January 27, 2020

RE: Request for information on a framework for analyzing the effects of FDIC regulatory actions
RIN 3064-ZA13

I am an economist at the Consumer Financial Protection Bureau (Bureau) and have eight years of experience relevant to the subject matter of this RFI. I am submitting this comment in my personal capacity and not on behalf of the Bureau.

In a few places I reference the paper "Jackson-Rothstein." This is Howell E. Jackson & Paul Rothstein "The Analysis of Benefits in Consumer Protection Regulations," Harvard Business Law Review, Volume 9, No. 2 (2020), pp. 197-321.[1]

Background

Bureau rulemakings are subject to the Regulatory Flexibility Act, Congressional Review Act, and Paperwork Reduction Act. Bureau rulemakings are not subject to the review processes specified in Executive Order 12866. The Bureau also has a statutory requirement to consider the benefits, costs and impacts of most of its proposed and final rules. This statutory requirement appears in section 1022(b)(2)(A) of the Dodd-Frank Act (section 1022 analysis). The exact requirement is useful background for the discussion that follows:

SEC. 1022. RULEMAKING AUTHORITY.
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(b) RULEMAKING, ORDERS, AND GUIDANCE.—
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(2) STANDARDS FOR RULEMAKING.—In prescribing a rule under the Federal consumer financial laws—
(A) the Bureau shall consider—
(i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule; and
(ii) the impact of proposed rules on covered persons, as described in section 1026, and the impact on consumers in rural areas;

In practice, this requirement applies to almost all Bureau rulemakings. The few exceptions include legislative rules not issued under Federal consumer financial law—such as a rule on appraisal management companies issued under FIRREA in 2015 with other financial regulators—and certain non-legislative rules, such as Bureau interpretive rules.

The Bureau developed its understanding and implementation of section 1022 in a period of intense Congressional scrutiny of the economic analyses conducted by other financial regulators in Dodd-Frank rulemakings.[2] The FDIC, the Board of Governors and the OCC do not have a general cost-benefit

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[1] Available at https://www.hblr.org/hblr-print/volume-9-2019/volume-9-issue-2/.
[2] See, for example, in February 2011, https://www.crapo.senate.gov/media/newsreleases/crapo-banking-regulators-sacrifice-quality-and-fairness-in-exchange-for-speed; May 2011, https://www.crapo.senate.gov/media/newsreleases/senators-are-the-costs-of-dodd-frank-being-countedd; and the reports Office of Inspector General, Board of Governors of the Federal Reserve System, "Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings," (June 2011); Office of Inspector General, Federal Deposit Insurance Corporation, Evaluation of the FDIC's Economic Analysis of Three Rulemakings to Implement Provisions of the Dodd-Frank Act," Report No. EVAL-11-003 (June 2011); Office of

requirement in rulemaking, and Congress wanted to know the extent to which serious consideration of costs and benefits factored into agency decisions. Further, the SEC does have a general requirement to consider the effects of its rules on efficiency, competition and capital formation. In July 2011, the D.C. circuit vacated an SEC rule because it failed to adequately assess the economic effects of the rule in light of the statutory requirement.[3] As a result, the few words in section 1022 have been highly salient to the Bureau since its inception, in my opinion.

Bureau section 1022 analysis provides, in rule preamble, a consideration of costs and benefits that reflects the work of economists, markets experts and others that is conducted throughout the rulemaking process. The analysis incorporates many best practices in regulatory impact analysis including, among other things, a discussion of the need for the rule, the possible market failures, consideration of alternatives, and consideration of the benefits and costs of all major provisions to consumers and covered persons. The analysis is conducted against a pre-statute baseline or a "no action" baseline as appropriate; I say more about this below in response to one of your questions. As such, a 1022 analysis is not just an exercise in "scoring" benefits and costs, although the facts about the expected effects of the rule on consumers and covered persons are central to the analysis. The discussions of rule purpose and alternatives also reflect the efficiency and distributional concerns of agency leadership in the subject market.

Discussion of the RFI

1. The RFI asks generally about "appropriate concepts for identifying the broad economic benefits and costs of changes in bank regulation" and the "effects of changes in bank regulation on the frequency or severity of bank failures or banking crises" (65813). The RFI also notes that "there often may be an insufficient basis for quantifying key costs and benefits associated with banking rules" (65813) and that Circular A-4 "draws its examples generally from health, safety and environmental regulation and does not explicitly address banking or financial regulation" (65809).

