

Economists in the Room at the SEC

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The SEC's economic analysis has been under fire in recent years. This essay argues that the agency's response to successful challenges to its rules has produced real progress in the SEC's rulemaking process as well. The SEC has refined its internal processes and improved its work product, albeit in ways that Congress and the courts may not have precisely directed. John Coates and many others sound a call for change at the SEC.¹ This Essay attempts to defend the thesis that the change they've been waiting for is occurring now. Complex systems can respond in unpredicted ways to challenges and shocks; some of those responses demonstrate creativity and resilience. I have no theory of "administrative optimality" to present, but recent events show how a notoriously bad situation seems somehow to have yielded a few good results.

During most of the SEC's long losing streak in the D.C. Circuit Court of Appeals,² three things were true: (i) the D.C. Circuit's opinions set standards for economic analysis that no agency rulemaking could possibly comply with,³ (ii) the SEC wasn't even trying,⁴ and (iii) Republicans in Congress were furious.⁵ Today, all this is changing.⁶ A D.C. Circuit panel including former critics

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1. John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 1, 913-14 (2015); see also *infra* note 18.
 2. See, e.g., *Bus. Roundtable v. SEC (BRT)*, 647 F.3d 1144 (D.C. Cir. 2011); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010); *Chamber of Commerce v. SEC (Chamber II)*, 443 F.3d 890 (D.C. Cir. 2006); *Chamber of Commerce v. SEC (Chamber I)*, 412 F.3d 133 (D.C. Cir. 2005).
 3. Bruce Kraus & Connor Raso, *Rational Boundaries for SEC Cost-Benefit Analysis*, 30 YALE J. ON REG. 289, 313-17 (2013).
 4. *Id.*
 5. See, e.g., CURTIS W. COPELAND, CONG. RESEARCH SERV., R41974, COST-BENEFIT AND OTHER ANALYSIS REQUIREMENTS IN THE RULEMAKING PROCESS 18 (2011); Curtis W. Copeland, *Regulatory Analysis Requirements: A Review and Recommendations for Reform*, ADMIN. CONFERENCE U.S. 31 (2012), <http://www.acus.gov/sites/default/files/documents/COR-Copeland-Report-CIRCULATED.pdf> [<http://perma.cc/EZ8W-GJZZ>]; Office of Inspector Gen., *Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings*, SEC.

of the Commission issued an opinion earlier this year praising an SEC economic analysis.⁷ The SEC has begun conducting and publishing important empirical research on financial markets, and SEC economists now have a seat at the table in the rulemaking process.⁸ Other financial regulators are feeling congressional pressure to meet the SEC's high standards.

Outcomes flow from who's in the room when real decisions are made and who holds the room's attention. Institutional details like these are too small for courts and legislatures to manipulate directly with the blunt instruments at their disposal and are often too fine for scholars to perceive unless they've been in that room themselves. The SEC has changed the process by which it makes its rules,⁹ and that is no small thing.

From this perspective, I'll comment on John Coates's excellent article, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, Part by Part. His criticisms of the D.C. Circuit's opinion in *Business Roundtable v. SEC*¹⁰ (*BRT*) and of Congressional proposals and pressures to mandate what he calls quantitative cost-benefit analysis of financial regulation, or "CBA/FR,"

& EXCHANGE COMMISSION 12 (2012), http://www.sec.gov/about/offices/oig/reports/audits/2012/rpt499_followupreviewofd-f_costbenefitanalyses_508.pdf [<http://perma.cc/6EAX-4GSU>]; Letter from Rep. Darrell E. Issa, Chairman, U.S. House Comm. on Oversight & Gov't Reform, to Hon. Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n (Apr. 29, 2011), <http://pogoarchives.org/m/er/2011-04-29%20DEI%20to%20Schapiro%20%20add'l%20questions%20on%20capital%20formation.pdf> [<http://perma.cc/AA5N-CFPW>].

6. See *infra* Part V and sources cited therein.
7. Nat'l Ass'n of Mfrs. v. Sec & Exch. Comm'n, 748 F.3d 359, 369 (D.C. Cir. 2014) (finding the SEC's cost-side analysis "exhaustive[]" and noting that the court "f[ou]nd it difficult to see" how the SEC could have improved its benefits-side analysis). Indeed, the tide can be said to have turned a year earlier in *Investment Co. Institute v. Commodity Futures Trading Commission*, 720 F.3d 370 (D.C. Cir. 2013), which distinguishes *American Equity* from *BRT* and upholds the challenged derivatives trading regulations. See also Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351 (2014).
8. See Craig M. Lewis, Chief Economist and Dir., Div. of Risk, Strategy & Fin. Innovation, Sec. & Exch. Comm'n, SIFMA Compliance & Legal Society Luncheon, *The Expanded Role of Economists in SEC Rulemaking* (Oct. 16, 2012), <http://www.sec.gov/News/Speech/Detail/Speech/1365171491420#.VCNogytdXkY> [<http://perma.cc/ZN7K-CRQ6>]; Michael S. Piwowar, Comm'r, Sec. & Exchange Commission, *Remarks to the First Annual Conference on the Regulation of Financial Markets* (May 16, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370541854237#.VCNojtdXkY> [<http://perma.cc/F62C-5K57>].
9. Div. of Risk, Strategy & Fin. Innovation & Office of Gen. Counsel, *Current Guidance on Economic Analysis in SEC Rulemakings*, SEC. & EXCHANGE COMMISSION (2012) [hereinafter *2012 Guidance*], http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf [<http://perma.cc/P289-SN7B>]; see also *infra* Part V (discussing the enhanced stature and role of SEC economists ushered in by the 2012 Guidance).
10. 647 F.3d 1144 (D.C. Cir. 2011).

are spot-on.¹¹ Importantly, Cass Sunstein and Eric Posner and E. Glen Weyl, in their respective commentaries,¹² concur with Coates¹³ and Kraus and Raso¹⁴ (if on little else, and albeit less emphatically) that courts should get out of the business of second-guessing CBA/FR, and that current statutory attempts to amplify judicial review would do more harm than good.

I admire the way Coates reads the work product of the SEC's economists with a critical eye and that he rolled up his sleeves and took a crack at writing a couple of CBAs himself.¹⁵ His compliments to the SEC staff, grudging and qualified as they may be, still mean a lot coming from him—a successful former adversary of the agency and its Chief Economist in the administrative law battle over the SEC's attempt to require mutual fund boards to elect independent Chairs.¹⁶

Finally, Coates is correct to argue that it's an illusion to think that regulatory analysis stands outside the systems it analyzes or to think that academic critiques of those analyses (or comments on such critiques) have some privileged place on which to stand. In fact, “[W]e are all we have.”¹⁷ Coates soundly re-

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11. Coates, *supra* note 1, Part II. I also appreciate Coates's seconding of some of Kraus and Raso's policy recommendations. *Id.* at 1007; *see infra* Part II.
 12. Eric A. Posner & E. Glen Weyl, *Cost-Benefit Analysis of Financial Regulations: A Response to Criticisms*, 124 YALE L.J. F. 246, 261 (2015), <http://www.yalelawjournal.org/forum/cost-benefit-analysis-of-financial-regulations> [<http://perma.cc/26R8-5JKH>] (agreeing with Coates, “albeit with less confidence, that judicial review is premature at the current time” and noting that additional statutory CBA/FR requirements “probably would bring financial regulation to a halt, which we do not think is socially desirable”); Cass R. Sunstein, *Financial Regulation and Cost-Benefit Analysis*, 124 YALE L.J. F. 263, 268 (2015), <http://www.yalelawjournal.org/forum/financial-regulation-and-cost-benefit-analysis> [<http://perma.cc/QU95-F8QV>] (noting that executive agency CBA subject to OIRA is expressly exempted from judicial review).
 13. Coates, *supra* note 1, at 1007.
 14. Kraus & Raso, *supra* note 3, at 341.
 15. Coates, *supra* note 1, at 926-78. Readers are cautioned to discount my own boosterism of the SEC's Division of Economic and Risk Analysis (DERA) appropriately for my own brief stint at DERA's predecessor, the Division of Risk, Strategy and Financial Innovation.
 16. *Id.* at 954.
 17. Arthur A. Leff, *Unspeakable Ethics, Unnatural Law*, 1979 DUKE L.J. 1229, 1249. *See also id.* at 1229-30 (explaining that “there cannot be any normative system ultimately based on anything except human will”). The late Arthur Leff also pointed out that Gödel's proof should have ended the rationalist dream of a decision-machine that could crank out the correct answer to the question “what should we do now.” Arthur Allen Leff, *Memorandum*, 29 STAN. L. REV. 879 (1977) (reviewing ROBERTO MANGABEIRA UNGER, *KNOWLEDGE AND POLITICS* (1975)).

futes CBA/FR proponents who assume that a logical or mathematical system can produce regulations without, or in spite of, the policymakers' judgments.¹⁸

Despite the pointlessness of imagining perfect systems,¹⁹ however, we should nonetheless pause to admire the informative empirical results and mathematical models that the SEC's recently re-named Division of Economic and Risk Analysis (DERA) has been cranking out, as well as the SEC's increased use of home-grown economic data and analysis.²⁰ As I show in Part V, the work of the SEC's economists is neither a meaningless exercise nor a partisan weapon, but honest, interesting work that should be informative to policymakers, whatever their preconceptions.

