JEB HENSARLING, TX , CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

MEMORANDUM

To: Members of the Committee on Financial Services

From: FSC Committee Majority Staff

Date: July 3, 2013

Subject: July 9, 2013, Subcommittee on Oversight and Investigations Hearing titled "Examining Constitutional Deficiencies and Legal Uncertainties in the Dodd-Frank Act"

The Oversight and Investigations Subcommittee will hold a hearing titled "Examining Constitutional Deficiencies and Legal Uncertainties in the Dodd-Frank Act" at 2:00 p.m. on Tuesday, July 9, 2013, in room 2128 of the Rayburn House Office Building. This hearing will examine whether the structure and/or certain provisions of Titles I and II of the Dodd-Frank Wall-Street Reform and Consumer Protection Act (Pub. L. No. 111-203) (the "Dodd-Frank Act") pose legal uncertainties for the financial services sector or, worse, are constitutionally infirm.

This will be a one-panel hearing with the following witnesses:

- Hon. C. Boyden Gray, Boyden Gray and Associates
- Prof. Thomas Merrill, Charles Evans Hughes Professor of Law, Columbia Law School

Enacted three years ago, the Dodd-Frank Act established several new regulatory bodies and granted federal financial regulators significant new authorities. Among the new regulatory bodies established by the Dodd-Frank Act was the Financial Stability Oversight Council (FSOC), which was also granted the authority to subject large, complex nonbank financial companies to prudential supervision by the Federal Reserve. The Dodd-Frank Act also gave the Federal Deposit Insurance Corporation (FDIC) the authority to resolve institutions whose failure might pose systemic risk—in the judgment of federal regulators—through a non-judicial resolution procedure, the "Orderly Liquidation Authority." Proponents of the Dodd-Frank Act have claimed that these authorities permit the federal government to more effectively assess and mitigate risks to the financial system of the United States. Others have pointed out that these authorities may be inconsistent with constitutional guarantees of due process, and that the structure of these new regulatory bodies may be incompatible with the Constitution's separation-of-powers principle.

Title I of the Dodd-Frank Act

Title I of the Dodd-Frank Act established the FSOC and directs it to identify U.S. and foreign nonbank financial institutions whose failure or activities "could pose a threat to the financial stability of the United States," and requires these institutions—upon designation by the FSOC—to be supervised by the Federal Reserve.[1] Although Title I lists ten factors for the FSOC to consider when determining whether a firm poses a risk to the financial system, Title I also permits the FSOC to consider "any other risk-related factors that the Council deems appropriate."[2] A federal district court may set aside the FSOC's designation of a nonbank financial company if it finds that the FSOC's designation is arbitrary and capricious.[3] The FSOC may also make recommendations concerning the supervisory standards adopted by the Federal Reserve after taking into account certain specified criteria and "any other risk-related factors that the FSOC deems appropriate."

The FSOC draws its budget from industry assessments deposited in a "Financial Research Fund" established pursuant to the Dodd-Frank Act, rather than through the congressional appropriations process. In addition, the Dodd-Frank Act requires state insurance, banking, and securities authorities to develop selection processes to designate a state insurance commissioner, a state banking supervisor, and a state securities commissioner to be non-voting members of the FSOC who nevertheless participate in the FSOC's deliberations and proceedings; no Executive Branch official appoints these officials to the FSOC.

Title II of the Dodd-Frank Act

Title II of the Dodd-Frank Act establishes the so-called "Orderly Liquidation Authority," which allows the FDIC to resolve a nonbank financial institution whose failure would threaten the financial stability of the United States. In a proceeding under Title II, the FDIC acts as the receiver for the financial institution, following a written recommendation of the FDIC's board of directors and the Federal Reserve Board of Governors and a determination by the Treasury Secretary. The Secretary must consider seven factors in making the determination, including whether the financial institution is in default or danger of default and whether its failure would have serious adverse effects on the financial stability of the United States. In an "Orderly Liquidation," the Dodd-Frank Act directs the FDIC to treat similarly-situated creditors in a similar manner; however, the Act also grants the FDIC the discretion to treat similarly situated creditors differently if the FDIC determines that doing so is necessary to maximize the value of the firm's assets, initiate or continue operations essential to the receivership, or minimize losses.[4]

The Dodd-Frank Act provides nonbank financial institutions and affected parties with little opportunity to challenge the Treasury Secretary's decision to initiate an "Orderly Liquidation." The Dodd-Frank Act does not provide a nonbank financial institution with

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[1] Dodd-Frank Act § 113.
[2] *Id.*
[3] *Id.*
[4] *Id.* § 210(b)(4).

notice and opportunity to be heard before the Secretary determines that the statutorily enumerated criteria are met and the institution can be resolved under the "Orderly Liquidation Authority;" the Secretary is required to give notice only upon making the determination.

If the company contests the Secretary's determination, the Secretary must petition the U.S. District Court for the District of Columbia for an order authorizing it to appoint the FDIC as receiver. The court must rule on the Secretary's petition within 24 hours or the petition is automatically granted. In its review, the court must consider whether the Secretary arbitrarily and capriciously concluded that the institution is a "financial company" (as defined by the Dodd-Frank Act) and that the institution is in "default or danger of default." The court is barred from reviewing the other factors specified in the statute underlying the Secretary's decision, including whether the institution's failure would have serious adverse effects on the United States.

The Dodd-Frank Act prohibits the court or any party from publicly disclosing the Secretary's determination or the court proceeding, including to the institution's creditors.[5] Finally, the Dodd-Frank Act prohibits the court from staying the FDIC's exercise of its "Orderly Liquidation Authority" pending an institution's appeal to the D.C. Circuit Court of Appeals or its petition for review by the Supreme Court.

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[5] The Dodd-Frank Act also provides that any person who recklessly discloses the Secretary's determination or the court proceedings may be subject to criminal penalties.