THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE MORE FREE?

HEARING

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THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE MORE FREE?

Thursday, September 17, 2015

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Royce, Lucas, Garrett, Neugebauer, Pearce, Posey, Fitzpatrick, Luetkemeyer, Huizenga, Duffy, Hurt, Stivers, Stutzman, Mulvaney, Ross, Pittenger, Barr, Rothfus, Messer, Schweikert, Guinta, Williams, Poliquin, Love, Hill, Emmer; Waters, Maloney, Velazquez, Sherman, Hinojosa, Lynch, Scott, Green, Cleaver, Himes, Kildee, Delaney, Sinema, and Vargas.

Chairman HENSARLING. The Financial Services Committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "The Dodd-Frank Act Five Years Later: Are We More Free?"

Before proceeding further, I would like to sadly inform all Members who may not be aware that the gentlelady from Missouri, Mrs. Wagner, lost her mother earlier this week, so she will not be here for today's hearing. And if you could certainly keep her and her family in your thoughts and prayers.

I now recognize myself for 3 minutes to give an opening statement.

Today, the committee holds the third of its three hearings looking at some of the consequences of the Dodd-Frank Act upon its fifth anniversary. Earlier, we explored how in many ways, Dodd-Frank has made us less prosperous and the economy less stable.

Today, as Americans commemorate the 228th anniversary of the signing of the Constitution, perhaps the greatest document devised by the mind of man, we explore how Dodd-Frank has, regrettably, made us less free.

We hold these hearings because too many of our fellow citizens have still not achieved economic recovery for themselves and their family, and many are losing hope. We want their lives to be better; we want them to thrive, achieve their dreams, pursue happiness, and earn success.

But none of that is possible without basic economic freedom in the rule of law, bedrock principles upon which our republic rests. Dodd-Frank erodes the economic freedom and opportunity that empowers low-income Americans to rise and generate greater shared prosperity.

Dodd-Frank moves us away from the equal protection offered by the impartial rule of law towards the unequal and victimizing rule of political bureaucrats. Of all the harm Dodd-Frank inflicts, this is the most profound and disturbing.

Dodd-Frank exemplifies the insidious belief among many Washington elites that the American people cannot be trusted to make good decisions for themselves so government must do it for them. Without Washington's coercive mandates we might just pick the wrong health plan, the wrong mortgage, the wrong financial advisor, or maybe even, God forbid, the wrong lightbulb.

Perhaps the ultimate expression of this elitist attitude is the Bureau of Consumer Financial Protection. Why? Why in America would we trust one American to decide which financial products and services the rest of us are allowed to have?

Pray tell, how does Dodd-Frank empower people to rise when it centralizes power in secretive distant bureaucracies and takes away consumers' freedom to make their own choices? This is not the rule of law; it is the rule of rulers.

Equally offensive is the Financial Stability Oversight Council. By defining vague statutory terms in any fashion that pleases them, this amalgamation of regulators can exert ultimate functional control of almost any large financial firm in our economy, and do so with utter disregard for due process. Again, this is not the rule of law; it is the rule of rulers.

Quite simply, Dodd-Frank hurts the poor and the unemployed when it smothers opportunities for their success with oppressive and costly rules that squeeze small businesses and devour dollars that could otherwise be used to secure a good job and a career path for those who need them.

To restore upward mobility, fight opportunity inequality, and create a healthier economy, it is time to move beyond Dodd-Frank. It is time to reinvest in the power of economic freedom and the American people, reestablish the rule of law, and then watch the American people rise and create a nation of boundless opportunity for all.

I now recognize the gentlelady from New York, Mrs. Maloney, ranking member of our Capital Markets Subcommittee, for 3 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman, for calling this third hearing of the committee.

Today, we meet to debate the merits of the constitutional challenges that have been brought against the Dodd-Frank Act and to consider whether the Act has made us "more free." However, I am afraid today's discussion won't be much of a debate.

In at least four cases, Federal district courts have rejected constitutional challenges against the Consumer Financial Protection Bureau (CFPB), the Financial Stability Oversight Council (FSOC), and the Orderly Liquidation Authority (OLA).

But today I would like to focus on the challenges to the Consumer Financial Protection Bureau because one of the most frequent criticisms of Dodd-Frank in these court challenges is that the CFPB is somehow a threat to individual liberty because the Bureau is not, "accountable to Congress." I agree that it is important for the CFPB to be accountable to Congress, but exactly what does "accountable" mean?

Webster's dictionary defines the word accountable as, "required to explain actions or decisions to someone." By this definition, the CFPB is definitely accountable to Congress. In fact, we are having a hearing next week in which Director Cordray will be here to explain his actions and decisions to this committee.

Every court that has addressed the issue of the CFPB's constitutionality has concluded that it is perfectly constitutional. In fact, just a few months ago a Federal court upheld the constitutionality of the CFPB and stated that the CFPB is, "no venture into uncharted waters. It is a variation on a theme—the independent regulatory agency with enforcement power—that has been a recurring feature of the modern administrative state."

So instead of arguing about whether the CFPB undermines the "rule of law," this committee would be better off recognizing that Dodd-Frank is the law and working cooperatively to improve the law.

Thank you. I yield back, and I look forward to the testimony of our guests today.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Financial Institutions Subcommittee, for 2 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

This hearing poses the question: Are we more free? And as I look at the government, particularly the structure of our financial regulatory system, I think the answer most surely is, we are not.

Seven years ago this week, Lehman failed. And in the following weeks our financial institutions experienced more failures. Government response focused on the suspension of free market principles by policymakers.

Looking back at this crisis, I can't help but think about the quote from Rahm Emanuel: "Never allow a good crisis to go to waste."

You see, the financial crisis provided political cover for suspending the rule of law and allowing the government to pick winners and losers. Crisis is often invoked to rationalize both government discretion and the waiver of rule of law.

Crisis also produced Dodd-Frank, which cemented principles that provide to the government broad and unchecked tools to micromanage private companies and the financial habits of American consumers.

One such example is the creation of the Orderly Liquidation Authority, OLA, over financial institutions in distress. Under OLA, once a financial institution is in the hands of the FDIC, the government can pick winners and losers of the firm's failed creditors.

This process subverts the carefully calibrated rules designated to protect all creditors under the bankruptcy principles. Further, OLA's original intent to liquidate failing firms has been distorted under the single-point-of-entry approach, to focus instead on reorganization of the firm with taxpayers taking the risk. Under this framework, the basic expectations of the rule of law that rules will be transparent and knowable in advance are subverted.

When the government is granted this much power, we surely cannot be free. I hope this committee will continue to take steps to restore the rule of law for our financial markets.

With that, Mr. Chairman, I yield back.

Chairman HENSARLING. The gentleman yields back.

Today, we welcome the testimony of a distinguished panel of witnesses.

First, Dr. Matthew Spalding, who is the associate vice president and dean of educational programs at Hillsdale College. Dr. Spalding is the executive editor of the "Heritage Guide to the Constitution." He was previously vice president of American Studies at the Heritage Foundation. He is a senior fellow at the Claremont Institute for the Study of Statesmanship and Political Philosophy. And he is a graduate of Claremont McKenna College and the Claremont Graduate School.

Ambassador Boyden Gray is founding partner of Boyden Gray & Associates. Mr. Gray has held a number of senior positions in government service, including as White House Counsel to President Bush 41, and ambassador to the European Union.

He practiced law for 25 years at an international law firm and clerked for Chief Justice Earl Warren. Ambassador Gray is a graduate of Harvard College and the University of North Carolina at Chapel Hill.

Professor David Skeel, of the University of Pennsylvania Law School, is the author of a number of books on financial services and law. In addition to Penn Law, he has taught at Georgetown University, the University of Virginia, the University of Wisconsin, and Temple University. He is a graduate of the University of North Carolina and the University of Virginia Law School.

And I wish to announce to all Members that we will be excusing this witness, Professor Skeel, at 12:30 due to a previous commitment.

Mr. Deepak Gupta is a founding principal of Gupta Wessler PLLC. Mr. Gupta specializes in Supreme Court appellate and complex litigation on a range of issues, including on constitutional law matters.

He was previously Senior Counsel for Enforcement Strategy at the CFPB. Mr. Gupta is a graduate of Georgetown University Law Center and Fordham University.

Last but not least, and no stranger to this committee, Professor Todd Zywicki of George Mason University School of Law. Mr. Zywicki previously practiced law in an international law firm, and worked for Judge Jerry Smith at the U.S. Court of Appeals for the 5th Circuit.

