Cost–Benefit Analysis of Financial Regulation

An Institutional Perspective

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Recent legal scholarship has focused on the feasibility of performing quantified cost–benefit analysis of financial regulations. An issue of the Yale Law Journal, published in January 2015, compellingly presents the competing positions. John C. Coates IV conducted case studies attempting to apply cost–benefit analysis to six representative financial regulations and concluded that “precise, reliable, quantified” analysis is currently “unfeasible” and as such there should be a moratorium on new cost-benefit requirements until agencies boost their analytical capacities.¹ Eric A. Posner and E. Glen Weyl rebut Coates’s arguments that the financial sector poses a unique challenge for cost–benefit analysis and argue that the nature of finance actually makes it highly suitable for quantified analysis.² Similarly, Cass Sunstein argues that “[t]here is no obvious reason . . . that financial regulation cannot be subject to [cost–benefit] analysis.”³

This chapter focuses on the institutional issues underlying this debate, arguing that the current structural arrangements for conducting cost–benefit

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analyses of financial regulation are clearly suboptimal.\textsuperscript{4} The independent agencies that have primary responsibility for financial regulation lack the capability to conduct cost–benefit analyses of the quality that is commonplace in the Executive Branch, in part as a result of the role of the Office of Information and Regulatory Affairs (OIRA).\textsuperscript{5}

The shortcomings of the cost–benefit analyses prepared by the financial regulatory agencies are ominous in light of the Supreme Court’s recent decision in \textit{Michigan v. EPA}.\textsuperscript{6} In this case, the Court invalidated a rule by the Environmental Protection Agency (EPA) on the ground that the agency had not considered costs in making the statutory determination that the rule was “appropriate and necessary.” These terms are commonplace in statutes that delegate rulemaking authority to financial regulators. For example, the governing statute of the Securities and Exchange Commission (SEC) requires agency rulemakings “to consider or determine whether an action is necessary or appropriate in the public interest.”\textsuperscript{7} Similarly, the Dodd–Frank Wall Street Reform and Consumer Protection Act uses “necessary or appropriate” or “necessary and appropriate” language eighty times in a variety of contexts.\textsuperscript{8} As a result, the requirement that the financial regulatory agencies engage in cost-benefit analysis is now likely to become more prevalent. Focusing on the institutional reforms necessary to improve the quality of the cost–benefit analyses performed by financial regulatory agencies is therefore an important challenge for the administrative state.

Section I uses three case studies to illustrate the shortcomings of independent agencies with respect to cost–benefit analysis. The first involves efforts by the Nuclear Regulatory Commission (NRC) to update its estimate of the Value of a Statistical Life (VSL). The other two deal with key financial regulators: the adoption by the SEC of OIRA’s approach to cost–benefit analysis, though only after having some significant regulations struck down by the D.C. Circuit; and the request by the Commodity Futures Trading Commission (CFTC) that OIRA provide it with technical assistance.

Section II focuses on institutional changes designed to improve the quality of the cost–benefit analyses prepared by the financial regulatory agencies. Possible improvements include expanding the role for the Financial Stability

\textsuperscript{6} Michigan v. EPA, 135 S. Ct. 2699 (2015).
\textsuperscript{7} 15 USC § 77b(b) (2012).
Oversight Council (FSOC), granting OIRA a formal role in the review of the cost-benefit analyses supporting regulatory action, and enhancing the economics capabilities of individual agencies. In each of these cases, the Executive Branch provides good models for independent agencies to emulate.

I am honored to have been invited to prepare this chapter for a conference honoring the work of Jerry L. Mashaw. Like much else in modern American administrative law, the themes in this chapter were explored by Professor Mashaw decades ago. For example, in *Improving the Environment of Agency Rulemaking: An Essay on Management, Games, and Accountability*, he stressed the “need to reconsider the structure of agency rulemaking as a mechanism of governance,” separate from its “substantive effects in particular instances.” In this connection, he urged a shift “toward macro-political accountability for bureaucratic policymaking,” as in the form of “structures that placed policy accountability clearly at the doorstep of the Chief Executive,” and lamented that “Congress seems destined . . . to leave the independent agencies outside the ambit of any accountability structure.” Professor Mashaw defined an extraordinary rich agenda for academics to follow.

## 1 THE SHORTCOMING OF COST–BENEFIT ANALYSIS BY INDEPENDENT AGENCIES

The capacity of federal regulatory agencies to perform cost–benefit analysis varies widely. The more proficient agencies are in the Executive Branch, and their regulations are subject to OIRA review under Executive Orders 12,866 and 13,563. The less successful agencies are independent and outside the purview of OIRA review. For example, of 101 major rules promulgated by independent agencies from 2008 to 2013, only one included a “complete cost–benefit analysis.” By comparison, executive agencies issued fifty-four major rules in Fiscal Year 2013 alone. Of these, thirty were budgetary “transfer rules,” nearly all of which were “quantified and monetized.” Of the remaining twenty-four, seven fully quantified costs and benefits, two included solely benefits, and

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10 See Bubb, supra note 5, at 50–53.
12 Id. at 249–50.
13 Id. at 253.
eleven calculated only costs, leaving four entirely without quantification. In some years, as OIRA pointed out for Fiscal Year 2011, the fully quantified rules constituted “the strong majority of the benefits and costs of rules issued.”

The financial regulatory agencies that are independent include the Office of the Comptroller of the Currency (OCC), the Consumer Financial Protection Bureau (CFPB), the Federal Deposit Insurance Corporation (FDIC), the Federal Housing Finance Agency (FHFA), the National Credit Union Administration (NCUA), the Federal Reserve, as well as the SEC, and the CFTC. What follows are three case studies designed to show some of the shortcomings of cost-benefit analyses performed by independent agencies relative to ones conducted in the Executive Branch.

A Nuclear Regulatory Commission and the Value of a Statistical Life

The Nuclear Regulatory Commission (NRC), like many federal agencies, conducts cost–benefit analysis “as a substantial part of its regulatory analysis.” For agencies tasked with the mission of regulating health, safety, and the environment, the number of lives saved – or, stated differently, premature deaths averted – is the biggest benefit of the agencies’ actions. This benefit is expressed as the “value of a statistical life” (VSL). So, for example, if a regulation reduces by one in a hundred thousand the risk that an individual in the affected population would die, and the regulation affects five million people, fifty statistical lives are saved as a result of the regulatory action.

