Public Interest Comment on

The Office of Management and Budget's

Draft 2012 Report to Congress on the Benefits and Costs of Federal Regulations

June 7, 2012

The Office of Management and Budget (OMB) has requested comment on the 2012 Draft Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local and Tribal Entities. This comment has been developed by Joe Aldy, Art Fraas, and Randall Lutter. Aldy currently serves as an Assistant Professor of Public Policy and Faculty Chair of the Regulatory Policy Program at the John F. Kennedy School of Government at Harvard University, and served as the Special Assistant to the President for Energy and Environment at the White House in 2009-2010. Both Fraas and Lutter currently serve as Visiting Fellows at the think tank Resources for the Future. Fraas served as an economist and branch chief within the OMB Office of Information and Regulatory Affairs (OIRA), the office responsible for coordinating regulatory review. Lutter also served as an economist at OMB/OIRA, as senior economist at the Council of Economic Advisers and as Chief Economist and Deputy Commissioner for Policy at the Food and Drug Administration. The three of us have extensive experience in government -- totaling about 50 years -- in undertaking benefit-cost analysis, designing regulations, and reviewing regulatory proposals and we have each published papers in peer-reviewed journals relevant to benefit-cost analysis and diverse aspects of regulatory policy.

This comment focuses on the major rules issued by independent agencies—particularly the independent financial regulatory financial agencies because their implementation of the Dodd-Frank Act is an especially important part of current Federal regulatory activity. A recent study by the Congressional Research Service estimated that rulemaking is expressly required or could be implemented under more than 300 separate provisions of Dodd-Frank. Furthermore, over 80 percent of these provisions assign responsibility to four key independent financial regulatory agencies—the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Consumer Financial Protection Bureau, and the Securities and Exchange Commission. These rules, issued by independent regulatory agencies (IRA)s beyond the control of any elected official of the U.S. government, are expected to have a significant effect on the financial sector and on the United States economy.

Unfortunately, the financial IRAs appear to be issuing these rules without identifying in their rulemaking which rules are "major rules" as defined by the Congressional Review Act (CRA). This practice appears to violate the spirit—if not the letter of the CRA. Indeed it is inconsistent with the fundamental principle that regulatory agencies need to distinguish publicly between big and small regulatory decisions. In addition, in a majority of cases, the financial IRAs are issuing final rules without presenting an adequate

analysis of the consequences, including a careful analysis of benefits and costs. For example, the "Volcker rule"— restricting banks' proprietary trading and ownership of certain interests in hedge funds and private equity funds—illustrates the need for a proper economic assessment. Regulatory agencies have proposed regulations to implement the Dodd-Frank's Volcker rule, but without benefit-cost analysis of the proposals, or any economic analysis of regulatory alternatives. J.P. Morgan's recent loss of more than $2 billion has sparked further public debate about these regulations, but this debate is not informed by any meaningful economic analysis by government regulators.

On July 11, 2011, President Obama signed Executive Order 13579—Regulation and Independent Regulatory Agencies—which set out as administration policy in Section 1(a):

> Wise regulatory decisions depend on public participation and on careful analysis of the likely consequences of regulation. Such decisions are informed and improved by allowing interested members of the public to have a meaningful opportunity to participate in rulemaking. To the extent permitted by law, such decisions should be made only after consideration of their costs and benefits (both quantitative and qualitative).

While the financial IRAs have said that they embrace the administration's Executive Order 13579 policy, our review suggests that actual practice falls far short of the basic principle of considering quantitative estimates of costs and benefits before making major regulatory decisions.

Therefore, we recommend that OMB establish regular and formal consultations with all of the independent financial regulatory agencies to ensure reasoned and consistent determinations as to whether their regulations are "major." This process should be transparent—and it should provide an evidence-based and data-driven determination of major rules for important financial regulatory decisions. We believe that establishing such a consultative process would have a salutary effect in providing transparency and a more complete accounting of the full effects of rulemaking by the independent financial agencies.

Discussion

OIRA's draft 2012 Report to Congress includes a section on the major rules issued by independent regulatory agencies during FY 2011, with a listing of the major rules in Table 1-7.[1] The draft report lists 17 major rules from independent agencies; 15 of these were issued by three independent financial agencies.[2] For these 15 rules, the draft OMB report states that only 5—all rules issued by the SEC--provide any quantitative estimate of the cost of the rule and none of the rules provide a quantified

[1] OIRA compiled the list in Table 1-7 from reports submitted to Congress by the Government Accountability Office (GAO). Section 801 of the Congressional Review Act requires the Government Accountability Office (GAO) to submit to Congress reports on the major rules issued by government agencies, including those for most of the independent regulatory agencies.

