U.S. Commodity Futures Trading Commission
Office of the Inspector General

A Review Of Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act

Prepared by the
Office of the Inspector General
Commodity Futures Trading Commission

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EXECUTIVE SUMMARY

The Office of the Inspector General for the Commodity Futures Trading Commission reviewed the formulation of cost benefit analyses for four notices of proposed rulemakings recently published by the Commodity Futures Trading Commission:

1. Protection of Cleared Swaps, Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, April 27, 2011, 76 FR 33818 (June 9, 2011) (segregation/bankruptcy rule);

2. Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3698 (Jan 20, 2011) (DCO risk management rule);

3. Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 FR 6715 (Feb. 8, 2011) (swap trading relationship documentation rule); and

4. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214 (Jan. 7, 2011) (SEF core principles rule).

We undertook this review at the request of ten members of the Senate Committee on Banking, Housing, and Urban Affairs.[1] We were asked to examine six factors in our review, and were requested to complete it by June 13, 2011.

In order to complete the review, we reviewed drafts of the cost-benefit analyses for the four proposed rules, staff e-mail, and internal memoranda. In addition, we conducted interviews with 28 CFTC employees at various staff and management levels who were involved with the cost-benefit analyses processes for the four rules. Multiple interviews were conducted with some employees.

The cost-benefit analyses were created as follows. After the Dodd-Frank Act was enacted,[2] the Chairman and Division Directors created 30 rulemaking teams.[3] Because section 15(a)[4] of the Commodity Exchange Act (the CEA)[5] required the consideration of a cost-benefit analysis for each rulemaking, the Office of General Counsel and Office of Chief Economist

[1] The Senators were: Senator Shelby (AL), Ranking Member; Senator Crapo (ID); Senator Corker (TN); Senator DeMint (SC); Senator Vitter (LA); Senator Johanns (NE); Senator Toomey (PA); Senator Kirk (IL); Senator Moran (KA); and Senator Wicker (MS).
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010)("Dodd-Frank Act" or "Dodd-Frank"). The text is available here in multiple formats: http://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm.
[3] A 31st team was later created and tasked with developing conforming rules to update the CFTC's existing regulations to take into account the provisions of the Act. Testimony of Chairman Gary Gensler before the House Committee on Agriculture, February 11, 2011, available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-68.html.
[4] 7 USC sec. 19.
[5] 7 USC sec. 1, et seq.

created a uniform methodology for cost-benefit analysis for use by each rule-making team. That methodology, contained in a September 2010 memo signed by the General Counsel and the Chief Economist,[6] set out in some detail the types of qualitative considerations that might inform a cost-benefit analysis, encouraged the use of both qualitative and quantitative data, and included a template for everyone to follow.

Although the development of a uniform methodology appeared to be an equal effort between the Office of General Counsel and the Office of Chief Economist, at the outset of the rulemaking efforts the cost-benefit analyses involved less input from the Office of Chief Economist, with the Office of General Counsel taking a dominant role. For three of the four rules we reviewed, all published in January or February 2011,[7] the cost-benefit analyses were drafted by Commission staff in divisions other than the Office of Chief Economist. In these earlier rulemakings, staff from the Office of Chief Economist did review the drafts, but their edits were not always accepted. In one rulemaking, the Office of Chief Economist did not participate at all.

To a greater or lesser extent for the three rules published in January and February of this year, the Office of General Counsel appeared to have the greater "say" in the proposed cost-benefit analyses, and appeared to rely heavily on prior somewhat stripped down analysis. While we offer no opinion on the legal sufficiency of this approach, we note that similar approaches to economic analysis in the context of federal rulemaking have proved perilous for financial market regulators.[8] Moreover, it seems odd for an agency that regularly engages in economic analysis. We recognize that cost-benefit analysis does not possess anywhere near the exactitude of, say, calculus, but it does provide structure for evaluation. We made these same observations in an earlier report addressing cost-benefit analyses in connection with Dodd-Frank rulemakings.[9] In our earlier report, we noted that a more robust process was clearly permitted under the cost-benefit guidance issued by the Office of General Counsel and the Office of Chief Economist in September 2010, and recommended such an approach to cost-benefit analyses, with greater input from the Office of Chief Economist.

The segregation/bankruptcy rule, published June 9, 2011 (addressing segregation and bankruptcy issues for cleared swaps),[10] represents a more current effort by the Commission to craft a cost-benefit analysis in connection with a Dodd-Frank rulemaking. Running to roughly 6,048 words, the cost-benefit analysis describes in great detail the potential cost impact of several proposed segregation methods on market participants, including discussions of comments received to an earlier advanced notice of proposed rulemaking published for this rule. While the

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[6] See Exhibit 1.
[7] E.g., Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3698 (Jan 20, 2011); Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 FR 6715 (Feb. 8, 2011); and Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214 (Jan. 7, 2011).
[8] See, e.g., *Am Equity Investment Life Ins. Co. v. S.E.C.*, 613 F.3d 166, 177-178 (D.C. Cir.2010); *Chamber of Commerce of U.S. v. S.E.C.*, 412 F.3d 133, 142-144 (D.C. Cir.2005).
[9] *An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act*, page iv, available at: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigationreport.pdf.
[10] 76 FR 33818 (June 9, 2011).

notice of proposed rulemaking for segregation and bankruptcy did not quantify the costs of compliance with the proposed rule in detail, cost estimates received in comments were described, and the Agency gave its opinions overall on the costs and benefits of the proposed segregation options in a robust manner. The cost-benefit discussion included internal references to discrete instances in the preamble where costs were discussed in greater detail.

Our review of drafts of the cost-benefit analysis for the segregation/bankruptcy rule indicates an evolution of the process from Fall 2010 to the present, with the cost-benefit analysis section of this proposed rule beginning as little more than a recitation of the template (as seen with the earlier proposed rules), and taking on greater detail in subsequent drafts, with substantial input from the Office of Chief Economist.

Our discussions with staff involved with the segregation/bankruptcy rule uniformly indicated that the Office of Chief Economist drafted the bulk of the cost-benefit analysis discussion, with the Office of General Counsel representatives suggesting edits, some of which were not accepted by the representatives from the Office of Chief Economist. It appears that issues were resolved to the satisfaction of both Offices, but it also appears clear that the Office of Chief Economist for this rule had a greater say in the substance of the cost-benefit analysis and in the outcome of most disputes. The Office of Chief Economist played an enhanced role. While the cost-benefit analysis discussion did not include a description of internal CFTC costs to implement the regulation, which we believe should not be overlooked, overall we were impressed with the cost-benefit analysis included with this notice of proposed rulemaking.

Earlier this year the Chairman initiated a review and revision of the earlier cost-benefit analysis methodology crafted by the Office of General Counsel and Office of Chief Economist in September 2010. The Office of General Counsel and Office of Chief Economist issued this new cost-benefit analysis guidance in May 2011. By its terms the updated guidance is applicable only to final rulemakings; however, it does clarify the role of the Office of Chief Economist, stating that the Office of Chief Economist

> will have a staff person on each rulemaking team, who will provide quantitative and qualitative input with respect to the costs and benefits of the final rulemaking, who should employ price theory economics or similar methodology to assess the costs and benefits of a rulemaking, and who will review each draft cost-benefit discussion.

We are hopeful the new guidance, with its enhanced level of detailed instruction, will result in more robust cost-benefit analyses for the final rulemakings.

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BACKGROUND

Section 15(a) of the Commodity Exchange Act (CEA)

Section 15(a)[11] sets out certain considerations regarding costs and benefits that the Commission shall evaluate before promulgating regulations under the CEA. Added to the CEA in 2000,[12] section 15(a) provides:

> (a) Costs and benefits.
>
> (1) In general. Before promulgating a regulation under this Act [7 USCS §§ 1 et seq.] or issuing an order (except as provided in paragraph (3)), the Commission shall consider the costs and benefits of the action of the Commission.
>
> (2) Considerations. The costs and benefits of the proposed Commission action shall be evaluated in light of—
> (A) considerations of protection of market participants and the public;
> (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets;
> (C) considerations of price discovery;
> (D) considerations of sound risk management practices; and
> (E) other public interest considerations.
>
> (3) Applicability. This subsection does not apply to the following actions of the Commission:
> (A) An order that initiates, is part of, or is the result of an adjudicatory or investigative process of the Commission.
> (B) An emergency action.
> (C) A finding of fact regarding compliance with a requirement of the Commission.

The legislative history for new section 15(a) is sparse, and appears to consist of this brief statement:

> [The CFMA] amends section 15 of the CEA to add a new subsection (a) requiring the CFTC, before promulgating regulations and issuing orders, to consider the costs and benefits of its action. This does not apply to orders associated with an adjudicatory or investigative process, or to emergency actions or findings of fact regarding compliance with CFTC rules.[13]

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[11] 7 USC section 19.
[12] Commodity Futures Modernization Act of 2000 (CFMA), Pub. L. No. 106-554, 114, sec. 1(a)(5), Stat. 2763 (Dec. 21, 2000).
[13] This statement is found in 106 H. Rpt. 711; Prt 1, *_____ (June 29, 2000); 106 S. Rpt. 390, *___ (August 25, 2000); and 106 H. Rpt. 711; Prt 3, *___ (September 6, 2000).

CFTC first interpreted new section 15(a) in a proposed rule titled "Addressing a New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations":[14] The proposed rule addressed section 15(a) in the preamble under the heading "cost-benefit analysis." The discussion listed the five factors under section 15(a) and provided a brief, qualitative discussion of associated benefits and costs for each factor. The CFTC's approach to cost-benefit analysis under section 15(a) remained relatively consistent through the years, though the Commission did drop the practice of separately listing the section 15(a) factors, and began grouping the cost-benefit analysis with the sections addressing Paperwork Reduction Act and Regulatory Flexibility Act compliance. [15] The Commission's compliance with section 15(a) has never been challenged in the courts.

Methodology for Cost-Benefit Analysis Under the Dodd-Frank Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[16] As described by the CFTC, Title VII of the Dodd-Frank Act amended the Commodity Exchange Act[17] to

> …establish a comprehensive, new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.[18]

The Dodd-Frank Act requires the Commission "to complete more than 60 rules within 360 days; some have deadlines of 90, 180, or 270 days."[19] CFTC began immediately to work on rule implementation, including the cost-benefit analyses for the Dodd-Frank rules.

From CFTC staff and management, we learned that in the early stages of rule drafting, the goal was to create a uniform cost-benefit analysis methodology for all Dodd-Frank rulemaking that would comply with section 15(a). Accordingly, the Office of General Counsel

[14] 66 FR 14262 (March 9, 2001).
[15] See, e.g., Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulation, 75 FR 4144 (January 26, 2010).
[16] See fn. 2.
[17] 7 USC section 1, *et seq.*
[18] Core Principles and Other Requirements for Designated Contract Markets; Proposed Rule, 75 FR 80572 (December 22, 2010).
[19] CFTC Strategic Plan 2011-2015, *Financial Reform Legislation*, available at: http://www.cftc.gov/reports/strategicplan/2015/2015strategicplan06.html.

and Office of Chief Economist created the following template, which was distributed to staff on September 29, 2010:

> TEMPLATE
>
> Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before issuing an order under the Act. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of a rule or to determine whether the benefits of the order outweigh its costs; rather, it requires that the Commission "consider" the costs and benefits of its actions. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the Act.
>
> Summary of proposed requirements. The proposed rule would [explain briefly the requirements of the rule].[20]
>
> Costs. With respect to costs, the Commission has determined that [draw conclusions about the costs of the rule, associating the appropriate cost-benefit categories either directly or by implication].
>
> Benefits. With respect to benefits, the Commission has determined that [draw conclusions about the benefits of the rule, associating the appropriate cost-benefit categories either directly or by implication].
>
> Public Comment. The Commission invites public comment on its cost-benefit considerations. Commenters are also are invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the Proposal with their comment letters.

In addition, the General Counsel and Chief Economist issued the following guidance to be followed when completing the template:

> In the cost-benefit section of a proposed or interim final rulemaking, an initial analysis of the Commission's views of the costs and benefits of the proposed rule should be presented so that interested parties may submit comments that challenge, defend, or provide additional support for the analysis. A declarative statement of the anticipated effects of the proposed rule should be provided, in

[20] Brackets in original. Bracketed text contains instruction to CFTC staff.

