

CFTC’s Cost-Benefit Analysis on Rule 4.5 Amendments: Insufficient, Incomplete, and “Unlikely [to] Survive Judicial Scrutiny”

The Commodity Futures Trading Commission provided a fleeting and incomplete analysis of the costs and benefits of its amendments to Rule 4.5, falling far short of the statutory requirements set by the Commodity Exchange Act (CEA).

Time and again, the CFTC failed to measure or even estimate what the agency itself called the “significant burdens” of its modifications to Rule 4.5. In several cases, the CFTC acknowledged that it could not determine the full extent of the costs its rulemaking would impose—simply declining to perform this part of its statutory mandate.

Meanwhile, the agency asserted benefits with no basis to quantify or assess their value, and failed to conduct an analysis to show that its regulatory scheme would provide fund investors significant benefits compared to funds’ current regulation by the Securities and Exchange Commission.

The CEA requires rigorous cost-benefit analysis of rulemakings

- The CEA requires that “the costs and benefits of the proposed [rule] shall be evaluated in light of”:
 - Protection of market participants and the public;
 - The efficiency, competitiveness, and financial integrity of futures markets;
 - Price discovery;
 - Sound risk management practices; and
 - Other public interest considerations.
- Federal courts have repeatedly vacated agency rulemakings when they fail to meet statutory requirements to assess the economic consequences of the rules.
- In particular, in *American Equity Life Insurance Company v. SEC* the Court of Appeals for the District of Columbia Circuit vacated an SEC rule because the agency failed to evaluate the protections offered investors by an existing regulatory regime.
- The DC Circuit reaffirmed the importance of complying with these requirements as recently as 2011 in *Business Roundtable v. SEC*.

The CFTC recognized that its Rule 4.5 amendments could impose “significant burdens” on registered investment companies (RICs), such as mutual funds and exchange traded funds. The CFTC acknowledged that it could not assess the full extent of the costs of its amendments—and in most cases didn’t even try.

- The CFTC declined even to attempt to calculate the added burden from the amendments to Rule 4.5.

- The CFTC included funds' swaps activity in the threshold test to determine which funds would be covered by the amendments, even though the agency has not yet met its Dodd-Frank Act requirement to define swaps.
- The CFTC failed to explain how it could meaningfully assess the costs of its Rule 4.5 amendments without knowing how the amended rule would operate or how many firms would be required to register.
- The CFTC acknowledged that it could not determine the cost of setting the threshold for non-hedging margin or premium at 5 percent. While admitting it lacked the data necessary to "evaluate the difference in market impact at various threshold levels," the agency did not undertake further study to obtain that information, although the need for the information and ways to obtain it were topics of discussion at a CFTC roundtable held on the proposed amendments.

The CFTC did not undertake a meaningful assessment of the purported benefits from its regulation.

- RICs are already subject to comprehensive regulation by the SEC. Yet the CFTC made no attempt to determine the extent to which current SEC regulation would meet the objectives of its Rule 4.5 amendments.
- The CFTC thus failed to establish a proper baseline against which to measure the benefits it claimed for its rule amendments.
- The CFTC did not undertake comparative analysis to present facts or support a conclusion that SEC regulation is not adequate to meet its regulatory objectives.
- The CFTC did not cite a single example of harm that had occurred as a result of the current regulatory regime.

The CFTC offered only a cursory discussion, based on unsupported assertions, of the specific cost-benefit factors required by the CEA.

- The CFTC said it "believes" its amendments will protect market participants and the public, but makes no attempt to assess whether those protections are already provided by SEC regulation of RICs.
- The CFTC claimed that its amendments will enhance the competitiveness of market participants, but ignores the fact that RICs will be subjected to significantly greater regulatory burdens than other market participants.
- With respect to sound risk management and the efficiency and integrity of the futures markets, the CFTC asserted benefits without demonstrating that RICs pose any risks that are not addressed by current SEC regulation. In fact, the CFTC in 2003 exempted "otherwise regulated" investment funds from CPO registration in order to increase liquidity in the futures markets; the release adopting the amendments fails to even mention that the agency's action likely will decrease liquidity, thus harming the efficiency of the futures markets.
- The CFTC failed to acknowledge the possibility that it could obtain the information it seeks by other, less burdensome means.

CFTC Commissioner Jill E. Sommers sharply criticized the agency’s cost-benefit analysis in [her dissent on Rule 4.5](#).

- Commissioner Sommers wrote: “I do not believe that the benefits articulated within the final rules outweigh the substantial costs to the fund industry.”
- She also concluded that “[i]t is unlikely, in my view, that the cost-benefit analysis supporting the rules will survive judicial scrutiny if challenged.”

The CFTC’s performance on cost-benefit analysis has faced sharp criticism within the agency and from Congress.

- Both the CFTC’s own Commissioners and members of Congress have recently raised concerns regarding the adequacy of the CFTC’s cost-benefit analyses.
 - Commissioner Sommers in February 2011 criticized the agency’s habitual “failure to conduct a thorough and meaningful cost-benefit analysis when we issue a proposed rule.”
 - Commissioner Scott O’Malia in February 2011 wrote to the Office of Budget and Management [requesting a review of the CFTC’s cost-benefit analysis](#).
 - Frank D. Lucas, Chairman, Committee on Agriculture, and K. Michael Conaway, Chairman, Subcommittee on General Farm Commodities and Risk Management, wrote to CFTC Inspector General in March 2011: “[T]he CFTC has taken a vague and minimalist approach to cost-benefit analysis that . . . fails to achieve the objectives of Section 15(a) of the CEA.”
 - A [recent report by the Office of the Inspector General](#) cautioned that “similar approaches to economic [cost-benefit] analysis in the context of federal rulemaking have proved perilous for financial market regulators.”