

**UPDATE: RECENT TRENDS IN THE LAW GOVERNING  
COST-BENEFIT ANALYSIS BY THE SECURITIES AND EXCHANGE COMMISSION**

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**Better Markets, Inc.**

**INTRODUCTION**

Decades ago, the United States Supreme Court and the lower federal courts established the basic principles governing judicial review of agency rulemaking under the Administrative Procedure Act. Those decisions repeatedly held that courts generally owe a high level of deference to agency expertise and judgment. And with respect to economic analysis, those precedents also held that courts must adhere to the actual requirements that Congress has imposed on an agency under its “organic statute,” whether it be (1) cost-benefit analysis; (2) something more limited, such as the duty merely to consider certain economic factors; or (3) in some cases, language prohibiting an agency from allowing the costs and benefits of regulation to influence the way an agency crafts its rules.

Unfortunately, from 2005 to 2011, the D.C. Circuit issued a series of opinions striking down several SEC rules based largely on what the court perceived as deficiencies in the SEC’s economic analysis for each rule. In reality, as discussed below, those opinions ignored or misread the actual text of the securities laws, the precedents limiting the scope of an agency’s duty simply to “consider” certain factors, and well-established principles of judicial deference to agency judgment. The court went so far as to impose a far-reaching duty on the SEC to determine the economic consequences of its rules, to quantify costs and benefits, and to assess whether a rule would confer a “net benefit.”

These cases ushered in a new era at the SEC, prompting it to undertake increasingly extensive cost-benefit analyses in its rulemakings, even though the securities laws impose no such requirement. This approach has taken a toll on the SEC’s rulemaking output. The agency has spent a huge portion of its budget expanding its pool of economists; the pace of its rulemaking has slowed; and some final rules appear to reflect the weaknesses born, at least in part, of concern that rules will be challenged in court.

In 2012, Better Markets issued a report highlighting the financial industry’s use of cost-benefit analysis to weaken and impede regulation in general and at the SEC in particular, detailing the legal and policy arguments against cost-benefit analysis and calling upon the SEC to change its approach.<sup>1</sup> Now, five years later, we revisit these issues and renew our call for change by the

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<sup>1</sup> BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC (July 30, 2012), *available at* <https://bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf>.

SEC, bolstered by new trends in the courts and new thinking among some academics regarding cost-benefit analysis. Recently, for example, panels of the D.C. Circuit, along with some district court judges, have signaled a welcome return to the basic canons of deference to agency judgment and fidelity to legislative text when deciding whether an agency rule should be upheld against an attack on its economic analysis. In addition, some academics have argued that cost-benefit analysis is either impossible or inappropriate in the context of financial regulation.

In the following sections of this update, we briefly review some of the basic truths about the flaws in cost-benefit analysis, and we canvass some of the most important recent developments in this area of financial regulation, highlighting these points:

- Cost-benefit analysis is an inherently appealing notion at first blush, but in reality, it represents an unreliable, biased, counterproductive, and even dangerous threat to the financial regulations we need to protect the stability of our financial system, prevent another crisis, and contain the fraud and abuse that continue to victimize investors and consumers.
- On the Hill, attempts to impose exhaustive cost-benefit analysis requirements on all regulatory agencies have continued unabated since the passage of the Dodd-Frank Act. So far, fortunately, they have not succeeded.
- In the courts, recent decisions reflect for the most part a welcome return to core principles, including, for example, that agencies are not required to perform cost-benefit analysis unless Congress has clearly and expressly said so—something it has not done with respect to the financial regulators, including the SEC.
- In the Administration, while President Trump has issued numerous executive orders and memoranda aimed at tearing down valuable financial regulations, the basic principle articulated in prior executive orders on cost-benefit analysis (including notably E.O. 12866) remains intact: The independent regulatory agencies are not subject to the cost-benefit analysis requirements set forth in those orders.
- Although the trend among academics is not uniform, a number of prominent thinkers have recently concluded that cost-benefit analysis cannot reasonably be applied to financial regulation.
- The SEC should take into account all of these developments as it continues to consider the role of economic analysis in its rulemaking process, and as we argued previously, it should scale back its commitment to conducting more detailed cost-benefit analysis than the law requires.

## ANALYSIS

### **I. Why cost-benefit analysis is such an appealing weapon for those in industry who seek to delay, weaken, or strike down financial regulation.**

Insisting on the application of rigid, quantitative cost-benefit analysis requirements to proposed financial regulations has proven to be an effective tactic that Wall Street and its allies use in their unremitting fight against financial reform. This tactic owes some of its success to the fact that “cost-benefit analysis” sounds like the type of exercise that no thoughtful person would oppose. The very phrase has a superficial appeal, as it connotes rigorous comparative scrutiny grounded in precise economic calculations, supposedly all in the quest for sound regulatory policy.

In fact, the opposite is closer to the truth. The costs and benefits of proposed financial regulations are inherently resistant to accurate quantification and numerical comparative evaluation. Attempting to subject such regulations to rigid, quantitative cost-benefit analysis suffers from multiple problems, as explained below, which undermine rather than promote the public interest.