The VSL is determined through willingness-to-pay methodologies, under which economists measure “the additional cost that individuals would be willing to bear for improvements in safety (that is, reductions in risks) that, in the aggregate, reduce the expected number of fatalities by one.”

example, if people are willing to pay $10 per year to reduce their annual risk of death by one in one million, the resulting VSL is $10 million.\footnote{See id.}

In 1995, NRC pegged VSL at $3 million, correctly describing this value as “consistent with” the Office of Management and Budget’s “best estimate and an extensive literature review performed by the NRC.”\footnote{Regulatory Analysis Guidelines of the US Nuclear Regulatory Commission, NUREG/BR–0058, Revision 2; Issuance, Availability, 60 Fed. Reg. 65,694 (Dec. 20, 1995).} The NRC’s VSL has remained in place for the past twenty years. In 2010, the Commission began the process of revising this figure,\footnote{R. W. Borchardt, US Nuclear Regulatory Comm’n, SECY-12–0110, Consideration of Economic Consequences Within the US Nuclear Regulatory Commission’s Regulatory Framework, at enclosure 8, at 1 (2012).} but it has yet to produce a final updated value. Over this twenty-year span, the NRC became an outlier, using a value that is only roughly a third of that used by the bulk of the federal health and safety agencies.\footnote{Cass R. Sunstein, Valuing Life: Humanizing the Regulatory State 94 (2014).} A stagnant figure over two decades is particularly problematic because VSL is a function of income,\footnote{Richard L. Revesz, Environmental Regulation, Cost–Benefit Analysis, and the Discounting of Human Lives, 99 Colum. L. Rev. 941, 962–63 (1999).} and is therefore affected by inflation.

In contrast to the NRC, agencies in the Executive Branch exhibit an “increasing consensus” placing their VSLs “in the vicinity of $9 million.”\footnote{See id.} Absent a difference in the nature of the risks,\footnote{Sunstein, supra note 23, at 94.} such variation is undesirable because it prevents the government from maximizing the number of lives it saves for a given expenditure.\footnote{Tammy O. Tengs & John D. Graham, The Opportunity Costs of Haphazard Social Investments in Life-Saving, in Risks, Costs, and Lives Saved: Getting Better Results from Regulation 167, 177–80 (Robert William Hahn ed., 1996); Tammy O. Tengs, et al., Five-Hundred Life-Saving Interventions and Their Cost-Effectiveness, 15 Risk Analysis 369, 369–72 (1995).} For this reason, John D. Graham, the OIRA Administrator during the presidency of George W. Bush, has been particularly critical of the lack of uniformity in VSLs.\footnote{Binyamin Appelbaum, As U.S. Agencies Put More Value on a Life, Businesses Fret, N.Y. Times, Feb. 16, 2011.}

OIRA has never imposed a uniform VSL on Executive Branch agencies, and the respective values do exhibit modest variations.\footnote{Office of Information and Regulatory Affairs, Regulatory Impact Analysis: A Primer 10 (2011); Sunstein, supra note 23, at 94.} But even without an express OIRA command, the institution of OIRA review plays a harmonizing function. Michael Livermore explains how the process of OIRA review leads Executive Branch agencies to influence one another.\footnote{Michael A. Livermore, Cost–Benefit Analysis and Agency Independence, 81 U. Chi. L. Rev. 609, 661–66 (2014).} He maintains
that in the application of cost–benefit analysis, agencies “seek guidance from one another and borrow or rely on each other’s work.”

Furthermore, agencies can also combine forces to push OIRA toward adopting a technique or perspective or work on opposite sides of an issue “with OIRA performing a mediating role.”

Regardless of the mechanics of the exchange, “the methodological advances or preferences of one agency can diffuse” throughout the Executive Branch.

In particular, Professor Livermore examines the impact of EPA advances in the quantification of VSL on Department of Transportation, Department of Homeland Security, and Department of Justice rulemakings.

As an independent agency, the NRC is outside the scope of OIRA review and has not been affected by the diffusion of knowledge that has taken place within the Executive Branch. The procedure it is using to update its VSL provides a prime example of the hazards faced by independent agencies.

In 2010, when the NRC embarked on this project, it enlisted the help of ICF International, a Virginia-based global consulting firm. After considering ICF’s recommendations and examining the VSLs used by other federal agencies, the NRC convened an “interagency regulatory analysis workshop” in March 2012. Following the conference, the NRC announced that it expected to issue a final document with its revised VSL in 2014, but that did not happen.

Instead, in August 2015, the NRC issued a draft report proposing to update its VSL measure from $3 million to $9 million and seeking public comments. After discussing a number of different approaches to the estimation of VSL, the NRC ultimately arrived at its new estimate of $9 million for VSL by averaging the calculations of EPA and DOT. It explained: “Given the extensive resources spent by other Federal agencies on this topic, specifically EPA and DOT, it is prudent for the NRC to leverage these resources and align its VSL recommendations with those of its Federal counterparts.” It is not clear when the NRC will respond to the comments it receives and issue a final report.

W. Kip Viscusi, the economist who played the most central role developing the VSL, sees no reason for the NRC’s long delay, arguing that a VSL update entails “no time-consuming process.” He claims that NRC could turn to

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31 Id. at 661.  
32 Id.  
33 Id.  
34 Id. at 661–66.  
35 Borchardt, supra note 22, enclosure 8, at 1.  
36 Id.  
38 Id. at 18.  
other agencies that have recently updated their VSLs in order to forgo the legwork of literature review. NRC Public Affairs Officer Scott Burnell disagrees, arguing that setting a new VSL is a time-intensive process that requires extensive hypothetical testing. This claim rings particularly hollow in light of the process used within the Executive Branch to calculate the VSL, dating back to EPA’s Guidelines for Preparing Economic Analyses, which were published in 2000. EPA relied on the twenty-six peer-reviewed empirical studies available at that time, five of them authored by Professor Viscusi. It converted the VSL estimate of each study to constant 1997 dollars and then took the mean of those studies. The resulting value of $5.8 million (in 1997 dollars), adjusted for inflation, amounts to the approximately $9 million that is now generally used by agencies in the Executive Branch. In light of this widely accepted methodology, the need for extensive hypothetical testing makes little sense. And, in its recently issued draft report, the NRC appears to have finally accepted this view.

