guidance in its rulemakings, but it has not established and implemented written procedures for a methodical process for economic analysis in accordance with its Current Guidance.

Issuance of and Direction to Use Current Guidance

The SEC issued the Current Guidance in memorandum form on March 16, 2012. The Current Guidance, which RSFI and OGC drafted with input from the rulewriting divisions, consists of guidelines to use for developing high-quality economic analyses that deliver the best available information about a rule's likely economic consequences.¹² In a June 11, 2012, letter to Congress, the former SEC Chairman, Mary Schapiro, stated that she had instructed SEC directors in the rulewriting divisions and offices to follow the Current Guidance.¹³ Also, during a staff meeting with the rulewriting division's directors, the former Chairman directed them to inform their staff to follow the Current Guidance. Further, RSFI's webpage, which is located on the Commission's public website, states that "[t]he Chairman has directed the staff to follow the Guidance in SEC rulemaking."¹⁴

Current Guidance Practices

We reviewed 9 of 23 rules issued between March 16, 2012, and November 30, 2012. On the basis of our review, we found that the Commission has used the Current Guidance in its rulemaking practice. For example, we found that RSFI economists were integral members of the rulewriting team and contributed to the three stages of the rulemaking process. Additionally, RSFI economists drafted or closely collaborated with the rulewriting divisions to prepare economic analyses in SEC rulemakings.

¹² SEC, *Current Guidance on Economic Analysis in SEC Rulemakings* (March 16, 2012), p. 2.

¹³ Letter from the former SEC Chairman, Mary Schapiro, to Chairman Patrick McHenry, Subcommittee on TARP (June 11, 2012), p. 2.

¹⁴ See http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.shtml.

During this audit, we did not analyze the quality and completeness of the economic analyses in the rules. However, we evaluated in more detail the economic analyses in SEC rulemakings in our concurrent review, *Use of the Current Guidance on Economic Analysis in SEC Rulemakings*, Report No. 518 (Phase 2).

Lack of Documented Operating Procedures

The SEC has not issued written operating procedures implementing the Current Guidance. In particular, TM and RSFI do not have written operating procedures for implementing economic analysis. TM and RSFI staffs believe that there may be tradeoffs in having documented operating procedures because they may result in prescriptive requirements that are not feasible or appropriate for all rules.

We found that IM has draft written operating procedures and CF has a rulemaking checklist, but neither division's documents have been updated to reflect the Current Guidance.¹⁵ Also, we reviewed OGC's *SEC Compliance Handbook* (October 1999)¹⁶ and found that it has not been revised since it was issued and therefore does not incorporate the Current Guidance, although OGC staff advised us that the Current Guidance is provided as a supplement to requests for the Compliance Handbook.

The Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, requires management to establish and maintain internal control to achieve effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations under five standards. One of the standards is control activities, which include "policies, procedures and mechanisms in place to help ensure that agency objectives are met."¹⁷

Not having documented operating procedures poses a risk that the SEC may inconsistently apply the requirements of the Current Guidance throughout the rulemaking process. Written policies and procedures assist management in ensuring its continuity of operations and help in preventing loss of institutional knowledge about the organization's processes.

Conclusion

The SEC issued the Current Guidance to improve the process for economic analysis in rulemakings. Our audit found that the Commission has used the

¹⁵ CF staff stated that they plan to update its checklist "in the near future."

¹⁶ The Handbook provides guidance on the SEC's rulemaking process, its process for economic analysis, and laws and regulations governing the rulemaking process.

¹⁷ OMB Circular A-123, *Management's Responsibility for Internal Control* (December 21, 2004), pgs. 7-8.

Current Guidance in its rulemaking practice. However, we found that the rulewriting divisions, RSFI, and OGC do not have written procedures for implementing the Current Guidance's substantive and process requirements. Having written operating procedures would help ensure staff in the rulewriting divisions, RSFI, and OGC consistently apply the Current Guidance when undertaking rulemaking at the SEC.

Recommendation 1:

The Chairman's Office, in coordination with the Office of the General Counsel (OGC) and the Division of Risk, Strategy, and Financial Innovation (RSFI), should issue—to SEC rulewriting divisions, RSFI, and OGC—written operating procedures for economic analysis that implement the *Current Guidance on Economic Analysis in SEC Rulemakings*.

Management Comments. The Chairman's Office concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased the Chairman's Office concurred with our recommendation. The OIG considers this recommendation resolved. However, this recommendation will remain open until documentation showing the recommendation has been fully implemented is provided to the OIG.

Finding 2: The SEC Hired Additional Economists and Formalized the Chief Economist's Concurrence Process for Economic Analysis

The Commission has taken steps to improve the process for economic analysis by requiring the participation of RSFI economists in the three stages of the rulemaking process, hiring economists with financial industry knowledge, and formalizing the Chief Economist's review and concurrence process.