At best, quantitative cost-benefit analysis of financial regulation is intrinsically biased against the public interest and in favor of leniency toward regulated industries. And it is highly assumption-sensitive, dependent on the exercise of immense discretion, and ultimately imprecise and unreliable. At worst, quantitative cost-benefit analysis requirements serve as a Trojan Horse for Wall Street and its allies to wage war against regulation under the guise of advocating objective economic analysis. Indeed, opponents of financial reform have chosen this front on which to wage battle precisely because “cost-benefit analysis” sounds like a neutral and unobjectionable instrument for developing public policy.

### **II. Why cost-benefit analysis is so unreliable and potentially harmful.**

Cost-benefit analysis is flawed for multiple reasons. In summary:

- Cost-benefit analysis is inherently unreliable, as it depends on imprecise assumptions, predictions, and quantifications that are extremely difficult to make with accuracy. One of the most challenging variables in the exercise is trying to predict how the industry will react and adapt to a rule. That difficult assessment largely determines how costly a rule will prove to be for industry and how effective it will prove to be in conferring benefits on financial markets and investors.
- Compounding the problem, reliable data on which to base cost-benefit analysis is often accessible only to the regulated firms and not to the agency attempting to promulgate a rule. Moreover, when the regulated firms do decide to share their data with regulators, they often do so selectively, thus undermining the accuracy of any resulting analysis and skewing it in favor of the industry’s perspective.

- Cost-benefit analysis is inherently biased in favor of the regulated industry, since costs of compliance and other costs borne by the industry are generally much easier to quantify in dollar terms than the benefits of regulations, which have a comparatively larger non-monetary component. For example, a rule that aims to reduce fraud and manipulation in the securities markets promises cascading benefits, well beyond preventing the monetary losses arising from fraud. These other benefits include greater investor confidence, leading to more robust financial markets, greater economic growth, and overall prosperity. In addition, preventing fraud and abuse confers incalculable benefits in terms of reducing the human anguish that comes with victimization and financial loss.
- Cost-benefit analysis is myopically focused on the costs and benefits of individual rules, typically ignoring the need to assess the value of rules holistically, each one serving as part of a collection of rules that work together in preventing extremely damaging and large-scale disruptions and failures in the financial markets. The financial crisis of 2008 will ultimately cost \$20 trillion in lost economic productivity, not to mention the enormous human suffering it spawned.<sup>2</sup> Many financial regulations are instrumental in helping to prevent such crises, yet that aspect of their value is routinely ignored or underweighted.
- Cost-benefit analysis is extremely time-consuming and costly, draining off scarce agency resources and protracting the rule-making process. A prime example is the SEC's decision some years ago to vastly expand the pool of economists on staff, in an attempt to produce more accurate cost-benefit analysis, at great expense to the agency.
- Cost-benefit analysis can put an agency in the untenable position of second-guessing value judgments that Congress has already made, especially if the rulemaking process is mandatory, not discretionary.
- Cost-benefit analysis makes rules more vulnerable to successful legal challenge in court. This is evident from the now-routine and often successful use of cost-benefit analysis as a basis on which to attack rules in court. Those court challenges not only threaten to invalidate important rules, they also further consume agency resources in the litigation process.
- Finally, cost-benefit analysis is dilutive, since the threat of legal challenge induces regulators to compromise or weaken the provisions of a given rule, not because those alterations will better serve the public interest, but because they may make the rule less likely to draw a successful court challenge.

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<sup>2</sup> See, e.g., BETTER MARKETS, THE COST OF THE CRISIS - \$20 TRILLION AND COUNTING (July 2015), <https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis-2.pdf>.

**III. The constant stream of legislative proposals to impose more onerous cost-benefit analysis requirements on agencies, particularly the independent agencies.**

Since the Dodd-Frank Act was signed into law in July of 2010, a steady stream of legislative proposals has emerged that would impose burdensome new cost-benefit analysis requirements on the SEC and other independent agencies. The timing of these bills was hardly coincidental, coming on the heels of the Dodd-Frank Act, which required financial regulatory agencies to produce hundreds of new rules. Included among those proposals were these:

- Congressional Office of Regulatory Analysis Creation and Sunset and Review Act of 2011<sup>3</sup>
- SEC Regulatory Accountability Act (2012)<sup>4</sup>
- SEC Regulatory Accountability Act (2013) (re-proposed)<sup>5</sup>
- Independent Agency Regulatory Analysis Act (2013)<sup>6</sup>
- Regulatory Sunset and Review Act of 2013<sup>7</sup>
- Unfunded Mandates Information and Transparency Act of 2014<sup>8</sup>

For example, the SEC Regulatory Accountability Act would require the agency to conduct a searching, quantitative cost-benefit analysis for every new rule. It would also mandate that the SEC identify every “available alternative” to a proposed agency action.<sup>9</sup> Given that “available alternatives” to any proposed action abound, this requirement would impose a crushing analytical burden on the agency.<sup>10</sup> The Act also would require several other new assessments of the effects of a rule on liquidity, investor choice, “market participants,” state and local governments, and small businesses—all of which effectively command the SEC to consider the costs of regulation without a corresponding analysis of the benefits.<sup>11</sup> Further, any questions concerning the SEC’s compliance with these new analytical requirements would render new rules more vulnerable to legal challenge.