I. WHAT IS CBA?

Coates starts out with a good distinction between two different ways in which the term "cost-benefit analysis" or "CBA" is used. Everyone agrees that a *policy* of applying reasoned analysis to the data at hand is a good thing. Who could be against that? A *legal requirement* that agencies conduct CBA, however, might seem innocuous, but it has proved insidious, as Coates shows. Such requirements, in the hands of regulated entities, acting indirectly through the major Washington business lobbies,²¹ are the perfect weapon to kill regulations costly to business interests, whether beneficial to society or not.²²

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18. Coates's repeated references to "CBA/FR proponents" and "advocates" could give readers the impression that the views he attributes to them are more widespread than they actually are. His three leading examples of CBA/FR advocates or proponents are COMMITTEE ON CAPITAL MARKETS REGULATION, *A BALANCED APPROACH TO COST-BENEFIT REFORM* (2013) [hereinafter CCMR REPORT]; Paul Rose & Christopher Walker, *The Importance of Cost-Benefit Analysis in Financial Regulation* (Ctr. for Capital Mkts. Competitiveness, Ohio State Pub. L. Working Paper No. 208, 2013) [hereinafter CCMC Report]; and GAO reports, including U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-151, *DODD-FRANK ACT REGULATIONS: IMPLEMENTATION COULD BENEFIT FROM ADDITIONAL ANALYSES AND COORDINATION* (2011). Coates, *supra* note 1, at 885 nn.4 & 6, 910 n.82. The CCMR is a law professor-led, financial industry-funded group that Coates later refers to, along with the CCMC, as a "trade group" or "political entrepreneur." Coates, *supra* note 1, at 923. The CCMC is an arm of the U.S. Chamber of Commerce, one of the successful petitioners in the *BRT* case and the lead plaintiff in *Chamber I* and *Chamber II*. It paid two law professors to write the CCMC Report. CCMC REPORT, *supra*, at ii; Coates, *supra* note 1, at 885 n.4; Kraus & Raso, *supra* note 3, at 293 n.12. The GAO is, of course, a Congressional agency. Coates's other examples of CBA/FR advocates are present or former political appointees. Coates, *supra* note 10, at 899 n.41 & 924 n.146.
19. See Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211 (1991).
20. See *infra* Part V.
21. Lucian Bebchuk has championed additional transparency regarding the funding of the dozen or so big business lobbies that account for most administrative rule challenges. Lucian A.

Coates's second distinction, "Quantities (or Guesstimates) vs. Concepts,"²³ is less successful. Coates defines "guesstimates" as CBA "supported only by weak, contested theory, unreliable research designs, or poor, unrepresentative evidence."²⁴ By definition, then, guesstimates are a waste of time or worse. Coates's major thesis is that what pass for rigorously-derived valuations and parameters in CBA/FR are in fact nothing but guesstimates. Quantification is what Coates says CBA/FR advocates expect and demand, but guesstimates are all they get.²⁵ He therefore concludes that, for now, we would all be better off abandoning any pretense of quantification in favor of what he calls "conceptual CBA," defined as "a disciplined framework for specifying baselines and alternatives, for insuring that (at least conceptually) both costs and benefits of rule are considered, and for encouraging the reliance on 'evidence' rather than *solely* on intuitive judgment."²⁶ Having demonstrated the pervasiveness of guesstimates, though, Coates never really gets around to comparing either them – or a more sophisticated form of quantification – to "Concepts" or "Conceptual CBA" at all.

Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923 (2013); Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83 (2010); Petition for Rulemaking from Lucian Bebchuk et al., Committee on Disclosure of Corporate Political Spending, to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n, (Aug. 3, 2011), <http://www.sec.gov/rules/petitions/2011/petn4-637.pdf> [<http://perma.cc/X78T-CC57>].

22. Kraus & Raso, *supra* note 3, at 319 ("Opponents of regulation find in litigation of this kind a perfect weapon – one that kills regulations while leaving no fingerprints.").
23. Coates, *supra* note 1, at 891.
24. *Id.*
25. *Id.* at 892-97. Coates does not attribute these unreasonable expectations to academic advocates of CBA such as Cass Sunstein and Eric Posner, whose more nuanced views he acknowledges while referring to them in distinct but confusingly similar terms, such as "CBA advocates" and "CBA optimists." *Id.* at 898-99; *see also id.* at 897-98 nn.33, 37 (citing Matthew D. Adler & Eric A. Posner, *Rethinking Cost-Benefit Analysis*, 109 YALE L.J. 165 (1999); Cass R. Sunstein, *Cost-Benefit Default Principles*, 99 MICH. L. REV. 1651 (2001)). Mainstream academic opinion on CBA generally is far from the naïve perfectionism that Coates seems to attribute to his CBA/FR proponents, having learned long ago to free itself from the "tyranny of false precision" and similar pitfalls. *See, e.g.*, FRANK ACKERMAN & LISA HEINZERLING, *PRICELESS: ON KNOWING THE PRICE OF EVERYTHING AND THE VALUE OF NOTHING* (2004); ADAM M. FINKEL, *RESOURCES FOR THE FUTURE, CONFRONTING UNCERTAINTY IN RISK MANAGEMENT: A GUIDE FOR DECISION-MAKERS* (1990); E. Donald Elliott, *Response, Only a Poor Workman Blames His Tools: On Uses and Abuses of Benefit-Cost Analysis in Regulatory Decision Making About the Environment*, 157 U. PA. L. REV. PENNUMBRA 178 (2009); Laurence H. Tribe, *Technology Assessment and the Fourth Discontinuity: The Limits of Instrumental Rationality*, 46 S. CAL. L. REV. 617, 630 (1973). Coates is right, however, that the naively perfectionistic CBA/FR has real traction in Congress. Kraus & Raso, *supra* note 3, at 322-24. The basis for the traction in those quarters, as at the trade groups, is probably more cynical than naïve. *See* Kraus & Raso, *supra* note 3, at 293-94.
26. Coates, *supra* note 1, at 893.

Coates's critiques of the CBAs of six financial regulations in Part III finds all of them to be guesstimates, at best.²⁷ Presumably, the theory behind a CBA must be both weak *and* contested to doom it to guesstimate status in his view. After all, any theory can be contested, and given sufficient economic incentives to do so, certainly will be. A theory's weakness should be an objective fact, as are the questions of whether the research design actually is unreliable, or the evidence unrepresentative. But who's to judge? Candidates for deciders on these questions include: a majority of sitting SEC Commissioners, the President, a majority of both houses of Congress, a majority of a panel of the D.C. Circuit Court of Appeals, the OIRA Director, a Harvard law professor, and the Chief Economist of the SEC. My own view is that it should be the last of these options, on grounds of expertise, and my argument is that this is the direction in which things are moving now, with the acquiescence—sometimes tacit—of the more powerful forces involved.

It's certainly true that some SEC releases are, as Coates says, overly long, repetitive, and boring to read. But as I hope to show in Part V, there actually are some good data and economics coming out of the agency, not just in the economic analysis contained in the releases themselves, but also the DERA white papers, working papers, research papers, and economic memoranda posted on the DERA section of the SEC website.²⁸ DERA posts its work product in the public comment files of proposed rules, resulting in a constructive, fact-based dialogue with commenters on the empirical economic evidence of a kind that was rarely seen in the past.²⁹

27. See *id.* at 996 (concluding that “[s]uch quantitative CBA/FR as has been done is better understood as ‘guesstimated,’ and has been presented without clear disclaimers and sensitivity analyses”).

