REGULATORY REPORT CARD | March 2014

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AGENCY

US Securities and Exchange Commission (SEC)

Rule title
Rules Implementing Amendments to the Investment Advisers Act of 1940

RIN	3235-AK82
Publication Date	July 19, 2011
Stage	Final

RULE SUMMARY

The new rules and amendments adopted in this regulation were designed in response to and consistent with the requirements set forth in the Dodd-Frank Act. In particular, the aspects of the Dodd-Frank Act addressed here include: the reallocation of oversight responsibility of midsized investment advisors from the commission to the states, the repeal of the hedge fund adviser and "private adviser" exemption granted in section 203(b)(3) of the Advisers Act, and the provision for the reporting by advisers of private funds which are exempt from registration with the commission or states authorities. Specifically, the rule requires approximately midsized 3200 SEC-registered advisers to register with state securities regulators instead. It specifies buffers and grace periods affecting when advisers have to switch between federal and state registration. It extends the exemption for consultants to pension plans from $50 million to $200 million. It allows some advisers to register with the SEC instead of with numerous states. The regulation also requires advisers to certain private funds to register with the SEC and provide additional information about the funds they advise.

COMMENTARY

Based on the commission's analysis, it is unclear whether this regulation will provide positive net benefits to society. While the time costs for compliance are estimated, the oversight costs to the commission are not addressed and the benefits of the regulation are not computed. Thus, net benefits cannot be estimated. The commission hints vaguely that the regulation will improve information available to investors, but it does not explain why the current level of information is suboptimal. The commission's decision on the final rule was influenced—and likely improved—through the public comments. That said, there is very little analysis and virtually no empirical analysis. No reference to peer-reviewed literature can be found. One area in which published economic literature could prove useful would be an estimate of the price elasticity of advising services, which could have been used to estimate the possible price reductions associated with options the commission claims lower costs.

This rule's economic analysis was scored by a team of economists as the basis for Jerry Ellig and Hester Peirce's study, "SEC Regulatory Analysis: 'A Long Way to Go and a Short Time to Get There.'"
For more information about Regulatory Report Cards issued by the Mercatus Center at George Mason University, see www.mercatus.org/reportcard.

OPENNESS	Score	Comments
1. How easily were the RIA, the proposed rule, and any supplementary materials found online?	5	1A
2. How verifiable are the data used in the analysis?	1	1B
3. How verifiable are the models and assumptions used in the analysis?	1	1C
4. Was the Regulatory Impact Analysis comprehensible to an informed layperson?	2	1D
Total Openness (Sum of 1–4)	9	

ANALYSIS	Score	Comments
5. How well does the analysis identify the desired outcomes and demonstrate that the regulation will achieve them?	1	2A
6. How well does the analysis identify and demonstrate the existence of a market failure or other systemic problem the regulation is supposed to solve?	1	2B
7. How well does the analysis assess the effectiveness of alternative approaches?	1	2C
8. How well does the analysis assess costs and benefits?	1	2D
Total Analysis (Sum of 5–8)	4	

USE	Score	Comments
9. Does the proposed rule or the RIA present evidence that the agency used the Regulatory Impact Analysis?	1	3A
10. Did the agency maximize net benefits or explain why it chose another alternative?	0	3B
11. Does the proposed rule establish measures and goals that can be used to track the regulation's results in the future?	0	3C
12. Did the agency indicate what data it will use to assess the regulation's performance in the future and establish provisions for doing so?	0	3D
Total Use (Sum of 9–12)	1	

Total Score **14**

This analysis was evaluated using the 2008–2012 scoring system, which evaluated regulatory analyses based on 12 criteria.
This analysis was scored on a scale from zero to 60 points.