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<sup>3</sup> H.R. 214, 112th Cong. (2011).

<sup>4</sup> S. 3468, 112th Cong. (2012).

<sup>5</sup> H.R. 1062, 113th Cong. (2013).

<sup>6</sup> S. 1173 113th Cong. (2013).

<sup>7</sup> H.R. 309, 113th Cong. (2013).

<sup>8</sup> H.R. 899, 113th Cong. (2014).

<sup>9</sup> *Id.* at § 2.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

An even more draconian set of cost-benefit analysis burdens has been proposed in Title III of the CHOICE Act 2.0, which passed the House on June 8, 2017.<sup>12</sup> Just a sampling of its provisions includes these requirements in the rulemaking process:

- An extraordinarily long list of newly required analytical steps, such as an identification of the need for the rule; an explanation as to why state, local, or tribal governments should not handle the problem; an analysis of the adverse impact on regulated entities, all market participants, and the economy; a quantitative and qualitative assessment of all anticipated costs and benefits of the rule; an evaluation of the costs to state, local, or tribal governments; an identification of available alternatives to the regulation; an explanation of how the burden of regulation will be distributed among market participants; an assessment of the extent to which the regulation is inconsistent, incompatible, or duplicative with existing regulations; a description of any studies, surveys, or other data relied upon in preparing the analysis; and a prediction of changes in market structure, infrastructure, and the behavior of market participants in response to the rule;<sup>13</sup>
- Retrospective review of all rules within one year and every five years thereafter, followed by mandatory reports on ways to simplify rules;<sup>14</sup>
- Expanded opportunities for challenging rules in court by any affected person;<sup>15</sup>
- Congressional approval for all major rules;<sup>16</sup> and
- De novo judicial review of all questions of law raised in a rule challenge, thus eliminating the long-standing *Chevron* doctrine that requires courts to defer to agency judgments where they are interpreting a statutory provision with some degree of ambiguity.<sup>17</sup>

Any agency subject to these impossibly burdensome requirements would be virtually unable to promulgate new rules, and any rules that did emerge from an agency would be easy targets for successful challenge in court. That of course, is the anti-regulatory intent behind these and similar statutory provisions. Fortunately, to date, these suffocating new rulemaking requirements have not emerged from Congress.

#### **IV. Trends in the courts.**

Allegations that an agency failed to conduct an adequate cost-benefit analysis are now a staple of court challenges to financial regulations. The push in the courts for judicially

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<sup>12</sup> H.R. 10, 115th Cong. (2017).

<sup>13</sup> *Id.* at § 312.

<sup>14</sup> *Id.* at § 315.

<sup>15</sup> *Id.* at § 317.

<sup>16</sup> *Id.* at § 332.

<sup>17</sup> *Id.* at § 341.

enforceable, quantitative cost-benefit analysis has been effective in many instances. The anti-reform movement reached a high point with the D.C. Circuit's opinion in *Business Roundtable v. SEC*,<sup>18</sup> striking down the SEC's proposed proxy access rule. Another more recently successful deployment of cost-benefit analysis appeared last year's decision in *Metlife v. Financial Stability Oversight Council*.<sup>19</sup> These and other cases are discussed below.

A. Earlier decisions where courts used cost-benefit analysis to strike down rules

Starting in the early- to mid-2000s, financial trade organizations initiated an aggressive series of rule challenges in court under the Administrative Procedure Act and applicable "organic statutes." One of the most significant early wins came in a 2005 case where the Chamber of Commerce sued the SEC to challenge its rule designed to promote better corporate governance in mutual funds.<sup>20</sup> There the D.C. Circuit held that the narrow statutory duty to consider whether a rule will promote efficiency, competition, and capital formation actually calls upon the SEC to conduct a much broader analysis and to "determine as best it can the economic implications of the rule."<sup>21</sup> The court ruled that the SEC's failure to quantify and analyze the costs of the conditions it was imposing under the rule ran afoul of this obligation. In effect, the court read statutory language commanding an agency to consider a rule's potential effects on discrete factors to mean that the agency was required to perform a broad cost-benefit analysis of the rule.

In the years following *Chamber of Commerce*, the D.C. Circuit continued to strike down major financial rules, in some cases relying explicitly on the agency's alleged failure to conduct an adequate cost-benefit analysis. For example, in *American Equity*, the D.C. Circuit vacated an SEC rule providing that fixed indexed annuities were not exempt from securities regulation, concluding that the SEC's consideration of the effect of the proposed rule on efficiency, competition, and capital formation was insufficient.<sup>22</sup>

Challenges to financial regulatory authority and well-established principles of judicial deference to the expert judgment of regulators arguably reached their peak in the 2011 case *Business Roundtable v. SEC*. The D.C. Circuit struck down a proposed rule requiring companies to provide information about, and the right to vote for, board nominees chosen by large shareholders rather than just those board nominees chosen by an incumbent board of directors. Although the SEC included a detailed cost-benefit analysis in its proposed rule, the D.C. Circuit nonetheless vacated the rule "for having failed once again . . . adequately to assess the economic effects of a new rule."<sup>23</sup>

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<sup>18</sup> 647 F.3d 1144 (D.C. Cir. 2011).