28. *Economic Risk and Analysis*, SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/dera#.U8F1EhZPX1j> [<http://perma.cc/8GND-N4VD>].

29. See, e.g., Comment Letter from Todd Feinstein, Esq., Feinstein Law, P.A., to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n, Crowdfunding (Feb. 3, 2014), <http://www.sec.gov/comments/s7-09-13/s70913-257.pdf> [<http://perma.cc/725T-AUTP>]; Comment Letter from David F. Freeman, Jr., Arnold & Porter LLP, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n, Money Market Fund Reform; Amendments to Form PF, File Number S7-03-13—Comments Regarding SEC Staff Analysis of Liquidity Cost During Crisis Periods (Apr. 23, 2014), <http://www.sec.gov/comments/s7-03-13/s70313-345.pdf> [<http://perma.cc/AY4F-SEEC>]; Comment Letter from Daniel Gorfine et al., Milken Institute, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n, Comments on Proposed Rule: Amendments to Regulation D, Form D and Rule 156 under the Securities Act of 1933 (Sept. 20, 2013), <http://www.sec.gov/comments/s7-06-13/s70613-371.pdf> [<http://perma.cc/8FM9-GQDW>]; Comment Letter from Marianne Hudson et al., Angel Capital Association, to Hon. Mary Jo White, Chairman, SEC, Accredited Investor Definition Comment and Recommendations (Feb. 28, 2014), <http://www.sec.gov/comments/s7-06-13/s70613-490.pdf> [<http://perma.cc/DU68-CU84>]; Comment Letter from Dennis M. Kelleher et al., Better Markets, Inc., to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n, Amendments to Regulation D, Form

I favor what Coates labels “Conceptual CBA,” but I think that his choice of that term is something of a misnomer³⁰ for four reasons:

1. He seems to mean it as a compliment, but it really doesn’t sound like one;
2. it’s not purely conceptual, including, as it does, reliance on quantitative baselines and whatever quantitative evidence there is;³¹
3. like guesstimated CBA, it relies on theories³² (just not, apparently, “weak, contested” ones); and
4. it’s proposed as a counterfactual,³³ while I contend that it’s what the SEC is doing now, and seeking every day to do better.

Coates and I (and perhaps Sunstein, and Posner and Weyl, too) all seem to agree on what financial regulatory agencies ought to be trying to do. A better name for it might be “Pragmatic CBA.” Simply stated, government economists should make whatever positive contributions they can to regulatory analysis and regulatory outcomes, up to the limits of their data and expertise, and policymakers should listen when the economists have something useful to say.

Coates’s third distinction is provocatively labeled “Camouflage vs. Discipline.” The canonical account of CBA—which Coates deems false—is that Congress, in the name of good government, invented it more than a century ago, the better to control the activities of the Army Corps of Engineers on the floodplain of the Mississippi River.³⁴ In Coates’s counter-narrative, CBA was actually invented by the Corps itself, as a means of maintaining its independ-

D and Rule 156 (Sept. 23, 2013), <http://www.sec.gov/comments/s7-06-13/s70613-410.pdf> [<http://perma.cc/RA48-VSWK>]; see also *infra* note 124 (citing various comment letters on money market fund reform).

30. Cf. Posner & Weyl, *supra* note 12, at 112 (“What is the difference between ‘conceptual CBA’ and ordinary CBA? We are not sure.”).

31. Coates, *supra* note 1, at 892-93.

32. *Id.* at 892-93, 955.

33. See, e.g., *id.* at 1009-10 (“A review of CBA conducted by the financial regulatory agencies demonstrates that fleshing out the benefits of financial regulation is a largely incomplete conceptual task The question, then, is how to encourage financial regulators to engage in meaningful, detailed conceptual CBA.”).

34. See generally JOHN MCPHEE, *THE CONTROL OF NATURE* (1989); THEODORE M. PORTER, *TRUST IN NUMBERS: THE PURSUIT OF OBJECTIVITY IN SCIENCE AND PUBLIC LIFE* ch. 7 (1995).

ence from Congress.³⁵ With its CBA in hand, the Corps could muster numbers no one could question, in support of whatever projects it had decided a priori to undertake, camouflaging the real reasons for its decisions, including patronage.³⁶

Coates asserts that guesstimated CBA serves much the same function. He views it as a potentially misleading effort to camouflage agency discretion and independence. This simply rings false to me. In society and politics, as in biological systems, appearances often contain an element of camouflage, but that's not enough to discredit them. A cynical reason doesn't preclude a parallel sincere one; sometimes, what cynicism camouflages is an ideal.

The pummeling and pounding described in Coates's Part II³⁷ has reinforced the SEC's corps of professional financial economists and thrust them into the mainstream of the SEC rulemaking process.³⁸ This formerly marginalized group, one step at a time, is simultaneously earning the trust of the lawyer-policymakers at the SEC and helping the SEC earn, or regain, the confidence of the other branches of government.³⁹ What's new at the SEC is that it is attracting and training economists interested in making a contribution to public policy, and the rest of the agency is willing, and even eager, to hear what they have to say.

Coates refutes those who claim that CBA can be a corrective to a supposed "tyranny of expertise," when in fact it is fundamentally an exercise in professional judgment and expertise.⁴⁰ I agree with this fully. The work of financial economists is not mechanical; it requires judgment at every step. Every day at the SEC, these days, financial economists interact with other policymakers at

35. Coates, *supra* note 1, at 900-01.

36. *Id.*

37. *Id.* at 909-26.

38. Some SEC economists long provided expert litigation support to SEC enforcement, and have always been valued and effective members of that team, while others are assigned to DERA's risk-assessment mission, supporting its storied "RoboCop" accounting fraud detection system. Al Holzinger, *New Robocop Tasked with Busting Fraudulent Financial Report Filers*, FSA TIMES <http://www.theiia.org/fsa/2013-features/new-robocop-tasked-with-busting-fraudulent-financial-report-filers/?staticReset&hardreset> [<http://perma.cc/U5R2-LYPK>]; Janet Novack, *How SEC's New RoboCop Profiles Companies for Accounting Fraud*, FORBES, Aug. 9, 2013, <http://www.forbes.com/sites/janetnovack/2013/08/09/how-secs-new-robocop-profiles-companies-for-accounting-fraud> [<http://perma.cc/AKT6-VBBM>].

39. See Office of Inspector Gen., *Implementation of the Current Guidance on Economic Analysis in SEC Rulemakings*, SEC. & EXCHANGE COMMISSION 7 (June 6, 2013), <http://www.sec.gov/oig/reportspubs/516.pdf> [<http://perma.cc/74UK-26W5>] ("[W]e 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.").

40. Coates, *supra* note 1, at 903-09.

all stages of the rulemaking process: informing, becoming informed, helping to ensure the success of the grand project each rule represents, and looking for ways to make a positive contribution with their expertise.⁴¹

II. JUDICIAL REVIEW AND CONGRESSIONAL OVERSIGHT OF CBA/FR

Labels aside, Coates's Conceptual CBA is essentially CBA within the "rational boundaries" advocated in Kraus and Raso—boundaries set on a case-by-case basis in good faith by the economists involved.⁴² We also agree (as do Posner and Weyl and Sunstein)⁴³ that these boundaries, and the work that takes place within them, should be exempt from judicial review,⁴⁴ legislative efforts to the contrary⁴⁵ notwithstanding.⁴⁶

In *Business Roundtable*, the D.C. Circuit struck down the SEC's long-considered proxy access rule, despite Dodd-Frank's express grant of statutory authority for it.⁴⁷ In a strongly worded opinion, the *BRT* court rejected the SEC's determinations of which empirical studies were valid and which were weak—determinations made by the agency's staff of eminent economists.⁴⁸ Coates notes and joins the remarkable consensus among academic commenters condemning the *BRT* ruling.⁴⁹ Coates himself is equally harsh, accusing the opinion's author, Judge Ginsburg, of hypocrisy.⁵⁰

