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# COMMENT: THE OIRA MODEL FOR INSTITUTIONALIZING CBA OF FINANCIAL REGULATION

RYAN BUBB\*

This comment is a brief response to the stimulating articles by Professors Coates<sup>1</sup> and Cox<sup>2</sup> in this volume. In responding, I follow an important analytic distinction that Coates makes that is critical for understanding the issues. One important issue in financial regulation is what *analytic framework and decision procedure* we want regulators to apply in setting policy. Given some resolution of this first issue, a second analytically distinct issue is what *institutional framework of administrative decisionmaking* will best bring about the application by regulators of our preferred analytic approach and decision procedure for financial regulation.<sup>3</sup>

Beginning with the first issue, both Coates and Cox largely agree that policy decisions about financial regulation should be made using what Coates refers to as “conceptual cost-benefit analysis (CBA).”<sup>4</sup> By conceptual CBA, Coates simply means standard economic analysis of policy, in which the analyst (1) specifies the problem the regulation aims to solve, (2) identifies and, when possible, measures the costs and benefits of a range of regulatory options, and (3) chooses the option that best optimizes the tradeoff between the costs and benefits.<sup>5</sup> As Coates puts it, CBA “remains the best available overarching

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\* Professor of Law, New York University School of Law.

1. John C. Coates IV, *Towards Better Cost-Benefit Analysis: An Essay on Regulatory Management*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 [hereinafter Coates, *Towards Better Cost-Benefit Analysis*] at 1. Coates’s article in this volume is a part of a larger project on cost-benefit analysis in financial regulation to which this comment is also responsive. John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882 (2015) [hereinafter Coates, *Cost-Benefit Analysis of Financial Regulation*].

2. James D. Cox, *Regulating Securities Markets after Business Roundtable*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 25.

3. Coates, *Towards Better Cost-Benefit Analysis*, *supra* note 1, at 2; Coates, *Cost-Benefit Analysis of Financial Regulation*, *supra* note 1, at 5–6. Coates uses different terminology than I use here, referring to the first issue of how regulatory decisions are made as “policy,” and the second issue of institutional design as “law.” *Id.* Professor Robert Bartlett provides an illuminating analysis of the various institutional frameworks that are currently used for CBA of financial regulation. See Robert Bartlett, *The Institutional Framework for Cost Benefit Analysis in Financial Regulation: A Tale of Four Paradigms?*, 43 J. LEGAL STUD. S379 (2014).

4. Coates, *Towards Better Cost-Benefit Analysis*, *supra* note 1, at 2–5; Cox, *supra* note 2, at 31 (“[A] close assessment of the costs and benefits matter a good deal in the sound formulation of policy.”).

5. Coates, *Cost-Benefit Analysis of Financial Regulation*, *supra* note 1, at 5–6.

conceptual framework for organizing and communicating the pros and cons of a proposed regulation.”<sup>6</sup> Amen to that.

Many objections to CBA of financial regulation that have been offered in the literature are not really objections to conceptual CBA as a decision procedure, but rather are objections to particularly stilted forms of CBA<sup>7</sup> or are objections to particular institutional mechanisms for bringing about some form of CBA.<sup>8</sup> An important contribution of Coates’s work is to clarify the terms of this debate. Virtually everyone engaged in the debate over CBA of financial regulation supports conceptual CBA as an analytic framework for financial regulation.

Relatedly, both Coates and Cox urge more experimentation, incrementalism, and retrospective review in financial regulation as ways to produce better information to guide regulatory policy.<sup>9</sup> Such methodological innovations are undoubtedly long overdue, and not just in financial regulation but in many policy domains.

Nonetheless, both articles express some skepticism about *quantified* CBA in financial regulation. Coates’s skepticism stems in part from a set of detailed case studies of how one might do quantified CBA in financial regulation, from which he concludes that “precise, reliable, quantified CBA remains unfeasible.”<sup>10</sup> If quantification is exceedingly difficult, then a norm requiring that costs and benefits be quantified might slow down or even paralyze the regulatory process. It might also simply serve to camouflage the agency’s discretionary choices by hiding them under “impressive numbers.”<sup>11</sup> Cox raises the related concern that it is often easier to quantify the costs of financial regulation than to quantify the benefits.<sup>12</sup> If so, then quantified CBA might systematically lead to too little regulation. So their objections to quantified CBA might stem in part from a concern that calls for quantified CBA of financial regulation may be little more than thinly veiled attempts by those opposed to financial regulation to gum up the regulatory works.<sup>13</sup>

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6. Coates, *Towards Better Cost-Benefit Analysis*, *supra* note 1, at 5.