[2] The three agencies are: the Commodity Futures Trading Commission, the Federal Reserve System, and the Securities Exchange Commission. For the purposes of the draft OIRA report, a rule was considered as major if it was estimated to have costs or benefits of $100 million or more or it was likely to have a significant impact on the economy. OMB, 2012 Draft Report to Congress, p. 28.

estimate of the benefits.[3] Of the 5 SEC rules with cost estimates, only two of the rules provided any additional cost estimate beyond the paperwork burden and cost estimates mandated by the Paperwork Reduction Act (PRA). For both of these rules, the SEC reported cost or cost savings estimates that exceeded the $100 million per year threshold for a major rule.

Other reviews of rulemaking by independent financial agencies report similar results. For example, the Government Accountability Office(GAO) reports that of ten final rules covered by its review where the issuing agency had some discretion, only two provided quantified cost and benefit estimates, only one of these monetized the cost, and none of the rules provided a monetized benefit estimate.[4] (p. 17) The Committee on Capital Markets Regulation (CCMR) reported that in its review of 192 proposed and final rules under Dodd-Frank, over a quarter had no benefit-cost analysis and an additional one-third or more only provided a non-quantitative benefit-cost analysis. Of the 50 rules with some quantitative analysis, the CCMR reported that most only provided a quantitative analysis limited to administrative and similar costs.[5]

The designation of individual rules as major is required by statute. The Congressional Review Act (CRA), requires Federal agencies to submit to both Houses of Congress and the Comptroller General a report containing: a copy of the rule; a concise explanation of the rule (including whether it is a major rule); and the proposed effective date of the rule. This report must be submitted before the rule can take effect.

Section 804 of the CRA defines a “major rule”, as follows:

> (2) The term "major rule" means any rule that the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget finds has resulted in or is likely to result in -
>
> > (A) an annual effect on the economy of $100,000,000 or more;
> >
> > (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or
> >
> > (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets. The term does not include any rule promulgated under the Telecommunications Act of 1996 and the amendments made by that Act.

In our review of the 15 final rules issued by the independent financial agencies in Table 1-7, we find that none of the 15 final rules contain an independent section providing a determination under the CRA that

---

[3] Ibid., Table 1-7, pp. 29-31.

[4] GAO, Dodd-Frank Regulations: Implementation Could Benefit from Additional Analyses and Coordination (Nov. 10, 2011), pp. 16-18.

[5] http://blogs.law.harvard.edu/corpgov/2012/05/12/the-need-for-improved-cost-benefit-analysis-of-dodd-frank-rulemaking/

the rule is a major rule.[6] Only one of these rules—the Debit Card Interchange Fees and Routing rule issued by the Federal Reserve System—includes any statement referring to a determination that the rule is a major rule—and, in this case, only as an incidental part of a discussion on the effective date of the rule.[7] There is no evidence that OMB/OIRA has played any role in the determination of whether the rules from these independent financial agencies were major rules.

In contrast, the Nuclear Regulatory Commission final rule revising its fee schedule (listed in Table 1-7 of the draft report) contains a specific section indicating that its rule is a major rule under the CRA, and that it verified its determination with the Office of Information and Regulatory Affairs in the Office of Management and Budget.[8] In addition, every one of the 9 major financial rules issued by Executive branch agencies over the period from October 2007 to 2011 refers to a determination under Executive Order 12866 that the rule is economically significant. Further, all but one of these rules—an interim final rule issued by Treasury establishing TARP limits on compensation—include quantitative/monetized estimates of benefits and/or costs.

There is no evidence that economic analysis of regulations by independent regulatory agencies charged with implementing Dodd-Frank has improved since President Obama issued E.O. 13579 on Regulation and Independent Regulatory Agencies last July. For the 26 final rules issued between October 1, 2011 and April 1, 2012, we found that only two rules, one by the National Credit Union Administration and one by the Federal Deposit Insurance Corporation, provide any discussion of whether they were major. In addition, none of the 26 provided a quantitative discussion of benefits while only two had any quantitative discussion of costs (beyond the costs of complying with paperwork requirements). This record is disappointing given that several of these independent agencies responded to the President's July 2011 E.O. by saying that they would indeed consider benefits and costs in rulemaking.