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41. See Office of Inspector Gen., *supra* note 39, at ii (“[T]he 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.”).
42. Kraus & Raso, *supra* note 3, at 333.
43. See Posner & Weyl, *supra* note 12 and accompanying text; see also Sunstein, *supra* note 12.
44. Coates, *supra* note 1, at 1002-05; Kraus & Raso, *supra* note 3, at 295.
45. See Independent Agency Regulatory Analysis Act § 4(b), S. 1173, 113th Cong. (2013).
46. See *infra* note 65 and accompanying text.
47. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 971, 124 Stat. 1376, 1915 (2010) (codified as amended at 15 U.S.C. § 78n(a)(2) (2012)).
48. *Bus. Roundtable v. Sec. & Exch. Comm’n*, 647 F.3d 1144, 1150-51 (D.C. Cir. 2011); see also Coates, *supra* note 1, at 918-21; Kraus & Raso, *supra* note 3, at 314-16.
49. Coates, *supra* note 1, at 918 n.116. Amid many harsh critiques, the closest thing to a scholarly defense of *BRT* was the CCMC Report, *supra* note 18, which was commissioned by the U.S. Chamber of Commerce itself, *id.*
50. *Id.* at 31 (“Inconsistently, it was Judge Ginsburg who penned the *Business Roundtable* decision, just two years after he joined the decision in *Stilwell*, where the same court held that the APA ‘imposes no general obligation on agencies to produce empirical evidence.’” (quoting *Stilwell v. Office of Thrift Supervision*, 569 F.3d 514, 519 (D.C. Cir. 2009) (Kavanaugh, J.))). Bad as *BRT* was, Coates’s charge of hypocrisy seems unwarranted.

Kraus and Raso, too, charged *BRT* with unnecessary roughness, noting that the case came down at a time when the SEC had already gotten the message from the *Chamber I* and *II* and *American Equity* cases and had begun implementing needed reforms.⁵¹ But the harsh tone of both articles toward the D.C. Circuit may now be outdated, if my reading of two recent D.C. Circuit decisions on Dodd-Frank rules, both issued after *BRT*, is correct.⁵²

Coates correctly notes that President Obama's long-stalled nominations to the D.C. Circuit were a driving force behind Senate Democrats' exercise of the so-called "nuclear option,"⁵³ ending the filibuster rule so that a simple majority of Senators could confirm court of appeals judges and other key presidential nominations.⁵⁴ The fate of financial reform legislation in the hands of the D.C. Circuit after *BRT*, in turn, may well have played a part in Senate Democrats' focus on that court: suggestive evidence is that immediately following the rule change, the nominations of Judges Millett, Pillard, and Wilkins to the D.C. Circuit were confirmed.⁵⁵ Notably, Judge Wilkins had recently written a strong opinion for the D.C. District Court upholding the SEC's economic analysis of the Dodd-Frank conflict minerals rule.⁵⁶

Coates asserts that outcomes in "the partisan lottery that is the D.C. Circuit"⁵⁷ are decided by "which judges are chosen for a given case."⁵⁸ This cynical view certainly augured ill for the appeal of Judge Wilkins's decision in *National Association of Manufacturers v. SEC (NAM)*,⁵⁹ since the panel included both Judge Randolph, a George H.W. Bush appointee, and Judge Sentelle, a Reagan appointee who was the author of the *American Equity* decision and member of

51. Kraus & Raso, *supra* note 3, at 301-08.

52. *Nat'l Ass'n of Mfrs. v. Sec. & Exch. Comm'n*, 748 F.3d 359 (D.C. Cir. 2014) (rejecting several allegations of "arbitrary" and "capricious" rulemaking); *Inv. Co. Inst. v. Commodity Futures Trading Comm'n*, 720 F.3d 370 (D.C. Cir. 2013) (same).

53. 113 CONG. REC. S8,414 (daily ed. Nov. 21, 2013) (statement of Sen. Harry Reid).

54. *Id.* at S8,422 (statement of Sen. Carl Levin) ("Republicans have filibustered three eminently qualified nominees to the Circuit Court of Appeals for the District of Columbia. They make no pretense of argument that these nominees are unqualified. The mere nomination of qualified judges, by this President, they say, qualifies as court packing.").

55. JUDICIALNOMINATIONS.ORG, <http://judicialnominations.org> [<http://perma.cc/5RYP-2JEH>].

56. *Nat'l Ass'n of Mfrs. v. Sec. & Exch. Comm'n*, 956 F. Supp. 2d 43 (D.D.C. 2013), *aff'd in part and rev'd in part*, 748 F.3d 359 (D.C. Cir. 2014). The fate of this rule on appeal is discussed immediately below.

57. Coates, *supra* note 1, at 1007.

58. *Id.* at 921.

59. 748 F.3d 359 (D.C. Cir. 2014).

the unanimous *BRT* panel as well.⁶⁰ Nonetheless, the *NAM* opinion went out of its way to praise the SEC's economic analysis.⁶¹

I therefore tentatively advance a more optimistic interpretation of *NAM*: as a quiet turning point for the court's attitude toward CBA/FR. The firestorm of scholarly criticism of *BRT*,⁶² Senate Democrats' exercise of the nuclear option for the D.C. Circuit (they stopped short of applying it to the U.S. Supreme Court), and the SEC's real economic work evident in the record could well have been factors leading the conservative judges who made up the majority of the *NAM* panel to conclude that it was a prudent time to change course—a time to begin giving substance, as well as lip service, to the idea of deference to agency expertise. How many more decisions like *BRT*, they may have privately reasoned, would it have taken before the D.C. Circuit's protestations of deference to agency expertise wore too thin? How long before certiorari would have been granted, those protestations notwithstanding, risking exposure of the whole line of cases as little more than an end-run around *Chevron*? Why risk the D.C. Circuit's de facto ability to have the last word in much of U.S. administrative law,⁶³ especially when a First Amendment approach was at hand that could be deployed to remand the rule?⁶⁴

When it first came down, *BRT* was brandished by opponents of financial regulation as evidence of the SEC's incompetence and lack of economic expertise.⁶⁵ This case led Republicans in Congress to propose legislation that would

60. Judge Sentelle himself penned the Court's unanimous opinion distinguishing *BRT* and *American Equity* and upholding a Dodd-Frank derivatives trading rule in *Inv. Co. Inst. v. Commodity Futures Trading Comm'n*, 720 F.3d 370 (D.C. Cir. 2013), joined by Judges Brown and Garland, both of whom had joined Judge Ginsburg's *BRT* opinion.

61. *Nat'l Ass'n of Mfrs.*, 748 F.3d at 369 (“The Commission exhaustively analyzed the final rule’s costs. It considered its own data as well as cost estimates submitted during the comment period That determination was reasonable. An agency is not required ‘to measure the immeasurable,’ and need not conduct a ‘rigorous, quantitative economic analysis’ unless the statute explicitly directs it to do so.”) (citations omitted).

62. See Coates, *supra* note 1, at 918 n.116.

63. See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984); Cass R. Sunstein, *Beyond Marbury: The Executive’s Power To Say What the Law Is*, 115 YALE L.J. 2580 (2006).

64. *Nat'l Ass'n of Mfrs.*, 748 F.3d at 373.

65. See Curtis W. Copeland, *Cost-Benefit and Other Analysis Requirements in the Rulemaking Process*, CONG. RESEARCH SERV. R41974 18 n.73 (2011), <http://www.fas.org/sgp/crs/misc/R41974.pdf> [<http://perma.cc/HS25-YY76>]; Curtis W. Copeland, *Regulatory Analysis Requirements: A Review and Recommendations for Reform*, ADMIN. CONFERENCE OF THE U.S. *supra* note 5; Letter from Darrell E. Issa to Mary Schapiro, *supra* note 5, at 31; Office of Inspector Gen., *Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings*, SEC. & EXCHANGE COMMISSION 12-15 (2012), http://www.sec.gov/about/offices/oig/reports/audits/2012/rpt499_followupreviewofd-f_costbenefitanalyses_508.pdf [<http://perma.cc/KNX7-V45F>].

spell out CBA requirements for financial regulations in greater detail.⁶⁶ Coates criticizes these bills, saying the quantitative CBA/FR they would require is in principle impossible.⁶⁷ These initiatives would deter agencies from even attempting to adopt financial regulations, by bolstering legal challenges to any adopted rules.⁶⁸

Today, however, the *BRT* decision could be on its way to becoming, and may have already become, an embarrassment to the D.C. Circuit for all the good reasons that still have Coates incensed about it three years after the fact.⁶⁹ Even Judge Ginsburg's own bristling defense of *BRT* in his subsequent *American Petroleum Institute*⁷⁰ opinion can itself be read (perhaps with some wishful thinking on my part) at least as a kind of tacit acknowledgement of the widespread criticism his earlier opinion attracted.⁷¹

The *BRT* case doesn't have to be overruled, because it didn't expressly invoke the wrong legal standard. It merely applied the standard irresponsibly—in the view of legal scholars.⁷² But if it has come to be viewed as a case of judicial overreach that led to “packing” the court—a reprise of the tale of substantive due process and the New Deal in miniature⁷³—we can hope that the case will not be cited with enthusiasm by the court in the future, and quietly forgotten by advocates for deregulation, who are already moving on to other lines of attack.⁷⁴

66. Kraus & Raso, *supra* note 3, at 322-24.

67. Coates, *supra* note 1, at 928-31, 995; *see also* Posner & Weyl, *supra* note 12, at 2-4 (challenging Coates's characterization of the difficulties of financial CBA).