   In considering the potential for rigorous, quantitative cost benefit analysis of financial regulation, it is essential to distinguish between financial *stability* regulation, on the one hand, and the subset of *consumer protection* regulation that specifically concerns consumer financial products and services. The latter is popularly referred to as consumer financial protection regulation.

   The past few years have seen a lively debate over the potential for rigorous cost benefit analysis of financial regulation.[4] The strongest arguments against the potential for—as opposed to the

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Inspector General, Commodity Futures Trading Commission, "A Review of Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act," (June 13, 2011); Office of Inspector General, United States Securities and Exchange Commission, "Report of Review of Economic Analyses Performed by the Securities and Exchange Commission in Connection with Dodd Frank Act Rulemakings," (June 13, 2011); Office of Inspector General, Department of Treasury, "Dodd-Frank Act: Congressional Request for Information Regarding Economic Analysis by OCC," OIG-CA-11-006 (June 13, 2011).

[3] For a discussion of Business Roundtable and subsequent court decisions, see Jackson and Rothstein, pp. 203-207.

[4] "The past few years have also seen a flood of articles on financial CBA that move well beyond the early critiques of the Business Roundtable decision. Crudely put, academics can be divided into two camps, with the CBA enthusiasts, led by Eric Posner and Glenn Weyl, on one side, and the CBA skeptics, including John Coates and Jeff Gordon, on the other. The enthusiasts argue that financial regulation is no different than other kinds of regulation and the same rules governing CBA in other areas should be applied to financial CBA. The skeptics, in contrast, emphasize the complexity of financial markets and the challenges of estimating both the positive and negative effects of financial regulatory intervention" Jackson-Rothstein 207-208 (citations omitted). For further discussion, see Jackson-Rothstein 207-209.

current practice of—rigorous, quantitative cost benefit analysis of financial regulation apply to financial stability regulation and not to consumer financial protection regulation.[5]

Jackson-Rothstein provide a number of directions for more rigorous, quantitative consumer financial protection regulation. We describe—with specificity—the strengths and weaknesses of benefit analysis in a large number of regulatory analyses. We argue that improvements in benefit analysis is certainly feasible but requires appropriate investments in data and modeling. We find that the key uncertainty is often about the initial, direct response to new requirements, since agencies often have a base of knowledge about other responses on which they are building. Thus, what is needed in many cases is investments that could recover these effects and replace quantitative assumptions. These investments, however, would only be justified when the costs or other stakes in the rulemaking were sufficiently great. Both quantitative assumptions and estimates have an important place in quantified benefit analysis.[6]

Finally, even in regards to financial stability regulation, there are optimists. For example, Richard Posner and Glen Weyl, argue specifically that the models used in health, safety and environmental regulation can—with some research and effort—be extended to financial stability regulation.[7] These models might also provide a unifying framework for some consumer financial protection regulation as well.

2. You state, "A unique feature of the notices of rulemaking for banking regulations is that some are published by individual agencies and others are published jointly by multiple agencies" (65809). This presents the question whether, in joint rules, a regulatory impact analysis by the FDIC would consider the benefits and costs of the rule just to the entities to which the FDIC portion of the rule applies or to all of the entities to which the rule in total applies.

   For a joint rule, the FDIC would need to consider any market-wide effects of the rule even if it only wanted to report on the costs and benefits to FDIC-regulated entities (and their consumers). Market-wide effects include effects on financial stability, innovation, entry, concentration, pricing, and price dispersion. Certainly no useful cost benefit analysis of a joint rule would result from assuming that these effects are *not* present when your analysis says that they are. As a technical matter, however, the FDIC can take these effects into account and report only the benefits and costs on FDIC-regulated entities (and their consumers) without commenting in any detail on the effects on entities with other regulators. Even better would be for the FDIC to also

[5] See John C. Coates IV, Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications, 124 YALE L.J. 882 (2015). In particular, Coates argues on the basis of a number of case studies that, "any substantial financial regulatory rules will face one or more of five serious challenges: (1) data limitations, (2) causal inference challenges, (3) the need to incorporate judgmental macroeconomic models, (4) the need to incorporate even more judgmental policy/political models, and (5) the need to make contestable, judgmental assumptions or modeling choices that have large effects on the outputs of the analysis." Challenges (3) and (4) apply to financial stability regulation but would not generally apply to consumer financial protection regulation.

[6] See Jackson-Rothstein, pp. 303-304.

