The argument that could upend Wall Street reform

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Scott O'Malia, one of two Republican commissioners at the Commodity Futures Trading Commission, doesn't believe that his agency's standards are up to snuff when it comes to Wall Street reform. "We don't do proper economic analysis," O'Malia tells me. His main concern is that regulators have failed to conduct a proper cost-benefit evaluation of the new financial regulations. And O'Malia has taken the unusual step of appealing to the Obama administration to examine the CFTC's practices

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(Richard Drew - AP)

In late February, O'Malia submitted a **letter** to the Office of Management and Budget to raise concerns about new record-keeping and compliance rules for derivatives traders known as **swap dealers**, which Zach Carter first **flagged**. O'Malia believes that the CFTC's analysis "has failed to comply with the standards for regulatory review" outlined by the OMB and President Obama's own executive orders. So he wants the OMB to review his agency's own analysis of these regulations--a request that has taken some CFTC-watchers by surprise.

"It's an unusual step for a sitting commissioner to express concern," says Timothy McTaggart, a partner in Pepper Hamilton's Washington office. "It's saying we don't have the technical expertise in a way that satisfies me in this role, and I'm crying out for help."

Specifically, O'Malia objects to the baseline that the CFTC has used to evaluate the impact of regulations, saying that it only measures changes after Dodd-Frank has already been implemented, failing to account for the costs of complying with the rules in the first place. O'Malia says that he has repeatedly brought up his concerns with other officials at the CFTC on these rules and others but hasn't seen changes so far. "I've raised it internally, in draft rules, and it's been a consistent concern," he says.

OMB hasn't responded yet to O'Malia's letter, and one Obama administration official believes the agency is unlikely to fulfill a request coming from an individual regulator, rather than an agency. "If this request for this kind of assistance came from an agency, we could offer it. But it does not; it comes from one commissioner," the official tells me. And the rules that O'Malia questioned in his letter **passed** the CFTC, 3-2, split along partisan lines, making it unlikely that the entire agency would get on board.

But regardless of whether the OMB takes up his request, O'Malia's letter could still have a broader impact. The argument that Dodd-Frank's regulations are too costly to comply with and harmful to the marketplace is the centerpiece of the financial industry's case against the law. Some outside experts say they're worried as well. Brookings sent congressional leaders a letter expressing its "deep concern about the inadequacy of cost-benefit analysis" of Dodd-Frank's rules, writing that the agencies' standards were inconsistent and sometimes non-existent when it came to analyzing the new regulations. The authors of the **letter**--Columbia professor and Romney adviser Glenn Hubbard, Brookings' John Thorton, and Harvard professor Hal Scott--emphasize that they support certain major provisions of Dodd-Frank. But they warn that the failure to conduct adequate cost-benefit analysis could result in legal delays and "cripple economic activity" as a result.

O'Malia's criticisms, moreover, come on the heels of a recent court ruling that effectively nullified part of Dodd-Frank due to cost-benefit concerns. In September, the D.C. Circuit **struck down** a new regulation from the Securities and Exchange Commission that allows shareholders who own at least 3 percent of a company's stock to nominate boardroom directors, principally because of cost-benefit considerations. According to the court's **ruling** on *Business Roundtable vs. SEC*, the SEC "failed adequately to quantify the certain costs" and "inconsistently and opportunistically framed the costs and benefits of the rule."

The SEC has **declined** to appeal the ruling, and the decision could help pave the way for future legal challenges to Dodd-Frank. Particularly in such a climate, the O'Malia letter "paints a target on the back of the [CTFC], potentially in future litigation," according to McTaggart. He believes that agencies like the CFTC may not be equipped to conduct "high-powered econometric analysis" when examining the impact of regulations, as compared to the OMB. "I'm not saying it's a rubberstamp process, but they don't have the same internal resources that someone at OMB does," McTaggart concludes.

The CFTC, for its part, defends its analysis of the new Wall Street rules from O'Malia's criticisms. "We have vigorous cost-benefit consideration in each of the rules, which the office of our chief economist has reviewed," says CFTC spokesman Steven Adamske. He adds that the GOP's commissioner's letter "is fundamentally an issue that Mr. O'Malia has with the OMB," as it's not addressed to the CFTC.

Others have stepped up to the CFTC's defense, including Better Markets, a public-interest group that sent its own **letter** to the OMB in response to O'Malia's criticism. Dennis Kelleher, the group's president and CEO, accuses the GOP commissioner of "trying to kill financial reform by burdening it with cost-benefit analyses that it isn't required to do." Kelleher argues that such considerations are irrelevant given the tremendous devastation caused by the financial crisis far outstrips the potential cost of any of the proposed regulations on the industry. "It doesn't really matter what it costs, because the costs to be avoided are so astronomical," he says.

Law professor Michael Greenberger, a former CFTC official who supports stronger regulations, agrees. "Being on a cost-benefit analysis warpath is completely myopic. People don't want to take into account what the taxpayer has paid to fix the system," Greenberger says. Kelleher also argues that the CFTC, as an independent agency, shouldn't be subordinated to the executive branch, pointing out that such agencies aren't legally required to comply with the OMB's own guidelines for cost-benefit analysis.

O'Malia denies that he's trying to overturn Wall Street reform. "I understand Dodd-Frank is the law, and my job is to carry out the law," he says. "We're not going to undo Dodd-Frank."