68. *See* Coates, *supra* note 1, at 909, 929; Kraus & Raso, *supra* note 3, at 317-18; Posner & Weyl, *supra* note 12, at 12.

69. Coates, *supra* note 1, at 918-21.

70. *Am. Petroleum Inst. v. Env't Prot. Agency*, 684 F.3d 1342, 1351 (D.C. Cir. 2012).

71. *Cf.* Kraus & Raso, *supra* note 3, at 318, 320 (discussing Judge Ginsburg's continuing ire expressed in *American Petroleum* as a reason why the SEC may have been prudent not to seek rehearing of *BRT* en banc). On reflection and re-reading, Judge Ginsburg's *American Petroleum* opinion, in which he attempts in dictum to affirm his own prior opinion on other grounds, now can be read as a (highly ambiguous) call for a retreat from *BRT*.

72. Coates, *supra* note 1, at 917 n.116 (“The decision provoked unusual agreement among legal commentators—all negative.”).

73. *See* Michael Ariens, *A Thrice-Told Tale, or Felix the Cat*, 107 HARV. L. REV. 620, 624-29 (1994); L.A. Powe, Jr., *Two Great Leaders*, 57 N.Y.L. SCH. L. REV. 465, 472-477 (2012/2013); Robert L. Stern, *The Commerce Clause and the National Economy, 1933-1946*, 59 HARV. L. REV. 645, 677-682 (1946).

74. *See* Nat'l Ass'n of Mfrs. v. Sec. & Exch. Comm'n, 748 F.3d 359, 370-73 (D.C. Cir. 2014) (rejecting a SEC rule on First Amendment grounds). Petitioners made a First Amendment claim in *BRT* as well, which the Court did not address. *Bus. Roundtable v. Sec. & Exch. Comm'n*, 647 F.3d 1144, 1156 (2011).

III. COATES TRIES HIS HAND AT QUANTITATIVE CBA/FR

The heart of Coates's paper, and its most impressive section, is Part III, in which he undertakes his own CBA/FR of four existing rules and critiques two other examples of CBA/FR touted as the "gold standard" in the field.

Oddly, the purpose of the exercise is not to provide examples of the Conceptual CBA that Coates says he favors, nor to show the financial regulatory agencies how to do quantitative CBA/FR better, but rather to demonstrate that the exercise is "not currently feasible with any degree of precision and reliability for representative types of financial regulation."⁷⁵ Coates believes, based on his own shot at the task, that all attempts at quantitative CBA/FR will yield nothing more than the mere guesstimates discussed above, which Coates dismisses as "judgment in drag."⁷⁶

I am predisposed to believe Coates's conclusions. But neither the professional proponents of quantitative CBA/FR that Coates describes,⁷⁷ nor reasonable but skeptical academics, are likely to be convinced by an argument that takes the following form:

1. You claim CBA/FR can be done;
2. I tried to do it and produced nothing useful; therefore
3. "the capacity of anyone—including financial regulatory agencies OIRA, academic researchers, CBA/FR proponents, litigators or courts—to conduct CBA/FR with any real precision or confidence does not exist"⁷⁸

While I believe the conclusion to be true, I find it more persuasively demonstrated on a theoretical level by recent papers by Alex Lee and Jeffrey Gordon, which argue that no real consensus is possible on which costs and benefits CBA/FR is trying to measure and that CBA/FR can end attempts at meaningful, comprehensive economic analysis before they begin.⁷⁹

75. Coates, *supra* note 1, at 996.

76. *Id.* at 909.

77. *Id.* at 978; see *supra* note 18 and accompanying text.

78. *Id.* at 997.

79. Gordon, *supra* note 7; Yoon-Ho Alex Lee, *The Efficiency Criterion for Securities Regulation: Investor Welfare or Total Surplus?*, 57 ARIZ. L. REV. (forthcoming 2015), <http://ssrn.com/abstract=2406032> [<http://perma.cc/UJ8H-X42Z>].

Coates's Case #2, the one dealing with the SEC's attempt to require mutual fund boards to elect independent chairmen,⁸⁰ is colorful, in part because Coates was a player in the events leading up to the withdrawal of the rules following the D.C. Circuit's *Chamber I* and *Chamber II* decisions.⁸¹ Fidelity Investments, whose Chairman, Ned Johnson, opposed the proposed rule, hired Coates, who wrote a critique of an analysis of the rule by the SEC's then-Chief Economist, Chester Spatt; the critique was attached as an exhibit to Fidelity's comment letter on the rule.⁸² Coates writes, correctly in my view, that he scored a few good points, but he allows that Spatt scored a few too.⁸³ It was a high-class conversation, but in the end its merits didn't matter. Coates defends his prior advocacy,⁸⁴ but at the same time, I detect a degree of mixed feelings. Is there possibly a note of regret at his complicity in this early link in the chain of events that led to the infamous *BRT* opinion? The skirmish was, as Coates now recognizes, part of the successful strategy to run out the clock until a new Chair took over at the SEC, leaving the independent chairman rule to die a quiet death.⁸⁵ None of the rules struck down on economic analysis grounds have been re-proposed.⁸⁶

Although Kraus and Raso noted that good regulatory analysis is a conversation, not a computation,⁸⁷ Coates dismisses his Case #2, like all the others, as just another guesstimate.⁸⁸ Why doesn't Coates regard his own spat with Spatt as an example of the kind of conceptual CBA/FR that he promotes as an unrealized ideal? Why is everything that's not quantitative CBA/FR automatically deemed invalid guesstimates⁸⁹ rather than a step toward conceptual, pragmatic CBA/FR?

80. Coates, *supra* note 1, at 948-55.

81. *Id.* at 955.

82. See Coates, *supra* note 1, at 954 n.257; Letter from John C. Coates IV, Professor of Law & Econ., Harvard Law Sch., to Nancy M. Morris, Sec'y, Sec. & Exchange Commission (Mar. 1, 2007), <http://www.sec.gov/rules/proposed/s70304/s70304-554.pdf> [<http://perma.cc/JN9J-2UWM>].

83. Coates, *supra* note 1, at 951-55.

84. *Id.* at 954-55.

85. *Id.* at 955.

86. Kraus & Raso, *supra* note 3, at 319, 331 (recommending re-adoption of a proxy access rule informed by an improved economic analysis).

87. *Id.* at 340.

88. Coates, *supra* note 1, at 996-97.

89. See *id.* at 997-98.

Coates takes as his fifth case study the 200-page economic analysis contained in the SEC's Cross-Border Swap Release⁹⁰—an analysis that serves as a poster child for CBA/FR proponents and that has been singled out as their “gold standard.”⁹¹ His demolition of that analysis is, therefore, crucial to his argument.⁹² Unlike (one suspects) some of this release's cheerleaders, Coates has actually read the Cross-Border analysis, an exercise he (understandably) found “exhausting.”⁹³ He finds the analysis itself “turgid, vague, and full of jargon.”⁹⁴ I do not disagree. He boils a 210-word paragraph down to a 35-word sentence with no loss of meaning.⁹⁵ I'm sure that he, or any other first-rate lawyer, could do the same with any number of documents authored by committees. But in the aftermath of *American Equity*, the SEC began including real economic analysis in its releases and, more importantly, in its rulemaking process. The *American Equity* decision came down in time to shape the final drafts of the Proxy Access Release, and the *BRT* decision accelerated the trend thereafter.

