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Costing Financial Regulation

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Bruce R. Kraus & Connor Raso, *Rational Boundaries for SEC Cost-Benefit Analysis*, 30 **Yale J. on Reg.** (forthcoming 2012), available at SSRN.

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Debates about the costs and benefits of regulation, and about particular rules, are a very visible feature of lobbying about proposed financial regulation and of challenges to final rules. Industry opposition to the Dodd-Frank Act has focused on arguments about the costs of regulations envisaged by the Act. For example, in the summer of 2012 the US Chamber of Commerce Center for Capital Markets Competitiveness published a report by Anjan Thakor on the Economic Consequences of the Volcker Rule which argued that the rule would adversely affect bank customers as well as banks. The report argued that reductions in the risk of banking and of costs to taxpayers could be achieved "with greater efficiency by making judicious use of capital and liquidity requirements." Senator Richard Shelby introduced the Financial Regulatory Responsibility Act of 2011 (FRRA) in Congress with a promise that it would hold "financial regulators accountable for rigorous, consistent economic analysis on every new rule they propose." Bruce Kraus and Connor Raso are concerned that the SEC's ability to regulate, and even to carry out its mandates under Dodd-Frank, will be severely compromised by these developments.

In this paper Kraus and Raso argue that, by failing to provide its own interpretation of the National Securities Markets Improvement Act's requirement that the SEC consider the impact of its rules on "efficiency, competition and capital formation," the SEC allowed commentators and the courts to define the agency's obligations with respect to cost-benefit analysis. The authors critique court decisions which have addressed the SEC's obligations to consider the impact of its rules on "efficiency, competition and capital formation,"(in particular Business Roundtable v SEC), and argue that the SEC should now "affirm its substantial and long-standing expertise in financial economics, and insist on the agency's right, derived from that expertise, to discern and define the boundary between economic analysis and policy choice." Kraus and Raso discuss the SEC's composition as a multi-member, bi-partisan agency which must, as a result, engage in compromise, even log-rolling, although its ability to do so is compromised by the Sunshine Act. The structure of the SEC is thus important in thinking about how the SEC should act, and the authors argue that the requirement that the SEC engage in cost-benefit analysis should not be interpreted to "invalidate the predictable results of such a system." Kraus and Raso approve of the SEC's March 2012 issuance of Guidance on Economic Analysis in SEC Rulemakings, but they urge the SEC to think of "involving economists more completely in the policymaking process" as more than "a procedural change." They argue that "the economic analysis will be more compelling if it influences (rather than merely describes and rationalizes) the substance of the rule."

As Kraus and Raso recognize, the SEC's composition has led to Commissioners making public statements on the adoption of final rules, often invoking arguments about inadequate cost-benefit analysis. For example, In August 2012 when the SEC adopted final rules on disclosures with respect to conflict minerals and on disclosures of payments resource extraction issuers make to governments (both mandated by Dodd-Frank), Commissioner Daniel Gallagher stated

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> I am not able to support this rule today, because the analysis is incomplete. The costs this rule will impose are clear enough. Its intended benefits, by contrast, are socio-political and aspirational in nature, worthy but indeterminate — although they are presumed to justify all costs. And certain key discretionary choices made by the Commission's rule will have the effect of increasing the rule's burdens….we have no reason to think the SEC will succeed in achieving complex social and foreign policy objectives as to which the policymaking entities that do have relevant expertise have, to date, largely failed.

This statement (invoking as it does the FRRA emphasis on quantified costs and benefits) does suggest a larger issue, that the regulatory process is being used to second-guess and undermine Congressional mandates. Kraus and Raso point out that the proxy access rule invalidated in the Business Roundtable decision "had been expressly and contemporaneously authorized by Congress." They ask whether the real explanation for the Business Roundtable decision is that the Court of Appeals did not think that the courts' deference to agency expertise in scientific areas such as toxicology should extend to expertise in financial economics. If this is so, then the SEC's implementation of the authors' recommendation that it insist on its expertise in financial economics will be unavailing. At the same time, the more seriously the SEC addresses cost-benefit analysis as a component of rule-making, the more problematic the courts' rejections of SEC rule-making will become.

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