[7] "The central trade-off in much EHS [Environmental, Health and Safety] regulation is between costs incurred with certainty and a reduction in the probability of extreme harms to human life or health. The value of a statistical life (VSL), the willingness of individuals to pay to reduce the probability of death, has become perhaps the central economic parameter used to evaluate EHS regulations. Broadly, financial regulation has a similar structure…. Unfortunately, a parameter for translating such a reduced probability of a crisis into a dollar value with certainty, call it the cost of a statistical crisis (CSC), has received far less attention than has VSL." 393. The authors then offer one approach to modeling the cost of a statistic crisis. See Richard Posner and Glen Weyl, "Benefit-Cost Analysis for Financial Regulation," American Economic Review 103(3), 2013, 393-397.

report aggregate effects on all other entities and consumers. Where there are no market-wide effects, the cost benefit analysis would be similar to the FDIC portion of the PRA analysis in a joint rulemaking.[8]

3. *The need for action.* Along with the possible reasons for rulemaking that you state in the RFI, you may also want to broadly consider why time and competition *won't* address the market failure that is prompting regulatory action. Real markets have dynamics that are not captured by textbook (i.e., static) discussions of market failures. These dynamics might, eventually, address the market failures. Of course Congress or agency leadership decides how long is "too long" for a market failure to persist and whether the risks of current harm overwhelm concerns about costs and unintended consequences.

4. *Defining a baseline.* You note, "Circular A-4 states that to facilitate a more comprehensive understanding of the effects of the rules, analysis should consider a pre-statute baseline." However, you note that a pre-statute baseline, "may also involve implicitly evaluating the merits of statutes," and that when a statute is prescriptive, "pre-statute baselines may not always produce results that inform the decisions actually available to the agency."

   It is useful to clarify how this work in practice. When an agency is conducting a discretionary rulemaking using longstanding statutory authority, the "pre-statute/post-statue" dichotomy is irrelevant. In this case, agencies use a "no-action" baseline. This is the regulatory regime absent agency action.[9] The pre-statute/post-statute dichotomy is relevant for mandatory rulemakings and discretionary rulemakings that are conducted (roughly speaking) early in the life of a new statute. On this point, OMB's April 2019 guidance on the Congressional Review Act noted that, per Circular A-4, "In general, when assessing the economic effects of the first rule that implements a statutory requirement, agencies should use a pre-statutory baseline" (6).[10]

   Now consider the central analytical problem with using a post-statute baseline where the pre-statute/post-statute dichotomy is relevant. An essential role of many of these rulemakings—whether mandatory or discretionary—is to clarify statutory language that is ambiguous. Unfortunately for those who would prefer to use a post-statute baseline, *a post-statute baseline is only as clear as the statute itself.* If the statute is less than perfectly clear about what it requires, the agency will have to explain which requirements or parts of requirements are truly required by Congress, and for which the costs and benefits do not belong to the agency. This exercise in attribution becomes unworkable and unpersuasive (i.e., presumptively opportunistic) with just a little bit of ambiguity in the statutory language.

   Secondarily, even when a statute is very clear regarding a specific requirement, the agency may not be able to avoid considering the benefits and costs against a pre-statue baseline in light of comments on the proposed rule. This is especially true if the agency has adjustment authority that depends, in effect, on a consideration of the benefits and costs of statutory requirements against a pre-statue baseline. Commenters critical of the rule who want the agency to use its adjustment authority will necessarily comment on the benefits and costs against a pre-statute baseline. To be responsive to the comments, the agency may need to do the same. If this is at all

[8] As you know, PRA burden is attributed to each agency according to the burden imposed by the rule on that agency's "respondents" (generally those entities against which the agency enforces the rule).
[9] This is true even if the statute expires on its own terms—in which case the baseline is the world without the statute and the effects of the rule would be measured against that baseline.
[10] https://www.whitehouse.gov/wp-content/uploads/2019/04/M-19-14.pdf

foreseeable, the agency might produce a clearer and more comprehensive view of the benefits and costs—and a clearer justification for the rule—by just conducting this analysis up front.

Finally, as the RFI notes, OMB generally requires executive branch agencies to use a pre-statue baseline instead of a post-statute baseline. Even granting your claim that measuring the *effects* of statutes (by using a pre-statute baseline) sometimes amounts to "evaluating the *merits* of statutes," the FDIC might want to consider how much of a concern this should be for them given that so many other agencies do exactly this. The public benefits when agencies use their expertise to review the full benefits and costs of the rule and statute combined, most especially when the review reveals distributional concerns or legal constraints that shape these benefits and costs.