> addition to requesting that interested parties submit their views on the five cost-benefit considerations enumerated in section 15.
>
> Typically, the costs typically may be presented by describing a counterfactual – what the Commission expects will happen if the rule is not adopted, with reference to previous or anticipated events. The benefits should be provided in declarative form.
> …
>
> The costs discussion in the cost-benefit analysis section of a rulemaking should include a quantitative or qualitative description of the kinds of costs involved, and upon which parties they will be imposed. When presenting costs qualitatively, the costs should be compared to some relevant alternative to the rule (i.e., the benchmark). In many cases, the benchmark would be the status quo regulatory approach. In some contexts, however, an alternative benchmark may be appropriate. If the rulemaking was designed to avoid certain costs associated with an alternative rule that could have been imposed, it should be discussed here as well; essentially comparing the proposed rule to a second benchmark.
> …
>
> With respect to the benefits associated with a proposed rulemaking, the comparison should be to the same benchmark(s) identified in the discussion of costs, and again the discussion should highlight the kinds of benefits anticipated, and the likely affected parties.[21]

Since enactment of the Dodd-Frank Act, CFTC has published more than 50 proposed rules, notices, or other requests related to the new law.[22] In a Federal Register release published in May of this year extending certain comment periods to June 3, 2011,[23] the CFTC listed the following 32 Dodd-Frank "rulemakings" proposed by the Commission, with their original comment periods:

Table 1 – Commission Rulemakings October 14, 2010 to March 10, 2011

Proposed[24]	Title of rulemaking	Closed[25]
10/14/2010	Financial Resources Requirements for Derivatives Clearing Organizations	12/13/2010
10/18/2010	Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest.	11/17/2010

[21] Memorandum: *Guidance on and Template for Presenting Cost-Benefit Analyses for Commission Rulemakings*, September 29, 2010 (attached as Exhibit 1).
[22] Statement of Jill E. Sommers, Commissioner, Commodity Futures Trading Commission, Before the Subcommittee on Oversight and Investigations, House Committee on Financial Services, March 30, 2011, available at: http://financialservices.house.gov/media/pdf/033011sommers.pdf.
[23] 76 FR 25274, *25275 (May 4, 2011).
[24] "Proposed" means the publication date in the Federal Register.
[25] "Closed" indicates the end for the comment period initially published with the notice.

Proposed	Title of rulemaking	Closed
10/26/2010	Agricultural Commodity Definition	11/26/2010
11/2/2010	Process for Review of Swaps for Mandatory Clearing	1/3/2011
11/3/2010	Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions.	12/3/2010
11/17/2010	Implementation of Conflicts of Interest Policies and Procedures by Futures Commission Merchants and Introducing Brokers.	1/18/2011
11/19/2010	Registration of Foreign Boards of Trade	1/18/2011
11/19/2010	Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant.	1/18/2011
11/23/2010	Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants	1/24/2011
11/23/2010	Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants.	1/24/2011
11/23/2010	Registration of Swap Dealers and Major Swap Participants	1/24/2011
12/3/2010	Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy.	2/1/2011
12/7/2010	Real-Time Public Reporting of Swap Transaction Data	2/7/2011
12/8/2010	Swap Data Recordkeeping and Reporting Requirements	2/7/2011
12/9/2010	Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants.	2/7/2011
12/13/2010	General Regulations and Derivatives Clearing Organizations	2/11/2011
12/15/2010	Information Management Requirements for Derivatives Clearing Organizations	2/14/2011
12/21/2010	17 CFR Part 1 Securities and Exchange Commission 17 CFR Part 240 Further Definition of ‘‘Swap Dealer,’’ ‘‘Security-Based Swap Dealer,’’ ‘‘Major Swap Participant,’’ ‘‘Major Security-Based Swap Participant’’ and ‘‘Eligible Contract Participant’’.	2/22/2011
12/22/2010	Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties	2/22/2011
12/22/2010	Core Principles and Other Requirements for Designated Contract Markets	4/18/2011
12/23/2010	Swap Data Repositories	2/22/2011
12/23/2010	End-User Exception to Mandatory Clearing of Swaps	2/22/2011
12/28/2010	Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants.	2/28/2011
1/6/2011	Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest.	3/7/2011
1/7/2011	Core Principles and Other Requirements for Swap Execution Facilities	3/8/2011

Proposed	Title of rulemaking	Closed
1/20/2011	Risk Management Requirements for Derivatives Clearing Organizations	4/25/2011
2/3/2011	Commodity Options and Agricultural Swaps	4/4/2011
2/8/2011	Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants	4/11/2011
2/8/2011	Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants.	4/11/2011
3/3/2011	Amendments to Commodity Pool Operator and Commodity Trading Advisor Regulations Resulting From the Dodd-Frank Act.	5/2/2011
3/9/2011	Registration of Intermediaries	5/9/2011
3/10/2011	Requirements for Processing, Clearing, and Transfer of Customer Positions	4/11/2011

In addition to the rules listed above, since March 10, 2011, the following rules have been proposed:

Table 2 –Proposed rules after March 10, 2011[26]

Proposed	Title of proposed rule[27]	Closed
4/25/2011	Swap data Recordkeeping and Reporting Requirements; Pre-Enactment and Transition Swaps	6/9/2011
4/28/2011	Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants	7/11/2011
5/12/2011	Capital Requirements of Swap Dealers and Major Swap Participants	7/11/2011
5/23/2011	Further Definition of "Swap," "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping	7/22/2011
6/7/2011	Adaptation of Regulations to Incorporate Swaps	8/8/2011
6/9/2011	Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions	8/8/2011

The Commission issued 25 rulemakings prior to January 18, 2011. On January 18, 2011, President Obama issued Executive Order (EO) 13563, *Improving Regulation and Regulatory*

[26] All CFTC proposed rules are available at: http://www.cftc.gov/LawRegulation/DoddFrankAct/Dodd-FrankProposedRules/index.htm.

[27] This table does not include other Dodd-Frank Federal Register publications, such as advanced notices of proposed rulemakings, corrections, and proposed interpretive orders. In addition to the proposed rules listed above, the Commission after March 10, 2011, issued a proposed interpretive order (and terminated a prior advanced notice of proposed rulemaking) addressing antidisruptive practices. Antidisruptive Practices Authority (Proposed Interpretive Order), 76 FR 14943 (March 18, 2011); Antidisruptive Practices Authority (Advanced notice of proposed rulemaking; notice of termination), 76 FR 14826 (March 18, 2011). The proposed interpretive order did not address section 15(a) of the CEA. We offer no opinion regarding whether section 15(a) would apply to an interpretive order.

Review,[28] which instructed covered agencies to consider, among other things, costs and benefits as follows:

> Each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible. Where appropriate and permitted by law, each agency may consider (and discuss qualitatively) values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts.
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> ***
>
> Where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, each agency shall identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public.

By its terms, EO 13563 did not apply to the CFTC, however, in light of instructions contained in EO 13563, CFTC tasked a new Dodd-Frank rulemaking team with developing conforming rules to update the CFTC's existing regulations to take into account the provisions of the Executive Order.[29]

By Spring 2011, the cost-benefit analyses issued by the CFTC in connection with notices of proposed rulemakings were the subject of various degrees of criticism by members of Congress, CFTC Commissioners, the industry, and the media. On February 24, 2011, Commissioner Sommers addressed her concerns regarding CFTC's cost-benefit analyses in her opening statement before the CFTC Open Meeting on the Twelfth Series of Proposed Rulemakings under the Dodd-Frank Act:

> I would like to talk about an issue that has become an increasing concern of mine – that is, our failure to conduct a thorough and meaningful cost-benefit analysis when we issue a proposed rule. The proposals we are voting on today, and the proposals we have voted on over the last several months, contain very short, boilerplate "Cost-Benefit Analysis" sections. The "Cost-Benefit Analysis" section of each proposal states that we have not attempted to quantify the cost of the proposal because Section 15(a) of the Commodity Exchange Act does not require the Commission to quantify the cost. Moreover, the "Cost Benefit Analysis" section of each proposal points out that all the Commission must do is "consider" the costs and benefits, and that we need not determine whether the benefits outweigh the costs.
>
> At the outset I ask, how can we appropriately consider costs and benefits if we make no attempt to quantify what the costs are? But more importantly from a good government perspective, while it is true that Section 15(a) of the Commodity Exchange Act does not require the Commission to quantify the cost

[28] 76 FR 3821 (January 21, 2011).
[29] Testimony of Chairman Gary Gensler before the House Committee on Agriculture, February 10, 2011. Available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-68.html.

> of a proposal, or to determine whether the benefits outweigh the costs, Section 15(a) certainly does not prohibit the Commission from doing so. We simply have chosen not to.
>
> Clearly, when it comes to cost-benefit analysis, the Commission is merely complying with the absolute minimum requirements of the Commodity Exchange Act. That is not in keeping with the spirit of the President's recent Executive Order on "Improving Regulation and Regulatory Review." We owe the American public more than the absolute minimum. As we add layer upon layer of rules, regulations, restrictions and new duties, we should be attempting to quantify the costs of what we are proposing. And we should most certainly attempt to determine whether the costs outweigh the benefits. The public deserves this information and deserves the opportunity to comment on our analysis. That is good government. Our failure to conduct a critical analysis of costs and benefits simply because we are not required to is not good government.[30]

Costs to implement Dodd-Frank were also emphasized by industry representatives. At a meeting of the CFTC Technology Advisory Committee[31] held on March 1, 2011, the Commission was presented with a $1.8 billion cost estimate to implement compliance with information technology requirements necessitated under Dodd-Frank, for the top 15 large dealers.[32]

A March 11, 2011 letter to the CFTC Inspector General from Representative Frank D. Lucas, Chairman, House Committee on Agriculture, and Representative K. Michael Conaway, Chairman, Subcommittee on General Farm Commodities and Risk,[33] detailed the extent to which diverse market participants noted concerns regarding costs and benefits issued in proposed Dodd-Frank rulemakings (as quoted here):

> From the Coalition of Derivatives End-Users, in a letter filed February 22, 2011 to the Proposed Rule "End-User Exception to Mandatory Clearing," 75 FR 80747:
>
> > "... the Commission has made no attempt to estimate or objectively value the costs imposed by this and other rulemakings under the Dodd-Frank Act. We believe the Commission's current approach does not satisfy the requirements of Section 15(a) (of the CEA)."

[30] Jill Sommers, Opening Statement, Meeting on the Twelfth Series of Proposed Rulemakings Under the Dodd-Frank Act, February 24, 2011 (available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/sommerstatement022411.html).
[31] Third Meeting of the Technology Advisory Committee, March 1, 2011, page 179, available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/tac_030111_transcript.pdf.
[32] Larry Tabb, Founder & CEO, TABB Group ,"Technology Implications and Costs of Dodd-Frank on Financial Markets," 9 (March 1, 2011), available at: http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_tabb.pdf.
[33] The letter is available here: http://agriculture.house.gov/pdf/letters/cftc_inspectorgeneral110311.pdf.

From the Working Group of Commercial Energy Firms, in a letter filed December 15, 2010 regarding the Proposed Rule "Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants," 75 FR 71297:

> "In order for a commercial energy firm that is deemed a Swap Dealer or Major Swap Participant to implement a "comprehensive risk management program"... ... the Working Group estimates it will require at least five new full-time employees….which, at a minimum, is 63 times greater than the Commission's estimate" (11% of one full-time employee).

Or similarly, an additional comment letter the Working Group filed on January 24, 2011 regarding the same rule:

> "The Commission estimates, for the purposes of the Paperwork Reduction Act, that the burden imposed by the Proposed Rules is $20,450. The Working Group estimates that, at a minimum, complying with the Proposed Rules would cost at least $418,440, or over 20 times the Commission's estimate."

From the International Swaps and Derivatives Association in a letter filed February 28, 2011 in response to the Notice of proposed rulemaking "Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants" 75 FR 81519:

> "We respectfully submit that the Commission's estimate of the cost of compliance with the Proposed Regulations is too low. The Commission pegs the upfront cost for technological improvements at $2400 for each SD and MSP, whereas at this juncture we believe that initial compliance with the Proposed Regulations will cost each such entity approximately $5-10 million."

In response to the March 11, 2011, letter issued by Representatives Lucas and Conaway, the CFTC OIG conducted an investigation into the cost-benefit analyses undertaken by the CFTC in connection with four proposed rules, and issued a report on April 15, 2011, that questioned the CFTC's cost-benefit analysis methodologies in some regards.[34] We were most concerned that the consideration of costs and benefits was being approached as a legal issue rather than an economic one, and that the process of section 15(a) compliance was being controlled foremost by attorneys, with input from Agency economists sometimes being overlooked or overruled by the attorneys. We agreed with a noted commenter that economic analysis in the context of rulemaking "is more than about satisfying procedural requirements for regulatory rulemaking."[35] We recommended that the Agency take more care in their analysis of

[34] See fn. 9.
[35] Testimony of James A. Overdahl, Vice President, National Economic Research Associates, Before the Committee on Financial Services, Subcommittee on Oversight and Investigations, United States House of Representatives March 30, 2011, available at: http://financialservices.house.gov/media/pdf/033011overdahl.pdf.

costs and benefits in numerous ways, emphasizing the need to conduct a more robust analysis with greater input from the Agency economists.

The Commission, in our opinion, has taken proactive steps to address concerns relating to its cost-benefit analyses raised by all sources. On March 14, 2011, CFTC extended the original comment period for the DCM Core Principles rulemaking from February 22, 2011, to April 18, 2011,[36] and on April 27, 2011, the Commission extended the comment period for all rulemakings, as follows:

> For all rulemakings listed herein for which the comment period has closed at the time of publication of this notice, the comment period is reopened until June 3, 2011. For those rulemakings listed herein for which the comment period closes during the extension's comment period, the comment period is extended until June 3, 2011. The comment period of any rulemaking subject of this extension that closes after the extension's comment period shall remain open until the originally published closing date. All comments that were received after the close of the originally established comment period of each of the reopened rulemakings will be treated as if they were received during the reopened comment periods and need not be resubmitted.[37]

On May 4, 2011, 10 Senators[38] requested our review of four additional proposed rules issued by the Commission under the Dodd-Frank Act:

1. Protection of Cleared Swaps, Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 76 FR 33818 (June 9, 2011) (segregation/bankruptcy rule);

2. Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3698 (Jan 20, 2011) (DCO risk management rule);

3. Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 FR 6715 (Feb. 8, 2011) (swap trading relationship documentation rule); and

4. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214 (Jan. 7, 2011) (SEF core principles rule).

