BETTER MARKETS
TRANSPARENCY · ACCOUNTABILITY · OVERSIGHT

February 29, 2012

The Honorable Jeffrey Zients
Acting Director
Office of Management and Budget
The White House
1650 Pennsylvania Avenue, NW
Washington, DC 20500

Re: Request from Mr. Scott O'Malia, one of five Commissioners on the Commodity Futures Trading Commission ("CFTC"), for review of cost benefit analysis in connection with several recently-approved CFTC rules.

Dear Acting Director Zients:

By letter to you dated February 23, 2012 ("Request"), Mr. Scott O'Malia, one of five CFTC Commissioners, asked the Office of Management and Budget ("OMB") to review the cost benefit analysis performed by the CFTC in connection with three rules ("Rules") recently promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The Rules were passed by a 3-2 vote and Commissioner O'Malia voted against them.

In his Request, Commissioner O'Malia asserts that the CFTC's cost benefit analysis "has failed to comply with the standards for regulatory review outlined in OMB Circular A-4, Executive Order 12,866, and President Obama's Executive Orders 13,563 and 13,579." Request at 1.

The Request lacks merit and would inject OMB into a highly contentious, ongoing legal and political dispute over the use of cost benefit analysis as a mechanism for obstructing the vitally important regulatory reforms that Congress mandated in the Dodd-Frank Act. As detailed below, Better Markets, Inc.[1] believes OMB should decline the Request:

- Because the CFTC is an independent agency, it is not subject to the standards of cost benefit analysis on which the Request is based.

- The Request is also inappropriate insofar as it seeks to enlist the aid of OMB in attacking the Rules, even though the cost benefit analysis performed by the CFTC and by other independent regulatory agencies is not subject to review by OMB.

- The Request ignores the boundary that insulates independent regulatory agencies from excessive oversight or interference from the Executive Branch, and it ignores

[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

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the Congressional prerogative to establish the procedures for issuing as well as challenging independent agency rules.

- The Request ignores the substantive standards governing cost benefit analysis that do apply to the CFTC, which Congress established in Section 15(a) of the Commodity Exchange Act ("CEA"). That statutory standard is broad and flexible, not rigid and formulaic as suggested in the Request.

- The Request ignores the single most important principle that must govern all rulemaking under the Dodd-Frank Act: the benefit of each rule must be analyzed in connection with its role in helping to prevent another financial crisis, which could inflict the same massive losses and human suffering we have witnessed since 2008, or worse.

- Finally, if the OMB were to respond to the Request from just one CFTC Commissioner who opposed the Rules unsuccessfully, it would open a Pandora's Box of requests to OMB from others seeking to re-litigate issues they were out-voted on according to the Congressionally prescribed procedures governing agency rulemaking.

Each of these points is discussed in greater detail below.

DISCUSSION

I. The standards of cost benefit analysis cited in the Request are inapplicable to independent regulatory agencies, including the CFTC. Moreover, OMB has no authority or duty to police the independent regulatory agencies, such as the CFTC, for their cost benefit analyses or to mandate alternative approaches.

Independent agencies, including the CFTC, are established by Congress to be independent from the control and direction of the Executive Branch. The rationale for this longstanding policy is to enable the independent agencies to fulfill their important statutory functions unhindered by political interference.

In recognition of this important policy, the executive orders that require agencies to conduct cost benefit analysis in their rulemaking expressly **exclude** the independent regulatory agencies. For example, President Clinton's 1993 Executive Order establishing the modern era duty to conduct cost benefit analysis, and providing for OMB's review of agency rules, expressly excludes all agencies "considered to be independent regulatory agencies." Exec. Order No. 12,866, § 3(b) (Sept. 30, 1993). OMB therefore has no authority to review the rules of the CFTC or any other independent agency on cost benefit grounds.[2] Similarly, OMB's guidance in

[2] Executive Order 12,866 only requires the independent regulatory agencies to submit a regulatory agenda and a regulatory plan to OMB, not for the purpose of policing the substance of rules, but to provide for better coordination in the issuance of federal regulations. Exec. Order No. 12,866 at § 4(b), (c).

Circular A-4, on which the Request heavily relies, does not apply to the CFTC's rulemaking process.[3]

The two more recent executive orders issued by President Obama–also relied upon in the Request—did nothing to alter these limitations or to impose any obligation on independent agencies to conduct cost benefit analysis. In fact, those orders scrupulously avoided doing so. Executive Order 13,563, issued on January 18, 2011, recapitulated the core principles in Executive Order 12,866, added some additional guidelines for the rulemaking process, and required agencies to develop a plan for retrospective rule review. However, it is directed exclusively at the executive agencies and it expressly excludes the independent regulatory agencies from its scope. Exec. Order No. 13,563, § 7 (adopting the same meaning of "agency" as set forth in Executive Order 12,866, which excludes the independent agencies).

