

COMMITTEE ON CAPITAL MARKETS REGULATION

*****Media Advisory*****

CCMR WARNS THAT INADEQUATE COST-BENEFIT ANALYSIS OPENS DODD-FRANK RULEMAKING TO CHALLENGE AND DELAY

Cambridge Mass., March 7, 2012—The Committee on Capital Markets Regulation today warned Congress of its “deep concern about the inadequacy of cost-benefit analysis” that its research has identified in proposed rulemaking under the Dodd-Frank, Wall Street Reform and Consumer Protection Act.

The independent, non-partisan Committee reported in a letter today to leaders of the Senate Committee on Banking, Housing and Urban Affairs and the House Financial Services Committee that it identified widespread inadequacies in its review of the cost-benefit analysis provisions contained in 192 proposed and final rules under Dodd-Frank.

Specifically, the CCMR found that:

- Over a quarter of the 192 rules have no cost-benefit analysis at all.
- Over a third have entirely non-quantitative cost-benefit analysis.
- The majority of the 50 rules that do contain quantitative analysis limit it to administrative and similar costs, but ignore the Rule’s expected broader economic impact.

“It would be an unfortunate outcome,” the letter says, “if after the Dodd-Frank rulemaking process has run its course for several years, much of the rulemaking is invalidated because of its inadequate cost-benefit analysis.”

Hal S. Scott, Director of the Committee as well as the Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School, adds that: “A recent D.C. Federal Appeals Court ruling that such rulemaking is not subject to direct appellate review means that the legal challenges of proposed Rules will subject them to a long, tortuous path through the courts, beginning at the District Court level. And that will result in the kind of prolonged uncertainty that can cripple economic activity.”

The text of today’s letter appears below. Alternatively, the letter and a chart summarizing the underlying Committee research, can be accessed at the CCMR website at www.capmksreg.org.

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COMMITTEE ON CAPITAL MARKETS REGULATION

March 7, 2012

The Honorable Timothy Johnson
Chairman
United States Senate Committee on Banking,
Housing and Urban Affairs
136 Hart Senate Office Building
Washington, DC 20510

The Honorable Spencer Bachus
Chairman
United States House of Representatives
Financial Services Committee
2246 Rayburn Building
Washington, DC 20515

The Honorable Richard Shelby
Ranking Member
United States Senate Committee on Banking,
Housing and Urban Affairs
304 Russell Senate Office Building
Washington, DC 20510

The Honorable Barney Frank
Ranking Member
United States House of Representatives
Financial Services Committee
2252 Rayburn Building
Washington, DC 20515

Re: Lack of Cost-Benefit Analysis in Dodd-Frank Rulemaking

Dear Chairman Johnson, Ranking Member Shelby, Chairman Bachus, and Ranking Member Frank:

We are writing to express our deep concern about the inadequacy of cost-benefit analysis in proposed and final rulemakings under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).¹ Cost-benefit analysis is a critical element of the Dodd-Frank rulemaking process, as this process will undoubtedly result in significant and fundamental changes across the financial industry which should be soundly justified. Particularly in light of the ruling this past July by the U.S. Court of Appeals for the D.C. Circuit in *Business Roundtable v. Securities and Exchange Commission*² and a current lawsuit seeking to strike down the Commodity Futures Trading Commission's (CFTC) recently promulgated position limits rule,³ we believe that many of the rules under Dodd-Frank could be subject to successful challenge in the courts due to inadequate cost-benefit analysis. In the aforementioned current lawsuit, the International Swaps and Derivatives Association (ISDA) and Securities Industry and Financial Markets Association (SIFMA) are challenging the position limits rule on the ground that the CFTC violated the Commodity Exchange Act by, inter alia, insufficiently evaluating the rule's cost and benefits.⁴ Specifically, ISDA and SIFMA allege that the CFTC failed to collect the data

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

² 647 F.3d 1144 (D.C. Cir. 2011). In its decision, the Court struck down the SEC's proxy access rule based on its failure to adequately consider its rules' effects upon efficiency, competition and capital formation, as required by law.

³ See ISDA and SIFMA v. CFTC, No. 1:11-cv-02146 (D.D.C. Dec. 2, 2011); ISDA and SIFMA v. CFTC, No. 11-1469 (D.C. Cir. Dec. 2, 2011). Issued pursuant to Dodd-Frank, the rule sets position limits on 28 classes of derivatives contracts. See Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (Nov. 18, 2011) (to be codified at 17 C.F.R. pts. 1, 150, and 151).

⁴ See Complaint at 27, ISDA and SIFMA v. CFTC, No. 1:11-cv-02146 (D.D.C. Dec. 2, 2011); see also 7 U.S.C. § 19(a).

needed to assess the rule's costs and benefits and failed to establish that the rule would deliver the desired benefits.⁵ These claims underscore our publicly stated views on cost-benefit analysis conducted by financial regulatory agencies—namely, that this analysis has generally been inadequate and must be improved.