B Securities and Exchange Commission and Its Rulemaking Problems

Since the early 1990s, the D.C. Circuit has treated SEC regulations with skepticism, particularly in connection with the Commission’s cost–benefit analyses. Timpinaro v. SEC struck down a rule that defined “professional traders” and prevented them from using an automated trade execution system to “earn riskless trading profits” through arbitrage. In an opinion by Judge Douglas Ginsburg, a former OIRA Administrator, the D.C. Circuit held “the SEC had not adequately substantiated its reasoning and remanded the rule for further analysis of its benefits and costs.”

In 1996, Congress added to the SEC’s burdens by enacting the National Securities Markets Improvement Act. It provides that, in promulgating rules, the Commission must “consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation,” which gives further statutory support to the SEC’s obligation to

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40 Id. 41 Id. 42 US Envt’l Protection Agency, EPA 240-R-00–003, Guidelines for Preparing Economic Analyses 87–94 (2000). I served on the EPA Science Advisory Board’s Environmental Economics Advisory Committee, which performed the peer review for this document. 43 Id. at 89, ex.7–3. 44 Id. 45 This calculation can be performed using the Bureau of Labor Statistics’ CPI Inflation Calculator. 46 2 F.3d 453, 455 (D.C. Cir. 1993); Bruce Kraus & Connor Raso, Rational Boundaries for SEC Cost–Benefit Analysis, 30 Yale J. on Reg. 280, 298–99 (2013). 47 Kraus & Raso, supra note 46, at 299. 48 15 USC § 77b(b) (2012).
conduct cost–benefit analyses. Nearly a decade later, the D.C. Circuit struck another blow to SEC rulemaking in *Chamber of Commerce v. SEC*, finding that the SEC had not followed the Administrative Procedure Act because it “fail[ed] to consider the costs that mutual funds would incur by complying with . . . a new rule” and did not examine alternatives. After remand and the SEC’s “decision not to modify” the relevant provisions, the Chamber of Commerce once again challenged them, and the D.C. Circuit vacated the rule.

The SEC’s next setback on the cost–benefit front came in *American Equity Investment Life Insurance Co. v. SEC*, in which the D.C. Circuit vacated a rule interpreting “fixed indexed annuities” under the Securities Act of 1933 because the SEC “failed to properly consider the effect of the rule upon efficiency, competition, and capital formation.” A perhaps more significant challenge to an SEC rule came in 2011 in *Business Roundtable v. SEC*. In this case, the D.C. Circuit vacated the SEC’s Exchange Act Rule 14a-11, which “requires public companies to provide shareholders with information about, and their ability to vote for, shareholder-nominated candidates for the board of directors,” because the SEC did not sufficiently consider the requirements of the 1996 statutory amendment.

Following its multiple judicial setbacks, though prior to *Business Roundtable*, the SEC formed a Division of Risk, Strategy, and Financial Innovation in 2009 to “integrate financial economics and rigorous data analytics into the core mission of the SEC.” After *Business Roundtable*, this division, collaborating with the SEC’s Office of General Counsel, updated the SEC’s internal rulemaking guidance. The new document points to court decisions and Congressional inquiries as drivers for the effort to improve economic analysis. It defines the following areas of focus:

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49 412 F.3d 133 (D.C. Cir. 2005).
51 *Chamber of Commerce v. SEC*, 443 F.3d 890, 893–94, 909 (D.C. Cir. 2006).
52 613 F.3d 166, 167–68 (D.C. Cir. 2010).
53 647 F.3d 1144 (D.C. Cir. 2011).
54 *Id.* at 1146.
56 Bishop & Coffee, supra note 50, at 599.
(1) Identifying the need for the rulemaking and explaining how the proposed rule will meet that need; (2) articulating the appropriate economic baseline against which to measure the proposed rule’s likely economic impact (in terms of potential benefits and costs, including effects on efficiency, competition, and capital formation in the market(s) the rule would affect); (3) identifying and evaluating reasonable alternatives to the proposed regulatory approach; and (4) assessing the potential economic impact of the proposed rule and reasonable alternatives by seeking and considering the best available evidence of the likely quantitative and qualitative costs and benefits of each.\(^5\)

The document borrows heavily from OMB’s Circular A-4, which guides agencies in the Executive Branch on how they should conduct their cost-benefit analyses. It explicitly points to the Circular along with Executive Orders 12,866 and 13,563 as dictating the “principles” that the SEC should follow, and refers numerous times to these foundational documents.\(^5\)

Moreover, to carry out the more sophisticated analyses, the SEC invested in additional economic expertise. For example, the Division of Risk, Strategy, and Financial Innovation hired sixteen full-time PhD economists in 2012 alone.\(^6\) At the same time, the role of economists became better integrated, as the Commission added an “Economic Analysis” section to the preamble of its rules, rather than having it appear in scattered sections, thereby lacking a coherent focus.\(^6\)

The results appear to have been positive. For example, the Committee on Capital Markets Regulation referred to SEC’s voluminous 2013 proposed rule on cross-border security-based activities\(^6\) as “[a] candidate for the ‘gold standard’ of cost–benefit analysis in the United States.”\(^6\) Similarly, the Center for Capital Markets Competitiveness “recommend[s] that all financial services regulators should follow similar protocols [to those] found in the SEC guidance memorandum and apply rigorous cost–benefit analysis to improve rulemaking and put in place more effective regulations.”\(^6\)

\(^5\) SEC Guidance, \textit{supra} note 57, at 1–2. \(^6\) Id. at 3–4.
These favorable assessments of the changes in the SEC’s cost–benefit practices once it started following the protocols used in the Executive Branch are, to some extent, evidence of success. But they also suggest that the SEC’s prior rules would have fared better if these improvements had been implemented decades earlier.