Overview

During our audit, we found that the SEC has taken certain actions to improve its process for economic analysis. These actions include requiring RSFI's involvement throughout the rulemaking stages, hiring economists with financial industry knowledge for rulemaking, and formalizing the Chief Economist's process for concurring with economic analyses. The Commission established RSFI as a division in September 2009. Three RSFI offices facilitate the division's collaboration with the SEC's rulewriting divisions. An assistant director, who is an

economist, leads each of the offices that is involved in rulemakings. Those offices are the Office of Corporate Finance, Office of Markets, and Office of Investments and Intermediaries.

RSFI has established designated points-of-contact for each rulemaking division. For economic analysis, the Office of Corporate Finance supports CF; the Office of Markets supports TM's Office of Market Supervision; and the Office of Investments and Intermediaries supports IM and other offices in TM.

When a rulemaking is initiated, the rulewriting division generally contacts the RSFI assistant director who supports the relevant division. The assistant director assigns one or more economists to work with the rulewriting divisions on the rule.

RSFI's Involvement in the Process for Economic Analysis

To assess whether RSFI economists were involved in the economic analysis process, OIG reviewed:

- emails between rulewriting divisions and RSFI;
- comments RSFI made on draft economic analyses and term sheets; and
- internal memoranda that RSFI prepared for rules.

In addition, we interviewed staff in the rulewriting divisions and RSFI to discuss their coordination process and verified RSFI's involvement throughout the rulemaking process. RSFI staff asserted that they often conduct initial research on a rule and review existing studies or data that could be helpful to a particular rule. RSFI also attempts to replicate or improve data or findings in studies pertaining to each specific rule.

Overall, we found that RSFI coordinates with rulewriting divisions to discuss the purpose of the rule, costs and benefits of the rule, what the Commission should discuss in the economic analysis, and whether and how the Commission can quantify benefits and costs.

On the basis of interviews and our review and analyses of documentation, we determined that RSFI is involved in all three stages (pre-proposal, proposing, and adopting) of the rulemaking process.

SEC’s Hiring of Additional Economists for Rulemaking

Since the passage of the Dodd-Frank Act, the SEC has hired additional economists. Prior to the passage of the Dodd-Frank Act,¹⁸ RSFI had 19 Doctor of Philosophy (Ph.D.) economists, one non-Ph.D. economist, and two research associates working on rulemakings. As of March 6, 2013, RSFI had 35 Ph.D. economists, one non-Ph.D. economist, and six research associates who work on rulemakings.

RSFI’s staffing levels for rulemakings prior to the Dodd-Frank Act and after the Current Guidance are illustrated in Table 1 below:

Table 1: RSFI Staffing Levels

Staff Category	Prior to Dodd-Frank Act	March 2013
Full-time SEC Economist with Ph.D.	18	29
Full-time SEC Economist without Ph.D.	0	1
IPA ¹⁹ Economist with Ph.D.	1	6
IPA Economist without Ph.D.	1	0
Total Number of RSFI Economists	20	36
Full-time SEC Research Associates	2	6
Total Number of RSFI Rulemaking Staff	22	42

Source: Office of Human Resources and RSFI’s staffing data.

SEC’s Plan for Hiring Additional Economists. On June 11, 2012, in a letter to Congress, former SEC Chairman Mary Schapiro informed Congress that RSFI would hire, in the near future, 16 economists with Ph.D.’s and that the Commission had requested 20 additional economist positions as part of its fiscal year 2013 budget. The former SEC Chairman further stated, “The potential need for additional economists beyond this will be analyzed on a going forward basis,

¹⁸ The Dodd-Frank Act was enacted on July 21, 2010. According to former SEC Chairman Mary Schapiro’s Testimony on Continued Oversight of the Implementation of the Wall Street Reform Act before the United States Senate Committee on Banking, Housing, and Urban Affairs on December 6, 2011, the Dodd-Frank Act contains 90 provisions that require the SEC to engage in rulemakings.

¹⁹ The IPA (Intergovernmental Personnel Act) provides, through a Mobility Program, for the temporary assignment to the Federal Government of personnel from state and local governments, colleges and universities, Indian tribal governments, Federally funded research and development centers, and other eligible organizations. The program helps Federal agencies meet their needs for hard-to-fill positions through the temporary assignment of skilled personnel from those entities.

and our ability to hire economists to fill these positions in the future will depend on the resources provided by Congress.”²⁰

In 2012, RSFI hired 16 Ph.D. economists. RSFI informed us that due to the continuing resolution, the SEC’s fiscal year 2013 staffing requests, including RSFI’s requests, were not approved. However, the SEC’s Budget Governance Committee²¹ approved RSFI’s request to hire, from external sources, nine additional financial economists for fiscal year 2013.