The Committee has reviewed the cost-benefit analysis provisions contained in 192 final and proposed rules, orders, and notices issued by the Securities and Exchange Commission, Commodity Futures Trading Commission, Federal Reserve, Federal Deposit Insurance Corporation, Financial Stability Oversight Council, Consumer Financial Protection Bureau, Office of Financial Research, Internal Revenue Service, Federal Housing Finance Authority, Office of Comptroller of the Currency, Office of Thrift Supervision, Department of Housing and Urban Development, Department of Treasury, Department of Energy, Department of Labor, National Credit Union Administration, Federal Trade Commission, and Farm Credit Administration under Dodd-Frank (collectively, the Rules) through November 16, 2011.⁶ We have found the following regarding these 192 Rules:

- 57 Rules contain no cost-benefit analysis. Note that certain of these Rules either reference review that has been conducted by the Office of Management and Budget or suggest that no cost-benefit analysis is required because the Rule is not expected to have significant impact or because the costs were imposed entirely by Dodd-Frank. We would encourage rulemakers either to provide the results of any OMB review performed or to provide further explanation as to how the significance of the Rule or the source of the costs was determined.
- 85 Rules contain cost-benefit analysis that is entirely non-quantitative. This category includes numerous Rules where rulemakers have said they expect costs to be insignificant or minimal. In such cases, we encourage rulemakers to explain how they reached such conclusions.
- 50 Rules contain quantitative cost-benefit analysis. Of these Rules, the vast majority limit their cost-benefit analysis to a review of the costs of paperwork, legal and compliance review, technology enhancements, and the like and do not contain any analysis of the expected broader economic impact of the Rule. In many instances, rulemakers request cost-benefit input from commenters. Nonetheless, this request for comment does not relieve them of their own obligation to conduct a cost-benefit analysis.

We recognize that the SEC's rulemaking, particularly more recently, has contained more cost-benefit analysis—including some quantitative. For example, Mary Schapiro wrote that the SEC, in considering potential standard of conduct regulations for broker-dealers and investment advisers, currently has three economists looking into the subject who “spend a significant amount of time on the matter”⁷; these economists “have reviewed and catalogued the publicly available data and information,” “maintain an ongoing dialog with financial economists from

⁵ See Complaint at 27-28, *ISDA and SIFMA v. CFTC*, No. 1:11-cv-02146.

⁶ For a summary of these rules, please see http://capmktsreg.org/pdfs/2012.03.06_CBA_chart.pdf.

⁷ See, Letter from Mary L. Schapiro, Chairman, United States Securities and Exchange Commission, to the Honorable Scott Garrett, Chairman, Subcommittee on Capital Markets and Government Sponsored Entities (Jan. 10, 2012)

academia and other agencies,” and “have been proactive in corresponding with industry groups and finance and law academics,” and “are drafting a public request for information to obtain data specific to the provision of retail financial advice and the regulatory alternatives.” While efforts like this are a step in the right direction, in light of the proxy access decision, we reiterate that significantly better cost-benefit analysis is required to withstand judicial scrutiny.

In response to a Senate request for a review of its economic analyses in connection with six specific Dodd-Frank rulemakings, the SEC Office of the Inspector General identified several shortcomings in the SEC’s process. It found that the extent of cost-benefit analysis varied among the rules in question and that none contained quantitative analysis other than of information collection costs; that the SEC tended to focus only on discretionary aspects of their rules, which could make it impossible to compare the effects of alternative regulatory actions; that the SEC sometimes used multiple baselines that were ambiguous or internally inconsistent; that certain rules lacked clear explanations of their justification; and that the SEC’s internal costs were rarely addressed.⁸ Clearly even the SEC recognizes there is significant room for improvement in its analysis.

It would be an unfortunate outcome if, after the Dodd-Frank rulemaking process has run its course for several years, much of the rulemaking is invalidated because of its inadequate cost-benefit analysis. And, whether or not a significant number of Rules are eventually invalidated, prolonged uncertainty surrounding their fate threatens to hamper economic activity. Such prolonged uncertainty seems especially likely given that the U.S. Court of Appeals for the D.C. Circuit has recently taken the position that neither the Commodity Exchange Act nor the Dodd-Frank Act permits direct appellate review.⁹ As a result, challenges like those to the CFTC’s position limits rule must first wind their way through the district court before reaching the appellate level in a process that could prove quite lengthy.

To obviate the need for these challenges in the first place, the regulators must improve their processes and conduct more thorough cost-benefit analysis. As the U.S. Court of Appeals for the D.C. Circuit stated in *Chamber of Commerce of the United States v. Securities and Exchange Commission*, when an “agency concludes no...data...has been produced during the comment period, the agency may develop data along the lines it has proposed to fulfill its statutory obligations.”¹⁰ If the regulators lack the data needed to conduct such analysis, they must either work with economists on their staffs to develop it, or obtain it from third parties. Specifically, they should request it of other agencies and self-regulatory organizations, trade organizations, or industry participants. If these efforts prove insufficient, then the regulators can request the disclosure of data from firms, with the caveat that any potential data requests must be made thoughtfully, with an eye to minimizing the imposition on and disruption to market participants.