<sup>19</sup> 177 F. Supp. 3d 219 (D.D.C. 2016).

<sup>20</sup> See *Chamber of Commerce v. Sec. & Exch. Comm'n.*, 412 F.3d 133 (D.C. Cir. 2005).

<sup>21</sup> See *id.* at 143.

<sup>22</sup> *Am. Equity Inv. Life Ins. Co. v. Sec. & Exch. Comm'n.*, 613 F.3d 166, 168 (D.C. Cir. 2010).

<sup>23</sup> *Business Roundtable v. Sec. & Exch. Comm'n.*, 647 F.3d at 1148.

The court explained that the SEC had “relied upon insufficient empirical data,” and it took issue with—and supplanted—the SEC’s judgments regarding the most reliable studies on the issues presented. The court faulted the SEC for relying “heavily upon two relatively unpersuasive studies” and, without explaining why the SEC’s favored studies were unpersuasive, found that the SEC had “not sufficiently supported its conclusion.”<sup>24</sup> In effect, the court dismissed pages of economic analysis and detailed consideration of opposing studies simply as inadequate. And in so doing, the court substituted its own **inexpert** judgment for the expert analysis of the agency, in contravention of long-established principles of administrative law.

The misinterpretation of the securities laws reflected in this series of decisions from the D.C. Circuit contravened a rich vein of precedent on cost-benefit analysis, not to mention broader, black-letter principles of deference to administrative agencies. For example, as far back as 1950, the Supreme Court held that the duty to “consider” factors—just as the securities laws narrowly provide with respect to efficiency, competition, and capital formation—entails wide agency discretion: When statutorily mandated “considerations” are not “mechanical or self-defining standards,” they “in turn imply wide areas of judgment and therefore of discretion.”<sup>25</sup>

More specifically, the Supreme Court has held that an agency’s duty to conduct cost-benefit analysis is not to be inferred without a clear indication from Congress: “Congress uses specific language when intending that an agency engage in cost-benefit analysis.”<sup>26</sup> And one of the basic canons of judicial review of agency rules is that “the scope of review under the arbitrary and capricious standard is narrow and a court is not to substitute its judgment for that of an agency.”<sup>27</sup> This is “especially true when the agency is called upon to weigh the costs and benefits of alternative policies,”<sup>28</sup> and in fact, “cost-benefit analyses epitomize the types of decisions that are most appropriately entrusted to the expertise of an agency.”<sup>29</sup> Fortunately, as explained below, some more recent decisions reflect a return to these principles.

#### B. The judicial movement away from strict cost-benefit analysis.

In two major cases since the *Business Roundtable* decision, the D.C. Circuit has upheld significant financial regulations of the Commodity Futures Trading Commissions (CFTC) and the SEC against challenges from the Investment Company Institute and the National Association of Manufacturers that were predicated largely on allegedly deficient cost-benefit analyses.<sup>30</sup>

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<sup>24</sup> *Id.* at 1151.

<sup>25</sup> *Sec’y of Agriculture v. Cent. Roig Refining Co.*, 338 U.S. 604, 611-12 (1950).

<sup>26</sup> *Am. Textile Mfrs. Inst., Inc. v. Donovan*, 452 U.S. 490, 510-512 & n. 30 (1981).

<sup>27</sup> *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983).

<sup>28</sup> *Consumer Elecs. Ass’n v. FCC*, 347 F.3d 291, 303 (D.C. Cir. 2003).

<sup>29</sup> *Office of Comm’n of United Church of Christ v. FCC*, 707 F.2d 1413, 1440 (D.C. Cir. 1983).

<sup>30</sup> *Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm’n*, 891 F. Supp. 2d 162, 202 (D.D.C. 2012), as amended (Jan. 2, 2013), *aff’d sub nom. Inv. Co. Inst. v. Commodity Futures Trading Comm’n*, 720 F. 3d 370 (D.C. Cir. 2013); *Nat’l Ass’n of Mfrs. v Sec. & Exch. Comm’n.*, 748 F. 3d 359 (D.C. Cir. 2014).



In *Investment Company Institute v. CFTC*,<sup>31</sup> the D.C. Circuit upheld the CFTC’s economic analysis for its rule requiring SEC-registered investment companies engaged in significant derivatives trading to also register as commodity pool operators. The court acknowledged that the relevant statutory standard does not require rigorous, quantitative analysis: “Where Congress has required ‘rigorous, quantitative economic analysis,’ it has made that requirement clear in the agency’s statute, but it imposed no such requirement [in the Commodity Exchange Act].”<sup>32</sup> The court further found that the agency had been faithful to the text of the Commodity Exchange Act, which requires only that the CFTC “consider” costs and benefits in light of certain factors. Summing up, the court added that “the law does not require agencies to measure the immeasurable.”