The 10 Senators requested our review of the following six issues pertaining to the Commission's cost-benefit analyses:

[36] 76 FR 14825 (March 18, 2011).
[37] Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 25274 (May 4, 2011).
[38] Senator Shelby (AL), Ranking Member; Senator Crapo (ID); Senator Corker (TN); Senator DeMint (SC); Senator Vitter (LA); Senator Johanns (NE); Senator Toomey (PA); Senator Kirk (IL); Senator Moran (KA); and Senator Wicker (MS).

A. The quantitative methodologies the agency uses to evaluate the costs and benefits of proposed rules and the effects those rules could have on job creation and economic growth;

B. The qualitative methods the agency uses to categorize or rank the effects of proposed rules;

C. The extent to which the agency considers alternative approaches to its proposed rules;

D. The extent to which the agency examines the costs, benefits, and economic impact of reasonable alternatives to its proposed rules;

E. The extent to which the agency seeks public input and expertise in evaluating the costs, benefits, and economic impact of its proposed rules, and the extent to which the agency incorporates the public input into its proposed rules; and

F. The extent to which the economic analysis performed by the agency with respect to its proposed rulemakings is transparent and the results are reproducible.

During this period, the CFTC Chairman directed Agency management to issue guidance to assist section 15(a) compliance in connection with final rulemakings under Dodd-Frank. On May 13, 2011, the General Counsel and Chief Economist issued "Staff Guidance on Cost-Benefit Considerations for Final Rulemakings under the Dodd-Frank Act."[39] The new guidance encourages compliance with aspects of EO 12866, EO 13563, and OMB Circular A-4, and contains detailed instructions. The guidance for final rulemakings states that the cost-benefit analyses should reflect either or both of the following:

> 1) Additional information provided by the comments on the proposed rule and any alternatives considered in the Proposed Rulemaking;
>
> 2) Additional alternatives provided by the comments that would achieve the regulatory objectives.[40]

In addition, the guidance for final rulemakings states the cost-benefit section should:

> (1) respond to the meaningful and significant comments received either on the specific Cost-Benefit section in the proposed rulemaking or on the costs or benefits of the proposed Rulemaking in general and how the comments informed the Final Rulemaking;
>
> (2) discuss the anticipated costs and benefits of the Final Rulemaking including whether such costs or benefits may be meaningfully quantified, as well as for other alternatives

[39] See Exhibit 2.
[40] Id. page 3.

> that would achieve the regulatory objectives, relative to the baseline, by evaluating reliable data if such data is available;
>
> (3) provide a clear explanation of why the Final Ruelmaking is being adopted over the alternatives; and
>
> (4) discuss whether and how costs or benefit were quantified. [41]

The new guidance for final rulemakings contains detailed instructions on when and under what circumstances further cost- benefit analyses will be necessary in response to public comments,[42] the scope of any new analysis,[43] and when to quantify costs and benefits.[44] These instructions are at times somewhat general, e.g., "Costs and benefits should be quantified when it is reasonably feasible and appropriate to do so." However, detailed instructions are included to cover many specific cost issues, such as the following:

> …costs of reporting and recordkeeping should be analyzed by asking what incremental cost will be imposed on a market participant over the cost that would exist under the baseline, and whether the costs that will be imposed will affect all market participants equally. When market participants will bear costs differently because the costs generally will be higher for small participants and lower for large participants, costs may be presented in terms of the anticipated effect on an average large participant and an average small participant.[45]

Examples of costs and benefits are described more thoroughly than in the September 2010 guidance.[46] Instruction is also given regarding when and under what circumstances to re-propose a rule for additional notice and comment, based on cost-benefit analysis considerations.[47] Finally, the new guidance responded in detail to each recommendation and criticism suggested in the CFTC OIG report of April 15, 2011.

THE COMMISSION'S COST-BENEFIT ANALYSES FOR FOUR PROPOSED RULES

1. Protection of Cleared Swaps, Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, June 9, 2011, 76 FR 33818 (2011) (segregation/bankruptcy rule)

Section 724(a) of the Dodd-Frank Act[48] mandates that each futures commission merchant (FCM) and derivatives clearing organization (DCO) "segregate" customer collateral supporting cleared swaps. The Commission states:

[41] Id. page 4-5.
[42] Id. page 5.
[43] Id. page 6.
[44] Id. page 7.
[45] Id. page 7.
[46] Id. page 8.
[47] Id. page 9-10.
[48] P.L. 110-203, 124 Stat. 1682 (July 21, 2010).

> In other words, the FCM and the DCO (i) must hold such customer collateral in an account (or location) that is separate from the property belonging to the FCM or DCO, and (ii) must not use the collateral of one customer to (A) cover the obligations of another customer or (B) the obligations of the FCM or DCO.[49]

Dodd-Frank section 724(b) addresses the bankruptcy treatment of cleared swaps.[50] The segregation/bankruptcy proposed rule implemented the provisions of section 724. The team that handled this rulemaking was based in the Division of Clearing and Intermediary Oversight, with team members from each of the CFTC major divisions.

Staff on the rulemaking team and management informed us that costs were raised early and often with this rule, with clear issues regarding costs associated with the various options for several segregation models (e.g., guarantee fund amounts) at the fore. Staff stated they received opinions in an early public meeting[51] in favor of both the more costly and less costly options for alternative segregation models. [52]

The Commission issued an Advanced Notice of Proposed Rulemaking on December 2, 2010, [53] seeking comment on four models for protecting the margin collateral posted by customers to support cleared swaps transactions. The first two models grant non-defaulting customers safety from loss in the event of default of other customers and the FCM, while the second two models potentially put non-defaulting customers at risk of loss in the event of default by other customers and the FCM:

> 1. Full Physical Segregation—this option gave the most security to customers, as the DCO would not be able to access segregated funds of non-defaulting customers in the event of a default by other customers and the DCO and separate accounts would be maintained for each customer with no commingling. When the FCM maintains separate customer segregation accounts, the default of one customer has no effect of the value of a non-defaulting customer's account.

[49] 76 FR 33818, *33819 (2011).
[50] P.L. 110-203, 124 Stat. 1684 (July 21, 2010).
[51] This public meeting held August 16, 2010. Participants included Bank of America Merrill Lynch, Barclays, Citi, Credit Suisse, Deutsche Bank, Goldman, HSBC, JP Morgan, Katten, MF Global, Morgan Stanley, Newedge, Nomura, Prudential, State Street, UBS, Macquarie, and RJ O'Brien. Information on Dodd-Frank public meetings is available here: http://www.cftc.gov/LawRegulation/DoddFrankAct/ExternalMeetings/index.htm
[52] It should come as no surprise that more costly regulatory options may be preferred by some market participants. There is historic evidence to suggest that market users value the strength of a market infrastructure over costs. According to a November 1999 report by the Division of Economic Analysis of the CFTC, "there is a lack of solid evidence supporting the notion that disparities in regulatory schemes are having significant effects on the U.S. competitive position." Div. of Economic Analysis, CFTC, The Global Competitiveness of U.S. Futures Markets Revisited 36 (1999), available at http://www.cftc.gov/dea/compete/deacompete.htm (quoted in, Andrea M. Corcoran, *The Uses of New Capital Markets: Electronic Commerce and the Rules of the Game in an International Marketplace*, 49 Am. U.L. Rev. 581, 585 n.39 (2000)).
[53] Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies, 75 FR 75162 (December 2, 2010).

2. Legal Segregation with Commingling – this option is almost identical to full physical segregation because it also would not permit the DCO to access segregated funds of non-defaulting customers of a defaulting FCM. However, because this model permits commingling of segregated customer funds by the FCM, if a default occurred the DCO would allocate collateral to customers based on information that the FCM provided the day prior to default, resulting in some investment risk depending on price movements on the day of default. That is, if a non-defaulting customer's swaps position gained in value on the day of the default, those gains would not be recognized.

3. Moving Customers to the Back of the Waterfall – this more ominous-sounding segregation model would give customers less security because the DCO would be able to access the segregated funds of non-defaulting customers; however, such access would take place only if other sources of funds were depleted first.[54] Customer funds would be commingled, so the same investment risk would also exist with this model (as with Legal Segregation with Commingling).

4. Baseline Model – this is simply the existing exchange-traded futures model. In this model customer funds would be commingled and the DCO would be able to access all customer collateral (both defaulting and non-defaulting customers could be accessed) after exhausting the property of the defaulting FCM.

The Advanced Notice of Proposed Rulemaking generated 33 comments,[55] and on April 27, 2011 the Commission issued the segregation/bankruptcy notice of proposed rulemaking for publication in the Federal Register, and posted the proposed rule as submitted to the Federal Register on the CFTC website. On June 9, 2011, the Federal Register published the notice of proposed rulemaking.[56] The proposed rule renamed (and in our opinion further clarified) the four segregation models as follows:

Table 3 – Segregation model titles altered during the rulemaking process

Advanced Notice of Proposed Rulemaking	**Notice of Proposed Rulemaking**
Full Physical Segregation	Physical Segregation Model
Legal Segregation with Commingling	Complete Legal Segregation Model
Moving Customers to the Back of the Waterfall	Legal Segregation with Recourse
Baseline Model	Futures Model

The Commission discussed each model at length (regardless of its name) and tentatively recommended the Complete Legal Segregation Model, while inviting comment on the Legal Segregation with Recourse and Futures Models. The Commission also invited comment on the feasibility of an optional approach.

[54] Thus, customers would be at the back of the "waterfall," presuming "waterfall" is an apt metaphor for a default. We hope it is not. The immediate difference between a waterfall and a FCM default (that occurs to us) is the presence of attorneys.
[55] http://comments.cftc.gov/PublicComments/CommentList.aspx?id=912.
[56] 76 FR 33818 (June 9, 2011).

The segregation/bankruptcy rule represents a more current effort by the Commission to craft a cost-benefit analysis in connection with a Dodd-Frank rulemaking and, with regard to cost-benefit analysis, this notice of proposed rulemaking far surpassed others we have examined in terms of thoroughness.

Running to roughly 6,048 words, the cost-benefit analysis describes in great detail the potential cost impact of the several proposed segregation models on market participants. The Commission discussed the costs and benefits of the Complete Legal Segregation Model and the Legal Segregation with Recourse Model in relation to a common baseline – namely, the Futures Model. The Commission recognized that the direct effect of the Complete Legal Segregation and the Legal Segregation with Recourse Models (as opposed to the Futures Model) is to protect the cleared swaps customer collateral of non-defaulting customers against claims by the DCO in the event of simultaneous default by one or more cleared swaps customers and their FCM. Within this framework, costs were broken down into three types: operational costs, risk costs, and costs associated with induced changes in behavior.

Operational costs for FCMs would include costs associated with producing and maintaining increased account information, and increased compliance costs. Not surprisingly, precise dollar figures for these costs would hinge on the number and types of cleared swaps customer accounts and other factors going to the size/volume of the FCM's business. The Commission discussed cost estimates provided by commenters, and also noted there would be costs faced by each DCO, likely of similar magnitude according to the Commission, unless the DCO already maintained sufficient information to implement the Complete Legal Segregation and the Legal Segregation with Recourse Models.

Risk costs would refer to costs associated with reassigning liability in the event of customer default under the Complete Legal Segregation Model or the Legal Segregation with Recourse Model (compared with the Futures Model). The Commission noted vast disparities in cost estimates expressed in comments to the advanced notice of proposed rulemaking issued for this rule, and noted the difficulty attendant to translating a cleared swaps customer collateral or guaranty fund increase to a cost increase in light of the fact that the funds are not lost and the cost therefore is the difference between actual and anticipated returns on the same investment, but for its use as collateral or guaranty.

Costs associated with induced changes in behavior are described in some detail. The Commission recognized concerns raised by commenters, to wit, that decreasing the customer's risk of adverse impact in the event of default by another customer (and the FCM) through the Complete Legal Segregation and Legal Segregation with Recourse Models will likely decrease the customer's motivation to carefully research a FCM (and the FCM's other customers) prior to opening an account. The Commission counters that the Complete Legal Segregation and Legal Segregation with Recourse Models will instead motivate the FCMs and DCOs to carefully research and monitor customers, and notes that the DCOs are in a better position to "have good information about the financial condition of both FCMs and customers."

While the notice of proposed rulemaking for segregation and bankruptcy did not quantify the costs of compliance with the proposed rule in detail, cost estimates received in comments were described, and the Agency gave its opinions overall on the costs and benefits of the proposed segregation options in a robust manner. The cost-benefit discussion included internal references to discrete instances in the preamble where costs were discussed in greater detail, as well as references in the preamble to the cost-benefit analysis section (for further discussion of costs).

Our review of drafts of the cost-benefit analysis for the segregation/bankruptcy rule indicates an evolution of the process from Fall 2010 to April 2011, with the cost-benefit analysis section beginning as little more than a recitation of the template (as seen with the earlier proposed rules) prepared by an OGC attorney, and taking on greater detail in subsequent drafts, with most drafting of the non-template portions crafted by the Office of Chief Economist, as well as team members familiar with the technical aspects of the rule. The cost-benefit analysis was referred to as the "caboose" in staff e-mail, but the volume of documented discussion regarding the relative costs associated with the various segregation models demonstrates the cost-benefit analysis section was given heightened importance.