OIG’s Review of RSFI Economists Hired. To determine how the SEC addressed RSFI’s need for economists, we obtained a list that contained the names of 14 economists that the SEC hired from March through November 2012 to evaluate the economic analyses for the SEC’s rulemaking initiatives. We obtained and reviewed the job descriptions, vacancy announcements, and resumes for the 14 RSFI economists. In our review, we found that the economists hired during that period had the financial industry knowledge consistent with the vacancy announcements.²²

Chief Economist’s Involvement and Concurrence

Overview of Chief Economist’s Involvement in Economic Analysis. In June 2012, the Chief Economist’s process for concurring with economic analyses was formalized. The Chief Economist is actively involved in the three stages of rulemaking and concurs with the economic analysis in the proposing and adopting stages. As Commission staff begins drafting the rule, the Chief Economist discusses, with RSFI staff, major economic issues, RSFI’s strategy, and data analysis required for the rule. Throughout the rulemaking process, RSFI staff members meet with the Chief Economist to discuss the progress and status of the rules and information pertinent to the economic analysis. Before the Chief Economist concurs with the economic analysis, he meets with RSFI staff working on the rule, discusses his observations, and provides additional guidance as necessary. When the draft of the rule is ready for circulation to the Commissioners, the Chief Economist determines whether the economic analysis for a rule is satisfactory. RSFI then communicates the Chief Economist’s concurrence, and the rulewriting division includes that concurrence in the action memorandum circulated to the Commissioners.²³

²⁰ Letter from the former SEC Chairman, Mary Schapiro, to Chairman Patrick McHenry, Subcommittee on TARP (June 11, 2012), p. 3.

²¹ The SEC established the Budget Governance Committee in 2011 to ensure a strategic staffing approach.

²² The hired economists’ resumes or supporting documents indicated financial industry knowledge in the following areas: corporate finance, investment, credit risk, capital markets, etc. However, we did not verify the assertions made by the applicants or the merits of the vacancy announcements.

²³ The Chief Economist concurred in all of the economic analyses we reviewed. RSFI stated that the rulewriting divisions should not formally circulate a rule to the Commissioners if the Chief Economist does not Implementation of Current Guidance on Economic Analysis June 6, 2013
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Chief Economist's Involvement in the Different Rulemaking Stages. The Chairman's office sets priorities for rulemaking and informs rulewriting divisions, RSFI, and OGC of those priorities. On the basis of our audit objectives, we outlined the Chief Economist's involvement in each stage of rulemaking as discussed below and illustrated previously in Figure 1.

Pre-Proposal Stage. Before the responsible division begins drafting a rule in the pre-proposal stage, staff in the rulewriting division meets with RSFI staff to provide background on the prospective rule and to get initial input from the RSFI economist. The Chief Economist meets with RSFI staff to discuss major economic issues, RSFI's strategy, and data analysis required for the rule. If the rule is complex, the Chief Economist also discusses with the division director economic analysis issues that are relevant to the rules. According to RSFI, its economists participate in the rulemaking division's preparation of a term sheet, which contains a high-level outline of an economic analysis.

Proposing Stage. As the rulewriting division drafts the proposed rule, RSFI staff coordinate with the rulewriting division's staff and assist in preparing the economic analysis. RSFI staff inform the Chief Economist of the progress of the rules and discuss information pertinent to the economic analysis. RSFI staff also meets with rulewriting divisions and communicates with them by phone or email during the rulemaking process. Each week the Chief Economist meets with the RSFI assistant directors to discuss the status of rulemakings and the rulemaking division's activities. RSFI staff provide the Chief Economist with a written summary that discusses the components of the economic analysis (baseline, alternatives, etc.) for the rulemakings.

Before the Chief Economist concurs with the economic analysis, he meets with the RSFI staff working on the rule, discusses his observations, and provides additional guidance as necessary. RSFI staff incorporate the Chief Economist's changes into the economic analysis and send it to the rulewriting divisions with the changes highlighted. The assistant director and economist(s) who are assigned to the rule ensure that the Chief Economist's changes are included in the draft rule release. This is part of the process for obtaining the Chief Economist's concurrence with the rule's economic analysis.

Additionally, the Chief Economist meets with division directors to discuss significant issues on rules. He meets with the Commissioners regularly to maintain awareness of current issues, discusses the Commissioners' general concerns about economic issues, and explains the rationale for a specific economic analysis.

During his review of the rules, the Chief Economist focuses on whether the economic ideas presented are sound and whether the SEC framed the economic

concur with the economic analysis. RSFI staff informed the OIG that they are not aware of any instance where the Chief Economist did not concur with the economic analysis.

ideas logically. He also verifies that the economic analysis complies with the Current Guidance requirements of having a consistent baseline, quantifying benefits and costs where appropriate, discussing alternatives to the rule, etc.

The rulewriting division determines when to submit its action memorandum to the Commission recommending action on a proposed rule. The rulewriting division is responsible for obtaining, and documenting in the action memorandum, the concurrence of the Chief Economist in the economic analysis for that proposing release. Once the Chief Economist determines that the economic analysis for a proposing release is satisfactory, RSFI communicates the Chief Economist's concurrence to the relevant staff in the rulewriting division. RSFI staff stated that the rulewriting divisions should not formally circulate the proposing release to the Commissioners if the Chief Economist does not concur with the economic analysis. RSFI staff told us that they are not aware of any instances in which the Chief Economist has not concurred with a rule's economic analysis.

Adopting Stage. The rulewriting divisions, in coordination with RSFI, revise and refine the economic analysis on the basis of comments received on the proposed rule and additional analyses that they determines are necessary. The Chief Economist reviews the adopting rule and indicates whether he concurs with the economic analysis.