In July of 2011, President Obama issued Executive Order 13,579. It does address the independent agencies, but it is carefully limited in two critical respects, which the Request ignores:

- First, unlike preceding orders, and in recognition of the independence of independent agencies, it uses entirely precatory rather than mandatory language, consistently replacing "shall" with "should."

- Second, although it encourages the independent agencies to follow certain specified guidelines in prior executive orders, and to conduct retrospective rule review, it excludes from that list any reference to the provisions dealing with cost benefit analysis. Exec. Order No. 13,579, § 1(c) (July 11, 2011) (encouraging independent agencies to comply with the requirements of Executive Order 13,563 on **public participation, integration and innovation, flexible approaches, and science,** but scrupulously avoiding imposition of cost benefit analysis on the independent agencies).

Removing any doubt, OMB itself plainly acknowledges that its purview does not extend to the independent regulatory agencies. In its most recent 2011 annual report to Congress on the overall benefits and costs of federal regulation, it clearly states that the regulations of the independent regulatory agencies "are not subject to OMB review under Executive Order 12,866." Office of Management and Budget, *2011 Report to Congress on the Benefits and Costs*

[3] Indeed, internal staff guidance on cost benefit considerations for final rules states, as it must, that the "Executive Order[s] **do not** govern the considerations of costs and benefits under section 15(a)." Memorandum from Dan M. Berkovitz and Andrei Kirilenko to Rulemaking Teams, U.S. Commodity Futures Trading Commission, Staff Guidance on Cost-Benefit Considerations for Final Rulemakings under the Dodd-Frank Act, at 3 (May 13, 2011) (emphasis added). Rather, "section 15(a) of the CEA sets forth the *requirements* the Commission must satisfy in considering the costs and benefits in Final Rulemakings while the Executive Order[s] offer[] *guidance* on how the teams may consider the costs and benefits." *Id.* (original emphasis). The memorandum explicitly sets forth guidance tailored to its own statutory mandate under section 15(a), which is notably different from OMB guidance in A-4, and merely suggests utilizing Executive Order principles "in a manner that is reasonable feasible and appropriate." *Id.*

of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities, at 4 ("OMB 2011 Report to Congress).[4]

Thus, the Request is inappropriate insofar as it asks the OMB not only to conduct an analysis for which it has no legal mandate, but also to apply standards that are simply not binding on the CFTC.

II. Congress has the prerogative of establishing cost benefit standards for independent regulatory agencies, as well as the procedures that must be followed to challenge rules on cost benefit grounds. Imposing Executive Branch standards and procedures on independent agencies—as suggested in the Request—threatens the independence of those agencies in violation of Constitutional principles.

It is for Congress, not the OMB, to establish (1) the substantive criteria that govern rulemaking by independent regulatory agencies, and (2) the mechanisms that Congress deems appropriate for any review or challenge to independent agency rules. This authority rests on longstanding Constitutional principles of separation of powers. The independent agencies are fundamentally creatures of Congress rather than the Executive Branch, and since 1935, the Supreme Court has recognized that their independence must be assiduously protected from undue influence by the Executive Branch. "The authority of Congress, in creating quasi-legislative or quasi-judicial agencies, to require them to act in discharge of their duties independently of executive control cannot well be doubted." *Humphrey's Executor v. United States,* 295 U.S. 602, 629 (1935) (holding that the Chairman of the Federal Trade Commission could only be removed by the President for the specific causes enumerated in the Federal Trade Commission Act).

With respect to cost benefit analysis, Congress deliberately and carefully imposes different regimes, as it deems necessary and appropriate, to achieve different Congressional objectives. In some statutes, the agency's obligation to conduct a thorough balancing of costs and benefits is explicit and prescriptive. *See, e.g.,* Flood Control Act, 42 U. S. C. § 6295 (a)(2)(D) (1976 ed., Supp. II) (requiring a balancing of enumerated benefits against enumerated costs). In some statutes, Congress imposes a rulemaking requirement that is entirely free from cost benefit analysis. *See Whitman v. Am. Trucking Ass'ns,* 531 U.S. 457, 471 (2001) (holding that section of Clear Air Act requiring EPA to set air quality standards at a level to protect the public health "unambiguously **bars** cost considerations" from the standard-setting process). And in yet other statutes, such as the CEA, discussed below, Congress imposes a limited and flexible obligation to consider costs and benefits in its rulemaking, along with other important objectives that serve the public interest. 7 U.S.C. § 19(a).