In *Nat’l Ass’n of Mfrs. v. SEC*,<sup>33</sup> the D.C. Circuit upheld the SEC’s economic analysis for its rule requiring public companies to track the origin of, and disclose information about, the conflicts minerals they use. The court wrote that the statutory test does not mandates rigorous, quantitative analysis: “An agency is not required to measure the immeasurable, and need not conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so.” The court identified two additional reasons why agencies like the CFTC and the SEC cannot be expected to perform cost-benefit analysis: It forces them to make an “apples-to-bricks” comparison whenever intangible benefits—such as peace and security—cannot be framed in terms of dollars and cents, and it forces them to second-guess the judgments that Congress has already made about the costs and benefits of regulation.

### C. Three recent cases.

Three recent decisions, one from the Supreme Court, one from the D.C. Circuit, and one from the D.C. district court, show that the judicial approach to cost-benefit analysis remains unpredictable. None of those decisions alter the recent and positive holdings from the D.C. Circuit in *ICI* and *NAM*, to the effect that agencies are not under an obligation to conduct quantitative cost-benefit analysis unless Congress clearly imposes that requirement. Nor do they alter the other core principle established 50 years ago that the duty to “consider” statutorily enumerated factors vests broad discretion in the agency as to how to evaluate those factors and what weight to give them. Clearly, though, the Supreme Court’s ruling in the *Michigan* case has already inspired at least one federal district court judge to take an extreme position in the *MetLife* case. And *Lindeen* signifies something of a middle ground in the jurisprudence surrounding cost-benefit analysis at the SEC, still embracing the idea that the agency must go beyond the statutory language and consider costs and benefits, but may do so without an empirically-based, quantitative analysis.

#### 1. *Michigan v. EPA*

In *Michigan*, the Supreme Court reached the expansive conclusion that the EPA was required to consider costs when determining whether regulation of power plant emissions was

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<sup>31</sup> *Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm’n*, 720 F. 3d 370 (D.C. Cir. 2013).

<sup>32</sup> *Id.* at 379.

<sup>33</sup> 748 F. 3d at 370.

“appropriate and necessary” under the Clean Air Act (42 U.S.C. § 7412(n)(1)(A) (2012)).<sup>34</sup> However, the holding was highly contextual, the Court observing that “[t]here are undoubtedly settings in which the phrase ‘appropriate and necessary’ does not encompass costs.”<sup>35</sup> A number of factors led to the Court’s decision. For example, the EPA was operating in the context of numerous environmental statutory provisions and mandated studies that were heavily focused on cost assessments. In addition, the EPA was dealing with a specific mandate to determine whether to regulate at all, a point that figured prominently in the Court’s decision: “Agencies have long treated cost as a centrally relevant factor when deciding whether to regulate.”<sup>36</sup> In contrast, the SEC is typically wrestling with how to regulate, not whether it should do so in the first instance.

## 2. *Metlife v. FSOC*

The holding in *Michigan* has inspired at least one district court judge to go to extraordinary lengths to impose a cost-benefit analysis duty where the applicable statute plainly does not require one.<sup>37</sup>

In December of 2014, after almost two years of careful analysis, the Financial Stability Oversight Council (FSOC) exercised its authority under Section 113 of the Dodd-Frank Act to designate the massive global insurance company MetLife as a systemically important nonbank financial company, which would subject it to enhanced supervision by the Federal Reserve. The purpose of the designation was to mitigate the risk that MetLife could cause or contribute to another devastating financial crisis like the one that engulfed the nation in 2008. MetLife challenged FSOC’s designation in the D.C. federal district court, and on March 30, 2016, Judge Rosemary Collyer rescinded it, concluding that FSOC’s designation was arbitrary and capricious, in part because the FSOC failed to consider of the cost of designation on MetLife.<sup>38</sup> In so doing, Judge Collyer misinterpreted both the Dodd-Frank Act and the Supreme Court’s decision in *Michigan v. Environmental Protection Agency*, 135 S. Ct. 2699 (2015).

The court acknowledged that the Dodd-Frank Act nowhere expressly required the FSOC to conduct a cost-benefit analysis, and it further acknowledged that Congress clearly **had** imposed that requirement on agencies in other contexts. In reality, Section 113 of DFA requires the FSOC only to “consider” 10 listed factors when designating nonbank financial companies, and none of them includes any references to the cost or benefits of designation. And the last catchall factor simply grants the FSOC broad discretion to consider “any other risk-related factors that the Council deems appropriate.”<sup>39</sup>

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<sup>34</sup> *Michigan v. Env’tl. Prot. Agency*, 135 S. Ct. 2699 (2015).

<sup>35</sup> *Id.* at 2707.

<sup>36</sup> *Id.* (emphasis added).

<sup>37</sup> See *MetLife, Inc. v. Financial Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016).

<sup>38</sup> See Better Markets, “Fact Sheet on the MetLife v. FSOC Decision” (Apr. 15, 2016), available at <https://bettermarkets.com/sites/default/files/MetLife%20Decision%20Fact%20Sheet%204-15-16%20Final.pdf>.