He has published many articles in leading journals and has held academic appointments at a number of institutions across the country. He is a graduate of the University of Virginia Law School, as well as Clemson University and Dartmouth College.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. For those of you who have not testified before, there is a lighting system before you. Yellow means that you have 1 minute to go, and red means it is time to stop and yield to the next witness.

Dr. Spalding, you are now recognized for a summary of your testimony.

STATEMENT OF MATTHEW SPALDING, ASSOCIATE VICE PRESIDENT AND DEAN OF EDUCATIONAL PROGRAMS, HILLSDALE COLLEGE

Mr. SPALDING. Thank you, Mr. Chairman.

My testimony this morning focuses on the broader issue of the rule of law and the rise of bureaucratic government, and I will summarize it by making four points.

First, the rule of law is the most important and significant and influential accomplishment for the long history of human liberty. One need only read Shakespeare to see that Anglo American history for 1,000 years is replete with the back-and-forth between despotism and the slow development of the concept of the rule of law. English kings regularly sought to get around the law by exercising the prerogative power.

It is associated with four key components: first, a regular process of law enforcement and adjudication, not arbitrary will.

Second, rules binding on rulers and the rulers alike and the ruled. No one is above the law. No one is privileged.

Third, there are certain unwritten rules and generally understood standards with which lawmaking must conform. No ex post facto laws, but there is due process.

And lastly, the rule of law is based on and emphasizes centrality of lawmaking as the authoritative source of those laws. In America, we can add to the Declaration of Independence, based on natural rights, the idea that legitimate governments are organized and structured according to the consent of the governed, and a carefully designed and maintained written Constitution where the primary functions of governing—lawmaking, executing, and enforcing the law—are divided into branches with independent, unique powers that can't be delegated away.

The modern state has a very different view that grows out of a faith in science applied to public policy. The 19th Century progressives took this argument and Americanized it to reshape the old constitutional rule of law system into a more efficient form they call the administrative state.

Politics were to remain in the realm of expressing opinions, but the real decisions and details of governing would be handled by administrators or experts, separate and immune from the influence of politics and public scrutiny.

The United States has been moving down this path for some time in fits and starts from the initial progressive-era reforms through the New Deal, but a significant shift and expansion occurred more recently under the Great Society and its progeny, Democratic and Republican. Whereas initial regulations dealt with targeted commercial activity, there was a turn in the 1970s to broader regulations concerning wide areas, such as the environment, employment, civil rights, and health care.

And the modern phase we are currently under is even a vast expansion to even more areas, and everything must be dealt with comprehensively, meaning centrally, uniformly, and systemically, by administrative apparatus that is more complicated and expansive than ever.

The Affordable Care Act is an example of that, but so is the Dodd-Frank Act. It requires administrative rulemakings reaching not only to every financial institution but well into the corners of everything in the American economy. Its new bureaucracies operate outside of the public eye and are subject to virtually none of the traditional checks.

The CFPB is literally outside the rule of law. It has its own source of revenue, insulation from legislative and executive oversight, and broad latitude and discretion to determine and enforce its own rulings, which is to say, define its own limits of its own authority.

The result, and my conclusion, is that the rise of bureaucratic government has changed the structural workings of the United States Constitution to the detriment of liberty and self-government. When Congress writes legislation that uses very broad language that turns extensive powers over to agencies, the result is that most of the practical decisions, for all intents and purposes, of lawmaking public policy are willingly, by Congress, delegated to others whose rules, there is no doubt, have the full force and effect of laws passed by Congress.

Modern administrative forms of governing consolidate the powers of government by exercising the lawmaking power, executing their own laws, and then judging their application in administrative courts, guiding individuals through rulemaking based on increasingly broad and undefined mandates with more and more authority over an ever-wider range of subjects, all the while less and less apparent and accountable to the political process and popular consent.

This is not merely an aspect of modern political life, a necessary adaptation. It is a new and all-encompassing form of political organization.

And so here we are 800 years after England's barons forced King John to sign the Magna Carta, and we are seeing the institutionalization of the very forms of prerogative power that, once practiced by feudal monarchs and against which the whole development of the rule of law was directed, operating outside the law and not responsive to the democratic institutions of government.

We should all—Republicans and Democrats alike—recognize and fear this new state of things, whether it is coming from the left or the right. If this becomes the undisputed norm of how things work in America, the characteristic of the modern state, I fear for the future of our experiment in self-government.

Thank you.

[The prepared statement of Dr. Spalding can be found on page 112 of the appendix.]

Chairman HENSARLING. Ambassador Gray, you are now recognized for a summary of your testimony.

Mr. GRAY. Thank you very much.

STATEMENT OF THE HONORABLE C. BOYDEN GRAY, FOUNDING PARTNER, BOYDEN GRAY & ASSOCIATES

Mr. GRAY. Thank you very much for the opportunity to testify. I have talked about these issues before, and I have enclosed the testimony with my prepared text so that everything will be included here before this committee.

The structural difficulties with the Dodd-Frank Act are, I think by now, fairly well known, and they have not been cured. The courts are beginning to get into it, and I hope that you will, also.

For example, the Orderly Liquidation Authority has legislation introduced in the Senate by Senator Cornyn and others to fix the favoritism and the discretion that is included in that legislation—included in Dodd-Frank, and including the secrecy and the penalties for disclosure to the public of what is happening.

The structural difficulties for the titles that I am going to talk about and have been involved in litigation against are Titles I, II, and X: the FSOC; the OLA, which you have mentioned; and the CFPB, which has also been mentioned. What appears to be the characteristic is just a stripping of all accountability among the political branches.

There is no White House supervision over the executive actions—or the agency action taken in any of these titles. There is virtually no congressional oversight. There may be a hearing, but Congress doesn't have control over the CPB's budget, and it doesn't have control over the OLA's budget.

The OLA, the Orderly Liquidation Authority, has the ability to raise money, to borrow money from the Treasury and get it paid back from a fee. It is called a fee, but it is really a tax on the financial community, which bypasses Congress' taxing authority and takes away from Congress, of course, as a result, Congress' ability really to follow what is going on.

And then for all three titles, there is truncated judicial review. In the case of the first two titles, the key issue identified by the White House as the most important defense, if you will, from abuse is that the agencies involved have to find that there is a systemic danger to the financial stability of the United States, but that standard, both as a matter of statutory construction and constitutionality, is expressly excluded from judicial review by the statute. Whether the courts will accept that exclusion is another question, but nevertheless, there it is.

The CPB has gotten the most attention of all of the agencies because it is doing the most at the moment. But it, again, is insulated from review by the White House, insulated from review by the Congress. It gets its money from the Federal Reserve, and the courts are required to exhibit deference to whatever the CPB says no matter what jurisdiction has—or belongs to other agencies that share the execution of these statutes.

The CPB has caused a lot of difficulty, along with Dodd-Frank, in just heaping regulations on all banks. The big banks don't like it, but they can live with it, and they can pay for it. And as the chairman of JPMorgan once said, "It is my moat—M-O-A-T—my protection against competition." Goldman Sachs has said much the same thing.

And this makes it very hard for community banks to survive. They have been consolidating at a very, very rapid rate. And the liquidity that I think local communities are used to is drying up as the community banks contract.

Some of the people on this panel have said, well, this is really nothing more than the nondelegation doctrine. It is a lot more. It involves all branches of the government, all three.

It is a much more serious problem than nondelegation, but I would submit that the nondelegation problems here are severe enough to cause dramatic change in the way these statutes are written and your attention.

Thank you.

[The prepared statement of Ambassador Gray can be found on page 60 of the appendix.]

Chairman HENSARLING. Professor Skeel, you are now recognized for your testimony.

STATEMENT OF DAVID A. SKEEL, JR., S. SAMUEL ARSHT PROFESSOR OF CORPORATE LAW, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL

Mr. SKEEL. Thank you for giving me the opportunity to testify. It is a great honor to be here.

The last time I was here, I said that it sends chills through my spine when I sit in this room, and it does, but somebody said maybe we should turn down the air conditioning. So maybe I shouldn't say that.

I would like to focus on the single most puzzling and worrisome feature of the Dodd-Frank Act. After previous economic crises, lawmakers have nearly always made a concerted effort to correct any departures from the rule of law. The Dodd-Frank Act did precisely the opposite.

The Dodd-Frank Act set up a corporatist partnership between the government and the largest financial institutions that perpetuates, in my view, some of the worst abuses of the bailouts of 2008 and 2009. The bailouts themselves repeatedly subverted rule-of-law principles.