5. *Benefits and costs of actions and alternatives.* The RFI states two principles for its regulatory analyses, "First, to consider costs and benefits from all major stakeholder and policy perspectives; and second, to attempt to identify costs and benefits relative to the concept of broad economic welfare." Regarding broad economic welfare, the RFI notes that while there is no universally agreed upon measure, it suggest, "maximizing long-term, sustainable U.S. economic output supported by the banking industry, subject to the achievement of statutory goals and avoidance of significant adverse unintended consequences."

   A few observation on this list:

   - You state as a fundamental goal maximizing long-term, sustainable U.S economic output. Later in the RFI, however, you state, "For most rules, such effects [on measured U.S. economic output] are likely negligible" (65813). If this is the case—that apart from rules that can affect financial stability (and thus economic output) that even "major" FDIC rules have only minimal effects on output—then this output measure is not a broadly useful benefit metric.
   - If the fundamental benefit of your rules is mitigating risks that businesses and consumers cannot insure against and may not even be aware of, then "harm avoided" (not output achieved) is closer to the benefit you want to measure.[11]
   - Considering costs and benefits from all major perspectives is necessary because the benefits of a rule can be highly heterogeneous. There are, however, at least two dimensions to this heterogeneity. There is an extensive margin, in which a benefit to one group is not a benefit to another. There is also an intensive margin, in which a benefit is worth more to one group than to another. It is important that stakeholders be sub-divided sufficiently so that these differences are at least recognized even if they cannot be measured precisely.
   - There is often a tension between the narrow goals handed to an agency by statute and "social welfare." For example, consider your discussion of the Deposit Insurance Fund (DIF). You state that a core mission of the FDIC is to ensure that the cost of bank failures is not borne by taxpayers (65812). This narrow goal could easily conflict with broader goals. Taxpayers who have no *direct* contact with a bank in their community that is put into receivership may also benefit from the protections provided to the bank's depositors and from orderly resolution. These positive externalities or "co-benefits" can be difficult to reconcile with statutory limitations on benefits. To manage this tension, you may want to conduct separate analyses for different purposes. Rule writing teams will need clear guidance on this issue up front.

[11] For a related discussion, see Jackson-Rothstein, pp. 300-303.

- You note, “For some regulatory actions it may be beneficial to gather information from banks or other stakeholders prior to the proposal stage” (65812).

  For a high stakes matter or a requirement that comes up frequently in multiple forms, it may make sense to do so. Consider (for simplicity) the effects of a new disclosure that makes a particular fee more transparent. For banks, there is an operational cost of providing the form and a loss in revenue if consumers, with better information, avoid the fee. Consumers benefit not only from avoiding the fee but also from avoiding the unpredictability of the fee. In other words, the willingness-to-pay to avoid the fee might exceed the fee itself (likely by a small amount). Further, the rule provides a competitive benefit to banks that rely less on this particular fee.

  All of these effects can be subject to rigorous, quantitative analysis. Agencies can conduct rigorous modeling as well as consumer testing in labs and in the field to study these effects. The United Kingdom’s Financial Services Authority, which operated under explicit cost-benefit requirements, generated a significant amount of regulatory focus and research on financial cost-benefit analysis as early as 1999. This scholarly trend in the United Kingdom has continued to mature, yielding technically sophisticated cost-benefit analyses.[12] Agencies can also conduct retrospective reviews to build a base of relevant, quantitative knowledge. The retrospective review of one rule informs the ex ante consideration of the benefits and costs of amendments to that rule and to related rules. See, as just one example, the Bureau’s 2019 proposed rule on remittance transfers and the numerous references therein to the Bureau’s retrospective review of the remittance rule that was issued in October 2018.[13]

  As noted earlier, the higher-stakes the rulemaking, the more justified the research investment. Further, an agency need not do this alone. Jackson-Rothstein note that targeted research projects for internal research staff or external academics are one possibility, as are academic conferences or prizes focused on topics of particular interest. In certain areas with overlapping interests, inter-agency collaborations across research departments could also be productive. In many instances, the work required to produce these estimates depends upon independent research that is best pursued outside of the regulatory process itself.[14]

Thank you for the opportunity to comment on this thoughtful and important RFI.

Sincerely,

--Paul Rothstein

[12] For a brief review of some of this research, see Jackson-Rothstein, pp. 201-202.

[13] https://www.federalregister.gov/documents/2019/12/06/2019-25944/remittance-transfers-under-the-electronic-fund-transfer-act-regulation-e and https://files.consumerfinance.gov/f/documents/bcfp_remittance-rule-assessment_report_corrected_2019-03.pdf

[14] See Jackson-Rothstein, 304.