RSFI stated the rulewriting divisions should not formally circulate the adopting release to the Commissioners if the Chief Economist does not concur with the economic analysis.

Concurrence Process Before the Current Guidance. Before issuance of the Current Guidance, the Chief Economist had an informal process for reviewing and concurring with economic analyses for rules. He communicated his agreement or disagreement with the economic analysis of the proposed rulemaking either verbally or in an email to division directors or rulewriting divisions. Below is an example of language in an action memorandum that the SEC used prior to issuance of the Current Guidance.

The draft release includes an economic analysis. We consulted with the Office of the General Counsel and the Division of Risk, Strategy, and Financial Innovation concerning this analysis.

Concurrence Process After the Current Guidance. The RSFI Chief Economist's concurrence process was formalized as reflected in a June 2012 email.²⁴ The former SEC Chairman agreed with the process, which requires that the rulewriting divisions obtain the Chief Economist's formal concurrence on

²⁴ June 11, 2012 email between RSFI and the former SEC Chairman's Office.

economic analyses for the proposing and adopting stages of rules.²⁵ The concurrence process required the rulewriting divisions to use, in the action memorandum, standard language that indicates the Chief Economist's concurrence with the economic analysis.²⁶ Below is an example of standard language from an action memorandum after the Current Guidance.

The Chief Economist concurs in the economic analysis contained in the attached draft release entitled "XXXX" and dated "XX XX, XXXX." RSFI Staff will review all changes made to this draft release and notification will be provided to the Commission if those changes result in the Chief Economist no longer concurring in the economic analysis.

Conclusion

Since the issuance of the Current Guidance, the Commission has taken steps to improve its procedures for economic analysis by requiring that the rulewriting divisions engage with RSFI before the Commission begins writing rules. Further, the SEC has hired and added a number of financial economists to the process for economic analysis. Lastly, on the basis of interviews and our review of supporting documents, we found that the Chief Economist was involved in the three stages of the rulemaking process and concurred with the economic analyses in the proposing and adopting stages of rulemakings.

The OIG makes no recommendation for this finding.

²⁵ The Current Guidance requires RSFI's formal concurrence on the economic analysis for both proposing and adopting rules. By concurring with the economic analysis, the Chief Economist asserts that the economic ideas presented are sound and that the SEC framed the economic ideas logically. This concurrence ensures that the economic analysis is consistent with the Current Guidance (i.e., it ensures that the economic analysis has a consistent baseline, quantifies benefits and costs where appropriate, and discusses alternatives to the rule). The Division responsible for a rule prepares an action memorandum to the Commission for each proposed or final rule when a rulemaking release is circulated to the Commissioners for their consideration. An action memorandum discusses a rulewriting division's specific recommendations and rationale for a rulemaking release. The rulemaking release to be considered and voted on by the Commission is attached to the action memorandum. The concurrence language is part of the action memorandum.

²⁶ The former Chairman, Mary Schapiro, approved the concurrence language for the action memorandum.

Finding 3: The Current Guidance Includes Recommendations from the SEC OIG and Other Commenters

The Commission incorporated, into its Current Guidance, recommendations that it received from the SEC OIG and other commenters. Specifically, the Current Guidance addressed recommendations from the SEC OIG’s follow-up review of Dodd-Frank rulemaking, a GAO report on Dodd-Frank rulemaking, and the U.S. Court of Appeals opinion that vacated an SEC rule.

Recommendations in SEC OIG Report No. 499

The OIG issued *Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings*, Report No. 499, on January 27, 2012 (Report No. 499). The Report contained six recommendations; the SEC has implemented and closed all of those recommendations. We found that the Current Guidance fully addressed the recommendations in Report No. 499. Table 2 below summarizes that information.

Table 2: Incorporation of SEC OIG Recommendations in the Current Guidance

SEC OIG Report No. 499 Recommendations	Text of Current Guidance
1. SEC rulewriting divisions and RSFI should consider ways for economists to provide additional input into cost-benefit analyses of SEC rulemakings to assist in including both quantitative and qualitative information to the extent possible.	To make the best use of RSFI’s expertise, 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 division and contribute to all elements of the rulewriting process (p. 15).
2. OGC, in consultation with RSFI, should reconsider its guidance that the SEC should perform economic analyses for rulemaking activities to the extent that the SEC exercises discretion and should consider whether a pre-stature baseline should be used whenever possible.	As a policy matter, where a statute directs rulemaking, rulewriting staff should consider the overall economic impacts, including <i>both</i> those attributable to Congressional mandates <i>and</i> those that result from an exercise of the Commission’s discretion... (p. 8).
3. SEC rulemaking divisions should generally use a single, consistent baseline in the cost-benefit analyses of their rulemakings related to a particular topic. The baseline being used should be specified at the beginning of the cost-benefit analysis section. If multiple baselines are appropriate, such as for evaluating alternative approaches or explaining the SEC’s use of discretion, they should also be explained and justified.	The baseline being used should be specified, either at the beginning of the economic analysis section or as a 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 (p. 8).