When Bear Stearns was bailed out in early 2008, its sale to JPMorgan Chase flagrantly violated Delaware corporate law. In the AIG bailout, the government illegally acquired nearly 80 percent of AIG's stock. Troubled Asset Recovery Program (TARP) money was used for purposes for which it clearly was not intended.

Rather than restoring the rule of law, the Dodd-Frank Act reinforced the partnership between the government and the largest banks, as Ambassador Gray just mentioned. And it invites regulators to channel policy through the banks by putting almost no rule-of-law curbs on their regulatory discretion.

Let me briefly mention two examples.

The most important source of regulation for the biggest banks right now is the so-called stress tests they are required to undergo, and the requirement that the banks prepare living wills. It is not any of the other regulations in Dodd-Frank and elsewhere; it really is the stress tests and the living wills. The stress tests and the living will process are highly secretive in most respects, often quite arbitrary, and put no real constraints of any kind on regulators' discretion.

The second example is the new resolution rules in Title II of the Dodd-Frank Act. When the FDIC takes over a bank, the bank is given almost no opportunity to respond. There is no due process whatsoever involved.

And although Title II purports to create creditor priorities, an orderly priority scheme for an orderly liquidation, the FDIC actually can pick and choose which creditors it would like to pay and which do not get paid.

Moreover, the FDIC has announced its intention to ignore one of the few very clear commands that the Dodd-Frank Act does provide. Although it is instructed to liquidate any big banks it takes over—and the liquidation requirement was added with great fanfare late in the legislative process—the FDIC has developed a strategy that would ignore this command and reorganize the troubled bank instead.

The cost of these and other radical departures from rule-of-law principles are enormous. Many of these costs—again, as Ambassador Gray just mentioned—will actually fall on the small and medium-sized banks that lend money to small and medium-sized businesses throughout our country.

My hope is that you all will re-work these features of the Dodd-Frank Act and establish rule-of-law principles as the foundation, once again, of American financial regulation.

Thank you.

[The prepared statement of Mr. Skeel can be found on page 97 of the appendix.]

Chairman HENSARLING. Mr. Gupta, you are now recognized for your testimony.

STATEMENT OF DEEPAK GUPTA, FOUNDING PRINCIPAL, GUPTA WESSLER PLLC

Mr. GUPTA. Chairman Hensarling and distinguished members of the committee, thank you for the opportunity to testify this morning.

I am going to be focusing my remarks on what I think is the Dodd-Frank Act's crown jewel, the Consumer Financial Protection Bureau, and in particular, the accountability critiques of the Bureau and the constitutional critiques of the Bureau that we heard from Ambassador Gray. I will make three basic points.

The first is that the CFPB has already proven that it is protecting the freedom of consumers to achieve the American Dream, and Congress should resist efforts to gut the agency. When we talk about the CFPB, we should not lose sight of the fact that Congress created the Bureau in response to an epic financial crisis—a crisis that touched the lives and livelihoods of millions of Americans and threatened the financial system's very stability.

Underregulated and unregulated risky financial products set off a wave of millions of foreclosures and depleted as much as $9 trillion in home equity. In just a few years of existence, the CFPB has already returned $11 billion for more than 25 million consumers harmed by illegal practices and has reined in some of the worst abuses. That includes $14 million that the Bureau won back from the payday lender Cash America for targeting and illegally overcharging members of the military.

And the Bureau's victories go beyond the numbers. Across a range of products and services, it is already making financial products more transparent and serving as a much-needed watchdog.

The Bureau is working to level the playing field both between financial institutions and consumers, and between large financial institutions and small financial institutions. And that makes all of us more free, not less free.

Yet the Bureau's opponents—those who stand to gain by exploiting consumers—are trying to hamstring its efforts and alter its structure to make it less effective. Those efforts should be stopped.

Second, the basic accountability critiques of the CFPB and Dodd-Frank are groundless. We should all care about whether our institutions of government are transparent and accountable, but the CFPB, which was specifically designed to resist capture by special interests in the financial industry, is at least as accountable to the public as were the existing banking regulators before and during the crisis.

And in several respects, the Bureau is actually more accountable. Its budget is capped. Its rules can be vetoed by a committee of other regulators, something that is not true of any other agency in Washington. And it is subject to special, time-consuming small business reviews that only the EPA and OSHA similarly face. Finally, the CFPB has also gone beyond legal requirements, using technology to make itself more directly responsive to the American consumer.

The third and final subject I want to address is the constitutional challenges to Dodd-Frank. These challenges are extreme. And they are utterly lacking in legal merit, and have failed across-the-board in the courts.

In the 5 years since the enactment of Dodd-Frank, its opponents have invoked every conceivable constitutional principle, from the separation of powers to the void for vagueness doctrine to procedural due process, in an effort to turn back the clock on consumer protection. As I said, these efforts have failed in every court that has considered them.

And these legal challengers are truly at the fringe. To see that, look at the recent D.C. Circuit case *Big Spring*—that is Ambassador Gray's case—where there were no amicus briefs; none of the major financial institutions or trade groups supported those challenges.

Unfortunately, however, these challengers tell us something about the moment we live in, in which every political disagreement, from health care to immigration, seems to become constitutionalized. When we don't have the votes to do what we want here, we take it across the street to the courts.

And we can have a legitimate policy debate about Dodd-Frank. We should. But we should be clear that that is not the same thing as a constitutional debate.

The main constitutional arguments against Dodd-Frank are at odds with at least 80 years of settled precedent. Most of them are really disguised nondelegation arguments, arguments that Congress somehow delegated too much or too vague authority to the agency.

That doctrine hasn't successfully been invoked in the courts since 1935, at the height of judicial resistance to the New Deal, and it has only worked once in the Supreme Court's history. As Justice Scalia has explained, the Court has never felt qualified to second-guess Congress regarding the degree of policy judgment that can be left to agencies.

The challenges based on Presidential removals similarly seek to turn the clock back to 1935, when the Supreme Court in *Humphrey's Executor* removed virtually identical for-cause removal procedures for Federal Trade Commissioners as we have with the CFPB.

So at the end of the day, these arguments are not really attacks on Dodd-Frank or the CFPB as much as attacks on the very foundations of the modern administrative state.

Thank you.

[The prepared statement of Mr. Gupta can be found on page 66 of the appendix.]

Chairman HENSARLING. Professor Zywicki, you are now recognized for your testimony.

STATEMENT OF TODD J. ZYWICKI, FOUNDATION PROFESSOR OF LAW AND EXECUTIVE DIRECTOR OF THE LAW AND ECONOMICS CENTER, GEORGE MASON UNIVERSITY SCHOOL OF LAW

Mr. ZYWICKI. Thank you, Chairman Hensarling, and members of the committee.

By coincidence, yesterday in the mail I just happened to receive the Human Freedom Index, and one of the things I found from that is today the United States has sunk to 20th in the world in economic freedom, and one reason is because we sunk to 19th in freedom of our financial system, tied with, among others, Panama and Mauritius and a few others, lagging behind countries such as Poland and a few others.

Now, what this simple number is telling us is that we are learning the hard way lessons we have learned in the past, which is giving more power, more money, and less democratic accountability to Washington bureaucrats is not a recipe for improving the freedom and prosperity for American families.

We see it every day in the impact on American families and small businesses, as they are losing access to mortgages, small business loans, and credit cards.

We see it in initiatives such as Operation Choke Point, an initiative which has targeted completely legal businesses, such as firearms dealers, payday lenders, and home-based charities, all under the theory of so-called reputational risk, while other controversial industries such as abortion clinics have escaped the net.

We see it in a crushing regulatory burden that is driving community banks out of business at twice the rate that they were shrinking prior to Dodd-Frank.

We see it in Jamie Dimon's remark that was referenced earlier, that Dodd-Frank has built a bigger moat around the big, too-big-to-fail institutions, protecting them from competition. And we see community banks leaving entire markets such as mortgages because of the regulatory burden and the risk of liability that they confront under those.

We see it in the inability of small businesses to get a loan to start a business, to build a business, to grow a business over time. Why? Because community banks provide most of the small-business lending in this country and most of the agriculture lending, as well.

And it is reflected in the fact that last year, for one of the first times in recent memory, we saw more small businesses disappear than were founded in the United States, in part because of Dodd-Frank shutting off access to small-business capital.

We see it in the continued inability of many consumers to be able to obtain mortgages because of the one-size-fits-all regulatory burden that Washington is imposing on banks all over the country, depriving community banks of, among other things, one of their greatest competitive advantages, which is the ability to engage in relationship lending with consumers, and the rule-of-law concerns about the threat of put-back liability for mortgages that end up going sour later.

