

Measuring the Costs and Benefits of New Rules

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

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

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

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

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

- 1) Rules must have sunsets and look back requirements when the agency represents that costs and benefits are difficult to estimate, as it represented in rulemaking pursuant to Section 404(b) of Sarbanes Oxley. At times much of the data relevant to a rule's costs and benefits will not be available until years after its implementation. This is demonstrated by the SEC's rulemaking under Sarbanes Oxley 404(b), where the SEC initially estimated compliance costs of \$90,000, despite their later revealed to be nearly \$1.8 million per company.
- 2) The SEC is required to compare the costs of a new rule against any alternatives advanced by a dissenting Commissioner. This was part of the reason SEC rules were overturned in two prior challenges before the DC Circuit.
- 3) Mandatory disclosure rules must be subject to the same materiality standard as private plaintiffs in 10b5 fraud cases. A disclosure that is not material to investors cannot be legitimately said to further "investor protection."
- 4) The agency must, in order to meet its requirement to consider the impact of a rule on capital formation and efficiency, estimate the impact of a rule on the competitiveness of U.S. exchanges against foreign exchanges for new listings, the competitiveness of U.S. issuers, the risk of proprietary information being revealed in mandatory disclosures, and the impact of a rule on stock prices of affected companies. The agency must also estimate the impact of a new rule on job creation and GDP.

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

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

7) The Division of Risk, Strategy and Financial Innovation should get authority in rule making. Economic analysis has historically been a mere afterthought for the agency, used to justify rules after the fact rather than to help in their design. The recent SEC memo notwithstanding, that practice is likely to continue unless the Division is given formal authority by way of changes to SEC internal operating procedures.

8) The Division of Risk, Strategy and Financial Innovation must be given a role in rating the impact of cases brought by enforcement lawyers for purposes of their personnel reviews. The agencies existing metric, which focuses on size of recovery and number of cases resolved, can distort incentives and lead to missed opportunities to stop ongoing fraud like that seen in the Madoff case.

I thank you for the opportunity to testify and I look forward to answering your questions.

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Publications:

Treasury Inc.: How The Bailout Reshapes Corporate Theory and Practice, forthcoming 2010.

Federalism in Banking Pre-Emption and Corporate Pre-Emption Compared, LOUISIANA LAW REVIEW, forthcoming 2010

The State of Hedge Fund Regulation Reform, SETON HALL LAW REVIEW, Symposium Edition, forthcoming 2010

Dr. Jones and the Raiders of Lost Capital; Hedge Fund Regulation, Part II: An SRO Proposal 32 DELAWARE JOURNAL OF CORPORATE LAW 799 (2007).

Pandora's Ballot Box, or a Proxy With Moxie? Majority Voting, Corporate Ballot Access and the Legend of Martin Lipton Re-Examined, 62 THE BUSINESS LAWYER 1007 (2007).

Economics Makes for Strange Bedfellows: Pensions, Trusts, and Hedge Funds in an Era of Financial Re-Intermediation, 10 UNIVERSITY OF PENNSYLVANIA JOURNAL OF BUSINESS AND EMPLOYMENT LAW 63 (2007).

(with Chief Justice Myron T. Steele) *Delaware's Guidance*, 2 VIRGINIA LAW AND BUSINESS REVIEW (2007).

SEC Certification to the Delaware Supreme Court, CORPORATE GOVERNANCE ADVISOR (January 2008).

Wait a Minute, Mr Postman, Chicago Tribune, (May 18, 2008). (Op-Ed)

A Self-Regulation Proposal for the Hedge Fund Industry, Administrative and Regulatory Law News, American Bar Association (Winter 2008).

Why Not Variable-Rate Airline Tickets? Orange County Register, September 9, 2008. (Op-Ed)

Why The Bailout is Self Defeating, Forbes, March 5, 2009. (Op-Ed)

Awards:

Searle-Kaufmann Fellow in Law, Innovation, and Growth. Awarded by Northwestern University Law School Searle Center, 2009.