SEC OIG Report No. 499 Recommendations	Text of Current Guidance
4. SEC rulewriting 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.	Combine the economic analysis considering costs and benefits with consideration of the effects on efficiency, competition, and capital formation (p. 14).
5. The Commission should consider directing rulewriting divisions to (a) explicitly discuss market failure as a justification for regulatory action in the cost-benefit analysis of each rule that is based in whole or in part on perceived market failure or (b) in the absence of market failure, demonstrate a compelling social purpose that justifies regulatory action.	Rule releases must include a discussion of the need for regulatory action and how the proposed rule will meet that need. 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 (p. 5).
6. SEC rulewriting divisions should consider including internal costs and benefits in the cost-benefit analyses of rulemakings.	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 (p. 12).

Source: SEC OIG Report No. 499 and Current Guidance

GAO Report Recommendation

The Current Guidance references GAO Report No. 12-151, *Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination*, in two places. GAO’s report stated, “To strengthen the rigor and transparency of their regulatory analyses, we recommend that the federal financial regulators take steps to better ensure that the specific practices in OMB’s regulatory analysis guidance are more fully incorporated into their rulemaking policies and consistently applied.”²⁷

The Current Guidance notes that although SEC is not required to follow the guidelines for regulatory economic analysis (enumerated in several executive orders)²⁸ that other executive agencies must follow, the Current Guidance “draws on principles set forth in those orders and in the Office of Management and Budget’s Circular A-4 (2003)....”²⁹

U.S. Court of Appeals Opinion

In its request for the SEC OIG to review the implementation of the Current Guidance, the Chairman of the House Oversight Committee referenced an opinion of the U.S. Court of Appeals for the District of Columbia Circuit. See *Business Roundtable and Chamber of Commerce v. Securities and Exchange*

²⁷ GAO Report No. 12-151, *Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination* (November 2011), p. 39.

²⁸ These executive orders include Executive Order 12866, *Regulatory Planning and Review*, and Executive Order 13563, *Improving Regulation and Regulatory Review*.

²⁹ *Current Guidance on Economic Analysis in SEC Rulemakings* (March 2012), p. 4.

Commission (Business Roundtable).³⁰ The petitioners in *Business Roundtable* challenged the Securities Exchange Act of 1934 (Exchange Act) Rule 14a-11 (Proxy Access Rule)³¹ on the basis that, among other things, “the Commission failed adequately to consider the rule’s effect upon efficiency, competition, and capital formation, as required by Section 3(f) of the Exchange Act and Section 2(c) of the Investment Company Act of 1940....”³² Section 3(f) of the Exchange Act and Section 2(c) of the Investment Company Act require that whenever it is engaged in rulemaking and “is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.” 15 U.S.C. §§ 78c (f) and 80a-2(c). The U.S. Court of Appeals agreed with the petitioners and vacated the rule, finding that the SEC had “failed...adequately to assess the economic effects of a new rule.”³³

The court agreed with the petitioners’ argument that the SEC promulgated the rule in violation of the Administrative Procedure Act and that the SEC acted arbitrarily and capriciously by having failed “adequately to assess the economic effect of a new rule.” The court set forth five ways that the SEC’s analysis failed.

We reviewed the *Business Roundtable* decision and compared it to the Current Guidance to determine whether the SEC addressed the court’s findings on the SEC’s analytical failures. As shown in Table 3 below, we found that the Current Guidance generally addressed the court’s findings and incorporated them into guidelines to avoid analytical failures in future rulemakings.

Table 3: Incorporation of U.S. Court of Appeals Opinion in the Current Guidance

Excerpts from U.S. Court of Appeals Opinion	Text of Current Guidance
[T]he Commission inconsistently and opportunistically framed the costs and benefits of the rule...	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 (p. 14).

³⁰ *Business Roundtable*, 647 F.3d 1144 (D.C. Cir. 2011).

³¹ The Proxy Access Rule required a company subject to the Exchange Act proxy rules to include in its proxy materials the name of a person or persons nominated by a shareholder or group of shareholders to the company’s board of directors, provided that the shareholder or group of shareholders met certain criteria.

³² *Business Roundtable*, 647 F.3d at 1146.

³³ *Id.*

Excerpts from U.S. Court of Appeals Opinion	Text of Current Guidance
[The Commission] failed adequately to quantify the certain costs or to explain why those costs could not be quantified...	<p>Quantify expected benefits and costs to the extent feasible...</p> <p>Identify and discuss uncertainties underlying the estimates of benefits and costs...</p> <p>Explain why costs and benefits cannot be quantified (p. 12-13).</p>
[The Commission] neglected to support its predictive judgments...	<p>Support predictive judgments and clearly address contrary data or predictions (p. 14).</p> <p>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 (p. 16).</p>
[The Commission] contradicted itself...	<p>Frame costs and benefits neutrally and consistently (p. 14).</p>
[The Commission] failed to respond to substantial problems raised by the commenters.	<p>As part of their continuing analysis of the potential economic effects of the proposed rule, the RSFI economists assigned to the rule 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 division expects that the outside party will provide additional data or comment upon the economic analysis or data contained in the proposing release (p. 16).</p> <p>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 (p. 16).</p>

Source: Business Roundtable, 647 F.3d 1144, and Current Guidance.