Staff involved with the segregation/bankruptcy rule uniformly told us that the Office of Chief Economist drafted the bulk of the cost-benefit analysis discussion, with the Office of General Counsel representatives suggesting edits, some of which were not accepted by the representatives from the Office of Chief Economist. It appears that issues were resolved to the satisfaction of both Offices, but it also appears clear that the Office of Chief Economist for this rule had a greater say in the substance of the cost-benefit analysis as well as the outcome of disputes. It appears quite clear that the Office of Chief Economist played an enhanced role. While the cost-benefit analysis discussion did not include a description of internal CFTC costs to implement the regulation, which we believe should not be overlooked, overall we were very impressed with the cost-benefit analysis included with this notice of proposed rulemaking.

2. Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3698 (Jan 20, 2011)(DCO risk management rule)

Section 725(c) of the Dodd-Frank Act amended section 5b(c)(2) of the CEA, the section that sets out core principles for Derivatives Clearing Organizations (DCOs). Existing core principles dated from the CFMA,[57] and in accordance with the CFMA the Commission adopted guidance for DCOs rather than regulations. The Dodd-Frank Act amended section 5b(c)(2) to confirm that the Commission may adopt implementing regulations. In this proposed rulemaking the Commission set out to implement six DCO core principles: Participant and Product Eligibility (Core Principle C), Risk Management (Core Principle D), Settlement Procedures (Core Principle E), Treatment of Funds (Core Principle F, Default Rules and Procedures (Core Principle G), and System Safeguards (Core Principle I). As stated by the Commission, the rule as proposed:

[57] Pub. L. 106-554, sec. 1(a)(5), 114 Stat. 2763.

> …would implement the participant and product eligibility, risk management, settlement procedures, treatment of funds, default procedures and system safeguards core principles for DCOs and would adopt an application form for DCO registration under the CEA, as amended by the Dodd-Frank Act.

The team that handled this rulemaking was based in the Division of Clearing and Intermediary Oversight, with team members from each of the CFTC major divisions. From our discussions with staff, we understand that one team member took the lead drafting the technical portions of the rule. She used the cost-benefit template included with the September 2010 guidance, copied some of what another Commission staffer had drafted for a (hopefully similar) rule that apparently was determined appropriate for this rule also, and then sent the draft cost-benefit analysis to Washington for further drafting, where the OGC representatives added some edits. Staff working at the request of the team leader drafted additional language for the cost-benefit analysis section of this rule, pulling in some costs described in the Paperwork Reduction Act section, since these costs would be part of the overall costs. The Office of Chief Economist had minimal involvement with this rulemaking. Initially two staffers from the Office of Chief Economist were assigned to this rule; however, one was recused early in the process. The other staff member told us he was assigned to six teams, and he simply did not get the chance to work on this one and is not sure he read the cost-benefit analysis. We found no instances of e-mail from staff in the Office of Chief Economist discussing the cost-benefit analysis for this rule.

The cost-benefit analysis section of the preamble to the proposed rule for swaps documentation contained roughly 645 words. The cost-benefit analysis quantifies the cost of "recordkeeping requirements" and states the Commission's estimate of costs is $500 annually. No explanation is given. Based on our discussions with staff, we knew to consult the Paperwork Reduction Act section. The Paperwork Reduction Act section states:

> The proposed regulations would require each respondent to maintain records of all activities related to its business as a DCO, including all information required to be created, generated, or reported under part 39, including but not limited to the results of and methodology used for all tests, reviews, and calculations. The Commission staff estimates this would result in a total of one response per respondent on an annual basis and that respondents could expend up to $500 annually, based on an hourly rate of $10, to comply with the proposed regulations. This would result in an aggregated cost of $6,000 per annum (12 respondents x $500).
>
> The proposed regulations also would require the submission of an application form by entities seeking to register as DCOs. The applicant burden is estimated to take, on average, approximately 400 hours, with an hourly rate ranging from $75-$400, for a total estimated cost of $100,000 per application. These estimates include the time needed to review instructions and to develop, acquire, install, and utilize technology and systems for the purposes of collecting, validating, and verifying information. Staff estimates that three entities will seek to register as a DCO on an annual basis.[58]

[58] 76 FR at 3716-3717 (January 20, 2011).

We noted that the $10/hour wage rate was not in line with hourly rates of pay estimated for similar tasks described in the Paperwork Reduction Act sections of other rules proposed under Dodd-Frank.[59] We noted the Paperwork Reduction Act section did not state authority for the $10/hour figure. We were told that the $10 figure was determined as the marginal cost of this activity for an employee.

Staff stressed that costs were considered throughout the rule-making process, and that this rule was codifying what much of the industry is already doing, which may indicate lower implementation costs. Indeed, the Commission stated:

> For purposes of this rulemaking, the estimated reporting and recordkeeping costs do not include other costs addressed by other rulemakings. However, the costs do take into account the costs of implementing certain reporting requirements which many DCOs already have in place, and thus, the actual costs to many DCOs may be far less than the Commission's estimates.[60]

On June 8, 2011, the Commission's public website indicated 101 comments or exparte communications for this proposed rule. We reviewed some, but not all, of the comments, finding several that claim that the rule as proposed will result in increased costs that are not warranted, or are without corresponding benefit.[61]

3. Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 FR 6715 (Feb. 8, 2011) (swap trading relationship documentation rule)

Section 731 of the Dodd-Frank Act added new section 4s to the Commodity Exchange Act. Section 4s sets forth a number of requirements for swap dealers (SD) and major swap participants (MSP). Specifically, section 4s(i) establishes swap documentation standards for registered SD and MSP. Section 4s(i)(1) requires SD and MSP to "conform" to Commission-set standards relating to: timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps." Section 4s(i)(2) requires the CFTC to adopt rules "governing documentation standards for swap dealers and major swap participants." The swap relationship documentation proposed rule implements section 4s(i) of the Act. The team that handled this rulemaking was based in the Division of Clearing and Intermediary Oversight, with team members from each of the CFTC major divisions.

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[59] See, e.g., Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 FR 71397, 71402 (November 23, 2010)(hourly rate of $100, based on statistics produced by the Bureau of Labor, applied for financial managers performing proposed recordkeeping requirements in connection with risk management programs); cf., Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 FR 29818, 29876 n.345 (May 23, 2011)(data from SIFMA's "Management & Professional Earnings in the Securities Industry 2009," modified by SEC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that that the cost of an attorney is $ 316 per hour.)

[60] 76 FR at 3717 (January 20, 2011).

[61] See, e.g., comment of CME Group, Inc., March 21, 2011; comment of Kansas City Board of Trade Clearing Corporation, March 21, 2011; comment of National Energy Marketers Association, February 22, 2011. Comments are available here: http://comments.cftc.gov/PublicComments/CommentList.aspx?id=957.

The relationship documentation rule sets out detailed requirements for relationship documentation that must accompany swap transactions, including terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon terminations, transfer of rights and obligations, governing law, valuation, and dispute resolution procedures.[62] In addition, trading relationship documentation must include certain swap transaction confirmations,[63] descriptions of credit support arrangements which include detailed margin information,[64] and documentation of the methods for determining the value of each swap at any time from execution to the termination of such swap (by any means).[65] Each SD and MSP must have at least 5% of their swaps trading relationship documentation audited each year by an independent internal or external auditor.[66] Records must be maintained in accordance with existing Commission regulations under the CEA and produced on demand to CFTC and certain other regulators.[67] Finally, SDs and MSPs must notify the Commission and certain other regulators of any swap valuation dispute within timeframes that vary (one business day or five business days) based on the status of the counterparty as a SD/MSP, or not.[68] Certain (and somewhat lesser) documentation must also be maintained for swaps excepted from a mandatory clearing requirement.[69]

Staff working on this rule told us that this proposed rule builds on efforts to standardize swaps market practices dating back to 1995. They stressed that the rule does not propose anything radically new. Nevertheless," the Commission recognized that "amending all existing trading relationship documentation would present a substantial undertaking for the market." We agree. While the Commission also expressed its belief that much of the existing swap documentation among SDs, MSPs and their counterparties "likely would be in compliance" with proposed documentation requirements, it nevertheless requested comment on a variety of factors transparently designed to elicit alternatives that would cost less (or be less burdensome) to implement. For instance, the Commission requested "comment on an appropriate interval following the effective date of the regulations after which to require compliance" In addition, the Commission invited comment on whether to provide a safe harbor for dormant trading relationships, whether to modify proposed regulations to reflect size differences among SD and MSP or asset classes, and how long to defer the effective date of the proposed regulations in order to permit regulatees to "bring their existing documentation into compliance."

The team leader for this group crafted the initial draft of the cost-benefit analysis. To the extent that information included under the Paperwork Reduction Act section was reiterated in the cost-benefit analysis section, this information was added by the team member who drafted the Paperwork Reduction Act language for the proposed rule. Staff also stressed that costs were considered throughout the process of crafting the technical portion of the rule and that the Commission took care to request comment on a variety of aspects of the proposed rule, with a view to finding more efficient and cost-effective ways to achieve the requirements of the Dodd-

[62] 76 FR 6726 (February 8, 2011)(proposed 17 CFR 23.504(b)(1).
[63] Id. (proposed 17 CFR 23.504(b)(2)).
[64] Id. (proposed 17 CFR 23.504(b)(3)).
[65] Id. (proposed 17 CFR 23.504(b)(4)).
[66] Id. (proposed 17 CFR 23.504(c)).
[67] Id. (proposed 17 CFR 23.504(d)).
[68] Id. (proposed 17 CFR 23.504(e)).
[69] Id. (proposed 17 CFR 23.505).

Frank Act. Staff also noted that this rule was drafted and approved by the Commission on January 13, 2011, prior to issuance of EO 13563. Staff said they were pleased that the Commission extended the deadline for comment, and looked forward to implementing the new guidance for cost-benefit analyses in connection with the final rule. Staff indicated that costs to the CFTC to implement this rule were not addressed during the rulemaking process.

The cost-benefit analysis section of the preamble to the proposed rule for swaps documentation contained roughly 900 words. The cost-benefit analysis does not include a quantification of any costs. Instead, the cost-benefit analysis states: "the Commission has determined that the cost that would be borne by [SDs and MSPs] to institute the policies and procedures, make and maintain the records, and perform the event-based reporting necessary to satisfy the new regulatory requirements are far outweighed by the benefits that would accrue to the financial system as a whole as a result of the implementation of the rules." The Commission also opined that "many, if not most" SDs and MSPs have already implemented documentation practices, and thus the documentation requirements for such market participants "may be limited to amending existing documentation to expressly include any additional terms required" under the new rules. While the Commission recognized that SDs and MSPs "may face certain costs, such as the legal fees associated with negotiating and drafting the required documentation modifications," it also recognized that these would largely be start-up costs and that as similar "revisions would likely apply to multiple counterparties," the start-up costs "per counterparty" would be thereby reduced.

The representative from the Office of the Chief Economist who worked on this rule has since left the CFTC and was not reached for comment; however, the team members who crafted the cost-benefit analysis believe the OCE representative did not have significant comment on the cost-benefit portion of the preamble. E-mail supplied by staff indicate that the OCE representative on the team received drafts of the rule as they were circulated to the team, but was not included in discrete e-mail discussions addressing the cost-benefit analysis section, which as stated by staff was written by the team leader with revisions by staff.

As of June 8, 2011, the CFTC displayed 34 comments on its public website. We identified no commenter quantifying costs; however, multiple commenters generally claimed the rule as proposed would result in increased costs with little benefit, notably with regard to the valuation requirement.[70]

4. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214 (January 7, 2011)(SEF core principles rule)

The Dodd-Frank Act created "Swap Execution Facilities" (SEF) – a new type of regulated marketplace for the trading of swaps.[71] Section 723(a)(3) of Dodd-Frank added new Section 2(h)(8) to the CEA to require that swaps subject to the clearing requirement of section

[70] See Comment by ISDA dated April 8, 2011, and Comment by Markit dated June 3, 2011, both available here: http://comments.cftc.gov/PublicComments/CommentList.aspx?id=970.

[71] Congress defined SEFs as follows: "The term 'swap execution facility' means a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that— (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market." P.L. 111-203, sec. 721, 124 Stat. 1670.

2(h)(1) of the CEA be executed either on a designated contract market ("DCM") or on a SEF, unless no DCM or SEF made the swap' "available for trading". Section 733 of the Dodd-Frank Act also added Section 5h(a)(1), requiring that no person may operate a facility for the trading or processing of swaps unless the facility is registered as a SEF or as a DCM. Section 733 of the Dodd-Frank Act added new section 5h to the Commodity Exchange Act to provide a regulatory framework of Commission oversight.

