REGULATORY REPORT CARD | March 2014

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AGENCY

US Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC)

Rule title
Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF

RIN	3235-AK92
Publication Date	November 16, 2011
Stage	Final

RULE SUMMARY

The SEC rule requires certain investment advisers registered with the Securities and Exchange Comission (SEC) to file Form PF. The Commodity Futures Trading Comission (CFTC) rule requires commodity pool operators and commodity trading advisors registered with the CFTC to satisfy certain CFTC filing requirements by filing Form PF with the SEC if they are registered with the SEC as investment advisers. The rule differentiates the requirements based on firm size. The information is intended to help the Financial Stability Oversight Council (FSOC) to monitor systemic risk.

COMMENTARY

The rule fails to explain the logic behind its main assertion that having proprietary information available to regulators will increase the regulators' ability to prevent the next financial crisis. The analysis does not explain in any great detail the problem this regulation will solve or the outcomes it will produce. The commissions simply assert that they and the FSOC need better data on private equity funds in order to develop regulations that will more effectively prevent a financial crisis and protect investors. The financial crisis is not traced to its root causes, which might reveal whether these information disclosure requirements could help avert a crisis in the future. The only costs actually estimated are compliance costs of furnishing the information; any negative effects on funds', managers', or investors' behavior are dismissed. In some cases, the commissions revised the regulation to reduce the compliance burden in response to public comments.

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.'"
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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?	2	1B
3. How verifiable are the models and assumptions used in the analysis?	2	1C
4. Was the Regulatory Impact Analysis comprehensible to an informed layperson?	2	1D
Total Openness (Sum of 1–4)	11	

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?	2	2C
8. How well does the analysis assess costs and benefits?	1	2D
Total Analysis (Sum of 5–8)	5	

USE	Score	Comments
9. Does the proposed rule or the RIA present evidence that the agency used the Regulatory Impact Analysis?	2	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)	2	

Total Score	**18**	

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	A RIN search on regulations.gov readily turns up the rule. So does a keyword search, but only if one uses the unconventional spelling "advisers" rather than "advisors." The benefit-cost analysis is in the notice. The rule is also available four intuitive clicks from the SEC home page by following the "regulations" link to a list of final rules.
2. How verifiable are the data used in the analysis?	2	2	Wage data used in cost calculations are sourced to industry salary reports, which are cited but not linked. Some estimates of burden hours are not sourced; others are sourced to public comments. Estimated number of firms are sourced to the proposed rule and to SEC data that may or may not be publicly available.
3. How verifiable are the models and assumptions used in the analysis?	2	3	There is very little in the way of a model. The link between information disclosure and systemic risk is not explained. Benefit section cites (but does not link) a few studies that conclude better information disclosure is needed. Ancillary assumptions in cost section (e.g., overhead rates) are not sourced.
4. Was the analysis comprehensible to an informed layperson?	2	4	The benefit-cost analysis is not very technical because it is not very extensive. It does not really demonstrate how the regulation will produce benefits; it merely shows the regulation will collect data, then asserts that regulators will use this data to produce benefits.
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?	4	5A	The principal classes of benefits mentioned are assisting the Financial Stability Oversight Council (FSOC) in understanding systemic risks and assisting the commissions in developing better regulatory policies and examination strategies. These are government activities, not outcomes. The only link to outcomes is an assertion that improving these activities will improve regulators' ability to prevent a financial crisis and protect investors from losses.
Does the analysis identify how these outcomes are to be measured?	0	5B	Discussion is brief and purely qualitative. The closest thing to quantification is a statement that "if this information helps to avoid even a small portion of the costs of a financial crisis like the most recent one, the benefits of Form PF will be very significant."
Does the analysis provide a coherent and testable theory showing how the regulation will produce the desired outcomes?	1	5C	The analysis says that the FSOC will use the data to monitor systemic risk, and it simply assumes that better information will produce more appropriate regulation, which will reduce risk. These are assertions, not a cause-and-effect theory.
Does the analysis present credible empirical support for the theory?	1	5D	The analysis cites several academic studies that conclude that more data on private funds are needed to monitor systemic risk, but it does not explain the underlying reasoning or evidence. The notice also says the FSOC has said it wants this information.

Does the analysis adequately assess uncertainty about the outcomes?	1	5E	The analysis acknowledges that the proposed measures may be insufficient to prevent a crisis and that they may have some adverse consequences.
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	Neither the analysis nor the rest of the notice provide a well-developed economic justification for the regulation. The regulation is justified largely in legal terms: the Dodd-Frank Act requires the SEC and CFTC to provide this information to the FSOC, so they are issuing this regulation to carry out the law. The need for the regulation is presumed obvious because of its intent: to help prevent another financial crisis. The closest thing to analysis of a systemic problem is repetition of the term "systemic risk," which is never defined.
Does the analysis outline a coherent and testable theory that explains why the problem (associated with the outcome above) is systemic rather than anecdotal?	1	6B	Buried in the cost section is a footnote to one law review article that asserts that individual investors or funds do not take risks to the financial system into account when they make investment choices. This is perhaps the beginning of an economic theory of externalities that explains why the regulation—or at least some government action—might be necessary, but this is never elaborated. On the contrary, there are also some assertions that the regulations will benefit investors, advisors, and the economy as a whole ("capital formation") by prompting advisors to review portfolios and practices and improve their investment choices—which implies that these sophisticated parties forgo profit opportunities under the current system.
Does the analysis present credible empirical support for the theory?	1	6C	No research is presented demonstrating that the nonexistent theory is true. A few studies are cited that claim regulators need more data.
Does the analysis adequately assess uncertainty about the existence or size of the problem?	0	6D	The problem is assumed to exist with certainty.
7. How well does the analysis assess the effectiveness of alternative approaches?	2		
Does the analysis enumerate other alternatives to address the problem?	5	7A	The notice claims the commissions considered these alternatives: "(1) Requiring more or less information; (2) requiring more or fewer advisers to complete the Form; (3) allowing advisers to rely more on their existing methodologies and recordkeeping practices in completing the Form (or, alternatively, requiring more standardized responses); (4) requiring more or less frequent reporting; and (5) allowing advisers more or less time to complete and file the Form."
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	These are all variations on the same basic regulatory approach.