We see it in the CFPB's attack on auto dealers through its claim of alleged discrimination, an industry over which the CFPB doesn't even have jurisdiction. What they have done here is basically weaponized American banks, as they have done with Operation Choke Point, to go after and enforce as an arm of the Federal Government at the whim of bureaucrats.

Yet, they have given no notice and comment rulemaking; they have never given any formal enforcement action. They promulgated their attack on the auto dealers through a five-page guidance document that contains no cost-benefit analysis, no analysis of the impact on consumers.

And we saw an article last week in The Wall Street Journal about what the impact on consumers has been. As a result of the CFPB's attack on auto dealers, the average American is now paying more for a car loan than they were previously.

What is the methodology they use for this? So-called Bayesian Improved Surname Geocoding, a concoction they came up with after the fact and which is shredded as completely scientifically unreliable in a report by Charles River Associates, yet they seem to continue doing it.

We see it in the CFPB's unbelievable data-mining operations. They scoop up hundreds of millions of credit card accounts every month, tens of millions of mortgages, tens of millions of bank accounts data, payday lending data, and the like.

Yet, they still have given us no explanation why they need so much data when there is no real regulatory purpose for needing data on this scale, and at the same time, they admit that there is a threat that this data could be compromised. As someone who just received a letter last week from the IRS telling me that I was a victim of identity theft, I am not comfortable with the Federal Government taking this much of my personal data without some good reason.

What we have seen, unfortunately, is something that we saw and learned our lesson about the hard way in the 1970s. In the 1970s, we unleashed unaccountable bureaucrats on the economy, and what we saw was declining American competitiveness, declining American entrepreneurship, and restrictions on freedom.

We are doing the same thing today under Dodd-Frank, and American consumers and small businesses in the economy are suffering.

Thank you.

[The prepared statement of Mr. Zywicki can be found on page 124 of the appendix.]

Chairman HENSARLING. Thank you.

I thank each of you for your testimony. Without objection, each of your written statements will be made a part of the record.

The Chair now yields himself 5 minutes for questions.

Professor Zywicki, on page two of your testimony you mention that a loss of the rule of law is "laying the foundation for the next financial crisis."

And Professor Skeel, I think you say something similar on page seven of your testimony when you say that departures from the rule of law might "magnify the consequences" of the next financial crisis.

So first Professor Zywicki, and then Professor Skeel, could you elaborate on those comments? How is the erosion of the rule of law in Dodd-Frank laying the foundation for the next crisis?

Mr. ZYWICKI. Thank you for asking that question.

It really has to do with what by pretty much common consensus is the entrenchment of the too-big-to-fail regime. Nobody seriously thinks that if there is another financial crisis, anybody will actually comply with the rules laid out in Dodd-Frank under the Orderly Liquidation Authority.

And what we have learned over time is that lack of respect for the rule of law creates a moral hazard problem. What we saw last time around is that the reason we ended up bailing out the big banks, Secretary Paulson said, was because the market expected us to bail out the big banks.

According to the studies we have—evidence is mixed, but most of this evidence points in the direction that there is still a too-big-to-fail subsidy for the largest banks, at least according to the GAO report. They said it has gotten smaller, but it is still there. And one would expect it would get bigger if we actually reach that point.

As long as the government has the ability to bail out banks and is not constrained by the rule of law, people are going to expect that they are going to do that. That creates its own moral hazard problem, and that creates an entrenchment of too-big-to-fail.

Chairman HENSARLING. The same question for you, Professor Skeel.

Mr. SKEEL. There are a couple of ways in which it seems to me Dodd-Frank has made us riskier rather than safer.

One of them is the effect of the so-called Volcker Rule, which prohibits banks from engaging in propriety trading. The effect that is already having—it has just gone fully into effect, and not even fully into effect, recently—is it is pushing a lot of basic banking activities such as market-making and trading for clients' accounts, outside of banks.

And so what is going to end up happening is banks are going to be doing less of this. They are concerned about regulatory intrusion in what they are doing, and it is impossible to tell where the lines are.

So this is going to end up outside of the banking system, and whatever potential problems there are down the road are going to blow up away from regulation, it seems to me.

The other thing I will mention is not so much in the Dodd-Frank Act itself, but in the litigation against the big banks after the crisis. The government leaned on the big banks, as part of the partnership that was set up, to acquire troubled institutions. JPMorgan was leaned on to acquire Bear Stearns; Bank of America was leaned on to acquire Merrill Lynch.

And then the government turned around and whacked them with a bunch of litigation that bears no relationship to traditional litigation. Much of the recovery goes to States and to people who were not harmed by the alleged misbehavior.

Next time around, those banks aren't going to be there. They are not going to agree to buy anything in a crisis, and so if we have another crisis, there is going to be no way to minimize its effect or to preempt it.

So those are two of the ways, I think, that we are in more dangerous waters now than we were—

Chairman HENSARLING. Another aspect of your testimonies that is somewhat similar, particularly in your close, Professor Zywicki—you indicate that this erosion of the rule of law ultimately is going to essentially hurt the unemployed, and low- and moderate-income persons the most.

I think, Professor Skeel, you used the term "corporatism," to where the average American can't afford a high-priced lobbyist or a presence in Washington.

So what aspects of the erosion of rule of law in Dodd-Frank are hurting the unemployed, low- and moderate-income, Professor Zywicki?

Mr. ZYWICKI. That is exactly right. What people don't appreciate is that the rule of law exists for all of us. It exists for the small banks, the small businesses, and the rest of us.

In a world of chaos, in a world where nobody knows what the rules are, the big banks, the Goldman Sachs or the JPMorgans, they can hire the lobbyists and the lawyers to weave their way through this, to figure out the regulatory burden, to create the contacts that they need in order to get through this process.

The rest of us can't afford high-priced lawyers; we can't afford lobbyists. All we can do is try to comply by the rules as they are written. And when the rules are constantly shifting around, when the rules are subject to push and pull of special interests and that sort of thing, the rest of us get the short end of the stick.

Chairman HENSARLING. Well, in an attempt to set a good example for other Members, I see my time has expired, so I won't go any further.

The Chair now recognizes the gentlelady from New York, Mrs. Maloney, ranking member of our Capital Markets Subcommittee.

Mrs. MALONEY. Thank you. Thank you very much.

Mr. Gupta, as you know, prior to Dodd-Frank the responsibility of enforcing consumer financial protection laws was spread across seven different agencies, and it was not a priority for any of them. And because these agencies all enforced consumer financial protection laws differently, that inconsistency was very confusing and frustrating for the financial industry.

And because it was not a priority, consumer protections were not thought about. It was an afterthought. It was the secondary thought, the third thought, or not thought about at all.

So we came out with things called the no-doc mortgages. The joke in New York was if you can't afford your rent, go out and buy a home, because they didn't even look at anything. They just signed up knowing that this was a disaster, collecting their fees, going on and creating a financial crisis.

In fact, many people argued back then that what really undermined the rule of law was the inconsistent enforcement, or not even looking or caring at all about consumer financial protection laws. If you looked at the responsibilities of agencies, they had this, and then you got way, way down there, they might mention consumer protection. And it wasn't protected.

So my question to you is, doesn't consolidating the responsibility for enforcement of consumer financial protection laws into one Bureau actually promote the rule of law?

Mr. GUPTA. Yes, exactly, Congressman Maloney, it does.

And I agree at a high level of generality with some of what Professor Zywicki said about the rule of law. For the rule of law to work, the rules have to be the same across-the-board. We can't have special rules for some people and different rules for other people.

And this was a central insight in creating the Consumer Financial Protection Bureau. As you said, you had these regulatory responsibilities spread out across a very confusing patchwork of different agencies with partially overlapping authority that left gaps which created very strange incentives, where you had, for example, the Office of Thrift Supervision—an agency that, thankfully, no longer exists—competing to basically offer the least regulation possible, and institutions could choose which regulator they wanted. That was a nonsensical system.

And, we hear critiques about the Bureau's funding scheme, but it was even worse with some of these agencies. They were actually getting their funding from the folks they were supposed to be regulating, rather than through congressional appropriations.

So it was a very bad system that we had, and part of the idea of the CFPB is, let's bring all of these institutions under the same umbrella. Let's bring nonbanks and banks under the same umbrella so that you can't have products offered by one kind of institution that are not allowed to be offered by another institution.

So if we care about rule of law, we should celebrate this consolidation so that we have a single set of rules that everyone has to play by.

Mrs. MALONEY. Mirroring some of your comments is a set of letters from a coalition of consumer groups on the constitutional challenges to Dodd-Frank.