This rule was known as the "SEF core principles rule." The proposed SEF core principles rule implemented sections 723(a)(3) and 733 of Dodd-Frank. The team that handled this rulemaking was based in the Division of Market Oversight, with team members from each of the CFTC major divisions. Team members told us that the Office of General Counsel and the Office of Chief Economist worked together on the cost-benefit analysis for the rule, and that there were significant issues that were resolved by the team leader. The first draft of the cost-benefit analysis, Regulatory Flexibility Act discussion and Paperwork Reduction Act discussion was prepared by an attorney in the Office of General Counsel; however, the attorney took care to leave blanks in the cost-benefit analysis section to be completed by representatives from the Office of Chief Economist. The representatives from the Office of Chief Economist "filled in the blanks" as it were, and ran the draft by team members who made additional edits, and then sent the edited version of the OCE draft back to the Office of General Counsel. A team member from the Office of General Counsel then edited this new draft and distributed it back to team members, including the Office of Chief Economist representatives, making minor edits. The next day the team member then sent the draft to OGC management, specifically requesting review of the cost-benefit analysis section. A new draft was prepared on the OGC side, and distributed to team members (including the OCE representatives), and OGC management. The new draft purported to "incorporate the best of all worlds" and satisfy the September 2010 guidance on cost-benefit analysis. In a nutshell, the difference between the OCE approach and the OGC approach centered on whether to break out for cost-benefit discussion specific tasks within the rule, or to address the regulatory scheme as a whole.

Following receipt of the new OGC version, the OCE representatives did not agree, and submitted a revision that essentially re-introduced language addressing discrete sections of the regulation. Attorneys in the Office of General Counsel expressed concern for the economists' approach, apparently believing the Commission needed to remain consistent in its interpretation of section 15(a) that had been in place since 2000, and that stepping away from the Commission's traditional interpretation of section 15 might carry a litigation risk. In any event, interviews with staff also indicated some concern that addressing costs and benefits in connection with certain provisions of the proposed rule while eschewing discussion of other provisions could be misunderstood or misinterpreted by the public. It is not clear whether these latter concerns were communicated to OCE.

The General Counsel was made aware of the dispute and, after discussion with the team leader, agreed that the OGC version could be published. While it appears that staff members in the Chairman's office were also made aware of the dispute, resolution of this dispute appears ultimately to have been made by the Team Leader, in consultation with the Director of the Division of Market Oversight. The team leader understood that sign-off for the cost-benefit analysis section was not required from OCE, and that any disputes would have to go to the Chairman, but this one did not.

In any event, the OGC version was published. The cost-benefit analysis section of the SEF core principles rule runs to roughly 607 words. The cost-benefit analysis consists of a very bare-bones, minimalist analysis, with little detail given. Moreover, no detail is given regarding costs to the Commission to oversee compliance with the core principles and regulatory requirements for SEFs. Because it is so very brief, we copy the entire section titled "Costs" here:

> As highlighted by recent events in the global credit markets, transacting of swaps in unregulated, over-the-counter markets does not contribute to the goal of stability in the broader financial markets. The public would continue to be at risk to such financial instability if certain derivatives were allowed to trade over the counter rather than on regulated exchanges. SEFs that determine to register with the Commission in order to provide for the transacting of swaps will be subject to core principles for transacting of swaps. If swaps were allowed to continue to be transacted bilaterally, rather than on the regulated market of a SEF, price discovery and transparency in the swaps markets would continue to be inhibited. These procedures are mandatory pursuant to the Dodd-Frank Act and any additional costs associated with these procedures are required by the implementation of the Dodd-Frank Act.

Staff stressed to us that costs were considered throughout the drafting of this rule when considering alternative approaches, and were discussed in public discussions of the rule. However, all cost discussions were not documented.

As of June 8, 2011, the Commission website displayed 104 comments (including ex parte communications) received for this rule. Even a cursory review of the comments indicates significant concerns regarding costs associated with compliance with the rule as proposed.[72] None of the commenters we reviewed quantified costs.

CROSS-CUTTING ISSUES ASSOCIATED WITH THE FOUR PROPOSED RULES

We are updating this section from our earlier report.[73] For the four proposed rules examined by this Office earlier this year, [74] we identified several cross-cutting concerns raised by CFTC staff and management, or by our Office. We found the same issues being voiced by staff associated with the four rules analyzed here as well, to a greater or

[72] See Comment from Morgan Stanley, March 2, 2011 (concern regarding transaction costs for market participants); Comment from ISDA, March 8, 2011 (concern regarding hedging costs); Comment from the Farm Credit Counsel, March 8, 2011 (concern regarding increased cost of financing for farmers if the rule is adopted as proposed). Comments are available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=955.

[73] An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act, 13 (April 15, 2011), available at: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigationreport.pdf.

[74] The four earlier rules were: Further Defining "Swap Dealer", "Security-based Swap Dealer", "Major Swap Participant," "Major Security-based Swap Participant," and "Eligible Contract Participant, 75 FR 80174 (December 21, 2010) (Joint proposed rule; proposed interpretations); Confirmation, Portfolio Reconciliation, Compression Requirements for Swap Dealers and Major Swap Participants," 75 FR 81519 (December 28, 2010) (Notice of proposed rulemaking); Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572 (December 22, 2010) (Notice of proposed rulemaking); Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 FR 71397 (November 23, 2010) (Notice of proposed rulemaking).

lesser extent, and continue to believe they should shape any consideration of the Commission's performance with regard to cost-benefit analyses. Issues raised across the board by CFTC staff and management include:

1. Unprecedented Nature of the Regulatory Initiative/Paradigm Shift.

From all CFTC divisions, the staff and management continued to emphasize that Dodd-Frank required regulation of the swaps industry for the first time and therefore presented unprecedented challenges. Consideration of costs and benefits associated with proposed regulations without a parallel in the futures markets was described as a formidable challenge.

2. Historic Difficulty of Quantifying Industry Costs.

Staff and management agreed that, historically, the futures industry has not presented the CFTC with quantified costs associated with compliance with existing or proposed regulations. Staff opined that the industry considers compliance costs to be proprietary and confidential information. Staff also opined that commenters would be highly unlikely to quantify projected costs for compliance in the context of a federal rulemaking due to the fact that comments are made available to the public.

There was some difference in staff opinion expressed for the four rules examined for this report as compared with the four rules examined with the last report. During fieldwork for our earlier report, some staffers indicated that costs could be estimated by market participants for those four particular rules.[75] Because our current review included proposed regulations pertaining to swap execution facilities, staff stated that costs might not readily be estimated as these will be new regulated entities. Moreover, management indicated that they have received feedback to the effect that the cost of providing information to the Commission for purposes of regulatory overhaul might not produce a corresponding benefit. Certainly there will be many instances where operational cost information will not readily influence a Commission regulation; however, we would posit that where operational cost information is relevant, analysis by the Commission in a comparative fashion would likely enable the Commission to craft regulatory solutions that foster a "best practices" approach taking into account both costs and benefits.

3. Frustration with Confusion Surrounding the Paperwork Reduction Act.

In our earlier report, we stated that staff expressed some frustration with a perceived confusion of costs listed under the Paperwork Reduction Act (PRA)[76] section of the proposed rules as compared with the cost-benefit analysis, and expressed a desire to better explain PRA in the future. We note with approval that the cost-benefit analysis guidance issued in connection with final rulemakings under Dodd-Frank contains instructions to clearly differentiate between PRA and cost-benefit considerations.

[75] An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act, 14 (April 15, 2011), available at: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigationreport.pdf.
[76] 44 U.S.C. chapter 35; see 5 C.F.R. Part 1320.

4. Need to Avoid Addressing Costs and Benefits for the Mandatory Aspects of Dodd-Frank.

To the extent the Dodd-Frank Act imposed mandatory requirements, staff uniformly stressed a desire to refrain from expressing mandatory rules in terms of costs and benefits. If Congress required certain conduct, necessarily the determination had been made that the benefits would outweigh costs. We continued to hear similar comments, for instance, staff opined that an analysis of the cost of not requiring segregation would not be appropriate where Congress has required segregation for swaps customer funds. Thus, the costs of various segregation models should be compared to a baseline futures model.

5. Costs were Considered During the Process of Constructing the Dodd-Frank Rules.

While the creation of policies regarding the construct of cost-benefit analyses were the province of the Office of the Chief Economist and Office of General Counsel, with Office of General Counsel essentially granting final clearance for each rule, staff on the rule-making teams stressed that costs were considered during the rulemaking process. In both internal discussions and meetings with industry representatives[77] costs were raised with a view to determining how to implement requirements that would result in less cost without sacrificing legitimate regulatory needs.

In addition to the five issues, above, our Office identified the following issues that applied to all four rulemakings we reviewed in our earlier report, and again we repeat them here:

1. Section 15(a) Compliance was Grouped with PRA and Regulatory Flexibility Act Discussions.

For all four rules requested by the Senators, the cost-benefit analysis was placed at the end of the preamble to the proposed text of the regulation, next to the PRA discussion and the Regulatory Flexibility Act discussion. These three portions were considered non-technical and we got the impression they were traditionally the province of the Office of General Counsel rather than the CFTC staff tasked with crafting the technical details of the rule. The cost-benefit analysis, PRA discussion, and Regulatory Flexibility Act discussion were referred to by team members as the regulation's "caboose." This treatment of the cost-benefit analysis discussion might have given the impression that it was merely an administrative task associated with the rulemaking, rather than a substantive analysis of the rule. We were pleased to see the segregation/bankruptcy rule present a far more robust approach to the cost-benefit analysis drafting process, with cross-references to cost discussions in the preamble. Commission staff also referred to this cost-benefit analysis as part of the "caboose," but because the cost-benefit analysis was thorough, the term "caboose" is not problematic.

2. Internal Costs Associated with Rule Implementation by CFTC were not Quantified.

Across the board, staff and management alike indicated that CFTC's internal costs were not calculated for purposes of analyzing the costs and benefits associated with the four proposed rulemakings. CFTC management stated that staff labor necessary to implement Dodd-Frank had

[77] CFTC has had at least 675 meetings with outside individuals concerning the Dodd-Frank rules. Testimony of Chairman Gary Gensler before the Senate Committee on Banking, Housing and Urban Affairs, April 12, 2011, available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-77.html.

been calculated overall by each Division, and these quantified estimates were included in CFTC budget submissions, but the cost to implement each regulation had not been quantified. Implementation costs were not reflected in the cost-benefit analyses for the four rules requested for review, or in any other rules we reviewed. CFTC also did not quantify or estimate opportunity costs, that is, the extent to which implementation of Dodd-Frank might be expected to diminish regulatory efforts in other areas. We are pleased that the recent staff guidance for cost-benefit analyses for the final Dodd-Frank rules states:

> [S]taff should consider the costs of implementation during its consideration of each final rulemaking. Staff should be prepared to present and discuss such costs and cost data, if any, with the Commission during the consideration of the final rulemaking.

ANALYSIS OF THE SIX FACTORS POSED BY THE SENATORS

1. The quantitative methodologies the agency uses to evaluate the costs and benefits of proposed rules and the effects those rules could have on job creation and economic growth.

The Commission does not as a rule employ quantitative methodologies to evaluate the costs and benefits of proposed rules at this time. They lack quantitative data, and their analysis therefore is qualitative somewhat out of necessity. Cost estimates posited by market participants through public meetings, communications and comments were compared and discussed in the cost-benefit analysis for the segregation/bankruptcy rule, and to our knowledge they were not independently verified. We are pleased that the recent staff guidance for cost-benefit analyses for the final Dodd-Frank rules contains instruction on quantitative analysis, and states:

> Costs and benefits should be quantified when it is reasonably feasible and appropriate to do so. When quantitative data is not readily available, or it cannot be gathered with specificity with reasonable effort, estimates or ranges may be used, provided there is a reasonable basis for such estimates or ranges. The methodology used to estimate costs and benefits should be discussed in the rulemaking. As the Executive Order acknowledges, in some areas quantification is not possible, and in these areas qualitative measure should be used instead.

Our discussions with management and staff indicated that the effect of the Dodd-Frank regulations on job creation and economic growth overall were not considered as a major factor in any rulemaking. The positive effect of the proposed rules on economic stability was a frequent "benefit" stated in the cost-benefit analyses (or the cost of not acting was described as a "cost").

2. The qualitative methods the agency uses to categorize or rank the effects of proposed rules.

This factor is discussed earlier in this report at pages 2 through 4 (proposed rules), and 11 through 12 (final rules), of this report.

As stated, CFTC began an initiative to rework and improve the cost-benefit methodology under section 15(a) earlier this year, issuing staff guidance for the final rules under Dodd-Frank

in May of this year. We are pleased with the specific responses to suggestions and recommendations contained in our earlier report.

3. The extent to which the Agency considers alternative approaches to its proposed rules.

Based on discussions with staff, we are satisfied that the Agency considers numerous approaches to its proposed rules. We did not ask staff to tally the number of alternatives considered in the process of crafting each technical detail for each of the proposed rules, but certainly it became clear through review of the proposed rules and discussions with staff that alternatives (and their cost implications) were discussed as a matter of course throughout the drafting process though often without being documented in a preamble. There are numerous examples in the four proposed rules we considered for this report and in the rules considered earlier this year where either an alternative is disclosed with its reason for rejection stated, or the Commission requests comment on costs and on alternatives to proposed regulations which, by implication, indicates the Commission has considered alternative approaches. Moreover, the number of public meetings and discussions related to the Dodd-Frank rulemakings indicates the Commission strove to consider all competing approaches. While we cannot certify that every possible regulatory alternative was considered by the Commission for each of the four rulemakings, we received no indication from staff that alternatives had been eschewed out-of-hand for any reason.

4. The extent to which the Agency examines the costs, benefits, and economic impact of reasonable alternatives to its proposed rules.

We are pleased with the extent to which the cost-benefit analysis of segregation/bankruptcy rule described the costs and benefits of the alternative segregation models. While the segregation/bankruptcy rule was described by staff as unique from the start in terms of cost considerations due to the focus on costs associated with the various segregation models, staff also indicated that the Commission is responding to the comments regarding costs-benefit analyses received earlier this year, and to our first report (specifically with regard to inserting in the cost-benefit analysis cross-references to further cost discussions in the preamble).

