

ICI VIEWPOINTS

AUGUST 10, 2011

The Uphill Path to Better Economic Analysis in Rulemaking

By Paul Schott Stevens

Last month, the United States Court of Appeals for the District of Columbia Circuit vacated the Securities and Exchange Commission's rule on proxy access. The unanimous ruling marked the fifth time since 2005 that the DC Circuit has struck down an SEC rule, and the third decision based on the agency's failure to properly weigh economic consequences and to consider—as the law requires—the effects of its rules on efficiency, competition, and capital formation.

The tough language of the opinion—"unutterably mindless" was one of its more memorable phrases—prompted the editors of the *Wall Street Journal* to characterize it as an SEC "[smackdown](#)."

As I see it, the decision in *Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission* is a marker along a path we've been on for years and one that we must continue to pursue toward a vital endpoint: a regulatory environment where agencies have the legal impetus, the inclination, and the capability to conduct rigorous and accurate economic analysis to support rulemaking. Investors and our markets deserve no less.

The year 2005 was an important milestone on this journey. That year, after the DC Circuit rejected an SEC rule on mutual fund governance requirements for lack of cost-benefit analysis, [I wrote in an op-ed for *InvestmentNews*](#) that "the court's ruling will be remembered for demanding a more stringent and thorough evaluation of the economic consequences of SEC regulation."

Four years later, in the wake of the financial crisis, we at ICI saw improved use of economics at regulatory agencies as a key facet of the comprehensive overhaul of financial regulation. [We proposed](#) that capital markets regulators should set up mechanisms to foster more robust dialogue with industry and to stay abreast of market developments. We even suggested each division of the SEC should have an economist-in-residence.

The Dodd-Frank Act made some progress in this direction, notably by directing the SEC to conduct [a study on how it could better use resources and improve capabilities](#). More broadly, President Obama also deserves credit for signing an executive order requiring government agencies to conduct robust cost-benefit analyses.

Despite these steps, the path toward better economic analysis looks long and, judging by other prominent rulemakings now underway, uphill. Beyond proxy access, consider the reform of fund distribution. In 2010, the SEC proposed rescinding and replacing Rule 12b-1, which permits funds to compensate brokers and other financial intermediaries from fund assets under specific conditions for services those intermediaries provide to investors.

The SEC conducted a cost-benefit analysis of its proposal, but that analysis was deeply flawed. ICI [conservatively estimates](#) that the initial costs of implementing the SEC's 12b-1 proposal will be more than twice the SEC's estimate, and ongoing costs will exceed the SEC's figures by a factor of eight. We also seriously question the SEC's estimates of the proposal's benefits, which rely on the faulty assumption that shareholders will pay less in fees while receiving the same level of services.

The SEC is not the only agency that needs a clearer focus on economics. A proposal from the Commodity Futures Trading Commission [could treat hundreds of mutual fund advisers as commodity pool operators](#), which would subject those funds to duplicative and fundamentally inconsistent regulatory requirements. The agency's supporting cost-benefit analysis was cursory and wholly inadequate to justify such costly and burdensome regulation.

Also worth mentioning in this context is the Department of Labor's proposed rewrite of the definition of "fiduciary" under the Employee Retirement Income Security Act. The Department's economic analysis simply fails to consider the costs of the proposal for individual retirement account investors and providers. This is a serious misstep, because the proposed rule would generate significant costs for IRA savers if financial intermediaries curtail the information and services they offer to avoid crossing into fiduciary status.

Congress seems attuned to the need for our government to achieve good cost-benefit analysis. Rep. Scott Garrett (R-NJ), Chairman of the Financial Services Subcommittee on Capital Markets and Government-Sponsored Enterprises, has recently introduced a bill that would extend President Obama's executive order on cost-benefit analyses to such independent agencies as the SEC.

Legislation like this may move us closer to our goal. In the meantime, let's hope regulators will keep sight of the critical role of sound economics in rulemaking process. We need strong regulations that protect investors. What we don't need, particularly in this beleaguered economy, are regulations that impose unexpected and unnecessarily high costs resulting from inadequate economic analysis.

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