OPENNESS			
Criterion	**Score**	Com. No.	Comment
1. How easily were the RIA, the proposed rule, and any supplementary materials found online?	5	1	RIN and keyword searches readily return the rule in regulations.gov. It can be found easily on the SEC website via the "laws and regulations" link. A RIN and keyword search on the SEC webpage also readily delivers the final rule. The cost-benefit analysis is in the *Federal Register* notice.
2. How verifiable are the data used in the analysis?	1	2	No data are used in the benefits section. Data concerning the number of advisers impacted by specific components of the regulation, the time typically required by the advisers to comply with the regulation, and time costs are generally not sourced. Some numbers of affected firms are sourced to "IARD data" or obliquely to SEC registration data. Wage data are sourced to the SIFMA Earnings Report. Ancillary assumptions, such as overhead markups, are either sourced to "commission experience" or simply presented without justification.
3. How verifiable are the models and assumptions used in the analysis?	1	3	The methods and assumptions are generally clearly stated; however, no justification for them or citations to other related literature supporting the model and assumptions are provided. There is not much underlying research, nor are there models other than calculations used to estimate the paperwork burden. These are explained in footnotes.
4. Was the analysis comprehensible to an informed layperson?	2	4	The description of benefits and costs is relatively easy to read and comprehend. There is really no substantial analysis of benefits, so it is hard to determine whether the asserted benefits are reasonable or not. Calculations of the paperwork burden are explained clearly, but a table showing final results would be helpful. References to forms, acronyms, etc., make the analysis hard to follow. There is much repetition throughout the document.
ANALYSIS			
5. How well does the analysis identify the desired outcomes and demonstrate that the regulation will achieve them?	1		
Does the analysis clearly identify ultimate outcomes that affect citizens' quality of life?	2	5A	The analysis mentions various (mostly intermediate) outcomes of the regulation, from increased competition and reduced investment adviser prices, to increasing investor knowledge of the advisers, to reducing confusion and costs associated with compliance. Some activities also mentioned, such as allowing the commission to better focus its resources in those areas most likely to impact national markets. The analysis evaluates only the effects of the SEC's discretionary decisions, not the major parts of the regulation required under Dodd-Frank. Consequently, most claimed benefits are marginal reductions in the regulatory burden due to administrative aspects of the regulation or reductions in uncertainty due to the SEC's interpretation of statutory language.
Does the analysis identify how these outcomes are to be measured?	0	5B	No effort appears to have been made to measure any of these outcomes. In only one case does the analysis discuss measurement issues (combined reporting and registering in a single form), in which case it is stated that it is "difficult to quantify."

Does the analysis provide a coherent and testable theory showing how the regulation will produce the desired outcomes?	3	5C	While no tests of the expected outcomes are discussed explicitly, the intuitive explanation is reasonable. For instance, simplifying the rules and making it easier to register with the commission and identify the registration requirements should reduce compliance costs. Further, if some of those reduced costs are passed on to the customer (investor), the price of investment advising services should fall.
Does the analysis present credible empirical support for the theory?	0	5D	No empirical support for the claims is provided. The claims are presented as truths requiring no testing.
Does the analysis adequately assess uncertainty about the outcomes?	1	5E	Some uncertainty about benefits is acknowledged, although no estimates of the benefits were provided.
6. How well does the analysis identify and demonstrate the existence of a market failure or other systemic problem the regulation is supposed to solve?	1		
Does the analysis identify a market failure or other systemic problem?	3	6A	The principal reason given is to implement relevant portions of the Dodd-Frank Act. Some additional information is claimed necessary to better target enforcement and examination activity, but this is mostly just asserted in a few places. There is some discussion concerning the investors' lack of information regarding advisers' risk levels and an overburdensome compliance cost with new requirements without changes to the existing structure. It is not clear why investors' current level of information is suboptimal.
Does the analysis outline a coherent and testable theory that explains why the problem (associated with the outcome above) is systemic rather than anecdotal?	2	6B	Requirements outlined in the Advisers Act, among others, result in higher than necessary compliance and oversight costs; the amendments to those rules reduce such costs. The lack of information by investors regarding the advisers is a standard asymmetric information problem, but the analysis does not present any theory to this effect.
Does the analysis present credible empirical support for the theory?	0	6C	No empirical support for the claims is provided. The claims are presented as truths requiring no testing.
Does the analysis adequately assess uncertainty about the existence or size of the problem?	0	6D	Vaguely defined problems are assumed to exist with certainty. No attempt is made to estimate the extent of the problems, much less acknowledge uncertainty about their extent.
7. How well does the analysis assess the effectiveness of alternative approaches?	1		
Does the analysis enumerate other alternatives to address the problem?	1	7A	The analysis does not consider any alternatives. The Reg Flex section mentions four generic modifications, dismisses three as inconsistent with Dodd-Frank, and claims that the regulation deals with the remaining option because it consolidates and simplifies reporting requirements. A few other alternative tweaks were apparently considered as a result of comments.