Conclusion

The Current Guidance incorporates recommendations from various commenters on the SEC’s economic analysis in rulemakings, including those from the SEC OIG, GAO, and a U.S. Court of Appeals opinion.

The OIG makes no recommendation for this finding.

Abbreviations

Business Roundtable	Business Roundtable and Chamber of Commerce v. Securities and Exchange Commission
CF	Division of Corporation Finance
Current Guidance	Current Guidance on Economic Analysis in SEC Rulemakings
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
Exchange Act	Securities Exchange Act of 1934
GAO	Government Accountability Office
House Oversight Committee	U. S. House of Representatives Committee on Oversight and Government Reform
IM	Division of Investment Management
IPA	Intergovernmental Personnel Act
OGC	Office of the General Counsel
OIG	Office of Inspector General
OMB	Office of Management and Budget
OS	Office of the Secretary
Ph.D.	Doctor of Philosophy
Proxy Access Rule	Securities Exchange Act of 1934 (Exchange Act) Rule 14a-11
RSFI	Division of Risk, Strategy, and Financial Innovation
SEC or Commission	U.S. Securities and Exchange Commission
Subcommittee on TARP	Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs
TARP	Troubled Assets Relief Program
TM	Division of Trading and Markets

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We determined that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope. Our audit focused on the Current Guidance for economic analysis in SEC rulemakings and on proposed, final, and interim final temporary³⁴ rules issued between March 16, 2012³⁵ and November 30, 2012. We also reviewed the practices and procedures for economic analysis of the rulewriting divisions, RSFI, and OGC. Further, the OIG reviewed laws, regulations, and policies applicable to economic analysis. We also interviewed staff of the rulewriting divisions, OGC, and RSFI, including the Chief Economist.

Methodology. To achieve the objective of determining whether the SEC established and implemented procedures for a methodical economic analysis process in accordance with its Current Guidance, we asked the rulewriting divisions, OGC and RSFI whether they had policies and procedures incorporating that guidance. We then examined existing internal policies and procedures. Additionally, we reviewed the Current Guidance and developed a standard checklist to obtain an understanding of the Commission's process for economic analysis. Further, we interviewed the Commission staff to determine what processes they had for preparing economic analyses and to assess whether their practices align with the principles of the Current Guidance.

To meet the objective of determining whether the Commission developed and uses procedures to improve the process for economic analysis, we verified that the Commission issued the Current Guidance, which incorporates best practices for conducting economic analyses and provides a broad guide on what an economic analysis should include, such as a baseline, alternative approaches, and discussions on costs and benefits of a rule. We also assessed whether the SEC hired additional economists with financial industry knowledge by reviewing resumes of the hired employees and comparing their experience to job descriptions and vacancy announcements. The OIG also interviewed economists working on the rulemaking initiatives to determine their knowledge about economic analysis.

³⁴ The SEC issues interim final temporary rules when the requirement for a rule is urgent and the Commission cannot follow the normal course of rulemaking process such as collecting comments from the public.

³⁵ OGC and RSFI issued the Current Guidance on March 16, 2012.

Further, we met with RSFI staff and the Chief Economist to obtain an understanding about the Chief Economist's review and concurrence process for economic analyses. We also reviewed action memoranda and emails from RSFI to rulewriting divisions for a sample of nine rules³⁶ to determine if the rulewriting divisions obtained the Chief Economist's concurrence on the economic analysis before transmitting the rule to the Commissioners for a vote on the rule.

Lastly, we reviewed emails between rulewriting divisions and RSFI, comments RSFI made on draft economic analyses, term sheets, internal memoranda RSFI prepared for rules, etc., and met with RSFI staff and rulewriting divisions to discuss the coordination between them for conducting economic analysis.

To meet the objective of determining whether the Current Guidance incorporates the SEC OIG's and other commenters' recommendations issued to the SEC on rulemaking, we reviewed recommendations from SEC OIG audit reports and GAO audit reports on rulemaking, comments on the Current Guidance from the Commissioners, and a legal opinion on SEC rulemaking. We analyzed the recommendations and comments to determine whether the Commission incorporated them into the Current Guidance.

Internal Controls. For our audit, we assessed the Commission's internal controls significant to our objectives on the basis of OMB Circular A-123, *Management's Responsibility for Internal Control*. That circular states, "Management is responsible for developing and maintaining internal control activities that comply with the following standards...control environment, risk assessment, control activities, information and communication, and monitoring." The internal controls that we assessed included: 1) the Chief Economist's review and concurrence process for economic analysis; 2) OGC's review of rulemakings to ensure that the Commission addressed legal requirements; and 3) the rulewriting division's internal review process, such as the preparation of the economic analysis by staff attorneys, and senior management's (associate directors, deputy directors, and directors) review of the economic analysis.

