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Investor Note: Implications of Proposed Updates to Federal Benefit-Cost Analysis

By James Crowe, DSW

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Proposed Updates to Benefit-Cost Analysis Methodology for Federal Regulations

The Biden administration's Office of Information and Regulatory Affairs (OIRA) has been working to update the methodology[1] for benefit-cost analysis used to support policy decisions made in regulations. OIRA, responsible for centralized review of draft regulations, has been described[2] as the "most powerful agency you've never heard of." If adopted as proposed, these updates are likely to lead to stronger regulatory intervention in markets by agencies like the Environmental Protection Agency and the Department of Labor and could also impact regulatory approaches taken by the Securities and Exchange Commission (SEC) in areas like disclosure of greenhouse gas emissions and human capital management.

While independent regulatory agencies, such as the SEC, are not subject to OIRA's regulatory review, the proposed updates are still relevant to investors. The SEC has made public statements[3] that its approaches are closely aligned with OIRA's current methodology, so changes made by OIRA are likely to influence the SEC and other independent regulatory agencies. Prior court decisions also set a clear expectation that the SEC produce benefit-cost analyses to justify its regulations and it's likely that judges would seek justification if the SEC's methodology were to differ from that of OIRA. Federal courts have vacated SEC regulations on the basis that insufficient benefit-cost analysis rendered those rules "arbitrary and capricious," prompting the SEC to invest additional resources in these analyses.

Significant proposed updates to OIRA's methodology include changes to discount rate calculations, distributional analysis, and consideration of impacts on other countries. A discount rate is used to convert future benefits or costs into their present value, consistent with a central principle of finance known as the "time value of money": money received now is worth more than the same amount of money received later. OIRA's new proposal would lower the annual discount rate used to calculate the present value from 3% or 7% to 1.7% or lower. This change in discount rate would mean, for example, that the estimated benefit of saving one ton of CO_2 may be more than 2.5 times higher than the estimated benefit under the current methodology.

Because regulations in areas like climate change and public health often involve higher upfront costs followed by benefits that accrue over long timelines, lowering the discount rate would make the present-day value of those long-term benefits higher, justifying regulations that impose higher costs compared to the current methodology.

The current methodology also focuses on maximizing net expected benefits to society, while the proposed approach includes a new category of distributional analysis to identify and address situations where a regulatory approach would maximize benefits to society through a disproportionate cost to specific groups (e.g., income groups, race or ethnicity, sex, gender, sexual orientation, disability, occupation, or geography). This change is likely to push agencies to make a values-based decision to avoid regulatory approaches that impose disproportionate costs on a specific group, even if doing so would be less economically desirable for society as a whole.

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[1] *See* https://www.whitehouse.gov/wp-content/uploads/2023/04/DraftCircularA-4.pdf
[2] For example, *see* https://www.washingtonpost.com/news/made-by-history/wp/2017/09/28/the-federal-agency-that-few-americans-have-heard-of-and-which-we-all-need-to-know/
[3] https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf

The current methodology also directs agencies to focus on the benefits and costs of a regulation for U.S. citizens and residents, with any analysis of international impacts reported separately. The proposed methodology would encourage additional analysis of international regulatory impacts, which may support more regulation in areas like climate change and social factors compared to the current methodology by considering global costs and benefits.

There are two other reasons that these changes are relevant to investors. First, reporting, disclosure, and recordkeeping requirements imposed on companies and investors—including those contained in SEC regulations—are still subject to OIRA's review and approval under the Paperwork Reduction Act[4] both at adoption and at least every three years thereafter, even though OIRA does not review entire SEC regulations and their supporting economic analyses. In the last three years, approximately 31 of these SEC "information collections" reviewed by OIRA were "approved with change," indicating at least some modification to the requirement, design, or supporting statement during OIRA's review.

Second, although the Biden administration has not indicated any intention to do so, the Department of Justice has issued an opinion[5] that the President has the constitutional authority to bring independent regulatory agency rulemakings, including those from the SEC, under OIRA review if the President were so inclined.

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[4] 5 U.S.C. 1320 *et seq.*
[5] https://www.justice.gov/olc/file/1349716/download