Testimony

Testimony on SEC Reform: Measuring the Costs and Benefits of New Rules

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Chairman McHenry, Ranking Member Quigley, and members of the Committee, I want to thank you for the opportunity to testify today. My name is J.W. Verret. I am an Assistant Professor of Law at George Mason Law School, where I teach corporate and securities regulation, and a senior scholar with the Mercatus Center at George Mason University.

In September of 2011, I had the opportunity to testify before House Committee on Financial Services on this topic. SEC staff were also present, where it was argued that economic analysis is not always required when rules are mandated under legislation and in any event measuring the impact of new rules can be prohibitively difficult.

I am aware that the SEC staff have prepared a memo on cost-benefit analysis in the past few weeks that represents a profound shift in the SEC's thinking. I want to congratulate the Commission and the Staff for their willingness to reconsider that position in this new memo. It remains to be seen whether that memo is just a memo, or will be put into practice in future rulemaking.

After a careful review of the legislative requirements that the SEC consider investor protection, efficiency, competition and capital formation in adopting new rules, I would like to simply offer a list of eight items that would demonstrate a sincere commitment by the SEC to fulfill its statutory mission. The first five I will list are in fact required by law if one carefully reads the legislative and judicial history of the SEC's mandate to consider the economic impact of new rules.

I offer this list as a test of the SEC's resolve to make economic analysis a real constraint on SEC rulemaking and a limit on the pressures it may face to politicize its activities and undermine its investor protection mission.

1) Rules must have sunsets and look back requirements when the agency represents that costs and benefits are difficult to estimate, as it represented in rulemaking pursuant to Section 404(b) of Sarbanes Oxley. At times

much of the data relevant to a rule's costs and benefits will not be available until years after its implementation. This is demonstrated by the SEC's rulemaking under Sarbanes Oxley 404(b), where the SEC initially estimated compliance costs of $90,000, despite their later revealed to be nearly $1.8 million per company.

2) The SEC is required to compare the costs of a new rule against any alternatives advanced by a dissenting Commissioner. This was part of the reason SEC rules were overturned in two prior challenges before the DC Circuit.

3) Mandatory disclosure rules must be subject to the same materiality standard as private plaintiffs in 10b5 fraud cases. A disclosure that is not material to investors cannot be legitimately said to further "investor protection."

4) The agency must, in order to meet its requirement to consider the impact of a rule on capital formation and efficiency, estimate the impact of a rule on the competitiveness of U.S. exchanges against foreign exchanges for new listings, the competitiveness of U.S. issuers, the risk of proprietary information being revealed in mandatory disclosures, and the impact of a rule on stock prices of affected companies. The agency must also estimate the impact of a new rule on job creation and GDP.

5) The agency must retract and re-propose rules advanced pursuant to the Dodd-Frank Act to reflect the agency's new policy on cost-benefit analysis, as it has not met this new guidance in design of existing pending rules. The SEC's rule proposal under Section 1504 of Dodd-Frank is a case in point, where the agency fails to consider the impact of disclosures on the proprietary exploration plans of US energy companies.

6) The agency should freeze attorney hiring until it hires at least 200 more economists. In achieving its market oversight mission, the FTC staff have about 10% PhD economists. At the CFTC, it is less than 5%. At the SEC, that number is still less than 1%. In order to be on par with its sister agencies like the FTC, the SEC needs to hire at least 400 new economists, but even 200 more would be a serious start. The fact that it has misallocated resources in the past should not justify added appropriations, but instead suggests a need for reallocation of present resources.

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