Information Systems Controls. We used computer-processed data from the Office of Human Resources to determine the number of economists in RSFI as of March 6, 2013. RSFI verified that the number of economists as of March 6, 2013, was accurate. We did not assess the system that generated the computer-processed data.

Judgmental Sampling. To identify our sample, we used judgmental sampling due to the small universe of rules in our scope. Between March 16, 2012, and November 30, 2012, the Commission released 23 rules—5 proposed rules, 16 final

³⁶ Two of nine rules were issued prior to the implementation of the formal concurrence process. The action memoranda for these rules stated that the rulewriting divisions consulted with RSFI, instead of including the standard concurrence language. Further, there were no emails from RSFI to rulewriting divisions, conveying the Chief Economist's formal concurrence with the rules.

rules and 2 interim final temporary rules. Out of the 23 rules, 8 rules did not require an economic analysis because they reopened a period for comment, corrected a typographical error, or adopted an updated Electronic Data Gathering, Analysis, and Retrieval filer manual. Out of the 15 rules that required an economic analysis, the OIG selected 9 rules consisting of 3 proposing rules, 5 final rules and 1 interim final temporary rule for review, on the basis of its judgment. We ensured that all three rulewriting divisions—TM, CF, and IM—were represented in our sample and that the nine samples covered different areas of the securities laws. The OIG reviewed the rules to assess involvement of RSFI and to determine whether the Chief Economist concurred in the economic analyses. Table 4 below identifies the nine rules that the OIG reviewed.

Table 4: Rules the OIG Reviewed

	Rule Release Number	Rule Issue Date	Responsible Rulewriting Division	Stage	Name of Rule
1	34-66868	April 27, 2012	TM	Adopting	Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”
2	34-67405	July 11, 2012	TM	Temporary	Extension of Interim Final Temporary Rule on Retail Foreign Exchange Transactions
3	34-67457	July 18, 2012	TM	Adopting	Consolidated Audit Trail
4	34-67717	August 22, 2012	CF	Adopting	Disclosure of Payments by Resource Extraction Issuers
5	33-9354	August 29, 2012	CF	Proposing	Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings
6	IA-3483	October 9, 2012	IM	Proposing	Temporary Rule Regarding Principal Trades with Certain Advisory Clients
7	34-68071	October 18, 2012	TM	Proposing	Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers
8	34-68080	October 22, 2012	TM	Adopting	Clearing Agency Standards
9	IC-30268	November 19, 2012	IM	Adopting	Purchase of Certain Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption

Source: OIG Generated.

Prior Audit Coverage. The SEC OIG conducted two reviews of the SEC's economic analysis in rulemaking.

- *Report of Review of Economic Analyses Performed by the Securities and Exchange Commission in Connection with Dodd-Frank Act Rulemakings*, SEC OIG, June 13, 2011.
- *Follow-Up Review of Cost-Benefit Analyses in Selected Dodd-Frank Act Rulemakings*, Report No. 499, January 27, 2012.

We did not make any recommendations in the June 13, 2011, report. In Report No. 499, the OIG made six recommendations that were closed in June 2012. During this audit, we verified that the Commission fully implemented the recommendations.

Criteria

Administrative Procedure Act of 1946, 5 U.S.C. §§ 501 et. seq. Provides minimal procedural standards that Federal administrative agencies must follow. With respect to rulemaking, the APA requires agencies to give the public advance notice of the contents of a proposed rule and to offer members of the public an opportunity to express their views on the proposed rule. The APA also provides that courts may set aside any rule found to be “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”

Current Guidance on Economic Analysis in SEC Rulemakings. Provides guidance on economic analysis and broadly outlines best practices in conducting economic analysis. Discusses four requirements of a good regulatory economic analysis and other factors necessary for a comprehensive economic analysis.

Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, July 21, 2010. Reformed the financial regulatory system, including how financial regulatory agencies such as the SEC operate, and mandated that the SEC undertake a significant number of studies and rulemakings, including regulatory initiatives addressing derivatives; asset securitization; credit rating agencies; hedge funds, private equity funds, and venture capital funds; municipal securities; clearing agencies; and corporate governance and executive compensation.

Jumpstart Our Business Startups Act, Public Law No. 112-106, April 5, 2012. Requires the SEC to write rules and issue studies on capital formation, disclosure, and registration requirements.

Office of the General Counsel, SEC, Compliance Handbook, revised October 1, 1999. Provides guidance applicable to SEC rulemaking and includes guidance specific to developing cost-benefit analyses.

Office of Management and Budget (OMB) Circular A-4, Regulatory Analysis, September 17, 2003. Provides OMB’s guidance to Federal agencies on developing cost-benefit analyses required under Executive Order 12866 and related authorities.

OMB Circular A-123, Management’s Responsibility for Internal Control. Establishes that management has a fundamental responsibility to develop and maintain effective internal controls.

Paperwork Reduction Act of 1980, 44 U.S.C. § 3501, et seq. Gave authority over the collection of certain information to OMB and mandated that Federal agencies obtain an OMB control number before promulgating a form that will impose an information collection burden on the general public. Also required

agencies to solicit and review public comments on the information collection requirements of proposed rules, to evaluate the need for information collection, and to provide an estimate of the information collection burden.