7. For example, Professor Jeffrey Gordon argues that applying CBA to financial regulation is a “category mistake” because the financial system is a “constructed system” whereas CBA was developed for “natural systems” like the environment. Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351, S352 (2014). However, his criticism boils down to a concern that it is hard to quantify the benefits and costs of financial regulation, and hence his objection seems to be to a particular form of quantified CBA, not to conceptual CBA. *See id.* at 6 (“[S]econd order effects make the benefits and costs of rule adoption impossible to quantify in a meaningful way” and hence CBA “will encourage a myopic focus on what is measurable in a time frame in which they can be measured.”).

8. *See, e.g.*, Coates, *Cost-Benefit Analysis of Financial Regulation*, *supra* note 1, at 90–91.

9. Coates, *Towards Better Cost-Benefit Analysis*, *supra* note 1, at 11–23; Cox, *supra* note 2, at 35–44.

10. Coates, *Cost-Benefit Analysis of Financial Regulation*, *supra* note 1, at 95.

11. *Id.* at 92.

12. Cox, *supra* note 2, at 29–31.

13. Hence Coates refers to “interest groups seeking to delay [new financial regulations]” as among the supporters of cost-benefit analysis for financial regulation. Coates, *Towards Better Cost-Benefit*

Although those concerns about quantified CBA are well taken, they are a bit overstated. Coates observes that he has yet to find a single example of a “reliable, precise, quantified” CBA of a significant financial regulation, despite significant efforts to identify one.<sup>14</sup> This lack of quantitative CBA of financial regulation stands in stark contrast to many other regulatory domains in which highly sophisticated, quantitative CBA plays a central role, including environmental, health, safety, and antitrust regulation. Why is financial regulation such an outlier with relatively little CBA? Coates’s explanation is that CBA of financial regulation is “an order of magnitude more difficult than its advocates seem to believe.”<sup>15</sup>

But relative difficulty of doing CBA in financial regulation seems an unlikely explanation for its paucity. CBA in financial regulation is undoubtedly difficult, for reasons both Coates and Cox adduce. But it is no more difficult—indeed, it might be less difficult—than it is in many other domains in which it plays a central role.<sup>16</sup>

Consider, for example, climate policy. One of the most rewarding projects I worked on in my time at the Office of Information and Regulatory Affairs (OIRA) prior to entering the legal academy was an interagency effort to quantify the social cost of carbon for use in CBA of rules affecting greenhouse-gas emissions.<sup>17</sup> The uncertainties and complexities entailed by the effort were in the extreme. To give just a taste, consider this: A substantial portion of the estimated present value of the benefits of reducing greenhouse-gas emissions today stems from resulting reductions in harm from global warming two-hundred years from now.<sup>18</sup> What will society look like in the year 2214? The uncertainties are legion. But the interagency working group forged on and produced a range of quantitative estimates that are now being used to inform policymaking.<sup>19</sup> Is quantified CBA of financial regulation really more challenging than quantified CBA of climate policy? I think the answer is no.

An alternative explanation for the varying role of CBA across regulatory domains leads to the second analytic issue: how best to institutionalize CBA as a decision procedure. A key institutional impetus for the adoption of CBA in

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*Analysis, supra* note 1, at 1.

14. Coates, *Towards Better Cost-Benefit Analysis*, *supra* note 1, at 10.

15. *Id.* at 3; Coates, *Cost-Benefit Analysis of Financial Regulation*, *supra* note 1, at 88.

16. Eric A. Posner & E. Glen Weyl, *Benefit-Cost Paradigms in Financial Regulation* 11 (Coase-Sandor Inst. for Law & Econ., Working Paper No. 660, 2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2346466](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346466) (arguing that quantification may in fact be easier in financial regulation than in other domains).

17. Interagency Working Group on Social Cost of Carbon, Technical Support Document—Social Cost of Carbon for Regulatory Impact Analysis—Under Executive Order 12866 (2010), available at <http://www.epa.gov/oms/climate/regulations/scc-tds.pdf>.

18. *Id.* at 25.

19. The social cost of carbon was estimated in order to allow agencies to incorporate the social benefits from reduced climate change in regulations that would have a “marginal” effect on global emissions. *Id.* at 1. For an example of its use, see Energy Conservation Standards for Refrigerated Bottled or Canned Beverage Vending Machines, 10 C.F.R. § 431 (Aug. 31, 2009).

environmental, health, and safety regulation was the imposition of centralized regulatory review. A series of executive orders required executive agencies both to conduct CBA and to submit their significant rules and accompanying analysis for review by OIRA prior to publishing them in the Federal Register.<sup>20</sup> Faced with an external reviewer that held a quasi-veto right over their most important regulations, executive agencies invested in analytic capacity for generating sophisticated, quantitative CBA to guide policymaking.<sup>21</sup>

In contrast, with the limited historical exception of the Office of the Comptroller of the Currency,<sup>22</sup> financial regulatory agencies are independent agencies outside the scope of the executive orders mandating CBA and centralized regulatory review.<sup>23</sup> CBA plays little role in financial regulation not because it is especially challenging but rather because institutional structures do not produce incentives for financial regulators to develop and employ CBA.