C Commodity Futures Trading Commission and Its Methodological Rescue

The CFTC’s attempts to meet its statutory mandates have faced extensive resistance from industry groups and concern from lawmakers, commentators, internal stakeholders, and others. Much of this friction stems from CFTC’s attempts to fulfill a requirement in its organic statute that “[b]efore promulgating a regulation . . . the Commission shall consider the costs and benefits of the action.” Dodd–Frank added significantly to the regulatory burdens of the CFTC, which had relatively little expertise in cost–benefit analysis at the time.

The CFTC saw its cost–benefit analyses questioned in two significant challenges to important Dodd–Frank rulemakings. The first was brought by the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association, which challenged the CFTC’s rule on position limits. The chief complaint was that the “CFTC had neglected to do an adequate cost–benefit analysis of the rule.” However, the D.C. Circuit invalidated the rule on other grounds, without considering the adequacy of the cost–benefit analysis.

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69 See Bishop & Coffee, supra note 50, at 569–70.
In a later case, the Investment Company Institute and the US Chamber of Commerce challenged CFTC rules forcing registration of mutual funds. The district court found “CFTC fulfilled its responsibilities under both the CEA and APA to evaluate the costs and benefits of the Final Rule.”\textsuperscript{74} The D.C. Circuit likewise held “that CFTC’s consideration and evaluation of the rule’s costs and benefits was not arbitrary or capricious.”\textsuperscript{75}

Even though neither case resulted in having a CFTC rule set aside for an inadequate cost–benefit analysis, they highlighted the Commission’s potential vulnerabilities. In this connection, commentators criticized its lack of cost–benefit expertise. For example, in testimony before a House subcommittee, Jacqueline McCabe, Executive Director for Research for the Committee on Capital Markets Regulation, a group composed by academics and industry members, worried that flawed cost–benefit analysis would render Dodd–Frank regulations vulnerable “to judicial challenge, prevent important rules from taking effect, and contribute to uncertainty in our markets over their fate.”\textsuperscript{76} In particular, McCabe criticized specific cost–benefit assessments, such as the CFTC’s “absurd contention” that its Derivatives Clearing Organization General Provisions and Core Principles rule would have “averted the entire [financial] crisis,” and therefore that “lost output...[of] between $60 trillion and $200 trillion” should be included in the cost–benefit inquiry.\textsuperscript{77}

The Commission itself shared the concern about how its future Dodd–Frank rules might fare. In this connection, Commissioner Scott O’Malia requested that OMB review the cost–benefit analysis for the CFTC’s “Internal Business Conduct Rules,” promulgated in February 2012.\textsuperscript{78} In a letter to OMB Acting Director Jeffrey Zients, O’Malia expressed “concern that the Commission’s cost–benefit analysis has failed to comply with the standards for regulatory review” dictated to executive agencies by OMB and the White House.\textsuperscript{79} O’Malia argued that the CFTC process fell short of Executive review requirements and guidelines as “outlined in OMB Circular A-4, Executive Order 12,866, and President Obama’s Executive Orders 13,563 and 13,579.”\textsuperscript{80}


\textsuperscript{75} 720 F.3d at 380. \textsuperscript{76} McCabe, \textit{supra} note 66.

\textsuperscript{77} \textit{Id}. Others have warned that CFTC cost–benefit analysis poses a risk to the “long-term viability and legitimacy” of rules implementing Dodd–Frank. See Bishop & Coffee, \textit{supra} note 50, at 567.


\textsuperscript{79} \textit{Id}. \textsuperscript{80} \textit{Id}.
In particular, he claimed that the Commission “failed to...identify a clear baseline against which” to gauge “costs and benefits and the range of alternatives.” OMB declined to review the analysis, citing the CFTC’s status as an independent agency.

One might attribute Commissioner O’Malia’s call for OMB review to a political disagreement with the CFTC’s Democratic majority, particularly since it echoed similar arguments by industry groups typically opposed to financial regulation, including the US Chamber of Commerce. But around the same time, the Commission itself negotiated a Memorandum of Understanding (MOU) with OIRA, which was signed in May 2012. The agreement’s main purpose is to bolster CFTC’s “consideration of the costs and benefits of proposed and final rules” in exercising the statutory grants of rulemaking authority under Dodd–Frank. The document stipulates that CFTC cost–benefit policy is to be “informed by OIRA’s guidance . . . as well as the best practices of other federal agencies, to the extent permitted by law.” OIRA, however, did not undertake to engage in a supervisory relationship by reviewing the CFTC’s cost–benefit analyses.

The agreement “allow[s] an OIRA staffer to work with the CTFC on the economic analysis of rule-making.” However, the MOU offers little specific information on the magnitude of OIRA’s overall help, describing it in vague terms as “technical assistance . . . during the implementation of [Dodd-Frank], particularly with respect to the consideration of the costs and benefits of proposed and final rules.”

The existence of an MOU between OIRA and an independent agency is very uncommon. The only other arrangement of this sort appears to be an agreement between OIRA and the Office of Advocacy of the Small Business Administration “for sharing information and providing training for regulatory agencies on compliance with the Regulatory Flexibility Act.” This

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81 Id. 82 See Trindle, supra note 70.
83 At the time of O’Malia’s letter, three of the CFTC’s five commissioners had been appointed by President Obama.
86 Id. 87 Id. 88 Trindle, supra note 70. 89 CFTC MOU, supra note 85.
agreement, entered into in 2002, had a duration of three years and was not renewed.\textsuperscript{91}

The Committee on Capital Markets Regulation performed a study of CFTC rulemaking by comparing the cost–benefit analyses conducted on proposed and final CFTC rules from before and after the MOU. The Committee concluded that CFTC has increased their use of quantitative analysis since OIRA began providing technical support, and that “the length, detail, and quality of the analysis have improved to a degree.”\textsuperscript{92} Further, the Committee reported that the proportion of post-MOU rules including quantitative cost-benefit analysis is more than double (up to 69.6 percent from 34.2 percent) what it was prior to the MOU.\textsuperscript{93} The Committee also noted that CFTC had ceased issuing rules with no cost–benefit analysis whatsoever and had halved the proportion promulgated with non-quantitative analysis.\textsuperscript{94}

This study, however, should not be viewed as a definitive assessment of the success of the collaboration between the CFTC and OIRA, in part because of methodological shortcomings. In particular, it uses the date of the MOU as a strict delineation point, comparing rules prior to the MOU with rules subsequent to the agreement. This binary categorization ignores the possibilities that OIRA began lending assistance while the MOU was still being negotiated, or that some rules promulgated after the MOU might have been in close to final form before OIRA’s assistance became available and might thus reflect an improvement in the CFTC’s cost–benefit capabilities before it could begin to benefit from OIRA’s influence. A more definitive conclusion will require further analysis.