And I ask unanimous consent to place this into the record, if I may.

Chairman HENSARLING. Without objection, it is so ordered.

Mrs. MALONEY. Okay. Thank you.

Mr. Gupta, can you discuss how Dodd-Frank and the CFPB's implementation of Dodd-Frank has been tailored to fit the unique needs of smaller banks, and credit unions, and consumer banks? When you worked for the CFPB, did you find that the Bureau was aware of and responsive to the needs of smaller institutions?

Mr. GUPTA. Thank you for the question. I think it is an important question because we hear today a lot of criticisms of the Bureau that are sort of made in the name of small banks or community banks. And I think what is really happening is that larger financial institutions or opponents of the Bureau are using smaller community banks as a guise to make criticisms that are really not about those smaller institutions.

The Bureau cares a lot about those smaller institutions and makes a lot of effort to specifically reach out to those institutions. There is no question that they are hurting. They were hurting before the CFPB was created. They face a lot of challenges.

It is built into the DNA of the CFPB. There is a $10 billion threshold so that banks under a certain threshold are not subject to CFPB enforcement. But it is also part of the charge of the agency to make sure that small banks are not harmed simply by being small, and that the regulatory compliance burden on them doesn't put them out of business.

So that is something that the agency cares a lot about. I think simply by having the same set of rules by all actors in the consumer financial marketplace, we ensure that doesn't happen, that the smaller players aren't squeezed.

Thank you.

Mrs. MALONEY. Thank you.

My time has expired.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Financial Institutions Subcommittee.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I want to review what I think I just heard. What I just heard is that consolidating the power to one agency to make unilateral decisions on the types of financial products that will be available promotes the rule of law and increases economic freedom for America's consumers.

Professor Zywicki, what would be your response to that?

Mr. ZYWICKI. I actually don't have a problem—and I have testified before—with actually having systematized the Federal consumer protections system in one agency. I oppose the idea of having a completely unaccountable agency that operates in violation of the Constitution and, in fact, does go out and ride herd on American consumers.

I think that the unfortunate thing to me, as somebody who has spent his life working in this field, is we had a great opportunity with Dodd-Frank to create a truly innovative 21st Century consumer protection agency that would promote innovation, would promote consumer choice, and would promote lower prices for consumers. Instead, what we got was a throwback to the 1970s, like a Jurassic Park-type agency that learned nothing from the experience of the last 30 or 40 years about what makes a responsive, innovative consumer protection agency.

Instead, we have old-fashioned command-and-control regulation that is restricting choice, raising prices, and restricting innovation, and I think that is a real tragedy.

Mr. NEUGEBAUER. Professor Skeel, does consolidating all of this power and giving the government unilateral control over our financial markets promote the rule of law and promote economic freedom?

Mr. SKEEL. My answer I think is a little bit more mixed than Todd's answer. I do think there was a problem before 2008, and the one danger with multiple regulators was that they were competing with each other. And you can get a race to the bottom if you are not careful how you structure that interaction, and I think we had it before 2008.

So it seems to me there are some things to be concerned about with the CFPB, with consolidating the power. I have some concerns about not having oversight of the funding. I have some concern about the difficulty of overturning rules put in place by the CFPB.

But I, like I think Professor Zywicki suggested, think the idea of a consumer bureau is a good idea.

Mr. NEUGEBAUER. I think the concern I have is that basically, there is a lot of talk about the Orderly Liquidation Authority and how the rule of law, and you have the government picking winners and losers, but I think who ends up being the losers in all of this that we don't think about—I think Professor Zywicki was trying to go to that point—is that now we have consolidated all this power into one agency with one person, and that person is basically telling the American consumers what kind of financial products that are appropriate for them.

How that promotes freedom in America is beyond my wildest dreams. I don't know how anybody can defend that that is in the best interest.

And what is happening, because of the thought out there in the credit markets that you can get haircuts arbitrarily, that the rule of law will not be followed, that raises the risk premium for the people who are actually buying car paper and how that trickles down to that single mom who is out there working two jobs trying to keep the wheels on her life, is the fact that her interest rate on her car may be increased because now the people who finance—buy car paper are concerned about whether the rule of law will be followed in the future.

And so I think the two things that are wrong there are, one, we have consolidated all that power—and by the way, the founders never intended to have a big, massive consolidation of power in the government. The power was supposed to reside in the people and not the government, and basically what we have done is we have tried to make utilities out of the financial markets with the government having the controls.

Professor Zywicki, you wanted to—

Mr. ZYWICKI. Yes. I will just add, we know how to design a regulatory agency. The Federal Trade Commission has been around for a century. It has congressional appropriations; it has a bipartisan commission structure; it has a dual mission of competition and consumer protection. It has worked for 100 years.

And all of a sudden, now we are going to just spring this new thing on the economy that has none of those advantages.

Mr. NEUGEBAUER. I see my time has expired, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Gupta, later today the Small Business Committee is holding a hearing to examine the effects of the Dodd-Frank Act on small financial institutions and small business access to credit. And this is what we know: The CFPB is required to comply with both the Regulatory Flexibility Act and the Small Business Regulatory Enforcement Fairness Act, SBREFA, to specifically examine how small entities will be affected by the agency's new regulation.

In listening to Professor Zywicki, he said that Dodd-Frank has hindered the ability of small businesses to access credit and to access capital. Yet according to the Thomson Reuters/PayNet Small Business Lending Index, access to credit continues to improve for small businesses.

The index, which measures the volume of U.S. small business lending, reached its highest level ever in June 2015. Small business lending is up 19 percent over the same period in 2014.

Also, the Wells Fargo/Gallup Small Business Index poll, conducted in July 2015, indicated a plus-11 percentage margin between the 33 percent of small business owners who say credit was easy to get in the past 12 months.

How do you reconcile that, Professor Zywicki?

And, Mr. Gupta, could you please explain how the CFPB implementation of that Act has been tailored to fit the unique needs of small business bank and credit unions that, after all, yes, Professor, they are the one who lend to small businesses?

Mr. ZYWICKI. I haven't carefully studied all the particular surveys that you reveal.

Ms. VELAZQUEZ. I will show them to you.

Mr. ZYWICKI. I would be happy to look at them. I have seen other ones that point the other way.

What I also know is that—we know that community banks do a lot of the small business lending in this country, and we also know that community banks are shrinking and disappearing, and that is having an impact on small communities and access to small business credit and the like. So I would be happy to look at the surveys that you suggest.

Ms. VELAZQUEZ. Professor, yes, I welcome you to look at both polls conducted by reliable sources. Don't come here and make such an assertion that Dodd-Frank is killing access to capital when the facts are demonstrated that you are wrong.

Mr. Gupta?

Mr. GUPTA. Thank you. I also haven't reviewed those studies, but—or polls, but I am not surprised to hear it. It is hard for me to see how the Consumer Financial Protection Bureau is inhibiting access to credit for small businesses.

This is not—the Consumer Financial Protection Bureau first of all doesn't regulate business-to-business lending, right? It only regulates consumer lending.

And we hear the claim that the community banks or the small banks are being strapped. It is true. But as I said earlier, that was true even before the crisis. It is because community banks and credit unions faced a whole host of challenges in the financial marketplace.

There is absolutely no evidence whatsoever of any correlation or causation between the existence of the CFPB or its regulation and the problems that are facing community banks.

So I am not surprised at all to hear those findings.

Ms. VELAZQUEZ. Thank you.

Mr. Zywicki, you have stated that the CARD Act would have a disastrous effect on the consumer credit market. However, the data have shown that not to be the case.

What do you make of this data? Would you say that the CARD Act has been helpful to consumers?

Mr. ZYWICKI. First, on the impact of the CFPB on community banks, I am just referring to a Mercatus study where 60 percent of small banks said that it has a significant impact on their bank earnings and that the regulatory cost imposed on them by the CFPB is causing a problem.

With respect to the CARD Act, I have written a 65-page paper analyzing the data on this, and the data is quite clear, which is that the studies that believe that the CARD Act has helped consumers are methodologically flawed because they simply do not account for the Federal Reserve regulations that came before the CARD Act. They are simply worthless studies.

In fact, what has happened is consumers lost trillions of dollars of credit access, low-income consumers lost access to credit cards—

Ms. VELAZQUEZ. Okay. I hear you.

Mr. ZYWICKI. —and fees and interest rates went up.

Ms. VELAZQUEZ. Thank you. And so you will say—

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, chairman of our Capital Markets Subcommittee.

Mr. GARRETT. I thank the chairman for this important hearing.