The other proposed rules we examined clearly are lacking in this regard; however, we would point out that the other three rules were published quite early in the Dodd-Frank rulemaking process for the Commission. With regard to the three earlier rules we reviewed for this report, the comments and recommendations contained in our earlier report would apply with equal emphasis.[78]

5. The extent to which the agency seeks public input and expertise in evaluating the costs, benefits, and economic impact of its proposed rules, and the extent to which the agency incorporates the public input into its proposed rules.

[78] The latest cost-benefit analysis guidance contains a succinct summary of all recommendations and suggestions in our first report. Exhibit 2, page 44-45 of this report (page 11 – 12 of the guidance).

The Agency seeks public input and expertise in evaluating the costs, benefits, and economic impact of its proposed rules to a great extent. The Chairman testified in February this year that the Agency had held over 500 public meetings regarding the Dodd-Frank regulations.[79] Details regarding the public meetings are available on the CFTC website,[80] and staff and management stressed that discussions regarding costs to comply with proposed regulatory approaches permeates these meetings. The Commission has also held numerous round tables.

6. The extent to which the economic analysis performed by the agency with respect to its proposed rulemakings is transparent and the results are reproducible.

Economic analysis performed by the agency is largely qualitative at this time, and transparent (where it is thorough). Unfortunately there is little quantitative data available to test.

CONCLUSIONS AND RESTATEMENT OF RECOMMENDATIONS

Since enactment of the Dodd-Frank Act, CFTC has published more than 50 proposed rules, notices, or other requests related to the new law.[81] In accordance with section 15(a) of the Act, CFTC has published cost-benefit analyses with each proposed rule. We examined the cost-benefit analyses for four proposed rules dealing with the treatment of segregated funds of swaps customers, derivatives clearing organization risk management requirements, swaps relationship documentation requirements, and core principles for swap execution facilities. Three of the proposed rules were issued prior to March of this year. The proposed rule addressing the treatment of segregated funds of swaps customers was issued by the Commission on April 27, 2011.

While the methodology initially adopted by the Office of General Counsel and the Office of Chief Economist would permit a detailed and thorough approach to the task, in the three earlier rules we examined it appears the Commission generally adopted a "one size fits all" approach to section 15(a) compliance without giving significant regard to the deliberations addressing idiosyncratic cost and benefit issues that were shaping each rule, and often addressed in the preamble. We made the same comments in our earlier report addressing four other proposed rules that were also issued early in the process. Our comments and recommendations made in the earlier report fully apply to these three rules, and we have no additional recommendations.[82]

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[79] Testimony of Chairman Gary Gensler before the House Committee on Agriculture, February 10, 2011. http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-68.html.

[80] http://www.cftc.gov/LawRegulation/DoddFrankAct/ExternalMeetings/index.htm.

81Statement of Jill E. Sommers, Commissioner, Commodity Futures Trading Commission, Before the Subcommittee on Oversight and Investigations, House Committee on Financial Services, March 30, 2011, available at: http://financialservices.house.gov/media/pdf/033011sommers.pdf .

82 See fn. 78.

For the more recent cost-benefit analysis accompanying the proposed segregation/bankruptcy rule, we are pleased with the cost-benefit discussion. Although staff told us this rule was different with regard to cost considerations from the start, they also told us the cost-benefit analysis section was influenced by concerns voiced this year regarding cost-benefit analyses, including our earlier report. With regard to the segregation/bankruptcy rule, the only deficiencies we detect – both minor – are the lack of clarification of the role of Paperwork Reduction Act costs in the context of the cost-benefit analysis, and the lack of quantified costs to the Agency to implement the regulation. Because the Agency currently includes with its budget requests amounts necessary to implement the Dodd-Frank Act, we believe these costs could also be discussed in the context of Dodd-Frank rulemakings. We believe internal Agency costs, including opportunity costs, are relevant because they may influence the Commission's decisions when faced with regulatory alternatives.

We close by reiterating that, although we have raised concerns regarding both the methodology and the resulting cost-benefit analyses with regard to certain aspects of the rules we reviewed, a determination whether the cost benefit analyses would survive judicial scrutiny is not the object of this review. The Commission's performance under section 15(a) of the Commodity Exchange Act has never been challenged; however, in recent years the courts have identified weaknesses in the application of economic analysis to regulatory decisions, resulting in rules being sent back to regulators for further consideration.[83] As in our first report, we would suggest that a more robust examination of costs and benefits should only enhance the Agency's ability to defend its cost-benefit analyses.

We again note with approval the recent cost-benefit analyses guidance for use with final rulemakings recently issued by the Office of General Counsel and the Office of Chief Economist. As before, we continue to recommend that the Office of Chief Economist take on an enhanced or greater role under both the existing methodology and any future methodologies for cost-benefit analyses for both proposed and final rules.

83 See, e.g., *Am. Equity Investment Life Ins. Co. v. S.E.C.*, 613 F.3d 166, 177-178 (D.C. Cir. 2010) ; *Chamber of Commerce of U.S. v. S.E.C.*, 412 F.3d 133, 142-144 (D.C. Cir. 2005).

EXHIBIT 1

U.S. COMMODITY FUTURES TRADING COMMISSION
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TO: Rulemaking Teams

FROM: Dan M. Berkovitz
General Counsel

Jim Moser
Acting Chief Economist

RE: *Guidance on and Template for Presenting Cost-Benefit Analyses for Commission Rulemakings*

DATE: September 29, 2010

Section 15(a) of the CEA requires the Commission to consider the costs and benefits before promulgating rules and certain orders.[1] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the Act.

As the Commission's rulemakings have long recognized, section 15 does not require the Commission to quantify the costs and benefits of an action. However, the Commission cannot consider the costs and benefits of an action unless they are presented either quantitatively or qualitatively. Moreover, as courts have interpreted section 553 of the APA, interested persons must be fairly apprised of the issues involving a proposed rulemaking and must be given an opportunity to comment on the substantive inputs into an agency's decisionmaking.[2]

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[1] 7 U.S.C. 19(a).

[2] See, e.g., American Equity Inv. Life Ins. Co. v. S.E.C., 613 F.3d 166, 177 (D.C. Cir. 2010) (the SEC's consideration of the effect of a rule on competition, which was required by statute, was found to be arbitrary and capricious because a reasoned basis for that conclusion was not disclosed), Chamber of Commerce v. S.E.C., 412 F. 3d 133, 144 (D.C. Cir. 2006) (SEC failed to satisfy its statutory obligation to consider the economic consequences of a rulemaking when it did not apprise itself, or the public and the Congress, of the expected consequences through section 553 notice and comment); and Portland Cement Association v. Ruckelshaus, 486 F.2d 375, 394 (D.C. Cir. 1973) ("[i]t is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or on data that,[in] critical degree, is known only to the agency"), cited by American Radio Relay League v. FCC, 524 F.3d 227, 237 (D.C. Cir. 2008).

In the cost-benefit section of a proposed or interim final rulemaking, an initial analysis of the Commission's views of the costs and benefits of the proposed rule should be presented so that interested parties may submit comments that challenge, defend, or provide additional support for the analysis. A declarative statement of the anticipated effects of the proposed rule should be provided, in addition to requesting that interested parties submit their views on the five cost-benefit considerations enumerated in section 15.

Typically, the costs typically may be presented by describing a counterfactual – what the Commission expects will happen if the rule is not adopted, with reference to previous or anticipated events. The benefits should be provided in declarative form. It is not necessary to present costs and benefits serially for each of the five considerations contained in section 15. Rather, as the costs and benefits are presented, they may be associated with the appropriate considerations in the narrative.

Finally, the requirement to present the costs and benefits of a rulemaking should also assure compliance with the agency's obligations under the Congressional Review Act. Among other things, the Congressional Review Act requires agencies to submit their cost benefit analyses for Congressional review at the time a rule of general applicability is finalized.[3]

GUIDANCE FOR PRESENTING COSTS AND BENEFITS

Costs. The costs discussion in the cost-benefit analysis section of a rulemaking should include a quantitative or qualitative description of the kinds of costs involved, and upon which parties they will be imposed. When presenting costs qualitatively, the costs should be compared to some relevant alternative to the rule (i.e., the benchmark). In many cases, the benchmark would be the status quo regulatory approach. In some contexts, however, an alternative benchmark may be appropriate. If the rulemaking was designed to avoid certain costs associated with an alternative rule that could have been imposed, it should be discussed here as well; essentially comparing the proposed rule to a second benchmark.

> EXAMPLE 1: "The costs of the new capital requirements imposed on FCMs will consist primarily of lower profits to FCMs, as they need to attract more capital to support the same number of positions. These higher capital requirements may also lead FCMs to take smaller proprietary positions, or charge higher fees to customers, potentially reducing the liquidity of some markets.

Benefits. With respect to the benefits associated with a proposed rulemaking, the comparison should be to the same benchmark(s) identified in the discussion of costs, and again the discussion should highlight the kinds of benefits anticipated, and the likely affected parties.

> EXAMPLE 2: "The primary benefit of additional capital requirements is the additional customer protection against FCM failure, especially in the event of another liquidity shortage, such as the one that affected the economy in 2008."

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[3] See 5 U.S.C. 801(a)(1)(B)(i).

For assistance on applying this guidance to specific rulemakings, please contact the Office of Economic Analysis and the Office of General Counsel.

STANDARD TEMPLATE

The following standard template has been prepared to assure consistency across Commission rulemakings:

> Section 15(a) of the CEA[4] requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the Act. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of rule or to determine whether the benefits of the rulemaking outweigh its costs; rather, it requires that the Commission "consider" the costs and benefits of its actions. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the Act.
>
> Summary of proposed requirements. The proposed rule would [explain briefly the requirements of the rule].
>
> Costs. With respect to costs, the Commission has determined that [draw conclusions about the costs of the rule, associating the appropriate cost-benefit categories either directly or by implication].
>
> Benefits. With respect to benefits, the Commission has determined that [draw conclusions about the benefits of the rule, associating the appropriate cost-benefit categories either directly or by implication].
>
> Public Comment. The Commission invites public comment on its cost-benefit considerations. Commenters are also are invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the Proposal with their comment letters.

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[4] 7 U.S.C. 19(a).

EXHIBIT 2

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TO:	Rulemaking Teams
FROM:	Dan M. Berkovitz General Counsel
	Andrei Kirilenko Chief Economist
RE:	Staff Guidance on Cost-Benefit Considerations for Final Rulemakings under the Dodd-Frank Act
DATE:	May 13, 2011
RESPONSIBLE STAFF:	Vivek K. Jain, Counsel, (x6626) David Reiffen, Senior Economist (x5602) Kirsten Soneson, Financial Economist (x5304)

EXECUTIVE SUMMARY

This memorandum provides guidance to staff for considering costs and benefits in final rulemakings under the Dodd-Frank Act ("**Final Rulemaking**"). Each rulemaking team should:

1. Consider costs and benefits in Final Rulemakings pursuant to section 15(a) of the Commodity Exchange Act ("CEA");

2. Summarize all of the public comments received that are related to the consideration of costs and benefits as part of the comment summary including a proposed response;

3. Respond to meaningful comments received on the costs or benefits of the rulemaking, whether or not such comments were directed specifically at the section of the proposed rulemaking discussing considerations of costs and benefits (the "**Cost-Benefit section**"), or cost-benefit concerns generally;

4. Incorporate the principles of Executive Order 13563(the "**Executive Order**") to the extent they are consistent with section 15(a) and it is reasonably feasible to do so; and

5. Exercise discretion under section 15(a) as to the manner in which costs and benefits are considered and to quantify costs and benefits to the extent it is reasonably feasible and appropriate to address comments received.[1]

[1] As used in this document, the phrase "reasonably feasible and appropriate" means the extent to which (i) certain analyses, quantitative or qualitative, is needed to address comments received ("**appropriate**") and (ii) whether such

BACKGROUND

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of the regulations it promulgates,[2] and the Administrative Procedure Act ("APA") requires the Commission to explain the factual and policy bases for its rulemakings, including the bases underlying any statutory considerations, in order to notify interested persons of the issues involved in a rulemaking and giving them an opportunity to participate in it.[3]

Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. Quantification of costs and benefits is permitted but not mandatory as part of such an evaluation. The Commission may, in its discretion, give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the Act.

In a memorandum dated September 29, 2010, the Office of General Counsel and the Office of the Chief Economist (respectively, "OGC" and "OCE") jointly provided guidance to staff on the consideration of costs and benefits in notices of proposed rulemakings under the Dodd-Frank Act ("**Proposed Rulemaking**") as required by section 15(a) of the CEA and the APA.[4]

This memorandum presents guidance to staff for the consideration of costs and benefits in Final Rulemakings. In preparing this guidance, consideration has been given to Executive Order 13563 – Improving Regulation and Regulatory Review – which was issued by the President on January 18, 2011. This Executive Order is supplemental to and reaffirms the principles, structures, and definitions governing contemporary regulatory review that were established in Executive Order 12866 of September 30, 1993, including OMB Circular A-4 guidance with respect to Executive Order 12866.[5]

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an analysis may be performed with available resources ("**reasonably feasible**"). Whether an analysis is appropriate and what analysis is reasonably feasible will vary depending on the nature of the rulemaking and the nature of the comments. If conducted, the analyses should yield results that will be relevant to Commission decision making.