II TOWARD AN INSTITUTIONAL TRANSFORMATION

The transformation of the institutional frameworks for financial regulation holds the promise of improving the quality of cost–benefit analysis. Three approaches appear particularly promising, and for each the Executive Branch offers useful models. First, FSOC should evolve to fulfill its statutory mandate and act as a coordinating body for financial regulatory agencies. Second, OIRA review should be extended to independent financial regulatory agencies. Third, the financial regulatory agencies should take steps to improve their internal economics capacities, using EPA’s experience as a model. These

\textsuperscript{91} Id.; Sam Kim, New Small Business Program Will Influence Agency Regulatory Reviews, Center for Effective Government (Sept. 11, 2007).
\textsuperscript{92} Committee on Capital Mkts. Regulation, supra note 63, at 8.
\textsuperscript{93} Id. at 9. \textsuperscript{94} Id.
proposals – taken individually or, preferably, in tandem – can catalyze an improvement in the economic analysis of financial regulation.

**A Empowering the Financial Stability Oversight Council**

In essence, what the financial regulatory agencies need to do in their cost–benefit analyses is to determine how a particular rule reduces the probability of a serious negative consequence to the economy.95 The problem, though, is that individual agencies such as the SEC and CFTC do not have – and probably could not practically have – the expertise to make these assessments because they do not have a macroeconomic jurisdiction. FSOC has great promise for improving the cost–benefit analyses of the financial regulatory agencies because it is composed of the senior officials within the federal government with responsibility over the stability of the economy. Its members (and their respective departments) bring to the table expertise in this area that the individual regulatory agencies could not possibly have.96 Moreover, FSOC’s explicit mandate to coordinate the work of these agencies provides it with an opening to perform this function.97 Unfortunately, that has not yet happened. In this sense the experience of the Interagency Working Group that determined the social cost of carbon – the quantified damage of the harm of a ton of carbon dioxide emissions – is instructive and provides a good model for FSOC to emulate.

Dodd–Frank created FSOC to fulfill three primary purposes: first, “to identify risks to the financial stability of the United States,” especially those posed by “large, interconnected bank holding companies or nonbank financial companies”; second, “to promote market discipline”; and, finally, “to respond to emerging threats to the stability of the United States financial system.”98 FSOC was designed to act as “a consultative council” across the Dodd–Frank regulatory landscape.99

FSOC has ten voting members: the Secretary of the Treasury, the Chair of the Federal Reserve, the Comptroller of the Currency, the Director of the CFPB, the Chair of the SEC, the Chair of the FDIC, the Chair of the CFTC, the Director of the FHFA, the Chair of the NCUA, and “an independent member appointed by the President . . . having insurance expertise.”100

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FSOC’s primary concern is with systemic risk. Though Dodd–Frank does not define “systemic risk” or “financial stability,”\textsuperscript{101} FSOC’s inaugural report portrays “a stable financial system” as one that is neither “the source of, nor amplifies the impact of, shocks.”\textsuperscript{102}

To perform its mission to protect against systemic risk, FSOC received significant regulatory authority.\textsuperscript{103} Among the most significant duties FSOC discharges is the ability to designate “nonbank financial companies” as systemically important.\textsuperscript{104} Dodd–Frank provides that FSOC may deem such a company a substantial enough potential danger to “financial stability” so as to require registration with the Federal Reserve and therefore the imposition of elevated requirements.\textsuperscript{105}

FSOC may also make recommendations to the Federal Reserve regarding restrictions imposed on the nonbank financial firms and “large, interconnected bank holding companies.”\textsuperscript{106} Under this provision, FSOC retains power to recommend changes to a variety of “prudential standards,” such as “liquidity requirements,” or “short-term debt limits.”\textsuperscript{107} Furthermore, FSOC can intervene to impose “mitigatory actions” on any institution that threatens “financial stability.”\textsuperscript{108} Such actions may include preventing an acquisition, limiting financial offerings, or mandating the firm cease specific activity.\textsuperscript{109}

Most importantly for the purposes of this chapter, FSOC also has an overarching coordinating and managerial role in regulation. It has mandates to “facilitate information sharing and coordination among the member [and other] agencies”; to suggest priorities for member agencies; to “identify” potentially perilous “gaps in regulation”; to “identify systemically important financial market utilities and payment, clearing, and settlement activities”; to recommend member financial regulators impose certain “standards and safeguards”; to comment on an “existing or proposed accounting principle, standard, or procedure”; and to provide a forum for examining changes in markets and regulation and undertaking member dispute resolution.\textsuperscript{110} To fulfill these mandates,

\textsuperscript{101} Murphy, supra note 99, at 5.
\textsuperscript{103} FSOC is deemed to be an Executive Branch agency as it is not included as an independent agency in the Paperwork Reduction Act, see Anderson P. Heston, Note, The Flip Side of Removal: Bringing Appointment into the Removal Conversation, 68 N.Y.U. ANN. SURV. AM. L. 85, 99 (2012), and OIRA has received each FSOC rulemaking for review, see Bartlett, supra note 4, at 587.
\textsuperscript{104} Dodd–Frank § 113.
\textsuperscript{105} Id.
\textsuperscript{106} Id. § 112(a)(2)(I).
\textsuperscript{107} Id. § 115(b).
\textsuperscript{108} Such actions are applicable only to “a bank holding company with total consolidated assets of $50,000,000,000 or more, or a nonbank financial company supervised by the Board of Governors.” Id. § 121(a).
\textsuperscript{109} Id.
\textsuperscript{110} Id. § 112(a).
FSOC operates through committees meant “to promote shared responsibility among the member agencies and to leverage the expertise” within each.”\textsuperscript{111} Subject-matter committees include “Systemic Risk,” “Designation of Non-bank Financial Companies,” “Designation of Financial Market Utilities,” “Heightened Prudential Standards,” “Orderly Liquidation,” and “Data.”\textsuperscript{112}