⁸ UNITED STATES SECURITIES AND EXCHANGE COMMISSION OFFICE OF INSPECTOR GENERAL, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS at vi - vii (Jan. 27, 2012).

⁹ See Tom Schoenberg, *CFTC Position Limits Rule Lawsuit Dismissed by U.S. Appeals Court in D.C.*, BLOOMBERG, Jan. 20, 2012, <http://www.bloomberg.com/news/2012-01-21/cftc-position-limits-rule-lawsuit-dismissed-by-u-s-appeals-court-in-d-c-.html>.

¹⁰ 443 F.3d 890, 904 (D.C. Cir. 2006).

Such steps seem particularly crucial given the regulators' stated agreement with and desire to adhere to executive orders calling for "[e]ach agency [to] base its decisions on the best reasonably obtainable... information"¹¹ and to "use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible."¹² Indeed, in their own guidance on cost-benefit analysis for Dodd-Frank rulemakings, the CFTC Chief Economist and General Counsel stressed that CFTC "staff should reiterate the [CFTC's] request for" additional quantitative and qualitative data sought in the CFTC's notices of proposed rulemakings.¹³

To be clear, in calling for better cost-benefit analysis, we are not suggesting that rulemaking should be delayed. To the contrary, we firmly believe that certain changes mandated by Dodd-Frank are crucial to the functioning of the financial markets and should thus be put into effect as soon as possible. For example, we strongly support central clearing of derivatives and hope that in the interest of reducing risk and increasing transparency, the agencies will expeditiously promulgate rules in this area.

We recognize that the regulators may need to hire additional economists to assist with additional data gathering, development, and analysis, and we fully support the necessary funding. Furthermore, if the regulators themselves are unable to conduct the required analysis, we would encourage the engagement of third-party experts, including, for example, consultants or accountants, to assist the regulators in their analysis. In addition, even where the regulators are able to conduct the required analysis, the engagement of independent experts may still be advisable. The most recent year-end report issued by the President's Council on Jobs and Competitiveness stressed that "[p]ublic confidence in government analysis is improved when it is reviewed by an independent party."¹⁴ This report specifically suggested that "Congress should consider commissioning periodic reports on the cumulative costs and benefits of regulations stemming from key authorizing legislation, and evaluating the impacts on public welfare and the GDP" modeled on the practices of the Congressional Budget Office and the Government Accountability Office.¹⁵ It further suggested that the Office of Information and Regulatory Affairs could provide assistance with the agencies' cost-benefit analysis by issuing guidance on the best methods for soliciting information and crafting notices of proposed rulemaking to achieve this end.¹⁶ We would support such efforts.

¹¹ Exec. Order No. 12,866, Regulatory Planning and Review, 58 Fed. Reg. 51,735, 51,736 (Oct. 4, 1993); see UNITED STATES SECURITIES AND EXCHANGE COMMISSION OFFICE OF INSPECTOR GENERAL, REPORT OF REVIEW OF ECONOMIC ANALYSES PERFORMED BY THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH DODD-FRANK ACT RULEMAKINGS 4-5 (June 13, 2011) (suggesting that while the SEC is not bound by the cited executive order, its rulemaking procedures are closely aligned with it and related orders).

¹² Exec. Order No. 13,563, Improving Regulation and Regulatory Review, 76 Fed. Reg. 3,821, 3,821 (Jan. 21, 2011); see *Testimony of Chairman Gary Gensler Before H. Comm. on Agriculture* (Feb. 10, 2011) (Chairman, CFTC), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-68> (stating that "the CFTC's practices are consistent with the executive order's principles").

¹³ Letter from Dan M. Berkovitz & Andrei Kirilenko to CFTC Rulemaking Teams 11-12 (May 13, 2011), *reprinted in* U.S. COMMODITY FUTURES TRADING COMMISSION, OFFICE OF THE INSPECTOR GENERAL, A REVIEW OF COST-BENEFIT ANALYSES PERFORMED BY THE COMMODITY FUTURES TRADING COMMISSION IN CONNECTION WITH RULEMAKINGS UNDERTAKEN PURSUANT TO THE DODD-FRANK ACT 44-45 (June 13, 2011), http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigation_061311.pdf.

¹⁴ PRESIDENT'S COUNCIL ON JOBS AND COMPETITIVENESS, 2011 YEAR-END REPORT: ROAD MAP TO RENEWAL 45 (2011).

¹⁵ *Id.*

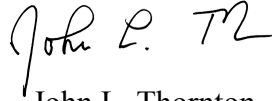
¹⁶ *Id.* at 43.

Thank you for considering our concerns. Please do not hesitate to contact us at (617) 384-5364 if we can be of any further assistance.

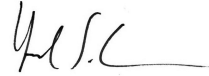
Respectfully submitted,



R. Glenn Hubbard
Co-CHAIR



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