[2] 7 U.S.C. § 19(a).

[3] *See* 5 U.S.C. §§ 553 and 706. *See also American Equity Inv. Life Ins. Co. v. S.E.C.*, 613 F.3d 166, 177 (D.C. Cir. 2010) (the SEC's consideration of the effect of a rule on competition, which was required by statute, was found to be arbitrary and capricious because a reasoned basis for the conclusion drawn was not disclosed) and *AFL CIO v. Donovan*, 757 F.2d 330, 340 (D.C. Cir. 1985) (an agency "must itself provide notice of a regulatory proposal … it cannot bootstrap notice from a comment"), *cited in Fertilizer Institute v. EPA*, 935 F.2d 1303, 1312 (D.C. Cir. 1991).

[4] *See Guidance on and Template for Presenting Cost-Benefit Analyses for Commission Rulemakings* ("September Guidance") available at http://openinterest/Policyguidance/rulemaking/guidancecba.pdf.

[5] *See* 76 Fed. Reg. 3821 (Jan. 21, 2011). Executive Order 13563 directs each federal agency to (1) "propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify);" (2) develop its regulations in a manner to impose the "least burden on

Succinctly put, section 15(a) of the CEA sets forth the *requirements* the Commission must satisfy in considering the costs and benefits in Final Rulemakings while the Executive Order offers *guidance* on how the teams may consider costs and benefits in Final Rulemaking. The entire rulemaking team is responsible for the substantive inputs to the cost-benefit considerations in the Final Rulemaking before it is presented to the Commission for consideration. Both form and content of such input will necessarily vary across teams according to regulatory objectives pursuant to the particular Dodd-Frank provision being implemented.

Although the Executive Order does not govern the considerations of costs and benefits under section 15(a), rulemaking teams should consider costs and benefits in the Final Rulemakings utilizing the principles set forth in Executive Order 13563 in a manner that is reasonably feasible and appropriate, and consistent with the underlying statutory mandate. In exercising discretion under section 15(a) as to the manner in which costs and benefits are considered in any particular Final Rulemaking, a rulemaking team may choose, to the extent reasonably feasible and appropriate, quantitative analysis to respond to comments received. Quantitative analysis should be conducted if the team, after consulting with OGC, OCE and other offices as necessary, determines that it is reasonably feasible and appropriate to address comments received, as part of an evaluation of one or more cost-benefit considerations specified in section 15(a).

I. Framework for Consideration of Costs and Benefits in the Final Rulemakings

Whenever the Commission has discretion as to whether and how to implement a Dodd-Frank provision, the costs and benefits of each regulatory alternative under consideration should be compared to a common baseline.[6] Under OMB guidance, there is flexibility in choosing a baseline to compare the costs and benefits of adopting a rule over potential alternatives.[7] As a way to consider the cost-benefit impact of regulatory alternatives, a baseline is simply a common point of reference which allows cost or benefit considerations of any contemplated agency action to be compared against any other potential agency action.

In going from a Proposed Rulemaking to a Final Rulemaking, the cost benefit considerations of the Final Rulemaking should reflect either or both of the following:

(1) Additional *information* provided by the comments on the proposed rule and any alternatives considered in the Proposed Rulemaking;

(2) Additional *alternatives* provided by the comments that would achieve the regulatory objectives.

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society," taking into account, to the extent practicable, "the costs of cumulative regulations;" and (3) select the alternatives that maximize net benefits. Executive Order 13563 further provides that "in applying these principles, each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible. Where appropriate and permitted by law, each agency may consider (and discuss qualitatively) values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts."

[6] *See* OMB Circular A-4.

[7] *See* id at 15.

When preparing a Cost-Benefit section for consideration by the Commission, each rulemaking team should begin by identifying the extent to which costs and benefits were addressed in the Proposed Rulemaking. This includes a review of both the Cost-Benefit section and any discussion of regulatory alternatives in the preamble of the Proposed Rulemaking.[8] The Cost-Benefit section and related preamble discussion of the Final Rulemaking should detail how cost-benefit issues were integrated into each rulemaking, what led the Commission to adopt particular alternatives, and the agency's response to comments received regarding costs and benefits. The Commission is only obligated to respond to meaningful and significant comments.[9] Such comments may be directed at either the Cost-Benefit section of the proposed rulemaking or at the costs or benefits associated with the rulemaking in general.[10]

When responding to comments regarding the consideration of costs and benefits, the Cost-Benefit section should discuss the extent to which the commentary informed the Final Rulemaking.[11] This may include an explanation of why qualitative or quantitative analysis has been selected to address any meaningful and significant comments, in addition to how the comments informed the Final Rulemaking.

This approach, however, does not mean that all possible costs and benefits of the Final Rulemaking should be considered and enumerated. Only those costs that are material – i.e., those relevant and significant to the Final Rulemaking – should be addressed. Further, the costs and benefits must be evaluated in light of the five statutory factors listed in section 15(a) of the CEA.

In sum, the Cost-Benefit section should: (1) respond to the meaningful and significant comments received either on the specific Cost-Benefit section in the Proposed Rulemaking or on

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[8] Typically, cost-benefit considerations are woven into the explanation of the basis for the rulemaking, either explicitly by reference to the costs or benefits of a rule or implicitly in the description of the proposal in comparison to alternatives in the preamble. To the extent cost-benefit issues of a Commission rulemaking are integrated into the preamble discussion of the legal, factual, and policy bases underlying the rulemaking, the Cost-Benefit section serves as a summary of the Commission's reasoned determination that the benefits of the chosen regulatory action justify the costs. Accordingly, if certain costs and benefits of a proposed rulemaking are discussed in detail in the preamble, the Cost-Benefit section of the final rulemaking should summarize and reference discussion in the proposal's preamble.

[9] *See, e.g., Interstate Natural Gas Association of America v. FERC*, 494 F.3d 1092, 1096 (D.C. Cir. 2007) (citations omitted) (the APA requires an agency to respond reasonably to comments, giving "reasoned responses to all significant comments in a rulemaking proceeding," which the court defined as those comments that are "significant enough to step over a threshold requirement of materiality before any lack of agency response or consideration becomes of concern"); *Louisiana Federal Land Bank Ass'n, FCLA v. Farm Credit Administration,* 336 F.3d 1075, 1080 (D.C. Cir. 2003) (citations omitted) (while an agency "is not required 'to discuss every item of fact or opinion included in the submissions' it receives in response to a Notice of Proposed Rulemaking … it must respond to those 'comments which, if true … would require a change in [the] proposed rule'"); and *Safari Aviation Inc. v. Garvey,* 300 F.3d 1144, 1151 (9th Cir. 2002) (citations omitted) (an agency must "respond only to "significant" comments, a category limited to those which raise relevant points, and which, if adopted, would require a change in the agency's proposed rule").

[10] General discussions of costs or benefits frequently will involve the consideration of potential alternatives.

[11] *See* note 14 *infra.*

the costs or benefits of the Proposed Rulemaking in general and how the comments informed the Final Rulemaking; (2) discuss the anticipated costs and benefits of the Final Rulemaking including whether such costs or benefits may be meaningfully quantified, as well as for other alternatives that would achieve the regulatory objectives, relative to the baseline, by evaluating reliable data if such data is available; (3) provide a clear explanation of why the Final Rulemaking is being adopted over the alternatives; and (4) discuss whether and how costs or benefits were quantified.

Lastly, there will be a team member from the Office of Chief Economist on each rulemaking team who will provide input into the consideration of costs and benefits, employing price theoretic economics or similar methodology to assess the costs and benefits of a Final Rulemaking, contribute to the preparation of the Cost-Benefit section, and review each draft Final Rulemaking for all cost-benefit considerations before the draft Final Rulemaking is presented to the Commission for consideration.

II. How to Consider Costs and Benefits in Final Rulemakings

(a) Whether to conduct additional analysis in response to public comments

When the Commission is adopting a rulemaking that replicates a statutory provision. When comments raise concerns about rulemaking provisions that merely replicate the statutory provisions the Commission is required to promulgate without the exercise of discretion, then cost-benefit considerations may not be a factor in the promulgation of the rule. In such circumstances, it should be explained in the Final Rulemaking to what extent, if any, the Commission considered the costs and benefits of the action.[12]

No comments on proposed cost-benefit considerations. When the Commission has received no comments either on the cost-benefit section of a Proposed Rulemaking or the costs or benefits of the Proposed Rulemaking in general, additional analysis or supplemental information may not be necessary.[13] In such cases, at a minimum, the cost-benefit section of the Final Rulemaking should reference any substantive discussion of costs and benefits from the Proposed Rulemaking. These substantive discussions typically will include discussion of the regulatory alternatives that were considered by the Commission in the Proposed Rulemakings.

Comments that raise only general cost-benefit concerns. A general comment that costs and benefits were not properly considered, without presenting any specific support for the comment, should be answered in the Final Rulemaking by detailing how costs and benefits were considered and elaborating on the analysis in the Proposed Rulemaking as necessary. This typically should include, by reference, discussion of any preamble text outside of the Cost-Benefit section of the proposed rulemaking that demonstrates that costs and benefits were

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[12] *Cf. Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 48-49 (1983) (an agency "must cogently explain why it has exercised discretion in a given manner"), *citing Atchison, T. & S.F.R. Co. v. Wichita Board of Trade*, 412 U.S. 800, 806 (1973), *Federal Trade Commission v. Sperry & Hutchinson Co.*, 405 U.S. 233, 249 (1972), and *NLRB v. Metropolitan Life Insurance Co.*, 380 U.S. 438, 443 (1965).

[13] *See id.*

considered and discussed expressly by the Commission. To the extent it is reasonably feasible to develop additional supporting information or explanation regarding costs and benefits since publication of the Proposed Rulemaking, such additional supporting information should be included in the Final Rulemakings and presented to the Commission for consideration.[14] Further, the Cost-Benefit section of the Final Rulemaking should include a summary discussion of such issues and references to relevant discussion in the preamble of the Proposed Rulemaking.

Comments that raise specific concerns regarding cost-benefit considerations of the Proposed Rulemaking. In the event that comments raise specific concerns or present additional material information regarding the costs and benefits of a Proposed Rulemaking, including estimated costs under the Paperwork Reduction Act ("PRA"), rulemaking teams should carefully review such comments and conduct any additional analysis that may be necessary to respond to the comments as discussed above. This may include verifying or attempting to replicate the facts and argument set forth by the commenter as well as evaluating any reasonable assumptions. The rulemaking teams may bring in additional information that is either available or that may reasonably be developed to supplement the initial analysis presented in the proposed rulemaking.[15] Responses to the comments, together with analysis to support the choices made in the Final Rulemaking, should be presented for Commission consideration.

Comments that propose alternative rules which achieve regulatory objectives. To the extent that comments suggest potential alternative rules that would achieve the regulatory objectives of the relevant provision of the Dodd Frank Act, these alternatives should be compared to the baseline. Analysis should incorporate all reasonably available information that is relevant to the Final Rulemaking, both quantitative (if reasonably feasible and appropriate) and qualitative depending upon the proposed alternatives under consideration. Responses to the comments together with analysis to support the choices made in the Final Rulemaking, should be presented for Commission consideration.

(b) Scope of analysis

The consideration of costs and benefits should be appropriate to the substance of the Final Rulemaking and its identified costs and benefits in order to provide meaningful insight into the Commission's decision making. In determining the scope, the only relevant costs and benefits are those that, in the reasonable determination of the Commission, are material, significant, or potentially significant to the public, the economy, the markets, and interested persons or a subset of persons according to factors such as size, sector or region affected by the rulemaking.

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[14] There may be APA implications as discussed in section IV below.

[15] *See, e.g., Idaho Farm Bureau, cited infra* at note 24. The Commission's rulemaking record typically may be supplemented with additional information without a need for additional notice and comment, provided that the information has roots in the proposed rulemaking. However, statements that address the costs of a rulemaking merely by representing them as, for example, "significant," "insignificant," "minimal," or "incremental," will not likely be considered to be sufficient roots. *See e.g., American Equity Life, cited supra* at note 3.

(c) When to quantify costs and benefits

Costs and benefits should be quantified when it is reasonably feasible and appropriate to do so. When quantitative data is not readily available, or it cannot be gathered with specificity with reasonable effort, estimates or ranges may be used, provided there is a reasonable basis for such estimates or ranges. The methodology used to estimate costs and benefits should be discussed in the rulemaking. As the Executive Order acknowledges, in some areas quantification is not possible, and in these areas qualitative measures should be used instead.

Because Title VII of Dodd-Frank regulates an area previously lightly regulated or unregulated, there often will be little reliable quantitative information upon which to quantify the measureable effects of regulations promulgated. In the absence of historical data, any proffered quantitative data will likely be premised on forecasts and assumptions as to causal relationships between regulatory action and its consequences.[16] For example, since no swap data repositories (SDR) exist, there is little data on the costs of SDR rules. To carry out quantitative analysis, the cost issue may be simplified by considering an element of the affected business process that is the key cost factor.