The fact that an SEC release is verbose and contains a lot of nonsense does not prove that it contains nothing but nonsense. Yet that's what Coates apparently means to imply:

I do not intend to criticize the authors of the Cross-Border Swap Release—to the contrary, I commend them. They accomplished an important goal—eliciting praise from a group of critics of the SEC's CBA practices—and likely helped set up the SEC to defend itself against any court challenges to its rules.⁹⁶

But is that all they accomplished, and is success at (it seems) pulling the wool over the eyes of congressional overseers and policy entrepreneurs the *only* reason to commend them?

Surviving judicial review and winning praise from former critics is naturally *part* of what the economic analysis in the Cross-Border Release was designed

90. Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 Fed. Reg. 30,968 (proposed May 23, 2013) (to be codified at 17 C.F.R. pts. 240, 242, 249), <http://www.sec.gov/rules/proposed/2013/34-69490.pdf> [<http://perma.cc/LW4D-QVA8>].

91. Coates, *supra* note 1, at 978-84.

92. His sixth example involves mortgage rules promulgated and analyzed by the United Kingdom's now-abolished FSA. Coates, *supra* note 1, at 984-89.

93. *Id.* at 981.

94. *Id.* at 983.

95. *Id.* at 984 n.373.

96. *Id.* at 984.

to accomplish, but that observation doesn't prove that it's *all* it accomplished. Professor Coates himself allows that the release accomplished some important, if limited, quantification, but for some reason those data points don't hold sway because they "are buried in footnotes."⁹⁷

Coates's paper begins by contrasting guesstimates unfavorably with conceptual CBA/FR.⁹⁸ He concludes that this conceptual process (which I think is more accurately called pragmatic) "remains the best available overarching framework for organizing and communicating the pros and cons of a proposed regulation . . . a commonsensical way to begin the analysis of a proposed rule by comparing it to the status quo and plausible alternatives."⁹⁹ Yet Part III, the heart of the paper, neither looks for nor supplies examples of how a valuable, pragmatic, conceptual CBA/FR should be done. It contents itself with holding both agency efforts and his own up to the impossible standard of quantitative CBA/FR, a standard that both the professor and the bureaucrats naturally fail.

IV. COATES CONCLUDES

Like Kraus and Raso, Coates concludes that:

1. the SEC should continue to do the best it can with the data and analytical tools at hand to produce conceptual or pragmatic economic analyses of rules that inform (but do not dictate) policy;
2. courts should get out of the business of second-guessing CBA/FR;
3. Congress, far from adding ever-more-explicit CBA/FR requirements, ought instead to insulate the process from judicial review and amend the Sunshine Act to allow Commissioners to speak privately with one another about these fundamental issues.¹⁰⁰

Coates then goes where Kraus and Raso feared to tread, offering reasons why quantified CBA/FR can't work,¹⁰¹ when by common consensus CBA does work in areas like environment, health, and safety.¹⁰² Coates notes that finance

97. *Id.* at 983.

98. *Id.* at 891.

99. *Id.* at 1008

100. *Id.* at 888-89, 1007-10.

101. *Id.* at 997-1001, .

102. See, e.g., ACKERMAN & HEINZERLING, *supra* note 25; CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION (2002); CASS R. SUNSTEIN, RISK AND

is central to the economy and is at bottom social and political, rather than scientific and creative, and is dynamic in its response to regulations in a way that the laws of physics and chemical reactions are not.¹⁰³

I decline to debate the merits of CBA in its original domain with experts like Sunstein, Posner, and Weyl, except to note that Judge Ginsburg himself has reportedly held out the EPA's CBA as a model for the SEC.¹⁰⁴ A particularly sobering perspective comes from a recent article seeking to explain the evident but peculiar fact that the intensity of the rhetoric and the amount of resources expended by both sides on proposals like proxy access far exceeds any practical effects of the proposal. Arguing from classic work by Thurman Arnold,¹⁰⁵ Kahan and Rock point to an important (but necessarily hidden) symbolic, mythological or ritual function of such debates, in which investor advocates battle corporate America for (what are in actuality) low stakes, while business goes on as usual, regardless of the outcome.¹⁰⁶ This view has depressing implications for anyone wishing to take CBA/FR seriously since CBA has no room for such subtleties and symbols. Indeed, the SEC lost the proxy access case in part because the CBA/FR exercise forced it to admit just how infrequently the rule, if upheld, was likely to have been used, causing the SEC to stumble in its comparison of costs and benefits.¹⁰⁷

V. PRAGMATIC, EFFECTIVE ECONOMIC ANALYSIS

The pragmatic (or "conceptual") CBA/FR that Coates and his commenters all seem to prefer to quantified CBA/FR has taken hold at the SEC, where it goes by the name of "Economic Analysis." Money Market Fund (MMF) reform is the best example of DERA's positive and influential results, but I'll mention some others as well and conclude with observations about the culture change within the agency that the 2012 Guidance has engendered.

REASON: SAFETY, LAW, AND THE ENVIRONMENT (2003); Adler & Posner, *supra* note 25; Karl-Göran Mäler, *A Method of Estimating Social Benefits from Pollution Control*, 73 SWEDISH J. ECON. 121 (1971); Cass R. Sunstein, *The Arithmetic of Arsenic*, 90 GEO. L.J. 2255 (2002); Sunstein, *supra* note 25.

103. See Coates, *supra* note 1, at 998-1001.

104. Robert P. Bartlett, III, *The Institutional Framework for Cost Benefit Analysis in Financial Regulation: A Tale of Four Paradigms?*, at 13 (Dec. 16, 2013) (unpublished manuscript) <http://ssrn.com/abstract=2488077> [<http://perma.cc/BH6W-BAKC>].

105. THURMAN W. ARNOLD, *THE FOLKLORE OF CAPITALISM* (1937).

106. See Marcel Kahan & Edward B. Rock, *Symbolic Corporate Governance Politics*, at 38-41 (NYU Ctr. for Law, Econ. & Org. Law & Econ. Res. Paper Series, Working Paper No. 14-07, Mar. 2014), <http://ssrn.com/abstract=2404530> [<http://perma.cc/K4F3-NQ5T>].

107. *Bus. Roundtable v. Sec. & Exch. Comm'n*, 647 F.3d 1144, 1152-54 (D.C. Cir. 2011).

A. Money Market Reform

Money market funds grew out of a 1983 SEC exemptive order¹⁰⁸ into a three-trillion-dollar industry that proved fragile following the collapse of Lehman Brothers. Only massive intervention by the U.S. Treasury (buying impaired MMF assets with no discounts and an outright, unlimited guarantee, issued at no cost to the funds) stopped the run on MMFs in the financial crisis, preventing catastrophe.¹⁰⁹

Despite Treasury pressure, the SEC took six years to adopt fundamental MMF reform.¹¹⁰ It is plausible to think that the industry was pleased with the status quo and continued to benefit to the extent investors believed that a Treasury backstop would be there for them next time, as well. Policymakers agreed that allowing MMFs to offer the equivalent of bank deposits without bank capital was a problem but they were sharply divided about whether the solution was to make them (or some of them) more like banks (by imposing the equivalent of capital requirements) or more like mutual funds, whose redemption price fluctuates daily with portfolio values (NAV). SEC economists played an important role in this big picture debate and in discussion of the question of which portions of the MMF industry were in fact vulnerable to the runs that a floating NAV was designed to mitigate.¹¹¹

The SEC's Chair was unable to muster majority support for even the *proposal* (much less the adoption) of fundamental reform.¹¹² SEC economists broke the deadlock with an influential study answering issues raised by recalcitrant Commissioners, including:

1. an assessment of whether the 2008 run on MMFs was a flight to quality, a flight to transparency, or a flight to performance;
2. the extent to which a fund's "breaking the buck" outside of a financial crisis could have systemic effects;

108. Valuation of Debt Instruments and Computation of Current Price per Share by Certain Open-End Investment Companies (Money Market Funds), 48 Fed. Reg. 32,555 (July 18, 1983) (to be codified at 17 C.F.R. pt. 270).