In a report issued in November 2011, the Government Accountability Office (GAO) found that FSOC had played a “limited role” in providing coordination among its members,\textsuperscript{113} and that the coordination tools that FSOC had developed were of “limited usefulness.”\textsuperscript{114} The GAO report recommended that FSOC “establish formal coordination policies” and that “federal financial regulators take steps to better ensure that the specific practices in OMB’s regulatory analysis guidance” are a bigger part of rulemakings.\textsuperscript{115} FSOC broadly agreed with the report’s conclusions.\textsuperscript{116}

A subsequent GAO report, published in September 2012, once again urged FSOC “[t]o strengthen accountability and collaboration,” including creating “formal collaboration and coordination policies.”\textsuperscript{117} And a September 2014 update lamented that FSOC had not heeded the GAO’s suggestions in this regard.\textsuperscript{118} FSOC justified neglecting to “more fully incorporate key practices for successful collaboration,” such as coordinating member agency rulemaking timelines, performing “collaborative systemwide stress tests,” or forming “external advisory committees,”\textsuperscript{119} by pointing to its lack of statutory authority over such agencies.\textsuperscript{120} The GAO disagreed, maintaining that FSOC could respect the autonomy of member agencies and still implement further coordinating practices.\textsuperscript{121}

\textsuperscript{111} About FSOC, US Dep’t of the Treasury,. http://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx (last updated May 19, 2015).
\textsuperscript{113} U.S. Gov’t Accountability Office, GAO-12–151, Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination (2011) [hereinafter GAO 12–151].
\textsuperscript{114} Id. at 27. \textsuperscript{115} Id. at 39.
\textsuperscript{117} GAO-12–151, supra note 113, at 55.
\textsuperscript{119} Id. at 13. \textsuperscript{120} Id. \textsuperscript{121} Id.
In contrast to FSOC’s hesitancy, the Interagency Working Group on the Social Cost of Carbon (IWG) is a forceful example of the potential of interagency collaboration and coordination. The IWG was established “[t]o facilitate accounting for the costs of climate impacts, and the benefits of reducing carbon pollution.” The agencies involved include the Council of Economic Advisers, Council on Environmental Quality, Department of Agriculture, Department of Commerce, Department of Energy, Department of Transportation, Environmental Protection Agency, National Economic Council, Office of Management and Budget, Office of Science and Technology Policy, and Department of the Treasury. The IWG first developed a figure for the social cost of carbon (SCC) in 2009, adopted this value in 2010 following public comment, and issued a revised estimate in 2013. Since the IWG released its first figure, the SCC estimate has been used in thirty-four proposed rulemakings as of July 2015, which were performed by five agencies: the Department of Energy, EPA, the Department of Transportation, the Department of Agriculture, and the Department of Housing and Urban Development.

The IWG’s process to determine an estimate for the SCC and for updating that initial estimate has been consistent, transparent, and open, offering scholars, industry groups and others ample opportunities to comment on its analytic method and decisions. In 2010, the IWG published a Technical Support Document that detailed its decision-making process with respect to how it assessed and employed scientific models. The IWG provided opportunities for public comments, and further comment opportunities were provided by the respective agencies in their notice-and-comment rulemakings that relied

123 See INTERAGENCY WORKING GROUP ON SOCIAL COST OF CARBON, RESPONSE TO COMMENTS: SOCIAL COST OF CARBON FOR REGULATORY IMPACT ANALYSIS UNDER EXECUTIVE ORDER 12866 (2015).
124 Id. at 3–4.
125 Id. at 4.
128 See id. (noting the rule was issued jointly with EPA).
130 See Walk-in Cooler Comment, supra note 122, at 3–6. 131 Id. at 4.
132 INTERAGENCY WORKING GROUP ON SOCIAL COST OF CARBON, supra note 123, at 4; Walk-in Cooler Comment, supra note 122, at 4 n.11.
on the SCC. In response to its most recent solicitation, the IWG received “140 unique sets of comments and over 39,000 form letter submissions,” to which the IWG responded in a forty-four-page July 2015 document. And, recently, the IWG asked the National Academy of Sciences “to review the latest research on modeling the economic aspects of climate change to further inform future revision to the SCC estimates used in regulatory impact analyses.”

The IWG has accomplished a great deal by convening an interagency group to perform the very difficult task of valuing the benefits of carbon dioxide reductions. It explicitly explained its methodology, established a protocol for dealing with uncertainties, and allowed meaningful opportunities for public participation. FSOC should be guided by the IWG’s experience in devising a robust collaboration with the financial regulatory agencies and creating an infrastructure to facilitate the preparation of cost–benefit analyses.

### B A Role for OIRA

Federal regulatory agencies have traditionally been divided into executive and independent categories, based primarily on whether the President can remove the agency head at will or whether the agency head (or heads) is protected by a for-cause removal provision. The requirement that OIRA review significant agency rules, and in particular scrutinize the cost–benefit analyses supporting such rules, extends only to executive agencies. The Executive Orders regarding regulatory review exempt independent agencies, including the key financial regulatory agencies like the SEC and CFTC. But the fact that no president has chosen to extend OIRA review to independent agencies does not mean that such expansion is unconstitutional or undesirable.

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133 Walk-in Cooler Comment, supra note 122, at 4 n.11.
134 Interagency Working Group on Social Cost of Carbon, supra note 123, at 2, 4.
135 See Id.
138 See Exec. Order No. 12,866, § 6, 3 C.F.R. 658 (1994); Datla & Revesz, supra note 137, at 856.
Kirti Datla and I have argued that “[b]ecause Congress has not by statute insulated the so-called independent agencies from regulatory review, the President can require them to comply with the governing executive orders.”