<sup>39</sup> 12 U.S.C. § 5323(a)(2) (2012).

The court side-stepped all of these facts, however, with a tortured chain of reasoning based primarily on the Supreme Court’s holding in *Michigan*, to the effect that in certain circumstances in the environmental context, the statutory word “appropriate” may call for an agency to look at cost considerations when deciding whether to regulate. Keying off this decision, the district court in *MetLife* held that the FSOC’s purely discretionary authority to consider other “risk-related factors that the Council deems **appropriate**” required it to consider the cost of designation to MetLife. To reach that highly implausible result, the court was left to reason that cost is a “risk-related factor” insofar as the costs of regulation imposed on an institution could make it more likely to experience financial distress in the first instance—a determination that the FSOC is not actually required to make at any point in the designation process.

The district court thus committed the following errors in its decision, among others:

- It stretched the Supreme Court’s holding in *Michigan* far beyond its narrow boundaries;
- It ignored the D.C. Circuit’s holdings in *ICI* and *NAM*;
- It dismissed the plain meaning and intent of the last catchall factor in Section 113 (“other **risk-related** factors”) (emphasis added), which has nothing to do with costs and benefits, either on its face or in context;
- It ignored the purely discretionary nature of the FSOC’s authority to consider any other risk-related factors it “**deems** appropriate” (emphasis added); and
- It rested on the erroneous premise (of its own making elsewhere in its opinion) that the FSOC must assess the likelihood that an institution might someday experience financial distress—a proposition that finds no support in the law.

In its brief on appeal to the D.C. Circuit, the FSOC itself appropriately stressed the flawed logic in reading the 10 factors (especially the catchall factor) in Section 113 as even suggesting a nexus to cost-benefit analysis:

In any event, the interpretation of “risk-related factor” adopted by the district court is untenable. The cost of complying with regulation bears no resemblance to any of the ten statutory factors that guide a designation decision. Those factors reflect Congress’s determination that designation is proper when a financial company’s material financial distress could threaten the stability of the U.S. financial system. **Keenly aware of the costs of inadequate regulation, Congress determined that the benefits outweigh the potential cost of regulations that are designed to improve the safety and soundness of the designated company as well as the stability of the financial system.**<sup>40</sup>

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<sup>40</sup> Brief of Appellant at 54, *MetLife, Inc. v. Financial Stability Oversight Council*, No. 16-5086 (D.C. Cir., June 16, 2016).

These, and other significant and obvious errors by the court cried out for appellate reversal, and extensive appellate briefing on the merits followed, including numerous amicus briefs from Better Markets and others arrayed on both sides of the important issues presented,<sup>41</sup> culminating in oral argument on October 24, 2016. However, the case lay dormant through the 2016 election, and beginning in April 2017, the Trump administration, embarked on what appeared to be a carefully choreographed plan, presumably in coordination with MetLife and its attorneys, to derail the appeal and prevent it from ever being decided on the merits by the D.C. Circuit. Specifically, President Trump issued a memorandum on April 21, 2017 directing the Treasury Secretary to review FSOC’s designation process and provide a report within 180 days. The factors the memorandum directed the Secretary to consider echoed the district court’s opinion and the arguments MetLife advanced in its briefs. The D.C. Circuit held the case in abeyance pending release of the report. When the report was released, paving the way for the appeal to go forward, MetLife argued in supplemental briefing that the report supported MetLife’s arguments, and FSOC, rather than opposing MetLife’s brief, joined with MetLife in a motion requesting the appeal be dismissed, which the D.C. Circuit granted in January of 2018. As a result, the district court’s flawed opinion stands as a lasting and crippling interpretation requiring FSCO to conduct a cost-benefit analysis as a condition of designation. FSOC’s ability to protect our economy from crisis has been severely damaged and the likelihood of future taxpayer bailouts and financial crashes will rise. Moreover, the proponents of cost-benefit analysis notched a significant victory, fortifying cost-benefit analysis as a weapon against important regulations that serve the public interest.<sup>42</sup>

### 3. *Lindeen v. SEC*

The D.C. Circuit’s recent opinion in *Lindeen v. Sec. & Exh. Comm’n*,<sup>43</sup> represents something of a mixed result with respect to the cost-benefit analysis requirements applicable to the SEC. The petitioners in that case challenged the SEC’s “Reg A+” regulation establishing a new exemption from securities registration for offerings up to \$50 million and preempting state registration and qualification requirements through the definition of “qualified purchaser.” The

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<sup>41</sup> See Amicus Brief of Better Markets (June 23, 2016), available at <https://bettermarkets.com/resources/better-markets-amicus-brief-metlife-v-fsoc>. Better Markets also filed an amicus brief on the merits in the district court, an unusual step but a necessary and appropriate one given the historic importance of the issues presented. See Amicus Brief of Better Markets in the District Court, filed May 22, 2015, available at <https://bettermarkets.com/resources/better-markets-amicus-brief-case-metlife-v-fsoc>.