109. See Money Market Fund Reform; Amendments to Form PF, 79 Fed. Reg. 47,736 (Aug. 14, 2014) [hereinafter MMF Final Rule] (to be codified in scattered parts of 17 C.F.R.).

110. *Id.*

111. See Craig M. Lewis, *The Economic Implications of Money Market Fund Capital Buffers*, SEC. & EXCHANGE COMMISSION (Nov. 2013), <http://www.sec.gov/divisions/riskfin/workingpapers/rsfi-wp2014-01.pdf> [<http://perma.cc/H7SR-EFF5>].

112. Nathaniel Popper, *A Regulator's Key Role in Failed Mutual Fund Reform*, N.Y. TIMES, Aug. 26, 2013, <http://www.nytimes.com/2012/08/27/business/luis-aguilar-sec-member-role-failed-mutual-fund-reform.html> [<http://perma.cc/5FYH-RBPV>].

3. the degree to which the 2010 reforms, if implemented earlier, would have mitigated the 2008 crisis; and
4. the performance of MMFs in the Eurozone sovereign debt crisis and U.S. debt ceiling impasse, following implementation of the 2010 reforms.¹¹³

Following these responses, fundamental MMF reform was finally proposed in 2013 in a unanimous Commission vote¹¹⁴ and adopted in August 2014 by a 3-to-2 vote¹¹⁵ in a release citing the DERA Study as “critically important,” and referring to it and relying on it¹¹⁶ throughout the 869-page release.¹¹⁷ In addition, the MMF rule relied on five additional DERA memoranda, referred to in the adopting release as the DERA Liquidity Fee Memo,¹¹⁸ the DERA Guarantor Diversification Memo,¹¹⁹ the DERA Government MMF Exposure Memo,¹²⁰ the DERA Municipal MMF Exposure to Parents of Guarantors Memo,¹²¹ and the

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113. Div. of Risk, Strategy & Fin. Innovation, *Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher*, SEC. & EXCHANGE COMMISSION (Nov. 30, 2012) [hereinafter DERA Study], <http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf> [<http://perma.cc/Z7D3-793J>]. The Division of Risk, Strategy, and Financial Innovation is now known as DERA.
 114. Money Market Fund Reform; Amendments to Form PF, 78 Fed. Reg. 36,834 (proposed June 19, 2013) (to be codified in scattered parts of 17 C.F.R.); Press Release, Sec. & Exchange Commission, SEC Proposes Money Market Reforms (June 5, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171575248> [<http://perma.cc/FEV8-WZ6H>].
 115. See MMF Final Rule, *supra* note 107.
 116. *Id.* at 47,746 (“The DERA Study, discussed throughout this Release, has informed our consideration of the risks that may be posed by money market funds and our formulation of today’s rules and amendments.”).
 117. *Id.* at 47,739. The 869 page release cites the DERA study 74 times.
 118. Memorandum from the Div. of Econ. & Risk Analysis, Liquidity Cost During Crisis Periods (Mar. 17, 2014), <http://www.sec.gov/comments/s7-03-13/s70313-321.pdf> [<http://perma.cc/953A-WUAA>].
 119. Memorandum from the Div. of Econ. & Risk Analysis, Government Money Market Fund Exposure to Non-Government Securities (Mar. 17, 2014), <http://www.sec.gov/comments/s7-03-13/s70313-323.pdf> [<http://perma.cc/K4QE-36FH>].
 120. Memorandum from the Div. of Econ. & Risk Analysis, Government Money Market Fund Exposure to Non-Government Securities (Mar. 17, 2014), <http://www.sec.gov/comments/s7-03-13/s70313-322.pdf> [<http://perma.cc/8KK6-36C3>].
 121. Memorandum from the Div. of Econ. & Risk Analysis, *supra* note 118.

SEC Staff Analysis,¹²² as well as a research paper by its Chief Economist,¹²³ all of which informed aspects of the final rule, large and small. The economic substance of the Release was further enriched by four detailed industry comments specifically directed at empirical aspects of these memoranda (which were put on public notice in the comment file).¹²⁴

Examples of DERA findings that informed the final rule on a granular level include:

- Quantification of MMFs that received support from affiliates (or assurances of support) during the financial crisis, through 2008;¹²⁵
- Estimates of increases in bid/ask spreads for corporate bonds during the financial crisis, informing the level at which the Commission set the rule's liquidity fee;¹²⁶
- Quantification of differences in MMF price fluctuation under basis-point rounding vs. 10-basis-point rounding;¹²⁷
- Quantification of exposures of municipal and taxable MMFs to guarantors,¹²⁸ informing a new "basket" threshold;¹²⁹

122. Memorandum from the Div. of Econ. & Risk Analysis, Demand and Supply of Safe Assets in the Economy (Mar. 17, 2014), <http://www.sec.gov/comments/s7-03-13/s70313-324.pdf> [<http://perma.cc/N3UG-7FUX>].

123. Lewis, *supra* note 108.

124. Comment Letter from Wells Fargo Funds Mgmt., LLC to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n, File No. S7-03-13—Money Market Fund Reform; Amendments to Form PF (Apr. 23, 2014), <http://www.wellsfargoadvantagefunds.com/assets/pdf/fmg/icm/Reform-20140423.pdf> [<http://perma.cc/U6VJ-4BX4>]; Comment Letter from Dreyfus Corp. to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n, Money Market Fund Reform Proposals: Staff Analyses of Data and Academic Literature Related to Money Market Reform (SEC File Number S7-03-13) (Apr. 23, 2014), <http://www.sec.gov/comments/s7-03-13/s70313-347.pdf> [<http://perma.cc/EYM5-AZ7K>]; Comment Letter from Fidelity Inves. to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n, Comments on Proposed Money Market Fund Reform; Amendments to Form PF (Apr. 22, 2014), <http://www.sec.gov/comments/s7-03-13/s70313-339.pdf> [<http://perma.cc/TPU6-MSG8>]; Comment Letter from Invesco Ltd. to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n, Money Market Fund Reform; Amendments to Form PF (File No. S7-03-13) (Apr. 23, 2014), <https://www.invesco.com/static/us/investors/contentdetail?contentId=fbc85559576a5410VgnVCM100000c2fibfoaRCRD> [<http://perma.cc/LER6-V6FQ>].

125. MMF Final Rule, *supra* note 107, at 47,742 n.53.

126. *Id.* at 47,763.

127. *Id.* at 47,779-81.

128. *Id.* at 47,878-80.

- Quantification of the portion of MMF assets invested in institutional funds subject to the new floating NAV requirement,¹³⁰ where those funds might go if investors sought a stable NAV instead,¹³¹ and the effects of such a reallocation;¹³²
- Economic analysis of alternatives, such as an NAV buffer.¹³³

These concrete examples demonstrate that the actual contributions of the SEC's economists to the agency's rulemaking process transcend the law professors' conceptual frameworks. Hard-won economic facts like these were simply unavailable to the Commission before its staff of empirical economists was expanded and charged with ascertaining them. These examples show how the SEC, no longer dependent solely on studies proffered by interested parties, now deploys its econometric abilities to ascertain for itself the economic reality of financial markets before it seeks to regulate them.

B. *Good Economics in Other Rules*

Space does not permit more than a sampling of DERA's other good work.

To support a recent SEC release proposing amendments to Regulation D,¹³⁴ DERA analyzed 33 million accounts held at broker-dealers registered with it.¹³⁵ The results reveal the reality of wealth inequality in the United States, results as interesting as any in Thomas Piketty's current bestseller.¹³⁶ The SEC's mission is to protect investors, but who are these investors, and who is the

129. *Id.* at 47,877.

130. *Id.* at 47,900-03.

131. *Id.* at 47,905-06.

132. *Id.* at 47,906-14.

133. *Id.* at 47,920-25.

134. Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44806 (proposed July 10, 2013) (to be codified at 17 C.F.R. pts. 230, 239) [hereinafter Reg. D Release], <http://www.sec.gov/rules/proposed/2013/33-9416.pdf> [<http://perma.cc/S5GF-HYYW>].

135. *Id.* at 122 n.202; see also Vladimir Ivanov & Scott Baugess, Div. of Econ. & Risk Analysis, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012*, SEC. & EXCHANGE COMMISSION (July 2013), <http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf> [<http://perma.cc/5YLY-JHB5>].

136. THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* (Arthur Goldhammer trans., Harvard Univ. Press 2014) (2013).

agency protecting them from? Data like these are a starting point to answering fundamental questions such as these.

Another table in DERA's analysis refutes the popular notion that public offerings of equity are a particularly important source of capital formation in the United States, showing that they are dwarfed by offerings under Regulation D and debt offerings.¹³⁷

To support a rulemaking on equity swaps,¹³⁸ DERA calculated that the total value of swap transactions annually, worldwide, exceeds one quadrillion dollars, and that the global notional trading volume in single-name of credit default swaps is down about 50% since the financial crisis.¹³⁹ Quantitative analysis enabled the Commission to draw important lines in the right places in definitions it was required to issue under Dodd-Frank, based on a picture of the types of entities actually involved.¹⁴⁰ A DERA white paper analyzed the concentration and interconnectedness of the world-wide single-name CDS market, finding, among other things, that the five largest buyers, by the number of contracts, were the counterparties for 44% of all contracts bought in 2012 and that the top ten sellers of CDS protection transacted in 77% of all contracts traded in 2012, while the top twenty sellers captured 92% of all contracts sold, enabling the Commission to draw rulemaking lines on an informed basis.¹⁴¹

These data are neither what Coates calls "guesstimates," nor are they a complete analytic engine that dictates results the way Coates seems to feel CBA/FR proponents expect quantitative CBA/FR to do.¹⁴² These are simply the kinds of facts that anyone would want agencies to generate, if they can, to inform, but not determine policy. And if they produce some positive externalities by producing data useful to scholars and the public interested in broader issues of public policy, all the better.

137. Reg. D Release, *supra* note 134 at 113 fig.1.

138. Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities, 79 Fed. Reg. 47277 (Aug. 12, 2014) (to be codified in scattered parts of 17 C.F.R.).

139. The buyer of a credit default swap (CDS) buys protection from a third party against a debt security default. Single-name CDS relate to debts of a single issuer. Single-name CDS figured prominently in the fall of AIG, a key event in the financial crisis.

140. See Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 Fed. Reg. 30968, 31121 (May 23, 2013).

141. *Id.* at 30,976; Div. of Econ. & Risk Analysis, *Interconnectedness in the CDS Market*, SEC. & EXCHANGE COMMISSION (Apr. 2014), <http://www.sec.gov/dera/staff-papers/white-papers/credit-default-swaps-interconnectivity-04-2014.pdf> [<http://perma.cc/MQV5-CUXJ>].

142. Coates, *supra* note 1, at 891-93; *cf.* Elliott, *supra* note 25 (arguing that CBA is too imprecise for environmental regulations but nevertheless useful in other respects such as priority-setting).

Readers may be shocked or dismayed that the SEC hasn't been in the business of making calculations like this all along, but few should disagree about the value of encouraging this kind of careful, quantitative work to continue.¹⁴³

C. Procedural Changes

An even more important result of these past years of litigation, congressional investigations, and appropriations funding dozens of new SEC economist posts is that SEC economists are now real players in the agency's rulemaking process.

When I arrived at the SEC, the relationship between the economists and lawyer-policymakers was in a stable dysfunctional equilibrium. The economists were bystanders in the rulemaking process, which was fine with them, since it gave them more time to pursue research interests of their own. Policymakers, for their part, feared that data and analyses they couldn't predict, understand, criticize, or control would force their hands and limit their policy discretion. These old habits, presumptions, and prejudices are largely gone now. Denial was no longer an option after *BRT* and the subsequent congressional firestorm.¹⁴⁴ Personnel turnover at key levels in the divisions, including DERA, has encouraged a new working relationship that puts economists at the table from the beginning of each rule to the end. The key to this transformation was the 2012 Guidance, the SEC staff's comprehensive response to the *BRT* decision.¹⁴⁵ While its details can be caviled at,¹⁴⁶ its details are not the point. The 2012 Guidance has in effect amended the micro-constitution of the SEC staff, elevating the economists to the status of a co-equal branch of the agency.¹⁴⁷

As the former DERA director put it:

that this seemingly simple document has focused and enhanced how the Commission and its staff approach economic thought and utilize

143. For additional examples of the quantitative results and mathematical models produced by DERA economists, see Div. of Econ. & Risk Analysis, *Economic and Risk Analysis*, SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/dera#.U8F1EhZPX1j> [<http://perma.cc/FE8C-WYJ4>], which is updated regularly.

144. Bruce R. Kraus, *Challenge to SEC Rule-Making*, PENSIONS & INVESTMENTS (Dec. 12, 2011), <http://www.pionline.com/article/20111212/PRINT/312129993/challenge-to-sec-rule-making> [<http://perma.cc/S4ZP-AUTX>].

145. See *supra* note 11.

146. Kraus & Raso, *supra* note 3, at 330-32.

147. See Craig M. Lewis, Chief Econ. and Dir., Div. of Econ. & Risk Analysis, Keynote Address at the Investment Company Institute 2014 Mutual Funds and Investment Management Conference (Mar. 18, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370541172162#.U8mLThZPX1g> [<http://perma.cc/U4N6-KVR4>].

the expert staff of DERA. . . . As DERA became larger and the Guidance became integrated into the rulewriting process, it became natural for DERA to similarly be included in the dozens upon dozens of other initiatives that didn't directly involve drafting a rule. We started proposing projects in a variety of spaces and found receptive audiences across the Commission.¹⁴⁸

An outline of the economic analysis to accompany the release has to be part of the term sheet, and everyone in the rulemaking divisions knows that the concurrence of the Chief Economist will be necessary before the circulation of a draft of the rule and release to the Commissioners. That's why the rulemaking team needs to engage the support of the economist in the room. Whatever the reason, that's what they're doing now.

As a result, the rulemakers now seek out economists, particularly those with a track record of coming up with good data, analyses, and ideas. DERA, for its part, is attracting a new breed of financial economists excited about using their expertise to make a difference in real-world rules. The Office of General Counsel and Commissioners have come to recognize the value to the SEC of having economists with distinguished publication records on staff. The old fear and suspicion of data has been replaced by an appetite for it, and demand from the rest of the rulemaking staff for economists who can deliver it.

Ironically, one of the ways that economists became more important in the lawyer-dominated SEC was by having lawyers of their own. The Chief Counsel at DERA views herself and her staff as guardians of the Guidance, deferential to the DERA's economists' expertise inside the Division, but advocates and defenders of their independence in their dealings with rest of the agency.

The process changes at the SEC have inverted the unworkable top-down process rules that *BRT* and proposed legislation would impose. That approach lists and requires documentation of every step of every kind of economic analysis known to man, and requires all of them for every rule. Pragmatic CBA begins with economists at the table. In formulating a regulatory approach to a problem, a principal goal of the entire team is to figure out what data exist or can be generated and what analyses can be done. The rational boundaries of the analysis are a function of the situation at hand, and the economists on the rulemaking team, who know where the reliable data can be found and how to use it, naturally take the lead.

The Kraus and Raso piece suggested that the courts have imposed extremely high standards on the SEC¹⁴⁹ and courts should therefore not be surprised when these standards cannot be met. Coates continues the story darkly: on his

¹⁴⁸. *Id.*

¹⁴⁹. Kraus & Raso, *supra* note 3, at 290.

account, the SEC has become an agency indifferent to the falsity or truth of its economic analysis.¹⁵⁰ I offer a different proposal, that of the *bildungsroman*, in which early adversity strengthens character.¹⁵¹ The underlying spirit (though not the letter) of the much-maligned *BRT* opinion has brought economists to the table in the SEC rulemaking process, where their contributions are real.

Bruce R. Kraus is Partner, Kelley Drye & Warren LLP. He would like to thank Don Elliott, Jeff Gordon, Alex Lee, Craig Lewis, Eric Posner, and Connor Raso for their many helpful comments and suggestions and Jessica Flores for diligent research assistance. All faults, however, are his own.

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150. Cf. HARRY G. FRANKFURT, ON BULLSHIT 56 (2005) (discussing the phenomenon of indifference to the truth or falsity of one's statements).

151. Compare, e.g., TALKING HEADS, *Psycho Killer*, on TALKING HEADS: 77 (Sire Records 1977), with JOHNNY CASH, *A Boy Named Sue*, on AT SAN QUENTIN (Columbia Records 1969).