And I think the majority of the panel would agree with the axiom that our country lives by, that no one is above the law. If you would just nod in agreement if you agree with that?

I see Mr. Gupta nodding, but I think your statements belay that. Your statements are that someone is above the law.

You lay out a pretty good case, that prior to the CFPB, other agencies had a bad system as far as their funding and their mechanism. But instead of correcting the problems in those other systems or formats, we created a new system, the CFPB, which is above the law.

Why do we say that? If you have come to our hearings in the past, this panel knows—Mr. Gupta, you would have learned—that when we asked the CFPB and Rich Cordray, "Are you answerable to the House?"

He replied, "No."

"Are you answerable to the Senate?"

"No."

"Are you answerable to the President of the United States?"

"No."

"Are you answerable to the inspector general?"

"No."

"Are you accountable to anyone?"

"Well, no."

So here we have an agency that is above the law, and how you can come here and say we have had a problem before—and I agree, we did—but now you propose or you support an idea that we actually have a system of government where some individual is above the law is beyond me.

You say also that there should not be special rules for some and not for others. If you dig into the testimony that we have here today, if we look in Dodd-Frank, that is exactly what we have.

Ambassador, you talked very plainly about that very fact with OLA and with FSOC, saying that what we have done in Dodd-Frank is something unheard of in the history of this country, and that is what? Take away judicial review.

And in the OLA situation, you actually take away judicial review except for arbitrary and capricious, which means, Mr. Gupta, that your statement that there should not be special rules—there are special rules.

And whom are those special rules for? It is not the middle class, it is not the lower income, it is not the minorities, it is not for women.

Those special rules are for whom? The insiders, the well-connected, the rich, the powerful, the lawyers, those who are able to find their way around the system and get to the solutions that they need, unlike the regular people who don't have access to those.

That is not just me speaking; that is various economists who are quoted in the testimony of the panel here today—I think, Professor, you raised that in some of the testimony here—that it is the rich and the powerful, the insiders who are able to play the game, those who are making lofty salaries, and the regular American people are the ones who are hurt.

Professor Skeel, would you want to comment in 10 seconds?

Mr. SKEEL. I have said most of what I had to say about the Consumer Bureau. I focused more on the other parts of Dodd-Frank. But—

Mr. GARRETT. Let's take a look at the Consumer Bureau for 1 second, then. Local auto dealers—we all have local auto dealers. One of the things that Dodd-Frank and the CFPB is trying to do is to do what? Just tell the banks that they have to have a uniform level of lending.

Whom does that benefit? When some average person goes in to get his car loan, there should be a level of lending. Whom does that benefit? That benefits the banks, the Wall Street insiders, the people who now will make a larger profit on the loans.

Whom does that hurt? The poor, the middle class, the minorities who, in the past, went to an auto lender and could actually get a lower rate. How? By competition.

Anyone want to—

Mr. SKEEL. I will jump in for a second on that. I agree with you that there are some pretty significant problems with some of the things the Bureau is doing. The auto lending is a concern to me.

It is also a concern to me that the qualified mortgage requirements are pretty close to making illegal other forms of mortgages that have benefited many consumers in the past. So I think there is a risk to what turns out to be command-and-control regulation—

Mr. GARRETT. Dr. Spalding, you referenced that the history of where law comes from is—first was—or not law, but where power comes from goes to the strong and the forceful through force and fraud. And whom does that go to? Those who are in power. And whom does that hurt? And that is the weak.

I am paraphrasing what you said in your testimony. But now we have come to a civilized society where that is not the case.

But doesn't Dodd-Frank turn that on its head? Doesn't that take away the rule of law and the equal treatment to all and due process rights to all? And isn't that, at the end of the day, meaning that what Dodd-Frank does is help the 1 percent and hurt the 99 percent?

Mr. SPALDING. Oh, absolutely. I think Dodd-Frank is a perfect example of how we have completely turned things on their head.

The American Revolution was precisely to overthrow that old regime, and as the only non-lawyer on this panel, I would point out the obvious sometimes, which is that we are being ruled by someone else who is not responsible to us. That is a blatant violation of everything the American Constitution stands for—in technical detail, which my legal friends who have been pointing out, but in general. And the Legislative Branch should be very aware of that violation.

Mr. GARRETT. Thanks a lot.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Mr. Chairman, the subject of this hearing is, are we more free? I would hope that banks would be less free to rip off consumers and less free to rip off the U.S. taxpayer through some new bailout program.

Dr. Spalding, you talk about the regulators having too much power. They clearly do.

We punted the power over to them, and we can take it back if we reach bipartisan agreement, but we can't take it back if it is only going to be Republican proposals that we will find a way to block in the House, the Senate, or at the President's desk. Congress will be powerful when Congress acts in a bipartisan way.

There is massive illegality. It was best exemplified by Secretary of the Treasury Paulson who just commented for a newspaper. His philosophy was to just act boldly and ignore the statute. That is what he did. And he got away with it.

The better example is the Iran Sanctions Act, which several Administrations ignored for more than a decade. And then we should be surprised that we aren't able to get a better deal in Vienna. If you ignore the Iran Sanctions Act because it requires sanctioning international oil companies and you don't want to do that, you are not only violating the U.S. law for the benefit of those who do business with Iran, you are gutting American foreign policy.

This body, when we passed Dodd-Frank, required the SEC to deal with the credit rating agencies—the only game where the umpire is selected and paid by one of the teams.

Debt issuances are far more significant than stock issuances. They involve trillions rather than billions or tens of billions of dollars—not any one issuance, but overall. And the SEC's response was to just issue a report saying that they are not going to do what Congress instructed them to do, and the statute gave them a way to weasel out. It said, "or they can adopt another plan." So they decided to do nothing at all.

We are told by Professor Zywicki about bailouts and how there is this subsidy the big banks get, as if the problem is Dodd-Frank. We didn't have Dodd-Frank in 2008.

Everybody on Wall Street was convinced we would pass a new law to bail them out. And guess what? They were right.

And Dodd-Frank doesn't provide a way for government money to be put at risk for the benefit of the creditors of giant financial institutions. But you know what? Everybody on Wall Street thinks that if it comes to it again, we will do the same thing again. And they are probably right.

There is only one way to end too-big-to-fail, and that is to say too-big-to-fail is too-big-to-exist. That is why Bernie Sanders in the Senate and myself in the House have introduced the Too Big to Fail is Too Big—break them up. That is real capitalism.

But you don't find support—enough support on either side of the aisle for that. I think we have two cosponsors in the House and no cosponsors in the Senate for the only bill that will prevent us from being back in 2008 and being told we have to pass some new statute, or just have the Administration ignore the law completely and bail out the big banks.

We need small business lending. That is why this committee needs to pass the member business lending bill for the credit unions.

Credit unions are prevented from making small business loans. You would think that instead of breaking the social contract and having TARP and giving money to the banks, we would just allow the credit unions to make small business loans.

Democrats control the Executive Branch of Government. They are using Operation Choke Point, as I believe Mr. Skeel pointed out, against those—who was it that mentioned Operation—Professor Zywicki. I am always raising the—always the same hands.

Anyway, I think it has been pointed out that we will not always control the Executive Branch of Government and the "reputational risk" won't be that a bank provides a checking account for a payday lender or the Republican Party or some other disreputable organization. There will come a time when the DCCC or an abortion clinic cannot get a bank account. That is a giant threat to democracy because if we are going to regulate abortion or we are going to regulate payday lending, we should do it here in Congress by majority vote, not secret statements by bank regulators, "Oh, don't give that group a checking account; choke them off."

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, chairman of our Housing and Insurance Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

We very seldom ever get anything right here in Congress. Whenever we pass a bill it is either the pendulum swings too far or it doesn't swing far enough.

And I think in this environment what we have done with Dodd-Frank is we have swung it too far, and what we have done is created an environment within which the bureaucracy believes that they can do more than what the law actually allows them to do because they are—we are overreacting to the situation created in 2008, they are overreacting to the law itself.

I think when you do that, I think Professor Zywicki made the comment a while ago that the lack of the rule of law creates a moral hazard problem, and I think we have done that with Operation Choke Point.

I am the gentleman who carries the bill, and we passed it out of committee here recently, and I think that the Oversight and Government Reform Committee's own reports of the emails of these two agencies, FDIC and DOJ, indicate a collusion there and even a disagreement among themselves whether doing something is even legal. CFPB is jumping in on this as well, although they won't quite admit to it.

But, Professor Zywicki, have you ever seen a precedent like this before for a government agency to try and choke off legitimate businesses doing legal business from access to credit to actually drive them—or access to financial services to actually drive them out of business?