<sup>42</sup> Fortunately, at least one other district court judge has recently read *Michigan* far more narrowly. See *Nicopure Labs, LLC v. Food & Drug Admin.*, No. 16-0878, 2017 WL 3130312 (D.D.C. July 21, 2017). In *Nicopure*, the court rejected claims that the FDA’s decision to regulate e-cigarettes as tobacco products was arbitrary and capricious, in part on cost-benefit grounds. The court (1) distinguished the specific language in the Clear Air Act on which the Supreme Court relied in *Michigan*; (2) correctly read *Michigan* as conferring broad discretion on an agency when it is “considering” cost as a factor; and (3) reiterated the principle that courts must not review an agency’s economic analysis de novo but must instead afford it an especially high degree of deference. *Id.* at \*32-38.

<sup>43</sup> 825 F. 3d 646 (D.C. Cir. 2016).

court upheld the regulation, in part on economic analysis grounds. On the one hand, unfortunately, it embraced the 2005 holding in *Chamber* to the effect that the SEC must “determine as best it can the economic implications of the rule.”<sup>44</sup> On the other hand, it made very clear that a relatively general qualitative consideration of costs and benefits, without any empirical data to support it, could suffice. Reciting from *NAM*, the court observed that “We do not require the Commission ‘to measure the immeasurable’ and we do not require it to ‘conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so.’”<sup>45</sup>

D. The persistent American Equity problem.

A recurrent and important problem facing the SEC and other agencies in the area of cost-benefit analysis deserves special mention. An agency can unnecessarily raise the bar on itself in judicial review if it attempts more economic analysis than the law requires. Where an agency conducts an analysis in adopting a final rule without any suggestion that such an analysis was not required, the court evaluates the propriety of the Commission's analysis as performed.<sup>46</sup> This principle continues to survive. For example, in 2012, the D.C. Circuit held that where the EPA undertook a cost-benefit analysis that was not required by statute, the court would nevertheless consider that analysis in reviewing the agency's rule.<sup>47</sup> The same principle was recognized even more recently in the district court's decision in *NAM*:

Nevertheless, insofar as the Commission considered itself subject to the requirements of Section 3(f), along with those under Section 23(a)(2), (see Def.'s Brief at 29), the Court need not conclusively decide this issue. Since the SEC conducted an analysis under Section 3(f) in adopting the Final Rule without any suggestion that such an analysis was not required, the Court evaluates the propriety of the Commission's analysis as performed, including its compliance with 15 U.S.C. § 78c(f). *Am. Equity*, 613 F.3d at 177 (“[T]he SEC must defend its analysis before the court upon the basis it employed in adopting that analysis.”). However, this should not be taken as a ruling that such an analysis was actually required in connection with this particular rulemaking.<sup>48</sup>

This principle continues to have significant implications for the SEC in particular. To the extent the agency voluntarily undertakes more extensive cost-benefit analysis than the securities laws require, it unnecessarily exposes itself to a heightened risk that its rules will be invalidated for failing to meet a standard that does not actually apply.

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<sup>44</sup> *Id.* at 657.

<sup>45</sup> *Id.* (quoting *Nat'l Ass'n of Mfrs.*, 748 F.3d at 369 (emphasis added)); *cf. Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (“Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouse holes.”).

<sup>46</sup> *See Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166, 168 (D.C. Cir. 2010).

<sup>47</sup> *Nat'l Ass'n of Home Builders v. EPA*, 682 F.3d 1032, 1039-1040 (D.C. Cir. 2012).

<sup>48</sup> *Nat'l Ass'n of Mfrs. v. SEC*, 956 F. Supp. 2d 43, 58 n. 15 (D.D.C. 2013).

## V. Executive Orders

The executive branch agencies have been required to conduct cost-benefit analysis for years, pursuant to a series of executive orders that date back to the Reagan Administration.<sup>49</sup> These orders require executive agencies to quantify costs and benefits; tailor regulations to impose the least burden on society; base decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended regulation; and adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs. However, those order expressly exclude the independent regulatory agencies.

President Trump has issued a spate of executive orders and memoranda that impose draconian new anti-regulatory obligations on agencies or call for studies that will serve as the basis for the expected repeal of important regulatory protections. Some of them incorporate costs and benefits as the subject of mandated studies or as factors that must be weighed in new and particularly onerous ways. They include the following:

- Core Principles for Regulating the United States Financial System, Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017) (requiring the Treasury Secretary to review all financial regulations).
- Enforcing the Regulatory Reform Agenda, Exec. Order No. 13,777, 82 Fed. Reg. 12285 (Feb. 24, 2017) (requiring agencies to appoint Regulatory Reform Officers and Task Forces to oversee implementation of regulatory reform initiatives).
- Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Orderly Liquidation Authority (Apr. 21, 2017) (requiring the Treasury Secretary to review the orderly liquidation authority).
- Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Financial Stability Oversight Council (Apr. 21, 2017) (requiring the Treasury Secretary to review the FSOC designation processes).
- Reducing Regulation and Controlling Regulatory Costs, Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Jan. 30, 2017) (requiring the repeal of two regulations for every new regulation that is promulgated and that any cost to the industry be balanced by the repeal of other regulations, regardless of the benefits of the new or rescinded rules).
- Executive Office of the President, Presidential Memorandum for the Secretary of Labor on the Fiduciary Rule (Feb. 3, 2017) (requiring the Labor Secretary to examine the fiduciary duty rule to determine if it may adversely affect the ability of Americans to gain access to advice).