Our review also suggests that there may be an important difference between the financial IRAs and OIRA in how they determine what rules are designated as "major" under the CRA. In the case of the SEC, for example, its discussion of the benefits and costs for its Shareholder Approval of Executive Compensation and Golden Parachute Compensation final rule explains: "We are sensitive to the costs and benefits imposed by the rule and form amendments we are adopting. The discussion below focuses on the costs and benefits of the amendments made by the Commission to implement the Act within its permitted discretion, rather than the costs and benefits of the Act itself."[9] This contrasts with the standard and long-standing practice of using a pre-statute baseline for OMB-coordinated regulatory review. Circular A-4 of the Office of Management and Budget, which OIRA is charged with

[6] The proposed rules issued by the SEC included a section outlining the basic requirements under the CRA, requesting comment on whether the proposal would be a major rule, and soliciting empirical data to support the comment. This NPRM request does not include any discussion on whether (or not) the rule is major.

[7] The preamble states that: "Additionally, the Congressional Review Act dictates that the Board's final rule— as a major rule—cannot be enforced until the end of a 60-day Congressional review period following transmission of the final rule to Congress."

[8] On the other hand, the rule issued by the Consumer Product Safety Commission—the other issuing independent regulatory agency—does not include any discussion on whether the rule is a major rule as defined by the CRA.

[9] 76 FR 6037. The CFTC also uses a post Dodd-Frank baseline. See the statement by Commissioner Scott O'Malia. 77 FR 20212-20215.

implementing, states that: "In some cases, substantial portions of a rule may simply restate statutory requirements that would be self-implementing, even in the absence of the regulatory action. In these cases, you should use a pre-statute baseline."[10] Imagine the reactions from across the political spectrum if the Environmental Protection Agency announced that there are no benefits and no costs of new air quality regulations simply because they implement a Congressional mandate!

The difference in the choice of baseline has important consequences. First, it could result in important differences in the determination of whether a rule is a major rule. Further, once a rule is designated as major, the resulting additional analysis could result in a more intensive effort to identify and evaluate reasonable alternative regulatory approaches and a more cost-effective rule.[11] We note that a key strength of the baseline embraced by A-4 is its support for accountability and transparency. Use of such a baseline in regulatory analysis provides information to the public and to Congress about the effects of statutes; such information would be generally unavailable in any government document absent use of such a baseline.

The relationship between OIRA and the independent regulatory agencies is mentioned in the draft OMB report, which notes somewhat plaintively that:[12]

> The agencies in question are independent under the law, and under existing Executive Orders. OMB generally does not have authority to review their regulations or to require analysis of costs and benefits. We emphasize, however, that for purposes of informing the public and obtaining a full accounting, it would be highly desirable to obtain better information on the benefits and costs of the rules issued by independent regulatory agencies. The absence of such information is a continued obstacle to transparency, and it might also have adverse effects on public policy. Recall that consideration of costs and benefits is a pragmatic instrument for ensuring that regulations will improve social welfare; an absence of information on costs and benefits can lead to inferior decisions.

Existing federal law (Section 804 of the CRA), however, already defines "major rule" in a way that provides a role for the Administrator of OIRA in making a determination that a rule is major. We believe that this provision can and should serve as the basis for a consultation between the independent financial agencies and OIRA on the determination of whether a final rule is a "major rule".

Such a consultation would offer several advantages. First, it would ensure a consistency that is apparently now absent in the determination that a rule is "major". Such consistency is surely consistent with Congressional intent, insofar as the statute assigns a role to OIRA presumably to avoid willy-nilly determinations whether a rule is "major". Second, such a consultation might lead to a modicum of quantitative benefit/cost analysis (arrived at through a transparent process), which we believe is necessary for reaching a decision on whether a rule is major. Indeed among executive branch agencies

[10] Circular A-4, pp. 15-16.
[11] Ibid. For example, in a recent CFTC rulemaking, Commissioner O'Malia notes that "…the Commission always has some level of discretion in determining the means to achieve such (statutory) mandates." 77 FR 20213.
[12] OMB, 2012 Draft Report to Congress, pp. 28-29.

with which we are personally familiar, it is established practice to estimate the costs of a rule with sufficient rigor to make an informed decision about whether it is economically significant or major, even if the cost estimate ends up being less than $100 million per year. Without such routine economic analysis it is hard to have confidence in determinations of which rules are major.

Therefore, OMB should establish regular and formal consultations with all of the independent financial regulatory agencies to ensure reasoned and consistent determinations as to whether their regulations are "major." This process should be transparent—and it should provide an evidence-based and data-driven basis for the determination of major rules for important financial regulatory decisions. We believe that establishing such a consultative process would have a salutary effect in providing transparency and a more complete accounting of the full effects of rulemaking by the independent financial agencies.