Mr. ZYWICKI. I have never seen anything like it. In the past, agencies have—in situations in which a payment processor is clearly involved in sort of facilitating a fraud, things have happened.

But to target entire legal industries and say, "We are going to choke off the air that they need to breathe basically because we don't like those industries and so we are going to declare a reputational risk," I have never seen anything like it, and I would have never dreamed that anybody would even think that was an appropriate use of government power.

Mr. LUETKEMEYER. Dr. Spalding, in your testimony you have a quote from John Adams, and let me read from your testimony: The classic American expression of the idea of the rule of law comes from the pen of John Adams when he wrote the Massachusetts Constitution in 1780, in which the powers of the commonwealth are divided in the document "to the end it may be a government of laws, not of men."

It looks like with Operation Choke Point, we have ignored the law, and we have a government of men. What do you think?

Mr. SPALDING. No, that is exactly right. The reason why these ideas of consolidation and efficiency are problematic is that is not the end of government. You, as the Legislative Branch, decide where exactly to draw those lines, but you must be careful about having gone too far. Process is important.

Rule of law is there to prevent, on both sides of the political aisle, that kind of corruption—moral corruption, political corruption, just administrative corruption and small-mindedness—from taking over our politics. This is clearly the rule of men, and the whole system of American constitutional government, why power is divided, why power is checked against each other, is because we don't trust individual men and women to rule. That is why we have popular government in the first place.

Mr. LUETKEMEYER. With Choke Point, though, we are not only allowing—we are allowing men to have their own interpretation of the law and allow their own outside ideas, political philosophies, moral judgments, and moral values to be imposed on somebody and not the rule of law.

Mr. SPALDING. That is exactly right. You also remember in the Federalist Papers when James Madison says the accumulation of all powers in the hands of one—executive, legislative, and judicial. That is the very definition of tyranny.

It is not what they do. It is the very idea of putting it all together in one place in the hands of one, based on their own passions and political own opinions, tends to cause problems.

Mr. LUETKEMEYER. Thank you.

Mr. Gupta, you were in an enforcement branch of the CFPB at one time. Is that correct?

Mr. GUPTA. Correct.

Mr. LUETKEMEYER. I had a discussion yesterday with a business that was fined by CFPB because they had a word in their documents that down the road CFPB is getting ready to propose a rule that will make that noncompliant. Now, let me go over this one more time. We have a situation where CFPB is fining an entity for what a rule down the road is going to hopefully—and it may not even go into effect, but they are proposing a rule down the road that it would be noncompliant.

Now, is that something that whenever you were there that you would have done?

Mr. GUPTA. No. I am not—

Mr. LUETKEMEYER. Can you tell me the reasoning on how that is legal?

Mr. GUPTA. I am not familiar with the facts of that case, and I suspect if you have only heard from one side, it might be more complicated than that. But the CFPB has a variety of tools. It has enforcement and it has rulemaking, and—

Mr. LUETKEMEYER. Okay, let me—

Mr. GUPTA. —lots of other agencies are like that. There is nothing wrong—

Mr. LUETKEMEYER. My time is running out, and I just want to make one more comment here.

What has happened with regard to Dodd-Frank, is now not only are the financial services folks supposed to be worried about complying with all these rules, they now have to be clairvoyant. They now have to have a crystal ball on their desk to be able to see down the road what may be proposed so that they will not be in noncompliance at some point.

That is how far they have gone. That is how out of control this agency is and what Dodd-Frank has allowed to happen with this environment.

Mr. GUPTA. I certainly saw nothing like that when I was—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Hinojosa.

Mr. HINOJOSA. Mr. Chairman, I ask unanimous consent for my statement to be made a part of the record so that I can go right into questions.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. HINOJOSA. Thank you.

My first question goes to Mr. Gupta.

The general gist of this hearing today is that an army of unaccountable bureaucrats over at the Consumer Financial Protection Bureau and the Federal Reserve and the Financial Stability Oversight Council have essentially overthrown the Constitution and the Congress via a regulatory coup d'etat. What do you make of these allegations? Why would the CFPB be any more unconstitutional than, say, the Federal Reserve?

Mr. GUPTA. Right. In fact, the CFPB is a lot more accountable than the Federal Reserve. And it is true that there are features of the CFPB that are new. They are designed primarily to resist industry capture, which was a problem before the crisis with the existing regulators.

But the various component parts of the CFPB that are being attacked here are nothing new. So there have been complaints about—we heard from—Congressman Garrett I guess is no longer here—that the Director of the CFPB is accountable to no one. In fact, the Director of the CFPB is removable for cause by the President, and that is the same system that we have for the Federal Trade Commissioners, and Professor Zywicki held up the Federal Trade Commission as an example of how to design an agency.

So that is nothing new. The Supreme Court in 1935 said—in a case called *Humphrey's Executor*—that is a perfectly permissible removal mechanism and is consistent with the separation of powers.

We also hear complaints that there is too much delegated authority to the agency—for example, the authority to define unfair and deceptive acts and practices. That is authority that the Federal Trade Commission has had for 100 years, and it is no different from authority that we delegate to agencies like the Environmental Protection Agency to consider environmental protection rules, and that Justice Scalia himself has said is perfectly permissible.

So the arguments that are being made here—this is why I said in my opening remarks—they are really efforts to attack the administrative state as a whole. The constitutional underpinnings of these arguments, if they were accepted, wouldn't simply attack the CFPB; they would sort of demolish the administrative state as a whole.

And I think at least the first witness we have heard, Dr. Spalding, is open about that. I think his testimony is an attack on the administrative state as a whole.

Mr. HINOJOSA. After that explanation, then tell us how the Bureau and the Council are accountable to the American people and to the Congress?

Mr. GUPTA. As you know, the Bureau is subject to congressional oversight and is up here—if there is another agency in Washington that has to face congressional hearings more than the CFPB and its Director, I am not aware of it. I think the average, if you look at the number of times they have been up on the Hill, is about once a month since the Bureau's inception.

So they are subject to congressional oversight. They are subject, as I mentioned earlier, to small business reviews that only two other agencies face. They are subject to the Financial Stability Oversight Council, a committee of other regulators that can conclude that—if they think that a substantive consumer protection rule poses a threat to the economy, they can actually gang up on the CFPB and veto the CFPB's rules.

The CFPB is subject to a really wide panoply of accountability measures that most other agencies are not subject to. So that is why I said in some ways this agency is more accountable than other regulators.

Mr. HINOJOSA. Thank you.

Mr. GUPTA. But to the extent that it is insulated from the appropriations process, that is a good thing.

Mr. HINOJOSA. Thank you for that explanation. My time is running out very quickly, and so I thank you for your responses.

My next question is to Professor Skeel.

Mr. Skeel, in the first footnote of your written testimony, you note that you believe that the Bureau has been a valuable and necessary innovation. Can you elaborate on what you meant by that?

Mr. SKEEL. What I meant was what I was referring to earlier, and that is I do believe that there were real problems with consumer protection and that the major agencies who had responsibility had conflicts of interest. And we did not have effective consumer protection in the financial services space before 2008.

I do think there are some rule-of-law issues with the Consumer Bureau. I think there are legitimate concerns about no accountability with the funding and with the difficulty of altering what the Bureau does, but I believe the Consumer Bureau was necessary.

Mr. HINOJOSA. I agree with you.

And I want to put into the record that I was here at the—in the year 2007 at the end of that year and the first quarter of 2008, when we heard many of the leaders on the other side of the aisle say, "We don't want any more regulations. We are doing fine. The financial system is strong." Vice President Cheney said that. Secretary Paulson said that.

And then all of a sudden, by the third month they wanted us to help the financial system be saved because they took us over the cliff.

You are absolutely right.

Chairman HENSARLING. The time of the gentleman has expired.

Mr. HINOJOSA. I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, chairman of our Monetary Policy and Trade Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman.

And I am a little flabbergasted by Mr. Gupta, who believes that somehow just because Congress created the CFPB that somehow the CFPB is accountable to it, since Congress then proceeded to put it outside of its purview. From the funding side itself, oversight—congressional oversight is very different than power of the purse. That is the constitutional power that we had.

So, Professor Zywicki, if you want to touch base on that. I am curious if this is, I think as you laid out, that this probably isn't even constitutional in the structure of it, and certainly isn't smart to do that. So if you don't mind touching on that.

I really want to get to, because we just had a graphic up there about business lending, how suddenly that has become apparently very easy to get business loans now that we passed Dodd-Frank. As a small business owner, I would like to actually give some testimony against that.