Similarly, costs of reporting and recordkeeping should be analyzed by asking what incremental cost will be imposed on a market participant over the cost that would exist under the baseline, and whether the costs that will be imposed will affect all market participants equally.[17] When market participants will bear costs differently because the costs generally will be higher for small participants and lower for large participants, costs may be presented in terms of the anticipated effect on an average large participant and an average small participant. It should be noted that before promulgating a final rule, Commission staff have the authority to survey market participants, subject to certain constraints.[18] Once these costs are articulated, the benefits of the rulemaking compared to the cost should be discussed for the Commission's consideration in accordance with section 15(a).

Quantitative benefits need not always be greater than costs because there may be a statutory mandate or policy rationale behind the rule, such as reduction of systemic risk, increased transparency and risk controls among other benefits intended by the statute that are difficult to quantify prospectively. Additionally, under section 15(a), the costs and benefits must be considered in light of the listed statutory factors.

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[16] Such forecasts and assumptions should be reasonable and should not predispose the analysis toward one set of conclusions over another.

[17] Often these costs will be considered in the Paperwork Reduction Act sections of a rulemaking and are a subset of the costs considered under section 15(a).

[18] Before engaging in any surveys of market participants, the rulemaking teams should consult with the appropriate Division Directors, as well as with OGC and OCE to ensure efficient collection of relevant information, compliance with administrative statutes and use of feasible and appropriate economic methodology.

III. Examples of Costs, Benefits and Data Elements

(a) Costs

The discussion of costs should be tailored to fit the particular rulemaking. Types of costs may include development costs, operational costs, non-recurring costs,[19] recurring costs,[20] the cost to the government of administering the regulation if this was a factor in developing the rule, and the policy costs to the economy and the market of implementing regulatory alternatives. Only costs that are material and significant need to be presented for Commission consideration. The determination of materiality typically will be established according to the impact of the rulemaking relative to the baseline. For example, teams will need to quantitatively or qualitatively assess who will bear the costs of the rulemaking and the extent to which such costs will impact the economy while recognizing the limitations on justifying general macro-economic conclusions either quantitatively or qualitatively,[21] and the market, or market participants of different types, size, and location if there is a likely to be a disparate impact among persons affected by the rule in comparison to alternatives. The teams need not assess attenuated costs (e.g. the cost of defending an enforcement action that commenced with a whistleblower tip).[22]

(b) Benefits

Many benefits are not readily quantifiable. These include reduced systemic risk, increased transparency and certainty, reduced need to build, operate, and maintain proprietary systems and practices, improved information handling, enhanced image, and, in light of the preceding paragraph, potential impacts on the macro-economy. In such cases, benefits may be qualified by linking the rulemaking to the policy goal.[23] To provide support for these stated benefits, teams may refer to data produced in scholarly publications to the extent available, for example, and identify links between the Commission's rulemaking and the particular failure for which Dodd-Frank safeguards are now in place.

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[19] Examples include site and facility, equipment, software, training, and initial costs of adjusting to a new regulatory regime.

[20] For example leases, training, and overhead.

[21] As an example, it will be difficult to translate industry-specific employment claims (e.g., a proposed rule affecting DCOs require labor-force reductions at the DCOs) into system-wide costs since (1) the natural rate of (full) employment, (2) any current slackness in employment measured relative to that natural rate, and (3) the mechanism needed to translate the aforementioned industry-specific event into a system-wide event is unknown. Because of similar unknowns in other areas, this inability to translate with any useful degree of confidence, for purposes of Dodd-Frank rulemaking, is a general problem when presented with claims of the economic impact of any particular Dodd-Frank rulemaking.

[22] The cost of defending an enforcement action would exist whether or not whistleblowers reporting a possible violation of the CEA are compensated eventually for the information they provided.

[23] For example, margin rules that are required under the Dodd-Frank Act are intended to benefit the markets and the economy as a whole because they will reduce systemic risk.

(c) Data and Arguments

When considering costs and benefits in the Final Rulemaking, supplemental data and arguments that were not presented in the Proposed Rulemaking may be used to bolster the choices made in the final rulemaking or to address a comment. The data and arguments presented in comments need not be taken at their face value. Comments should be evaluated to determine the merit of the positions advocated, the value and relevance of the data offered, and the stated and unstated assumptions underlying the commentary. Like the proposal itself, assertions about the cost-benefit consequences of the rule should be judged in light of the statute and section 15(a) cost-benefit considerations. The Final Rulemaking should include discussion, for example, of whether the Commission is making changes to accommodate a point on costs raised by a commenter; whether it is rejecting a comment because it could not validate the assertions made or the Commission does not agree that an alternative proposed by the commenter is a reasonably feasible alternative to the Final Rulemaking; or whether it agrees with the comment but is choosing not to revise the rule because the statutory or policy goals underlying the rule then would not be met.

IV. Potential for Additional Notice-and-Comment

Rulemaking teams should present costs and benefits for Commission consideration consistent with the statutory requirements of the CEA and section 15(a) regardless of whether such additional analyses may require further notice and comment. Notice typically is considered to be adequate if interested persons will not be prejudiced by a lack of notice and opportunity to comment on an issue involved in a rulemaking.[24] Additionally, further notice and comment is not required when the issue may be considered to be a logical outgrowth of a proposed rulemaking.[25]

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[24] *See, e.g., United Mine Workers v. Mine Safety and Health Administration,* 626 F.3d 84, 95-96 (D.C. Cir. 2010) (in order to successfully challenge a rulemaking for inadequate notice, the challenger must show that it was prejudiced by the lack of notice), *citing Owner-Operator Independent Driver's Ass'n v. Fed'l Motor Carrier Safety Admin,,* 494 F.3d 188, 202 (D.C. Cir. 22006) ("[t]o show that error was prejudicial, a [petitioner] must indicate with reasonable specificity what portions of the documents it objects to and how it might have responded if given the opportunity") (citation omitted); and *Idaho Farm Bureau Federation v. Babbitt,* 58 F.3d 1392, 1402 (9th Cir. 1995), *quoting Solite Corp. v. EPA,* 952 F.2d 473, 484 (D.C. Cir. 1991) (agency study added to the administrative record after the close of the comment period, in response to comments, is permissible provided that the interested parties will not be prejudiced by the agency's reliance on the newly available study). *Cf. CSX Transportation, Inc. v. Surface Transportation Board,* 584 F.3d 1076, 1082 (D.C. Cir. 2010) (though the Board's final rulemaking did not amount to a complete turnaround from the proposed rulemaking, the final rulemaking was not a logical outgrowth of the proposal when the Board significantly expanded the data set (from one to four year's worth) that was used to support the Board's final decision making), *citing Fertilizer Institute,* 935 F.2d at 1311 and 1312.

[25] *See United Mine Workers,* 626 F.3d at 95 (a final rule will be deemed to be the logical outgrowth of a proposed rule if a new round of notice and comment would not provide commentators with their first occasion to offer new and different criticisms which the agency might find convincing") and *CSX Transportation, Inc. v. Surface Transportation Board,* 584 F.3d 1076, 1082 (D.C. Cir. 2010) (though the Board's final rulemaking did not amount to a complete turnaround from the proposed rulemaking, the final rulemaking was not a logical outgrowth of the proposal when the Board significantly expanded the data set (from one to four year's worth) that was used to support the Board's final decision making), *citing Fertilizer Institute,* 935 F.2d at 1311 and 1312.

In general, "further notice and comment are not required when additional fact gathering merely supplements information in the rulemaking record by checking or confirming prior assessments without changing methodology . . . or by internally generating information using a methodology disclosed in the rulemaking record."[26] Additionally, "[c]onsistent with the APA, an agency may use 'supplementary' data, unavailable during the notice and comment period, that 'expands on and confirms' information contained in the proposed rulemaking and addresses 'alleged deficiencies' in the pre-existing data, so long as no prejudice is shown."[27]

In *Chamber of Commerce II*, however, the court of appeals found that information presented by the SEC in a final rulemaking cost benefit analysis was not merely supplementary to information already in the record, but rather was new information that needed to be provided for notice and comment. The court stated:

> The Commission's bare request for information on costs [in the proposed rulemaking] and its expectation that these costs would be 'minimal' did not place interested parties on notice that, in the absence of receiving reliable cost data during the comment period, the Commission would base its cost estimates on an extra-record summary of extra-record survey data that, although characterized as 'a widely used survey,' was not the sort, apparently, relied upon by the Commission during the normal course of its official business.[28]

In *Chamber of Commerce II*, the court also addressed the situation where an agency seeks comment on a proposed rulemaking, requests comment, does not receive such comment, and then supplements the record with information that has roots in the proposed rulemaking:

> To be clear, the requirement, deriving from sections 553(c) and 706 that an agency may rely on supplemental materials to fill gaps in the rulemaking record only when there is no prejudice to the interested parties does not mean parties can withhold relevant data and blind side the agency on appeal. When, after an agency explains the basis for its preliminary conclusions by reference to the information on which it has relied and requests data regarding its conclusions, and the agency concludes no such data (or not data the agency concludes is reliable) has been produced during the comment period, the agency may develop data along the lines it has proposed to fulfill its statutory obligations without further public comment. In light of the notice provided, there is no fair-comment prejudice to interested parties under section 553(c) even if the extra-record materials serve as the crucial confirmation of the agency's preliminary conclusions, or even as the compelling reason for the agency's modification of its preliminary conclusions. A contrary rule would provide a perverse incentive for parties opposing a rule to withhold data in order to seek vacation of the rule on appeal.[29]

The teams should consult with OGC with respect to issues regarding notice-and-comment that may arise.

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[26] *Chamber of Commerce II*, 443 F.3d at 890 (internal citations omitted).

[27] *Solite Corp*, 952 F.2d at 484.

[28] *Chamber of Commerce II* at 904-5.

[29] *Id.* at 904 (citations omitted).

V. Guidance in Response to Recommendations of the Inspector General

On April 15, 2011, the CFTC's Inspector General (IG) issued a report on the manner by which the Commission considered costs and benefits in several of the Dodd-Frank proposed rulemakings. The IG Report raised a number of concerns and made a number of recommendations regarding the consideration of costs and benefits in Dodd-Frank rulemakings. This section provides guidance as to how to address the IG's concerns and recommendations as part of the consideration of costs and benefits in final rulemakings.

- *IG Concern: The consideration of costs and benefits during the proposed rulemakings reflected a "one size fits all" approach. This "homogenized" approach often resulted in the exclusion of economic factors from consideration.*

  Guidance: This guidance provides that the specific manner by which costs and benefits should be considered in final rulemakings will vary depending upon the nature of the rulemaking and the nature of the comments received on the proposed rule. Specific guidance is provided as to when quantitative data should be developed or considered.

- *IG Concern: The consideration of costs and benefits in the proposed rulemakings did not always reflect all of the cost issues addressed by the technical experts on the rulemaking teams.*

  Guidance: The Office of Chief Economist will have a staff person on each rulemaking team, who will provide input into the consideration of the quantification of costs and benefits, who should employ price theory or other methodologies and will review each draft cost benefit discussion.

- *IG Recommendation: The distinction between Paperwork Reduction Act (PRA) analyses and cost-benefit considerations were not clear and should be better explained in proposed and final rules.*

  Guidance: Rulemaking teams should clearly differentiate between the specific analyses undertaken to fulfill the requirements of the PRA and the broader consideration of costs and benefits. Considerations of costs and benefits should incorporate the costs identified in the PRA analysis and clearly identify those costs as also pertaining to the PRA. If the only material costs of a rulemaking will be costs associated with information collection, then the same data may be presented both in the PRA section and Cost-Benefit section of the Final Rulemaking. In such circumstances, it should be expressly stated in the Cost-Benefit section that there are no costs of the rulemaking except for PRA costs.

- *IG Concern: The IG expressed concern over "the lack of available (and verified) data pertaining to compliance costs borne by the industry, at least at the proposed rulemaking stage."*

  Guidance: Notices of proposed rulemakings included questions seeking additional quantitative and qualitative data. In meetings with commenters, staff should reiterate the

Commission's request for such data. To the extent that data is provided by commenters, staff should verify any such data received, and discuss the evaluation of the data in the Cost-Benefit section of the Final Rulemaking.

- *IG Recommendation: Staff should review the transcript of the Third meeting of the CFTC Technology Advisory Committee on March 1, 2011, in light of the "apparent staff view that the Dodd-Frank rules (or at least the four we reviewed) largely document current practices."*

  Guidance: Staff should review the cited transcript in the manner recommended.

- *IG Recommendation: "We believe it would be feasible to estimate the costs of implementing the [sic] each regulation and include it in any cost-benefit analysis. CFTC's opportunity costs might also be considered."*

  Guidance: As requested by Commissioner Dunn at the last Commission meeting, the staff should consider the costs of implementation during its consideration of each final rulemaking. Staff should be prepared to present and discuss such costs and cost data, if any, with the Commission during the consideration of the final rulemaking.

- *IG Recommendation: The Sept. 2010 guidance would permit "a detailed and in-depth qualitative or quantitative approach. We believe it should be followed in a more robust fashion."*

  Guidance: This guidance provides guidance on employing quantitative and qualitative analysis of costs and benefits in the final Dodd-Frank rulemakings.

- *IG Recommendation: "We believe that as a market regulator, any cost-benefit analysis should take account of price theory economics, which should involve the Chief Economist."*

  Guidance: The Office of Chief Economist will have a staff person on each rulemaking team, who will provide quantitative and qualitative input with respect to the costs and benefits of the final rulemaking, who should employ price theory economics or similar methodology to assess the costs and benefits of a rulemaking, and who will review each draft cost-benefit discussion.