Regulatory Flexibility Act of 1980, 5 U.S.C. § 601, et seq. Requires agencies to consider the needs of small entities in evaluating proposed and final rules for all rules subject to notice and comment under the APA and to describe the impact of proposed and final rules on small entities, unless the agency head certifies that the rule will not have a significant economic impact on a substantial number of small entities.

Section 23(a)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a)(2). Requires the SEC to consider the effect on competition of any rule promulgated under the act.

Securities Act of 1933, Securities Exchange Act of 1934, Investment Company Act of 1940, and Investment Advisers Act of 1940. Contain provisions that require the Commission, when it is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

U.S. Court of Appeals Opinion, *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). The petitioners in *Business Roundtable* challenged the Exchange Act Rule 14a-11 (Proxy Access Rule) on the basis that, among other things, the Commission failed adequately to consider the rule's effect upon efficiency, competition, and capital formation, as required by Section 3(f) of the Exchange Act and Section 2(c) of the Investment Company Act of 1940, which require that whenever it is engaged in rulemaking and the Commission is required to consider or determine whether an action is necessary or appropriate in the public interest. The U.S. Court of Appeals agreed with the petitioners and vacated the rule, finding that the SEC had failed adequately to assess the economic effects of a new rule.

Recommendation

Recommendation 1:

The Chairman's Office, in coordination with the Office of the General Counsel (OGC) and the Division of Risk, Strategy, and Financial Innovation (RSFI), should issue—to SEC rulewriting divisions, RSFI, and OGC—written operating procedures for economic analysis that implement the *Current Guidance on Economic Analysis in SEC Rulemakings*.

Management Comments

MEMORANDUM

To: Jacqueline Wilson, Assistant Inspector General for Audits,
Office of Inspector General

From: Erica Williams, Deputy Chief of Staff, Office of the Chairman 

Cc: Mary Jo White, Chair
Anne K. Small, General Counsel
Craig M. Lewis, Director, Division of Risk, Strategy, and Financial
Innovation

Re: Management's Response to the Office of Inspector General's Draft
Report, *Implementation of the Current Guidance on Economic Analysis
in SEC Rulemakings*, Report No. 516, dated May 24, 2013

Date: May 31, 2013

Thank you for the opportunity to respond to the Office of Inspector General's (OIG) Formal Draft Report No. 516 entitled *Implementation of the Current Guidance on Economic Analysis in SEC Rulemakings*, dated May 24, 2013 ("Report"). The Report contains one recommendation, with which we concur.

As described in your Report, the Division of Risk, Strategy, and Financial Innovation (RSFI) and the Office of the General Counsel (OGC) circulated to the staff of the SEC rulemaking divisions and offices a memorandum, dated March 16, 2012, entitled "Current Guidance on Economic Analysis in SEC Rulemakings" (the "Current Guidance"). Then-Chairman Mary Schapiro directed the rulemaking divisions and offices to follow this guidance.

We believe that the Current Guidance has enhanced the process for economic analysis in rulemakings and are pleased that the Report concludes that the Commission has been using the Current Guidance. We are also pleased that the Report found that the Commission has hired additional qualified economists and implemented a process for the Chief Economist to review and concur with the economic analysis. Further, we are pleased that the Report found that the Commission appropriately incorporated into the Current Guidance recommendations from prior OIG Reports and other commenters.

The Commission staff has worked diligently to implement the Current Guidance as part of our commitment to conducting high-quality economic analyses in Commission rulemaking.

The Report contains the following recommendation:

Recommendation 1: The Chairman's Office, in coordination with the Office of the General Counsel (OGC) and the Division of Risk, Strategy, and Financial Innovation (RSFI), should issue—to SEC rulewriting divisions, RSFI, and OGC—written operating procedures for economic analysis to implement the requirements in the Current Guidance on Economic Analysis in SEC Rulemakings.

The Office of the Chairman concurs with this recommendation. As reflected in the Report, the Current Guidance contains a process requirement designed to enhance the integration of economic analysis into SEC rulemaking, and one particularly important procedural element, the concurrence of the Chief Economist, has already been implemented effectively with written procedures. We agree that additional written operating procedures will further enhance the staff's implementation of the Current Guidance. In coordination with RSFI and OGC, the Office of the Chairman will issue such procedures to the staff.

Audit Requests and Ideas

The Office of Inspector General welcomes your input. If you would like to request an audit in the future or have an audit idea, please contact us at:

U.S. Securities and Exchange Commission
Office of Inspector General
Attn: Assistant Inspector General for Audits (Audit Request/Idea)
100 F Street, N.E.
Washington D.C. 20549-2736

Tel. #: 202-551-6061
Fax #: 202-772-9265
Email: oig@sec.gov

SEC OIG Hotline

To report fraud, waste, abuse, and mismanagement at the SEC, contact the Office of Inspector General at:

Phone: 877.442.0854

Web-Based Hotline Complaint Form:

<http://www.sec-oig.gov/>