Does the analysis evaluate how alternative approaches would affect the amount of the outcome achieved?	1	7C	Outcomes are not measured at all. In a few sentences, the analysis mentions that more extensive or frequent reporting could improve the value of the data but would also increase costs. Several aspects of the original proposal were relaxed in response to comments. The benefit-cost analysis does not compare the benefits or costs of alternatives.
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?	0	7D	The analysis assumes, without explicitly claiming, that the baseline is greater risk to the financial system because this information is not reported to regulators. This implicit baseline cannot be verified due to the scant analysis. The analysis does not assess what would happen in the absence of this regulation.
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	Benefit-cost analysis asserts that the primary costs are the paperwork costs. The analysis calculates paperwork burden and filing fees. It estimates that these total $108 million the first year and $60.5 million annually in subsequent years, plus $0–25 million in hardware costs the first year. It does not estimate costs of alternatives.
Does the analysis identify all expenditures likely to arise as a result of the regulation?	3	8B	These sound like the principal direct expenditures for the private sector. It is not clear if the filing fees cover the government's full costs of administering the regulation.
Does the analysis identify how the regulation would likely affect the prices of goods and services?	2	8C	One paragraph notes that the costs of compliance could be passed on to investors or employees. It then dismisses these costs because they are largely transfers and are small compared to the incentives that usually motivate funds and their advisors. There is no discussion of how these costs might alter investors' behavior.
Does the analysis examine costs that stem from changes in human behavior as consumers and producers respond to the regulation?	1	8D	No such costs are estimated, but they are sometimes qualitatively discussed. One acknowledgement of costs beyond paperwork costs is an admission that public disclosure of the information could create costs for firms because it is proprietary information. No estimate or calculation is offered, and the commissions say they will mitigate this by ensuring that the information does not get disclosed publicly. One sentence notes that the regulation could reduce capital formation if it makes advisors more risk-averse. The analysis argues that the regulation is unlikely to drive private funds overseas because the European Union is adopting a similar regulation and the costs are small compared to funds' assets or fees. The discussion is largely armchair reasoning, not based on research.
If costs are uncertain, does the analysis present a range of estimates and/or perform a sensitivity analysis?	0	8E	There is some discussion of variability based on different types of firms but no acknowledgement of uncertainty.
Does the analysis identify the alternative that maximizes net benefits?	0	8F	Net benefits are not calculated. The analysis perhaps implies that benefits will outweigh costs when it asserts, in the cost section, that the aggregate benefits will likely be large.
Does the analysis identify the cost-effectiveness of each alternative considered?	0	8G	There is no relevant discussion.

Does the analysis identify all parties who would bear costs and assess the incidence of costs?	1	8H	The analysis notes that costs are borne largely by private funds and investors and, for some parties, the costs may exceed the benefits. It acknowledges that costs might be proportionately higher for smaller firms, and so these firms face less extensive requirements. None of these costs are actually calculated.
Does the analysis identify all parties who would receive benefits and assess the incidence of benefits?	2	8I	In a few places, the analysis asserts that the regulation will benefit funds or investors by prompting them to make better investment decisions. Mostly, though, it says the financial system, all investors, or the general public receive most of the benefits. The benefits are not quantified; we are just assured that they are probably big.
USE			
9. Does the proposed rule or the RIA present evidence that the agency used the analysis?	2	9	The analysis asserts that the alternative chosen is the best and claims that the SEC made many changes to the original proposal intended to reduce cost burdens in response to comments claiming that the true cost of the regulation is higher than the SEC estimated. These include extending compliance dates, allowing some firms to report annually rather than quarterly, increasing size thresholds for firms that need to file, and allowing advisors to use existing data-tracking methodologies to a greater extent. However, it seems clear that these changes were made in response to comments, not because of anything the commissions learned from the benefit-cost analysis, and the analysis was then updated to reflect the revised regulation.
10. Did the agency maximize net benefits or explain why it chose another alternative?	0	10	Net benefits were not calculated. In several cases, however, the commissions sought to reduce compliance burdens on investment firms while still obtaining the information. This suggests a concern for getting the information cost-effectively, though this is not linked to ultimate outcomes.
11. Does the proposed rule establish measures and goals that can be used to track the regulation's results in the future?	0	11	There is no commitment to any type of measure or goal, and the analysis is not sufficient to develop them.
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	The commissions claim that they and the FSOC will use the data to make better regulatory decisions, but because outcomes are not well defined, it is not clear what could be measured to assess whether this regulation has produced favorable outcomes for the public.