

Date 11/14/75

From: THE OFFICE OF POLICY PLANNING

To: Mr. Malkiel

The attached material is for your information. There might be two additional people joining us for lunch Wednesday, but I will confirm this before then.

Andrew P. Steffan

## 2 - CURRENT AND HISTORICAL APPROACHES TO CARRYING OUT ECONOMIC ANALYSIS

The question of the appropriate role of economic analysis at the SEC and the most effective approach to carrying it out has received considerable attention over the years. For example, the Special Study conducted in 1963 recommended "accumulation of data with respect to fundamental, but often obscure changes in ... trading markets" and "greater emphasis ... (on) compilation, analysis and, where appropriate publication of data." An OMB study conducted in 1972 points out that "The Commissioners have expressed a desire to have a policy research unit which will assist them in diagnosing emerging problems." <sup>1/</sup> To provide some understanding the Commission's involvement with economic analysis, this chapter outlines the approach currently being taken and how this approach evolved.

### CURRENT APPROACH TO ECONOMIC ANALYSIS

At the present time, the primary formal responsibility for carrying out economic analysis and providing economic advice to the Commission resides in the Office of Economic Research (OER). OER is authorized 52 people plus 6 additional people under a contract from HUD. Roughly \$934,000 is allocated to OER for salary expenditures, including \$100,000 from HUD. In addition, OER has full-time use of a \$35,000 programmable calculator and a very substantial amount of time on the SEC's computer.

In addition to the Office of Economic Research, there now exists an Office of Policy Planning which has responsibility for assisting the Commission in setting long-range policy and planning for future problems. The Office has specific responsibility for monitoring and coordinating Commission activities related to internationalization of the securities market.

---

<sup>1/</sup> Full text of relevant sections appear in Appendix A.

Photocopy from Gerald R. Ford Library

As shown in Exhibit 1, OER is organized into four branches. Two of the branches report to the Assistant Chief Economist, and two to the Senior Statistician. These two men, in turn, report to the Chief Economist.

Exhibit 1 summarizes the major responsibilities of each branch. However, because of the frequent reorganizations of OER, the informality of its management, and the frequent crossing of branch lines to work on projects, it is extremely difficult to determine the precise responsibilities and end products of each branch.

For this reason, the nature of OER's activities is better understood by reviewing:

- The content of existing data bases
- The focus of research on Commission problems.

#### Content of Data Bases

As part of its participation in Government-wide statistical programs and for the use of the staff in performing analyses, OER currently maintains data bases in the eight areas shown on Exhibit 2. The contents of the data bases range from financial information filed by broker-dealers to data developed from surveys distributed by OER, to compilation of stock market indicators from publicly available data. The data bases are typically on computer tape and are updated periodically throughout the year.

Maintenance of a data base usually consists of compiling and updating new information as it becomes available. Many of the forms and surveys are completed once a year, while others are filed quarterly.

Statistics such as new offerings data, are compiled on an irregular basis as companies file offering information.

Most data bases are routinely compiled into a series of charts and tables which are published in three main sources: the SEC Annual Report, the Statistical Bulletin, or the Statistical Reference Memorandum. The Statistical Bulletin is published and sold by the GPO, as is the Annual Report. The Statistical Memorandum is not made available to the public on a mass circulation basis, but is available on request.

Special compilation of data is made on request of staff members in support of on-going analysis. This type of compilation where data is presented in different formats than is usually made public has proved to be particularly necessary in the analysis of broker-dealer operations and determination of their financial condition.

The SEC is the primary source for data on institutional investment including non-insured pension funds and for data on corporate liquidity and working capital. A contract from HUD supports six employees and provides for survey collection of mortgage market information.

In general, the 22 people involved in maintaining the OER data bases are relatively low-level statistical assistants and clerks. Their jobs are rather routine and is not particularly challenging, thus causing some morale problems.

### The Nature of Research on Commission Problems

Twenty-eight professional and semi-professional and 6 clerical personnel are currently involved in research and analysis relating to Commission problems. In general, OER projects originate from:

- Requests from the Commission or staff for informal studies not requiring written output;
- Requests for formal studies requiring written output;
- Studies done at the initiative of OER staff in anticipation of Commission needs.

Naturally, the focus on analytical activity will differ from year to year. Exhibit 3, which indicates the major projects worked on in fiscal 1974, shows that examination of broker-dealer economics was the major activity of OER. The majority of these studies were in response to MR requests and implemented in cooperation with Market Regulation. New issue economics and registrant economics represented another major focus of OER. Most of these projects were originated by OER, and are smaller in scope than the broker-dealer efforts. Finally, there are also numerous short analyses covering a variety of problem areas. The largest project in this group involved analysis of international capital markets. Again most of these projects were small in scope and were originated by OER itself.