Relying on both statutory interpretation and constitutional analysis, we explained why it is inappropriate to imply constraints on presidential control over an agency beyond those specified in the agency’s enabling statute. We pointed out that agencies exhibit different indicia of independence beyond for-cause removal, including specified tenure, multimember status, partisan balance requirements, independent litigation authority, authority to bypass OMB’s budget process, and adjudication authority. Many executive branch agencies have some indicia of independence, and many independent agencies lack others. We showed that the world does not neatly divide into a binary scheme. In light of this pattern, and rejecting dicta to the contrary in Humphrey’s Executor v. United States, we argued that one indicia of independence should not be used to imply indicia that Congress did not provide. Relying on some different grounds, the Office of Legal Counsel expressed a congruent view in a February 1981 memorandum to David Stockman, then the Director of OMB. The document argued that Humphrey’s Executor’s view of rulemaking as entirely insulated from politics was anachronistic, and it relied on statutory powers granted to the President with regard to independent agencies under the Paperwork Reduction Act and Regulatory Flexibility Act as evidence of the legitimacy of some executive influence. The OLC memorandum also argued that the Constitution’s Take Care Clause gave the President the authority to ensure independent agencies faithfully execute the laws. The OLC concluded that extending executive review of independent agency analysis is permissible under the law and Constitution, provided the likely event that the Supreme Court was open to disclaiming dicta in Humphrey’s Executor.

The OLC memorandum did worry about the possibility of a congressional backlash if the President extended OIRA review to independent agencies, and it is primarily for this reason that no President has invoked that authority, as the Congressional Research Service noted in a 2012 report. As

140 Datla & Revesz, supra note 137, at 837.
141 See id. at 773.
142 Id. at 772.
143 295 US 602 (1935).
144 See Datla & Revesz, supra note 137, at 827–32.
146 Id. at 159–63, 163 n.16
147 Id. at 162.
148 Id. at 158–64.
149 Id. at 158–59.
150 See CHU & SHEDD, supra note 139, at 12.
then-Professor Elena Kagan notes, “[t]he Reagan Administration almost cer-
tainly exempted the independent agencies because it feared provoking a
Democratic Congress, rather than because it believed the law... required
this course of action.”151 Similarly, former OIRA administrator Sally Katzen
maintains that the absence of any decision to widen OIRA was the product of
a desire not to “antagoniz[e]” Congress, rather than a decision predicated on
any legal objection or uncertainty.152

But a number of factors suggest that the political landscape on this issue
might be shifting, at least subtly. The introduction by Senators Rob Portman,
Mark Warner, and Susan Collins of the Independent Agency Regulatory Anal-
ysis Act of 2015,153 which would extend OIRA review to independent agencies,
shows at least some level of bipartisan congressional support for the idea, even
if the bill never passes.154 This support at least suggests that if the President
took this action by Executive Order, an effort to congressionally override it
might be stopped by a Senate filibuster, and that even if legislation passed
there might not be sufficient votes to overcome a presidential veto.

This bill provided the occasion for six former OIRA Administrators of both
parties to advocate for more rigorous cost–benefit mechanisms in such agen-
cies: James C. Miller III (Reagan), Wendy Lee Gramm (Reagan), Sally Katzen
(Clinton), John Spotila (Clinton), John D. Graham (George W. Bush), and
Susan Dudley (George W. Bush).155 They wrote to the leadership of the Sen-
ate Committee on Homeland Security and Governmental Affairs to decry
the shortcomings of rulemaking by independent agencies: “Our concern is
that independent regulatory agencies typically do not engage in the economic
analysis that has come to be expected from executive agencies.”156 The former
Administrators claimed that, for 2012, “not one of the 21 major rules issued
by [independent] agencies was based on a complete benefit–cost analysis,”
and advocated for the proposed Act as a means of “affirming the president’s

152 Sally Katzen, Opening Remarks at the Resources for the Future Conference: Can Greater Use
of Economic Analysis Improve Regulatory Policy at Independent Regulatory Commissions?, at
153 S. 1607, 114th Cong. (2015). The same bill was introduced in two previous sessions.
infra text accompanying notes 155–159.
155 See Letter from Sally Katzen, former Adm’r., Office of Info. & Regulatory Affairs, et al., to
Thomas R. Carper, Chairman, S. Comm. On Homeland Sec. & Gov’t Affairs & Thomas A.
Coburn, Ranking Member, S. Comm. On Homeland Sec. & Gov’t Affairs (June 18, 2013),
http://www.portman.senate.gov/public/index.cfm/files/serve?File_id=6f3f466c-e744-4d99-
892a-91f6e6548ef.
156 Id.
authority to extend to these agencies the same principles of regulation that have long governed executive agencies.”

In another letter, former high-ranking officials at independent agencies – including two former Acting Chairmen of the CFTC, William P. Albrecht (Clinton) and Sharon Brown-Hruska (George W. Bush) – argued that “[t]he justification for cost–benefit analysis and review applies no less to independent agencies than to executive agencies,” in effect urging the application of the White House’s “regulatory analysis and review regime” to independent agencies through statutory mandate. Further, they lamented the lack of analytical transparency from independent agencies, claiming, as had the former OIRA Administrators, that none of the rules such agencies promulgated in 2012 was predicated on “a complete, quantified cost–benefit analysis.”

The case studies presented in Section I provide significant fodder against an argument that the administrative state would be worse off with OIRA review. The NRC’s stalled efforts on VSL, the SEC’s adoption, decades late, of the standard approach to performing cost–benefit analysis, and the CFTC’s call for an OIRA rescue from its methodological shortcomings are strong evidence that independent agencies are significantly underperforming relative to their counterparts in the Executive Branch. Indeed, in a review of Dodd–Frank implementation, the Government Accountability Office concluded that if financial regulators followed the OIRA approach to cost–benefit analysis, their regulatory decisions would have greater “[t]ransparency and [r]igor.”

These shortcomings are likely to be magnified by the Supreme Court’s decision in Michigan v. EPA. As discussed above, it is likely that the courts will now impose cost–benefit requirements on a broader set of financial regulations. And, unless the agencies can improve their performance, their work will be even more vulnerable than it already is.

In theory, financial regulatory agencies could follow the Executive Branch’s directives on the preparation of cost–benefit analyses, such as Circular A-4, without being subjected to OIRA review. As Ryan Bubb has noted, however, the institutional role of OIRA review has significant value: “The OIRA model has been a substantial success in other regulatory domains, and there

\[\text{Id.}\]


\[\text{Id.}\]

\[\text{GAO-12–151, supra note 113, at 14.}\]

\[\text{See supra text accompanying notes 6–8.}\]

\[\text{See supra text accompanying note 8.}\]
is no reason why that model could not be similarly successful in financial regulation.”

