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August 8, 2016

The Honorable Richard Shelby
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Jeb Hensarling
Chairman
The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Amendments to the Commission's Rules of Practice*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission) entitled "Amendments to the Commission's Rules of Practice" (RIN: 3235-AL87). We received the rule on July 15, 2016. It was published in the *Federal Register* as a final rule on July 29, 2016. 81 Fed. Reg. 50,212.

This final rule amends the Commission's Rules of Practice—Rules 360, 233, 232, 222, and 250. These changes concern, among other things, the timing of hearings in administrative proceedings, depositions, summary disposition, and the contents of an answer. According to the Commission, the amendments to Rule 360 concern the timing for the various stages of an administrative proceeding, providing additional time for discovery. The amendments to Rule 233 permit a limited number of depositions, while the amendments to Rule 232 support this change by providing standards governing motions to quash or modify deposition notices or subpoenas. The amendments to Rule 222 concern requirements for a written report for expert witnesses. The amendments to Rule 250 clarify how dispositive motions will operate with the amendments to Rules 233 and 360 and provide the procedures and standards governing the various types of dispositive motions. The final rule becomes effective 60 days after publication in the *Federal Register*.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review of the procedural steps taken indicates that the Commission complied with the applicable requirements.

If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer
Managing Associate General Counsel

Enclosure

cc: Robert W. Errett
Deputy Secretary
Securities and Exchange Commission

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
“AMENDMENTS TO THE COMMISSION'S RULES OF PRACTICE”
(RIN: 3235-AL87)

(i) Cost-benefit analysis

The Securities Exchange Commission (Commission) analyzed the benefits and costs of the final rules. However, the Commission determined that it is unable to precisely predict the economic effect of the final rules on administrative proceedings, as the number and type of proceedings can vary based on many factors unrelated to the Rules of Practice. The Commission states that over the last three completed fiscal years, the number of new administrative proceedings initiated and not immediately settled by the Division of Enforcement (Division) has ranged from approximately 170 to approximately 230 proceedings, only a portion of which would be impacted by certain of the amended rules.

The Commission states that the amendments to rules governing depositions and the timing of hearings in administrative proceedings (Rules 232, 233, and 360) may benefit both respondents and the Division by providing them with additional time and tools to potentially discover additional relevant facts. According to the Commission, these amendments may facilitate information acquisition during the prehearing stage, ultimately resulting in more focused hearings. The Commission states that it is unable to quantify these benefits, however, because any potential cost savings would depend on multiple factors, including the specific claims, facts, and defenses in a particular proceeding. The Commission estimates that the depositions and a longer prehearing period will, however, impose additional costs compared to the current practice in administrative proceedings where, with limited exception, depositions are not permitted and maximum prehearing periods are shorter. The Commission continues to believe that the costs of the adopted amendments will be borne by the Division as well as by respondents and deponents who provide deposition testimony. These costs will primarily stem from the potential costs of depositions and the extension of the maximum prehearing period.

The Commission estimates the cost to a respondent of conducting one non-expert deposition to be approximately \$45,640 and the cost of conducting one expert witness deposition to be approximately \$75,696. In single-respondent proceedings, if both the Division and the respondent each take three depositions, respondents may incur the cost of conducting or attending up to six depositions plus expert witness fees and costs—an estimated total of \$303,896 compared to multi-respondent proceedings wherein respondents may attend up to 10 depositions and incur an estimated total of \$486,456. The adopted amendments expand the potential use of depositions by allowing each side to request an additional two depositions from a hearing officer. According to the Commission, this would place the ultimate limit on depositions at five depositions for each side in a single respondent proceeding, and seven depositions for each side in a proceeding against multiple respondents. The Commission estimates that the range in costs incurred for single-respondent proceedings would be an estimated total of \$486,456 compared to multi-respondent proceedings wherein respondents may incur up to an estimated total of \$669,016.

Similarly, the longer maximum prehearing periods permitted by the amendment to Rule 360 may impose costs on the parties. Based on the Commission's estimates of staffing requirements and corresponding hourly rates, the Commission estimates that the potential to lengthen the overall timeline in 120-day proceedings by up to 6 months to allow more time for discovery may result in additional costs to respondents of up to \$754,080. The Commission estimates that the combined costs of the lengthened prehearing period and the availability of depositions could cost respondents in a single-respondent 120-day proceeding \$1,240,536. According to the Commission, similar combined costs for respondents in a 120-day multi-respondent proceeding could be as high as \$1,423,096.

The amendments concerning expert reports and testimony (Rule 222) specify a set of submissions and disclosures that hearing officers may require from parties to a proceeding, and require parties to a proceeding who intend to call expert witnesses to submit information about these expert witnesses. According to the Commission, though producing submissions and disclosures may cause parties to proceedings to incur costs, these amendments may yield benefits by facilitating access to information that may aid in interpreting statements, evidence, and testimony during hearings. However, the final rule will impose costs and yield benefits only to the extent that they result in additional information being submitted to hearing officers beyond that submitted under current practice.

Finally, amendments concerning dispositive motions (Rule 250) may improve the efficiency of administrative proceedings by eliminating unnecessary hearings. Because the amendments to Rule 250 largely clarify how pre-existing motion practice will operate alongside the amendments to Rules 233 and 360, the rule change may not result in a significant departure from current practice. Further, the Commission states that it cannot predict with certainty how practice will change in response to the availability of dispositive motions filed pursuant to amended Rules 250(a), (b), and (d) as a matter of right—rather than with leave of the hearing officer—given that parties will respond based on the individual facts of each case and their own cost estimates of filing the motions. Thus, according to the Commission, it is unable to estimate the total potential costs associated with these amendments.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

According to the Commission, the Regulatory Flexibility Act does not apply because the rule revisions are not subject to the provisions of the Administrative Procedure Act requiring notice, opportunity for public comment, and publication.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to the Act.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act (APA), 5 U.S.C. §§ 551 et seq.

The Commission finds, in accordance with section 553(b)(3)(A) of APA, that these revisions relate solely to agency organization, procedure, or practice. They are therefore not subject to the provisions of APA requiring notice, opportunity for public comment, and publication.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

According to the Commission, to the extent these rules relate to agency information collections during the conduct of administrative proceedings, they are exempt from review under PRA.

Statutory authorization for the rule

These amendments to the Rules of Practice are being adopted pursuant to statutory authority granted to the Commission, including section 3 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7202; section 19 of the Securities Act, 15 U.S.C. 77s; sections 4A, 19, and 23 of the Exchange Act, 15 U.S.C. 78d-1, 78s, and 78w; section 319 of the Trust Indenture Act of 1939, 15 U.S.C. 77sss; sections 38 and 40 of the Investment Company Act, 15 U.S.C. 80a-37 and 80a-39; and section 211 of the Investment Advisers Act, 15 U.S.C. 80b-11.

Executive Order No. 12,866 (Regulatory Planning and Review)

As an independent regulatory agency, the Commission is not subject to the Order.

Executive Order No. 13,132 (Federalism)

As an independent regulatory agency, the Commission is not subject to the Order.