Is the range of alternatives considered narrow (e.g., some exemptions to a regulation) or broad (e.g., performance-based regulation vs. command and control, market mechanisms, nonbinding guidance, information disclosure, addressing any government failures that caused the original problem)?	1	7B	No alternatives are considered in the analysis. In the text discussing comments, the alternative is as simple as considering a 180-day transition period rather than a 90-day period. As such, the alternatives offer very little variation in the solution to the problem. The four alternatives to minimize the impact on small entities offer a bit more variation (use of performance rather than design standards, for instance), but these are dismissed without much elaboration.
Does the analysis evaluate how alternative approaches would affect the amount of the outcome achieved?	0	7C	Benefits are not quantified, and alternatives are not analyzed.
Does the analysis adequately address the baseline? That is, what the state of the world is likely to be in the absence of federal intervention not just now but in the future?	1	7D	The assumption appears to be that asset price bubbles would continue to come about in the future as the most recent one due to the lack of focused oversight and asymmetric information problems. Further, it is suggested that a possible rise in compliance costs may result, given the new requirements of the Dodd-Frank Act, should the amendments to existing rules and forms not be undertaken.
8. How well does the analysis assess costs and benefits?	1		
Does the analysis identify and quantify incremental costs of all alternatives considered?	2	8A	The analysis estimates only the paperwork costs and filing fees for the proposed regulation, not for alternatives. Some discussion, although no quantification, is presented in regards to the commenters' concerns and suggested alternatives.
Does the analysis identify all expenditures likely to arise as a result of the regulation?	3	8B	The primary costs considered are the time costs for compliance, both employee wages and the costs of hiring consultants. The costs to the commission appear to be ignored.
Does the analysis identify how the regulation would likely affect the prices of goods and services?	2	8C	Without empirical support or point estimates, it is suggested that the price of investment advising services may be reduced slightly (compared to alternatives) if some of the compliance cost savings are passed on to the consumer due to competitive pressures. No references to price elasticities are provided, which should be a relatively simple extension to quantify the claims.
Does the analysis examine costs that stem from changes in human behavior as consumers and producers respond to the regulation?	1	8D	The analysis acknowledges the possibility of "non-quantifiable costs" that stem from behavioral changes. The SEC apparently eliminated some questions from forms when these seemed to create burdensome costs of this type, but the actual analysis consists of citing comment letters that raised the issue and noting that commenters did not quantify costs. Apparently the SEC considered these concerns somehow. It also mentions that transition provisions will impose unspecified temporary costs by delaying disclosure of information.
If costs are uncertain, does the analysis present a range of estimates and/or perform a sensitivity analysis?	0	8E	There is no relevant content. All costs are presented as point estimates.
Does the analysis identify the alternative that maximizes net benefits?	0	8F	Benefits were not quantified, so net benefits could not be calculated. Only the point estimates for the costs of the chosen final rule are presented.

Does the analysis identify the cost-effectiveness of each alternative considered?	0	8G	Benefits were not quantified, so cost-effectiveness could not be calculated.
Does the analysis identify all parties who would bear costs and assess the incidence of costs?	2	8H	Advisers and occasionally other parties are identified as bearing costs, but there is no extensive analysis of how costs might be passed through or affect other parties. Costs per adviser are computed for each amendment and rule adopted. Oversight costs for the commission are not discussed.
Does the analysis identify all parties who would receive benefits and assess the incidence of benefits?	1	8I	The analysis sometimes mentions investors as beneficiaries, sometimes advisers, when the regulation adopted an approach that reduces the burden. Some hypothetical positive effects on capital formation are mentioned. Since benefits were not quantified, there was no significant assessment of incidence.
USE			
9. Does the proposed rule or the RIA present evidence that the agency used the analysis?	1	9	No alternatives were analyzed. Decisions about the regulation appear to be driven by legislative requirements and suggestions from commenters. (The 180-day transition period rather than the 90-day period is one such example.) That said, these changes are only slight variations from the commission's proposed rule. The commission did no comparison of its own of the final rule and the four alternatives, suggesting that this solution was decided upon in advance of the analysis.
10. Did the agency maximize net benefits or explain why it chose another alternative?	0	10	Net benefits were not computed, nor can they be inferred based on the information given.
11. Does the proposed rule establish measures and goals that can be used to track the regulation's results in the future?	0	11	The release proposes no goals or measures, and the economic analysis is not sufficient to develop outcome goals or measures.
12. Did the agency indicate what data it will use to assess the regulation's performance in the future and establish provisions for doing so?	0	12	There is no commitment to assessing the performance of the regulation in the future. It is not clear what data the SEC has that would allow it to evaluate the outcomes or costs of this regulation after it is in place.