And, as Professor Livermore has indicated, OIRA review allows particular agencies to benefit from the experience of other agencies.

There are opposing views, which object to the application of OIRA review to certain types of agencies. For example, Bruce Kraus and Connor Raso argue that OIRA review of multimember independent agencies would not be productive. In their view, “the degree of rationality we expect from hierarchical bureaucracies” constitutes an “unrealistic expectation” for “multimember bi-partisan bodies,” like many of the financial regulatory agencies.

As an example, Kraus and Raso catalog the SEC’s incompatibility with OIRA review. For example, though SEC staff is responsible to the Chairman, the Commission’s other members – even those from the same political party or appointed by the same president – are independent and not bound to support the Chair’s positions. In this environment, compromise might play an important role because unanimous decisions might be less likely to be challenged in the courts. They claim that economic analysis, while important to “inform” agency decision-making, cannot possibly play the same role in a multimember agency as it does a single-head agency, where “policy options and decisions can flow down and up the chain in an orderly, logical manner, with big decisions made first, informed by cost-benefit analysis.”

The main problem with this argument, however, is that courts are already requiring cost–benefit analysis, and are likely to move even more decisively in that direction in the future. And, if the independent regulatory agencies would face problems before OIRA because of the need to compromise their decisions, they are likely to face exactly the same problems in the courts, with worse consequences.

In the current political climate, the enactment of legislation extending the scope of OIRA review is unlikely. Legislative efforts to reform the administrative state have been largely unsuccessful since the defeat of Newt Gingrich’s Contract with America following the 1994 elections, and if anything the congressional stalemate is more pronounced than it has been for decades. But for the reasons discussed above, the President might now be able to do so by Executive Order without facing the same level of political backlash that the Executive Branch has historically feared. And, to blunt some opposition, this

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163 Bubb, *supra* note 5, at 52.
164 See *supra* text accompanying notes 30–34.
166 Id.
167 Id. at 336–37.
168 Id. at 337.
169 Id. at 337–38.
Executive Order could make clear that certain actions by the Federal Reserve, where independence is most prized, would not be subject to presidential oversight.

C Building Economic Expertise in Individual Agencies

Financial regulatory agencies could also take unilateral steps to improve their quantification capabilities. Here, the example of Executive Branch agencies can also be instructive. For example, EPA has long-standing experience and deep expertise on cost–benefit analysis. As a result, Judge Douglas Ginsburg of the D.C. Circuit has suggested that the SEC should aim to emulate EPA’s cost–benefit practices.

Since 1971, EPA has undertaken economic research and analysis. The agency first developed an internal blueprint for quantification in 1983. In September 2000, EPA published its Guidelines for Preparing Economic Analysis, “revised to reflect the evolution of environmental policy making and economic analysis that had accrued.” The 300-page manual is billed as “part of a continuing effort . . . to develop improved guidance on the preparation and use of sound science in support of the decision-making process” and contains, among others, sections on “Statutory and Executive Order Requirements for Conducting Economic Analysis,” “Statement of Need for Policy Action,” “Baseline,” “Discounting Future Benefits and Costs,” “Analyzing Benefits,” “Analyzing Costs,” Economic Impact Analyses,” and “Presentation of Analysis and Results.” This document has been periodically updated by the National Center for Environmental Economics (NCEE), a group within EPA that is responsible for taking the lead on quantified analysis and serves as a “clearinghouse for economics within the agency.” Additionally, the EPA Science Advisory Board has a standing committee, the Environmental Economics Advisory Committee, which scrutinizes the agency’s economic analysis as “a peer review system dedicated to economic questions.”

Today, EPA’s economic analysis capacity is formidable. In fact, “there are probably more economists working on environmental issues employed at
EPA than at any other single institution in the world.”\textsuperscript{180} EPA has more economists than OIRA’s total staff.\textsuperscript{181} Its NCEE, which employs over twenty-five PhD economists,\textsuperscript{182} sits within the Office of Policy at EPA, which “has been characterized as a ‘mini-OMB’ within the agency” for its contributions to the analysis of the impacts of regulations.\textsuperscript{183} The Center is responsible for core economic functions such as providing analytical advice to other EPA components, disseminating guidance on cost–benefit analysis across the agency, and funding outside projects.\textsuperscript{184} The Center also serves as a “training ground” for economists who ultimately leave for jobs elsewhere in EPA or other federal regulatory apparatus, which is an acknowledgment of its proficiency and competence.\textsuperscript{185} And, despite its robust internal capabilities, EPA does not shy away from seeking outside help, often engaging consultants in economic projects and seeking the input of its Science Advisory Board members.\textsuperscript{186}

As indicated above in Section I.B, to its credit the SEC has recently begun to follow Judge Ginsburg’s advice and taken significant steps to improve its economic capabilities. But those efforts, which are ones that EPA took more than two decades ago, are still very recent. Nonetheless, among financial regulatory agencies, the SEC is acknowledged to have become the leader in the economic analysis of regulations.\textsuperscript{187} The other agencies are further behind and would be well advised to begin taking serious steps in this direction.

CONCLUSION

This chapter illustrates the deep shortcomings of independent agencies in general, and of the financial regulatory agencies in particular, with respect to the preparation of cost–benefit analyses in rulemaking. As a result, many significant rules have fared poorly in the courts, and a defeatist debate has ensued on whether such cost–benefit analysis is even possible. This debate detracts attention from the important institutional issue at stake: given that the requirement that the financial regulatory agencies justify some of their rules in cost–benefit terms is here to stay, what institutional structures are best able to perform this task? And, fortunately, there are good models within the Executive Branch to guide this inquiry.

\textsuperscript{180} Id. at 627.  
\textsuperscript{181} Id.


\textsuperscript{183} Livermore, supra note 30, at 627.

\textsuperscript{184} Id. at 627–28.

\textsuperscript{185} Id. at 628.

\textsuperscript{186} Id. at 628–29.

\textsuperscript{187} See Rose & Walker, supra note 64, at 36–37.