The Need for Rigorous Cost-Benefit Analysis in Regulations*

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Section 1022 of the Dodd-Frank Act reflects a consensus among the Members of Congress that regulators should not be free to adopt regulations implementing statutory directives without first considering the costs of those regulations compared with the benefits that are obtained. Last summer, the D.C. Circuit Court of Appeals confirmed that Congress really meant what it said, and in a decision that has caused considerable strain at the SEC, ruled that the regulations the SEC had adopted to implement the proxy rules of the Act did not have the firm underpinning of a taut cost-benefit analysis[1] and such an analysis was necessary to adopt a binding rule.

While the SEC has been the target of the resistance to rules whose costs and benefits have not been carefully weighed, such a requirement pervades all of the Dodd-Frank Act regulations. For example, section 1022 of Dodd-Frank requires the Consumer Financial Protection Bureau to consider the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products, as well as the impact on covered persons and consumers in rural areas.[2] The Circuit court's opinion is a warning shot across the bow that the analysis must be professional and capable of withstanding rigorous attack.

Administrations and congresses have traditionally supported the need

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[1] Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir 2011).

[2] In addition, the Bureau must consult with appropriate federal agencies prior to issuing a rule regarding consistency with prudential, market or systemic objectives administered by those agencies.

for regulators to consider the impact of their regulations. In 1993, President Clinton issued a major Executive Order outlining the process which federal agencies should pursue, and said that each agency shall "design its regulations in the most cost-effective manner to achieve the regulatory objectives." In doing so, each agency shall consider incentives for innovation, consistency, predictability, the costs of enforcement and compliance (to the government regulated entities and the public) flexibility, distributive impact, and equity."[3] In addition,

> "each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs."

President Obama endorsed that philosophy by generally paraphrasing major segments of the Clinton Order in January of 2011:[4]

> "each agency must, among other things: (propose and adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify); (2) (tailor its regulations to impose the least burden on society consistent with regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations);. . .

There is a lingering question whether or not the CFPB is an independent agency or one reporting directly to the President. But to address that point, the President issued yet another Executive Order in July of 2011;[5]

[3]Executive Order 12866 of September 30, 1993.
[4]Executive Order 13563 of January 18, 2011.
[5]Executive Order 13579 of July 11, 2011

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> Executive Order 13563 of January 18, 2011... directed to executive agencies was meant to produce a regulatory system that protects public health... while promoting economic growth, innovation, competitiveness, and job creation. Independent regulatory agencies, no less than executive agencies, should promote that goal.

That failure to create a firm record of analyzing costs and benefits under rules that require such analysis is not exaggerated, the Committee on Capital Markets Regulation, a bipartisan group of which Professor Hal Scott is the Director, reviewed the record on proposed and final rules under Dodd-Frank. They 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.[6]

Expressing "deep concern about the inadequacy of cost-benefit analysis in proposed and final rulemaking under the Dodd-Frank [Act], the letter concluded that:

> 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.

In late March of this year, Congressmen Neugebauer and Capito sent a detailed letter to Director Cordray of CFPB seeking answers to seven

[6] See letter to Messrs. Johnson, Shelby, Bachus and Frank, March 7, 2012.

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detailed questions about the cost-benefit analysis conducted by the Bureau when drafting its rules. Introducing its request by saying:

> I would like your assurance that the CFPB will conduct rigorous, transparent cost-benefit analysis whenever it drafts a new rule.[7]

No response to that letter has yet been published, so perhaps it has not yet been sent. The questions are many but briefly direct responses to the following:

- In light of section 1022 of DFA, would a rule be arbitrary and capricious if the Bureau failed to quantify its costs and benefits?
- Is the Bureau an independent regulatory agency, and, if so, will it commit to follow the dictates of the Executive Orders?
- Which principles articulated in the Orders does the Bureau plan to follow?
- Will the Bureau encourage the public to examine its methodologies for determining costs and benefits?
- Will the Bureau choose not to adopt a rule if its costs outweigh its benefits?
- What is the Bureau's definition of a significant rule?
- Congress may review major rules in a 60 day period; what is the Bureau's definition of a major rule?

Currently, the Bureau is considering rules relating to the Ability to Repay provisions of Dodd-Frank. While there are no specific references to cost-benefit analysis in that section, the Executive Orders remain in place as the Bureau considers the rule. In addition, the statute provides that the Bureau may make exceptions to the criteria defining a qualified mortgage:

[7] Letter of Congressman Neugebauer and Congressman Capito, March 29, 2012.

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> "upon a finding that such regulations are necessary and proper to ensure responsible, affordable mortgage credit remains available to consumers..."[8]

One could expect, in light of this language and the express language in the Executive Orders, as well as the directives in section 1022 with respect to regulations promulgated by the Bureau generally, that the Bureau would do a thorough taut analysis of the costs and benefits of any QM rule it promulgates. Such analysis should go beyond the standard question about the costs of collecting and processing data necessary to comply with the rule. It should consider the impact on consumers, and the economy generally, the issues that have been raised recently by a variety of both industry and consumer groups.[9]

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[8]Section 1412 of the Dodd-Frank Act, adding subsection 129C(b)(3)(B)(i).
[9]See letter signed by 33 industry and consumer groups of April 16, 2012 to the CFPB.

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