Whatever standard Congress has chosen, it is imperative that its determination be respected, as the imposition of an overly prescriptive and quantitative cost benefit analysis can easily **prevent** agencies from achieving the regulatory objectives set by Congress.

[4] Under The Regulatory Right to Know Act, OMB has a duty to provide Congress with an annual report totaling the costs and benefits of all federal rules. Pub. L. No. 106-554, § 1(a)(3), 114 Stat. 2763 (enacting § 624 of Title VI of H.R. 5658 (114 Stat. 2763A-161)), Dec. 21, 2000. But, OMB focuses on rulemakings issued by executive agencies and relies on GAO reports, issued under the Congressional Review Act, 5 U.S.C. § 801(a)(2)(A), for their brief descriptions of independent regulatory agency rules.

Even the OMB, one of the proponents of traditional cost benefit analysis, acknowledges the inherent difficulty in quantifying costs and benefits:

> Many rules have benefits or costs that cannot be quantified or monetized in light of existing information, and the aggregate estimates here [of total costs and benefits] do not capture those non-monetized benefits and costs. In fulfilling their statutory mandates, agencies must often act in the face of substantial uncertainty about the likely consequences. In some cases, quantification of various effects is highly speculative.

OMB 2011 Report to Congress, at 4.

In light of these challenges and uncertainties, which apply with full force in the context of commodity market regulation, an overly strict adherence to cost benefit analysis can plainly be used to justify regulatory inaction, or worse, reversal of regulatory action that is essential to protect the public welfare. In fact, critics of cost benefit analysis have long warned that it has been used as a "device not for producing the right kind and amount of regulation, but for diminishing the role of regulation even when it was beneficial." *See* Richard H. Pildes and Cass R. Sunstein, *Reinventing the Regulatory State,* 62 U. CHIC. L. REV. 1, 5-6 (1995). Thus, where Congress has clearly given an agency leeway in statutory language to apply a broad cost benefit standard, as in Section 15(a) of the CEA, any effort to transform that standard into something more onerous must be rejected.

The Request validates these very concerns, as it seeks to impose Executive Branch standards of cost benefit analysis on the CFTC that Congress did not in fact require or intend to impose in the governing statute. This effort not only undermines Congress's important regulatory objectives, it also violates the core principles governing the autonomy of independent regulatory agencies.

The Request is inappropriate not only from a substantive point of view, but from a procedural one as well. Just as Congress determines what standards govern rulemaking by independent agencies, it also determines the procedures that must be followed whenever those rules are challenged. Challenges to independent agency rules on cost benefit or any other grounds are to be brought in court and in accordance with the judicial review procedures set forth in the Administrative Procedure Act ("APA"). 5 U.S.C. § 706. Given that the Request plainly circumvents these procedures, it is also inappropriate for that independent reason.

This procedural irregularity has significant implications for the entire process of agency rule approval. The Request is from one of five CFTC Commissioners, who was also one of two Commissioners who voted against the Rules. The CFTC as a whole has acted pursuant to its statutory authority and there are long-standing and well-established mechanisms for challenging any such actions, as discussed above. This attempt to attack the agency both from within and by enlisting an Executive Branch agency, initiated by a single Commissioner who was on the losing side of a vote, would open up a Pandora's Box of foreseeable and unforeseeable consequences. At a minimum, it would incentivize every dissenting commissioner at any independent agency to seek OMB's help in undermining an agency decision with which they disagreed. OMB will become a battleground where both sides will have to engage if OMB allows itself to be used in

such a way. Moreover, it is only a matter of time before OMB's responses to such requests appear in court filings in litigation challenging the rules. The OMB should not allow its own mission to be commandeered in this manner, and for this reason as well, it should decline the Request.[5]

III. Congress has established a broad and flexible standard for cost benefit analysis by the CFTC, and the application of that standard to rules under the Dodd-Frank Act must account for the benefit of preventing another financial crisis.

The CFTC's duty to conduct cost benefit analysis has been defined by Congress in the CEA, and it is appropriately broad and qualitative, not narrow and quantitative as the Request suggests. Section 15(a) of the CEA directs the CFTC to consider the costs and benefits of its actions in light of five broad considerations: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations.

Moreover, the governing statute is plainly devoid of any language requiring the use of any specific methodology, any degree of quantification, any particular weighing of the five considerations, any findings that benefits exceed the costs, or any of the many other requirements that opponents of regulatory reform would wish to impose on the CFTC. This is all the more significant in light of Congress's frequent use of such statutory language to impose such additional requirements on other agencies, as set forth above. There is only one defensible conclusion: Congress intended to give and did give the CFTC broad authority to conduct the analysis as it sees fit to accomplish the very important public policy goals of the statute.