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<sup>49</sup> See, e.g., Exec. Order No. 12,866, 58 Fed. Reg. 517735 (Sept. 30, 1993); Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

So far, however, none of those orders purport to impose cost-benefit analysis obligations on the independent agencies.

## VI. Academic views.

Academic views on cost-benefit analysis diverge greatly and have resulted in papers both decrying and supporting the practice. Despite disagreement over whether and when cost-benefit analysis should be used, there is widespread agreement at least that cost-benefit analysis faces problems quantifying abstract social benefits. A comprehensive review of the scholarship on regulatory cost-benefit analysis is beyond the scope of this update, but a sampling of articles is illuminating.

John Coates, a Harvard professor, recently undertook a close examination of six rules (including the SEC's mutual fund governance reforms and cross-border swaps proposals), focusing on the details of how quantitative cost-benefit analysis requirements would work in practice if applied to these rules.<sup>50</sup> He concluded that cost-benefit analysis of such rules "can be no more than guesstimates," as they contain "the same contestable, assumption-sensitive macroeconomic. . . modeling used to make monetary policy, which even cost-benefit analysis advocates would exempt from cost-benefit analysis laws."<sup>51</sup>

Jeffrey Gordon, a professor at Columbia Law School, argues that the system in the financial sector that generates costs and benefits "is 'constructed' by financial regulation itself and by the subsequent processes of adaptation and regulatory arbitrage."<sup>52</sup> He concludes that new rules change the system "beyond our calculative powers."<sup>53</sup> By contrast, Gordon identifies "natural" systems (e.g., the natural environment and environmental regulation) where there are certain fixed costs and benefits that do not change in response to regulation.<sup>54</sup> Gordon believes that instead of weighing costs and benefits, financial regulation must be designed pragmatically and grounded in analysis of the tradeoffs in normative values inherent in different regulatory approaches.<sup>55</sup>

Even advocates of quantitative cost-benefit analysis like John Cochrane of the University of Chicago have expressed significant doubts about whether the social costs and benefits of financial regulations are ultimately susceptible to reliable and precise quantification.<sup>56</sup> Likewise, Richard Revesz of New York University, who promotes cost-benefit analysis as a regulatory tool, argues that regulators have not properly executed cost-benefit analysis in the past and that

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<sup>50</sup> John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 886 (2015).

<sup>51</sup> *Id.* at 887.

<sup>52</sup> Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351 (2014).

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> John H. Cochrane, *Challenges for Cost-Benefit Analysis of Financial Regulation*, 43 J. LEGAL STUD. S63, S69 (2014).

institutional changes at regulatory agencies would have to be made before it could be used effectively.<sup>57</sup> And Cass Sunstein of Harvard Law acknowledged in a recent paper that “[v]alues such as dignity, equity, and fairness might be relevant, and they might prove difficult or impossible to quantify.”<sup>58</sup>

Finally, a recent paper from Robert Bartlett of the University of California at Berkeley argues that “uneven” application of formal cost-benefit analysis requirements in financial regulatory agencies demands the adoption of a “single cost-benefit analysis paradigm that requires interagency coordination and avoids judicial review.”<sup>59</sup> According to Bartlett, such an approach would have the best chance of providing meaningful and transparent analysis of rulemaking while avoiding regulatory paralysis.

### CONCLUSION

In light of these recent developments, the SEC should revisit and revise its approach to economic analysis in its rulemaking process. It should limit its economic analysis to what Congress actually required and intended under the securities laws and other applicable statutes; it should refrain from devoting excessive resources to the impossible task of calculating the costs and benefits for each rule; it should revise its internal guidelines specifying its protocols for conducting economic analysis, to more accurately reflect the limited nature of its obligation under the law; and if, after appropriately narrowing its economic analysis in future rulemakings, the SEC continues to be challenged in court, the SEC should vigorously defend those rules, taking full advantage of the recent case law and seeking to establish further precedent vindicating its approach. Finally, to the extent the SEC chooses to continue conducting more cost-benefit than the law requires, it should expressly state that the exercise is not legally required, to avoid the *American Equity* problem, and further, it should apply its cost-benefit analysis to fulfill its primary investor protection mission to the maximum possible extent.

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<sup>57</sup> Richard L. Revesz, *Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation*, 34 YALE J. ON REG. 545, 548 (2017).

<sup>58</sup> Cass R. Sunstein, *Cost-Benefit Analysis and Arbitrariness Review*, 41 HARV. ENVTL. L. REV. 1, 40 (2017).

<sup>59</sup> Robert P. Bartlett III, *The Institutional Framework for Cost-Benefit Analysis in Financial Regulation: A Tale of Four Paradigms?*, 43 J. OF L. STUDIES S379 (2014).