The historical development of CBA in other regulatory domains thus provides useful lessons for institutional reforms to improve CBA in financial regulation. Consider in particular the adoption of CBA at the Environmental Protection Agency (EPA). When President Nixon created the EPA in 1970, it was staffed by political appointees and civil servants committed to its environmental protection mission and highly motivated to issue new regulations to protect the environment.<sup>24</sup> But parallel to the inception of a mission-oriented EPA was the emergence of centralized regulatory review and the requirement that the agency, when not prohibited by statute, use CBA. Centralized regulatory review is often dated back to an executive order issued by President Reagan in 1981 that formalized the process,<sup>25</sup> but the practice predates that executive order by a decade. The EPA and the regulatory reviewers at the Office of Management and Budget (OMB) came into conflict shortly after the EPA was created,<sup>26</sup> and that conflict between the EPA and OMB (specifically OIRA, the subunit of OMB now tasked with regulatory review) has continued across presidential administrations and remains today.<sup>27</sup>

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20. Exec. Order No. 13,563, 3 C.F.R. 14 (2011); Exec. Order No. 12,866, 3 C.F.R. 190 (1993); Exec. Order No. 12,291, 3 C.F.R. 127 (1981).

21. See Michael Livermore, *Cost-Benefit Analysis and Agency Independence*, 81 U. CHI. L. REV. 609 (2014) (explaining that the imposition of OIRA review led the EPA to develop expertise in CBA of environmental regulation).

22. Housed within an executive-branch agency, the Office of the Comptroller of the Currency was subject to OIRA review under Executive Order 12,866 until it was specifically exempted from OIRA review by the 2010 Dodd-Frank Act. See Bartlett, *supra* note 3, at §381.

23. *Id.*

24. See Ryan Bubb & Patrick Warren, *Optimal Agency Bias and Regulatory Review*, 43 J. LEGAL STUD. 95, 128 (2014).

25. Exec. Order No. 12,291, 3 C.F.R. 127 (1981).

26. See ALFRED A. MARCUS, *PROMISE AND PERFORMANCE: CHOOSING AND IMPLEMENTING AN ENVIRONMENTAL POLICY* 125 (1980) (describing how the OMB forced the EPA to submit its regulations for review beginning in 1971).

27. For example, Cass Sunstein, the first Administrator of OIRA in the Obama administration, returned the EPA's proposal to regulate ozone more stringently, explaining that the president had "instructed [him] to give careful scrutiny to all regulations that impose significant costs on the private

In response to both the executive-branch norm that the agency use CBA, and to the conflict between the EPA and bureaucrats at OIRA who passed judgment on the quality of its CBA and on its proposed rules, the EPA developed substantial analytic capacity, both in house and in a network of government contractors.<sup>28</sup> And the mission orientation of the EPA staff helped mitigate potential ossification of the agency's regulatory process produced by regulatory review. Today it is not unusual for significant rules issued by the EPA to be accompanied by many hundreds of pages of supporting analytic materials.<sup>29</sup> The creative tension within the executive branch between the EPA and OIRA has produced more and better information and analysis for regulatory decisionmaking.<sup>30</sup> For example, when the interagency effort to quantify the social cost of carbon was initiated, the working group was able to rely on substantial in-house expertise at EPA on the relevant economic models of climate change.

This history suggests a similar approach could be successful in institutionalizing CBA of financial regulation. A norm requiring conceptual (and, when possible, quantified) CBA in financial regulation should be established. To provide meaningful incentives for the financial regulatory agencies to implement that norm, the agencies' rules and accompanying CBA should be subject to review by a body external to the agencies.<sup>31</sup> That review process should be given teeth by authorizing the reviewing body to reject rules that lack a sound policy basis or for which the costs and benefits have not been identified and quantified to the extent feasible. A clearer sense of mission in each agency should be institutionalized to combat any increased risk of ossification in the regulatory process.

Which brings me to the infamous *Business Roundtable* decision.<sup>32</sup> Coates and Cox are each vociferous critics of the decision on both legal and functional grounds,<sup>33</sup> and their articles share a common theme that courts should play a limited role in reviewing agency CBA.

An additional reason for skepticism about judicial review of CBA relates to

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sector" and "does not support finalizing the rule at this time." Letter from Cass Sunstein, Adm'r, Office of Info. and Regulatory Affairs, to Lisa Jackson, Adm'r, EPA (Sept. 2, 2011), available at [http://www.whitehouse.gov/sites/default/files/ozone\\_national\\_ambient\\_air\\_quality\\_standards\\_letter.pdf](http://www.whitehouse.gov/sites/default/files/ozone_national_ambient_air_quality_standards_letter.pdf).