## HISTORY LEADING TO CURRENT ORGANIZATION

The history of Commission organization of resources devoted to economic analysis reflects a series of never entirely successful attempts to create the appropriate organization and competence to carry out three related, but distinct, types of tasks:

1. Maintain accurate financial and economic data bases for internal and external use. ("Data base management")
2. Provide economic input to commission decisions requiring it and do analyses of specific problems ("Specific problem analysis")
3. Carry out insightful, creative analysis of fundamental capital market changes and emerging problems and recommend Commission priorities based on them. ("Fundamental Trend Analysis")

Currently, OER has responsibility for all data base maintenance. However, the project work which OER carries out includes both specific problem analysis, e.g., input to commission rate hearings and fundamental trend analysis, e.g., profile of oil and gas offerings. In addition, the Office of Policy Planning does some trend analysis.

This is consistent with past practices. At various points in the Commission's history, responsibilities for these tasks have been joined and separated; further, special high-powered think-tank project units have been used, such as the Special Study and the Institutional Investor project teams. The following sections describes these historical division of responsibility, which are shown graphically on Exhibit 4. Knowing what has been tried to date should be helpful both in evaluating the current effort and planning for the future.

EXHIBIT 4

HISTORICAL DIVISIONS OF RESPONSIBILITY FOR ECONOMIC ANALYSIS

Year	"Fundamental Trend"		Specific Problem Analysis	Data Base Maintenance	Staff Involved
	Legal	Economic			
1962		Special Study	Division of Trading and Exchange, Branch of Economic Research		39
1963		Office of Program Planning	Division of Trading and Markets, Branch of Statistical Studies		53
1964					53
1965		Office of Program Planning Div. of T & M Br. of Stat. Studies			52
1966	Chairman's Office and Divisions				48
1967					48
1968					48
1969		Institutional Investor Study	Office of Policy Research		48
1970					48
1971					48
1972					51 (+6 HUD)
1973		Office of Policy Planning	Office of Economic Research		53
1974					54 (+6 HUD)

Photocopy from Gerald R. Ford Library

Prior to the completion of the Special Study in 1963, a branch of "Economic Research" in the Division of Trading and Exchanges had responsibility for data base maintenance and whatever economic analysis there was. Then the Special Study suggested establishment of a separate, permanent policy planning unit to accumulate and analyze pertinent data, to make special studies as needed, and to review policies and regulations. Based on this recommendation, an "Office of Program Planning" was established with 14 people, most of whom had participated in the Special Study, in July of 1963. The group was asked both to provide high-powered analytical support to the Commission and to assist in implementing the 175 recommendations of the Special Study. The branch of Trading and Exchanges was renamed the "Branch of Statistical Studies" and was charged with "the performance of the SEC's responsibilities for the Federal Statistical Program, for compilation of data relevant to the SEC, and for provision of statistical and economic advice of top management."

This, then, was the Commission's first effort to ensure a permanent high-powered analytical capability by establishing a separate unit for this task. Like the Special Study, the Office of Program Planning included both economists and lawyers.

Evidently, the effort was not totally successful; over the period of the next two years, the functions of the branch of Statistical Studies were transferred to the Office of Program Planning, and the title of that office was changed to the "Office of Policy Research." However,

Microcopy from Gerald R. Ford Library

the lawyers involved in the effort returned to the Division of Trading and Markets. The net result of these transfers was that the Office of Policy Research had full formal responsibility for data base maintenance, problem analysis and interpretative analysis - all of the economic research functions formerly handled by the Trading and Markets branch.

In 1969, the Commission's internal economic research activities were augmented by the famous Institutional Investor Study. This massive effort involved 12 economists and 32 other people from outside the Commission, as well as 29 Commission staff members. The Office of Policy Research continued its responsibilities, but the creative, fundamental research was taken over by the study. While there were many reasons for undertaking the study, one of them clearly was a sense that the Commission's internal ability to analyze fundamental changes in the market was inadequate.

No formal change in internal responsibilities was made at the completion of the Institutional Investor Study, but in September of 1972, the Office of Policy Planning was established. This office was to "assist the Commission in setting long-range policy objectives and in planning for future problems." Simultaneous with this change, the Office of Policy Research was renamed the Office of Economic Research. This, again, was an effort to focus people on fundamental, long-range problems, by establishing that function in a separate office.