Experience:

George Mason University School of Law 2008-present

Currently an Assistant Professor of Law, specializing in Corporate Law, Delaware Business Law, Securities Regulation, & Financial Regulation. I also founded and direct the Corporate Federalism Initiative, a research organization that obtains grants to support corporate and business law scholars in original research and media and policy outreach on issues concerning the role of federalism in business law.

Mercatus Center at George Mason University Financial Markets Working Group 2008-present

Currently a Senior Scholar, developing original research, writing policy papers, commenting in print and online newspapers, and engaging in outreach in Congress and with staff and financial regulators at executive agencies.

Skadden, Arps, Slate, Meagher, & Flom, 2007-2008

Served as an associate in the Securities Enforcement Defense Practice Group at the Washington, D.C. office.

Delaware Court of Chancery, 2006-2007

Law Clerk, Chambers of Vice-Chancellor John W. Noble

Drafted opinions in corporate governance related actions, including appraisals and fiduciary duty derivative suits, and performed legal research for pending cases.

John Olin Center for Law, Economics, & Business

Harvard Law School Program on Corporate Governance, 2006

Research Fellow

Wrote an article on Hedge Fund Regulation as part of a funded fellowship grant under the guidance of Profs. Bebchuk, Shavell and Jackson.

Presentations & Appearances:

Regular contributor and visiting contributor to various corporate and legal blogs from 2007-present, including The Conglomerate, Deal Lawyers, The Harvard Corporate Governance Forum, The Volokh Conspiracy, & The Delaware Corporate and Commercial Litigation Blog.

University of Toronto School of Law, 2007 Annual Meeting, Canadian Law and Economics Association

May 13, 2009, Testimony before the House Oversight Committee regarding the consequences of the Government as a shareholder in AIG¹

April 23, 2009. Northwestern Law School Searle Center on Law, Innovation, & Economic Growth Program on Attorney General Education, at which I gave a lecture on federal pre-emption of financial services before a dozen state attorney generals and many their chief deputies

June 11, 2009, Testimony before the House Financial Services Committee regarding shareholder say-on-pay requirements²

¹<http://www.cspan.org/Watch/Media/2009/05/13/HP/R/18523/Congress+Questions+AIGs+Progress+Accountability.aspx>

²http://www.c-spanarchives.org/library/index.php?main_page=product_video_info&products_id=286970-1

June 15, 2009, Gave a lecture to the Board of Directors of Riskmetrics, the leading proxy advisory company in the United States, regarding the consequences of government ownership in the financial sector.

July 13, 2009, Testimony before the House Financial Services Committee regarding changes to insider trading rules

July 29, 2009, Testimony before the Senate Banking Committee regarding increasing shareholder power in corporate governance³

July 31, 2009, Appearance on The News Hour with Jim Lehrer to discuss executive compensation legislation

October 30, 2009, Scheduled to participate in the Seton Hall Law School Symposium on Developments in Financial Services Regulation

Education

HARVARD LAW SCHOOL & HARVARD KENNEDY SCHOOL OF GOVERNMENT 2006

Juris Doctor & Masters in Public Policy (Financial Regulation specialization)

Activities: Olin Fellow in Law and Economics, Program on Corporate Governance
Journal on Legislation

LOUISIANA STATE UNIVERSITY, B.S., Financial Accounting 1998-2002

Honors: Magna Cum Laude Graduate
LSU Chancellor's Scholarship
National Merit Finalist Scholarship

³ http://www.c-spanarchives.org/library/index.php?main_page=product_video_info&products_id=288107-1

Committee on Oversight and Government Reform
Witness Disclosure Requirement – “Truth in Testimony”
Required by House Rule XI, Clause 2(g)(5)

Name: J.W. Verret

1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2009. Include the source and amount of each grant or contract.

2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

George Mason University, Asst. Professor

3. Please list any federal grants or contracts (including subgrants or subcontracts) received since October 1, 2009, by the entity(ies) you listed above. Include the source and amount of each grant or contract.

I certify that the above information is true and correct.

Signature:

J.W. Verret

Date:

April 15, 2012