In a telling omission, the Request contains no reference whatsoever to Section 15(a). It thus erroneously focuses on Executive Branch criteria that do **not** apply to CFTC rulemakings, while ignoring the Congressionally mandated criteria that clearly **do** apply.

The Request also ignores the broad approach to cost benefit analysis that all agencies must follow when considering the costs and benefits associated with rules implementing the Dodd-Frank Act. In keeping with the broad scope of Section 15(a), any review or assessment of the CFTC's cost benefit analysis must account for the benefit that its rules will provide in helping to avoid another financial crisis. Cost benefit analysis must include not only the consequences of a rule in isolation, but also its role as part of a comprehensive regulatory framework—its cumulative impact. The intent of the Dodd-Frank Act, pursuant to which these Rules were promulgated, was **not** to repair isolated flaws in our regulatory structure, but to prevent another financial collapse by instituting a new framework that would create a more stable, transparent, and fair financial market. Each of the Rules must be evaluated in terms of its contribution to this comprehensive new system and the many trillions of dollars in costs avoided by preventing another financial crisis.

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[5] The danger posed by the Request is more than theoretical. Another CFTC rule, relating to position limits, has been challenged in court under the APA. The basis for that challenge includes the CFTC's interpretation and application of its cost benefit analysis. The Request risks placing the OMB in the position of effectively taking sides in that litigation. *See Int'l Swaps & Derivatives Ass'n v. CFTC,* 1:11-cv-2146 (RLW) (D.D.C. 2011).

The Request reflects a narrow, technical approach to cost benefit analysis that is antithetical to the more holistic view embodied in the statute. Even Commissioner O'Malia has himself implicitly recognized the need to evaluate the impact of rules on a collective basis. In his published statements issued on the same day he announced the Request, he repeatedly decries the "collective burden" and the "cumulative consequences" of regulatory requirements. *See* "Unreasonably Feeble," Opening Statement of Commissioner Scott D. O'Malia Regarding Open Meeting on One Final Rule and One Proposed Rule (Feb. 23, 2012); Statement of Commissioner Scott D. O'Malia on Re-Proposed Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades: Further Measures to Protect the Identities of Parties to Swap Transactions (Feb. 23, 2012).

But if it is appropriate to examine those alleged collective costs, then it must also be appropriate to consider the collective benefits of the entire architecture of rules designed to stabilize our financial markets and spare the American people a recurrence of the nightmare they have witnessed and suffered since 2008. In the Request, there is no hint of this essential perspective and balanced analysis, one that must be included in any meaningful evaluation of the CFTC's rules consistent with Congressional intent.

As the Chairman of the CFTC said in his opening statement at the meeting where the Rules were adopted:

"Lowering Risk and Increasing Transparency in the Economy"

> "In 2008, swaps helped concentrate risk in the financial system that spilled over into the real economy, affecting businesses and consumers across the country. Eight million Americans lost their jobs and thousands of small businesses were lost as a result of the crisis."
>
> "The derivatives reforms in the Dodd-Frank Act, once implemented, will lead to significant benefits for the real economy—that which makes up over 94 percent of private sector jobs in America. The derivatives reforms also will bring significant benefit to all Americans who depend on pension funds, mutual funds, community banks and insurance companies."
>
> "They will benefit from lowering the risk of the swaps market and increasing transparency. Today is our 24th open meeting on Dodd-Frank reforms, and we will consider rules addressing both of these goals. To lower risk, we will consider business conduct standards for swap dealers and major swap participants—what we've come to call internal business conduct. To promote greater transparency, we will consider a proposal of the block rule."

The Chairman's statements are an essential reminder that the Rules were not passed in isolation or pursuant to an isolated statute. Rather, they were mandated by the Dodd-Frank Act, a comprehensive network of reforms that were passed for one purpose: to protect the American people from suffering another financial crisis. The many consequences of that crisis are still being inflicted upon tens of millions of American families and communities across the country. The United States just barely avoided a Second Great Depression in 2008-2009. The Dodd-Frank Act was passed to make sure that never happens again, but the attainment of that goal will

depend on the law being implemented as intended by the independent agencies Congress has empowered to carry out its mandates.

CONCLUSION

For all of the reasons set forth above, OMB should decline the Request to pass judgment on the cost benefit analysis conducted by the CFTC in connection with the now final Rules.

Sincerely,

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cc: Chairman and Commissioners of CFTC