EXHIBIT 6

DESCRIPTION OF DATA BASES MAINTAINED BY OER

DATA BASE	1974 MAN-YEARS	SOURCE	END PRODUCT
Broker-Dealer Financial and Capital Condi- tion	2.5	Industry filings with Self-Regulatory Agencies.	<ul style="list-style-type: none"> <li>• Aggregate Income and Expense Statement</li> <li>• Aggregate Balance Sheet</li> <li>• Data for special analyses of industry</li> </ul>
Financial Market Indicators	4.0	Compilation from Public Data Sources	<ul style="list-style-type: none"> <li>• Volume and Market Value of Trading on U.S. Stock Exchanges</li> <li>• Round-Lot and Odd-Lot Trades on NYSE and AMEX</li> <li>• Market Measures (Dow Jones, S &amp; P, etc.)</li> <li>• Block Transaction and Margin Account Data</li> </ul>
Institutional Transactions and Holdings*	5.5	SEC Survey and Public Data Sources	<ul style="list-style-type: none"> <li>• Transactions of Selected Financial Institutions</li> <li>• Assets of Private Non-Insured Pension Funds</li> </ul>
Mortgage Lending Activity	6.0 (HUD fi- nanced)	SEC Survey	<ul style="list-style-type: none"> <li>• Mortgage Lending Activity of Pension Funds, REIT's and Mortgage Bankers</li> </ul>
New Securities Offerings	7.0	Industry Filings	<ul style="list-style-type: none"> <li>• Number, Value, and Gross Proceeds by Industry of Primary Securities Offerings (6 Tables)</li> <li>• Value of Secondary Offerings on Common Stock</li> </ul>
Private Placements	1.5	SEC Survey	<ul style="list-style-type: none"> <li>• Number and Value of Private Placements of Securities</li> </ul>
Industry Classifications of Registrants	2.0	Industry Filings	<ul style="list-style-type: none"> <li>• Classification of Registrant Offerings by Industry</li> <li>• Annual Publication of All Registrants Classified By Industry</li> </ul>
Corporate Liquidity*	2.5	SEC Survey	<ul style="list-style-type: none"> <li>• Working Capital of Non-Financial U.S. Corporations</li> <li>• Liquidity Ratios of Non-Financial U.S. Corporations</li> </ul>

Photocopy from Gerald R. Ford Library

\*SEC is primary source for major government program.

RESEARCH PROJECTS IN FISCAL 1976

EXHIBIT 2

SUBJECT AREA	PROJECTS	ESTIMATED MAN-YEARS	ORIGINATOR	END USE	PERSONNEL
Broker-Dealer Economics	1973 Commission Rates	3.3	Market Regulation	Input to Hearings	
	Intra-Member Rates	2.0	Market Regulation	Input to Hearings	
	Characteristics of Firms Entering and Leaving Ind.	1.25	OER	Report	
	Parent Companies of Broker-Dealers	.7	OER	Report	
	FOCUS Report	.5	Market Regulation	Input to Advisory Comm.	
	Brokerage Industry Financial Tables	.5			
	Publicly-Owned Broker-Dealers	.5	OER	Report	
	Branch Office Patterns	.5	OER	Report	
		<u>9.2</u>			
Securities Market Economics	Effect of Option Trading	.25	DER	Input to Hearings	
	Analysis of Speculation Trading on CBOE	.25	Market Regulation	Input to Hearings	
	Factors Affecting demand for broker-dealer services	.5	OER	Report	
	New NYSE Transaction Study	1.0	OER	Report	
	Sullivan Price Manipulation Theory	.25	Enforcement	Report	
	Net Capital Rule	.25	Market Regulation	Input to Rule	
	Central Market System	.5	Executive Director	Analytic Support	
		<u>2.7</u>			
New Issues Economics	Rule 144 Impact	.25	Enforcement	Report	
	The Cost of Violations of Securities	1.0	DER	Report	
	Profile of Oil and Gas Offerings	.5	OER	Report	
	Profile of Cattle-Breeding Programs	.25	OER	Report	
	Survey of Condominiums		BUD	Report	
	Symposium Participation	.25	OER	Update Report	
		<u>2.25</u>			
Registrant Economics	Review of Corporate Liquidity	1.0	DER	Report	
	Accounting Rule Change Analysis	.25	Commissioner Summers	Report	
	Role of Public Directors	.25	OER	Report	
	Trends in Corporate Finance	.25	OER	Report	
		<u>1.75</u>			
Other	Foreign Capital Markets	.75	OER	Report	
	Section 22(d)	.25	IMR	Report	
	Investment Company Prospectus Base	.25	OER	Data Base	
	Analytic Assistance	1.0	Commissioners & Members of Cong.	Reports	
	Forecasting Model	.25	OER	Analytic Framework	

Photocopy from Gerald R. Ford Library