28. Livermore, *supra* note 21.

29. For example, the regulatory impact analysis for the EPA's recent Clean Power Plan proposed rule ran some 376 pages. *Regulatory Impact Analysis for the Proposed Carbon Pollution Guidelines for Existing Power Plants and Emission Standards for Modified and Reconstructed Power Plants*, EPA, available at <http://www.epa.gov/ttn/ecas/regdata/RIAs/111dproposalRIAFinal0602.pdf>.

30. Bubb & Warren, *supra* note 24, at 127–30.

31. Professor Bartlett similarly advocates for a form of intra-executive branch review of financial regulatory agencies' CBA in order to improve the use of CBA in financial regulation. See Bartlett, *supra* note 3, at S399–S403. However, he envisions a weaker form of review than proposed here, emphasizing the desirability of an "effectively unenforceable obligation" for financial agencies to use CBA. *Id.* at S382.

32. *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

33. Coates, *Cost-Benefit Analysis of Financial Regulation*, *supra* note 1, at 28–29; Cox, *supra* note 2, at 27–31.

one of Coates's important big-picture points: that institutionalizing CBA is largely a challenge of management. One of the reasons OIRA was so successful in spurring the development of analytic capacity at the EPA and other executive agencies is that it collaborated with the agencies in both developing cost-benefit methodology and in incorporating the outputs of CBA into agencies' proposed rules. When the EPA submits a proposed rule and accompanying analysis to OIRA for review, the result is not an adversarial hearing but rather a series of conference calls and meetings. Policy analysts at the EPA and at OIRA, as well as at other relevant agencies, informally work through the analytical issues together. What emerges is a substantially improved work product. Judicial review is ill-suited to replicating this type of organizational process.

The *Business Roundtable* decision, however, has shaped the debate over CBA in financial regulation in an unfortunate way. The choice seems to be framed as either (1) having judges on the D.C. Circuit using some form of CBA legal requirement to routinely reject rules they deem lacking, or (2) simply hoping that despite the lack of any substantial institutional reform, agencies will start investing in needed analytic capacity for CBA and seriously employing it in their decisionmaking. For example, Coates writes that "new legal mandates for [CBA] . . . would be a bad idea" and that instead "[CBA] should be conducted only to the extent and in the manner the expert agencies choose to do so."<sup>34</sup>

But there are options for institutionalizing CBA in financial regulation other than legal mandates subject to judicial review, à la *Business Roundtable*, or complete agency autonomy. In particular, a CBA and regulatory-review regime for the independent financial regulatory agencies could be fashioned along the lines of OIRA review. The OIRA model has been a substantial success in other regulatory domains, and there is no reason why that model could not be similarly successful in financial regulation.

Notably, Coates's skepticism about the feasibility of quantification in financial regulation in particular is not an objection to applying to financial regulation CBA as it is practiced in the executive agencies under OIRA's supervision. Executive Order 12,866 mandates quantification only when feasible,<sup>35</sup> and agencies subject to it routinely do not quantify benefits and costs of rules.<sup>36</sup>

There are of course numerous legal and institutional challenges to developing an OIRA-type regime for financial regulation. Perhaps most importantly, it is not clear how compatible OIRA review is with the various ways that independent agencies are, well, independent. When I was at OIRA, the staff at the agencies listened to me, at least some of the time. Although I

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34. Coates, *Cost-Benefit Analysis of Financial Regulation*, *supra* note 1, at 91.

35. Exec. Order No. 12,866, 3 C.F.R. 190, § 6(a)(3)(C) (1994).

36. See Cass Sunstein, *The Limits of Quantification*, 102 CAL. L. REV. 1369, 1370-71 (explaining that executive agencies are frequently unable to quantify the benefits or costs of their rules).

would like to think that was because of the ineluctable logic of many of my arguments, I suspect that where I sat in the org chart was often more important. If the agency staff and I could not resolve an issue, it was elevated to the administrator of OIRA and the relevant senior political appointee at the promulgating agency to resolve. Failing their agreement, it went up the chain in the White House, and ultimately the President was indeed “the decider.”

The chain of command in independent agencies does not run to the White House. Accordingly, OIRA itself might not be the right institution to play the role of external reviewer, at least not without more far-reaching reforms to the governance of the financial agencies.<sup>37</sup> The devil is surely in these implementation details, but this sort of challenge seems to me to be eminently solvable. And I would encourage critics of judicial review of CBA, like Professors Coates and Cox, to consider seriously such an intraexecutive branch solution to institutionalizing CBA for financial regulation.

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37. Bartlett, *supra* note 3, at 12–13.

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