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Financial regulation sans analysis

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The financial crisis destroyed trillions of dollars of wealth, yet federal regulators are implementing the 2010 Dodd-Frank law, intended to prevent the next crisis, with virtually no quantitative economic analysis.

Independent regulatory agencies are busy issuing hundreds of rules — without flagging for the public which could have major effects on the economy, let alone providing a meaningful assessment of real economic effects. Without this, the most important and costly proposals cannot get the careful attention they deserve by stakeholders and Congress. More important, without proper assessments, they could end up doing more harm than good.

A federal court last year found that the Securities and Exchange Commission analysis of the benefits and costs of a new regulation was inadequate. Industry groups are suing other agencies on similar grounds. But they shouldn't have to.

The "Volcker rule"— the proposal that would restrict banks' proprietary trading and ownership of certain

interests in private-equity funds — illustrates the need for a proper economic assessment.

Regulatory agencies have proposed regulations to implement this rule, but without benefit-cost analysis or any economic analysis of regulatory alternatives. JPMorgan's recent loss of more than $2 billion has sparked further public debate about these regulations. But the conversation is not informed by any meaningful economic analysis by government regulators.

Agency practices violate the spirit if not the letter of the Congressional Review Act — which designates a rule as "major" if it has an annual economic effect of at least $100 million and gives Congress a fast-track option to reject such rules. Independent financial regulatory agencies, according to the Office of Management and Budget, issued 15 "major" regulations in fiscal 2011. No agency, however, offered any explanation for the designation and just one rule making included a statement that it was major.

These major rules generally offer only a sketchy, qualitative economic analysis. None provided a quantitative estimate of the rule's benefits; only two provided any cost estimates beyond extra paperwork costs. The Government Accountability Office and the

Committee on Capital Markets Regulation report similar results.

In contrast, executive branch agencies overseen by the Office of Management and Budget recently issued nine “major” financial rules and all included a discussion of why specific rules had effects over the $100 million threshold. Eight of these provided a substantive, quantitative discussion of their costs and benefits.

Thorough cost-benefit analysis can strengthen public confidence in the resulting rules. A preliminary analysis of economic impacts helps distinguish major rules — those meriting more detailed analysis — from less significant regulations. It can promote data-driven rule making and enhance the accountability of regulators.

Such analysis also provides a credible, transparent evaluation of whether a regulation improves the operation of financial markets.

There’s no evidence that economic analysis of Dodd-Frank Act implementation has improved since President Barack Obama issued his July 2011 Executive Order Improving Regulation and Independent Regulatory Review. Only two of the bill’s 26 final rules issued in the six months ending April 1

— one by the National Credit Union Administration and one by the Federal Deposit Insurance Corp. — provide any discussion of the “major” rule determination. None has a quantitative discussion of benefits, while only two look into costs beyond those tied to paperwork.

In addition, the SEC and the Commodity Futures Trading Commission use the Dodd-Frank provisions as the baseline for analysis, arguing that there are no benefits or costs if they simply implement the statute. With this reasoning, many rules would not be considered “major.”

This contrasts with OMB’s standard practice of a pre-statute baseline — comparing economic effects to a status quo policy. Imagine the reactions from across the political spectrum, for example, 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!

Stakeholders should not have to rely on federal courts to ensure that financial regulators provide thorough analysis when requiring major rule changes governing financial markets. The Congressional Review Act gives OMB the responsibility of determining whether a rule is considered major for the executive branch

agencies.

The budget office must now establish regular and formal consultations with all the independent financial regulatory agencies to ensure reasoned and consistent determinations as to whether their regulations are “major.”

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