But when we are talking about consumer credit, in 2013 the Federal Reserve Board had a report which found that 22 percent of consumers who borrowed to buy a home in 2010, one out of every five, would not have met underwriting requirements of the qualified mortgage. That is the kind of damage, I think, that we are seeing from CFPB—maybe not intended, but that is the effect.

And again, this is the Fed saying who this is going to affect is 34 percent of the African American borrowers, and 32 percent of Hispanic borrowers in 2010 would be unable to meet the debt-to-income ratio requirements but for the temporary GSE-backed loan exemption that the CFPB has so graciously given to everybody.

So, but guess what? If you can give it you can take it back, and that is the fear.

So, Professor Zywicki, do you have a comment?

Mr. ZYWICKI. I will try to be brief.

First, we all know that you have to—that the only way to make bureaucracies accountable is to have carrots and sticks, otherwise it is just a dog and pony show when they come up here. And the power of the purse is, of course, is Congress' first prerogative. And this is an agency that is engaging in widespread policymaking on the economy and should be subject to the power of the purse.

It is also the case, yes, that removal for cause has been held by the Supreme Court to be constitutional, but the idea of one person running the entire agency? What we have learned over time is the reason why the FTC works to the extent it does is because the bipartisan process of deliberation, the ability of dissenting Commissioners to speak, that sort of thing, that we basically substitute internal accountability into deliberation.

And the Supreme Court has basically said if you have a commission, that is good enough. I don't know that they have said that unleashing one person on the economy like this is not.

Just a final word about your comment on CFPB and mortgage lending, which is one of the astonishing things about the qualified mortgages rule is as it is depriving consumers of credit, they did nothing to increase requirements on downpayments, for example. So the chairman asked earlier, how will this exacerbate the next crisis? One of the reasons is they didn't do anything about one of the primary causes of foreclosures, which was negative equity. By not requiring higher downpayments and that sort of thing, they did nothing to stave off that problem.

Mr. HUIZENGA. Thank you. I appreciate that.

Ambassador Gray, I would like to really quickly have you touch on the SIFI designation situation. In your testimony you wrote about the wide latitude granted to FSOC by Dodd-Frank to designate these SIFIs. Is it constitutionally appropriate to so drastically alter a designated financial company's standing within a greater global financial system?

So if you wouldn't mind just commenting on that?

Mr. GRAY. The latitude that the FSOC has, that the government has—it is a little agency that is set up by Dodd-Frank—the latitude is very, very wide, and the only standard, the only limit to the designation of a financial institution is that it may be in trouble and therefore may endanger the financial stability of the United States. The problem—

Mr. HUIZENGA. Is there an impending threat to that right now?

Mr. GRAY. I don't think there is any, but there is a case that has been brought that is a designation made of MetLife. It is an insurance company. It doesn't pose a threat to anybody.

I could go into—I don't have time to go into the—

Mr. HUIZENGA. Yet they have been designated, correct?

Mr. GRAY. But they have been designated, and there is no way really to review it because the courts are prohibited from reviewing a question about whether the designation actually endangers the—or poses a risk to the economy of the United States.

So there is no accountability. The designation is final. There is no appeal. There is no appeal to you; there is no appeal to the courts; and there is no appeal to the White House.

I am sure that designation is going to fail, but I think it is going to be followed by more and more and more as the government continues to try to strengthen its hand and broaden its power. That is always the case with bureaucracy.

Mr. HUIZENGA. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Professor Zywicki—I hope I got your name right there—

Mr. ZYWICKI. Perfect.

Mr. SCOTT. —your testimony certainly intrigued me in your talk about Dodd-Frank. I want to mention just one of the issues you talked about, the impact with community banks, auto dealers, and you mention Operation Choke Point.

Now, what I try to find is ways we can work up in this committee in a bipartisan way to get a solution to the problem, to solve unintended consequences. And I want to get your take on this.

Operation Choke Point is basically right now an investigative issue, really in the hands of the Justice Department and the Federal Trade Commission. And it is based upon basically one big example with payday lenders with one bank, Fair Oaks Bank, I believe, in North Carolina, that they have done.

My concern comes in with this is a growing—rapidly growing industry of online electronic transactions. More and more people are now shopping at the mall online. Malls are being replaced with online. They go on, they get what they want from eBay, then they go to something like PayPal, a transaction payment processor, to get this.

So the accounts for our consumers that need protection on this rests within this wheel of which at the center of which are your electronic payment transaction processors, a growing, growing business. My concern is that—and the reach of this Justice Department on some of these cases, there is an excellent opportunity here for Dodd-Frank to work if it is used to work here, because what will happen is if we are not careful, because of this action by some bad—one or two bad actors—and let me say, everybody is a good actor until they do something bad, so how do you catch them?

And so I am concerned about these people who are vitally important to the consumer who goes online, and they have to have confidence with that payment processor. So don't you see some value here where Dodd-Frank, and particularly with the consumer protection angle of that, can come in there and make sure that we are not throwing the baby out with the bath water in this Operation Choke Point and really doing a devastating hit on some innocent people like our payment transaction processors?

Can't Dodd-Frank be a positive role to make sure that doesn't happen?

Mr. ZYWICKI. Thank you, Congressman Scott. I agree with pretty much everything you said, and the nuanced way in which you said it, which, as I alluded very quickly earlier, I worked at the Federal Trade Commission. I understand that the ability to have this sort of power does have a legitimate power, and the FTC is using it.

In situations where a payment processor is basically knowingly engaged in and facilitating fraud, it has been a longstanding power to be able to do that. The problem is once you move beyond that very narrow area, which the DOJ has tried to claim that is all Operation Choke Point is, when in reality it seems to be much, much more.

We don't know how much more because they are so—it is really like a Black Ops operation, as far as I could tell. It is really hard to find out who they are targeting, why they are targeting them, and that sort of thing.

And I agree with you that one of the tragedies of Dodd-Frank is that we are driving consumers out of the mainstream financial system. We have taken away bank accounts as a result of the Durbin Amendment; we have taken away credit cards as a result of the Credit Card Act; we have targeted—and payday loans are disappearing. And we are driving more and more consumers online.

I agree with you that online lending and the way in which that is done raises for me real concerns that other things do not. That is not to say it is inherently corrupt, but giving somebody online your bank account information raises for me particular concerns.

And so I share your concern, and I share a recognition that there can be a legitimate power here, and I just don't like the sort of targeting of big groups.

Mr. SCOTT. Well, okay.

My time is up. Thank you.

Mr. ZYWICKI. I hope I was agreeing with you—more or less—

[laughter]

Mr. SCOTT. But the point I am trying to make is that this is a growing industry that is going to grow by even more leaps and bounds, and if we don't have something in there to deal with these unintended consequences to protect both sides of the equation, both the processors and the customers they rely on.

Thank you, sir.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, chairman of our Oversight and Investigations Subcommittee.

Mr. DUFFY. Thank you, Mr. Chairman.

I think it appropriate on Constitution Day that we celebrate the idea that man could be free, the idea that man could govern itself, that Americans could make decisions for themselves. They didn't need the elite to govern them. They didn't need the elite to make decisions for them.

Sadly, I think that we are having that debate again 200 and some odd years later because there are some across the aisle—and they don't want to say it; I know they were called out by Mr. Gupta, who basically said Americans are stupid. They are dumb. And there is a belief that Americans are too stupid to make decisions for themselves.

I don't believe that to be the case. I think if we have disclosure, if we have good information, Americans make the best choice for them and their family. And bureaucrats at the CFPB don't know what is best for them.

And so it brings me to the idea of the administrative state versus elected representatives—who is more accountable?

There was a really bad health care law that was passed. I am hearing stories about monthly costs going up from $800 to $1,300 and $1,400 a month. To all of my friends across the aisle who voted for that, what happened to many of them?

To the panel, what happened?

They got voted out. They lost their elections. Many of them are no longer here because America said, "That is a bad law. That doesn't work for my family." And they held them to account.

Because it wasn't special interest who on that day carried the Obamacare legislation. The real accountability came when they had to go back home and face their constituents who said, "I am going to vote you out." And so now, they are no longer here.

But I want to talk about the CFPB a little bit because I think there is this perception that special interest has no impact on the CFPB because they are an agency that isn't funded through Congress, right? They are unaccountable; they can do whatever they want with their single director.

So there was a recent study that came out and it says the Consumer Financial Protection Bureau released a study indicating that arbitration agreements restrict consumers' relief for disputes with financial service providers by limiting class actions.

Now, does anyone on the panel have an idea on how this study might impact the special interests? Anybody?

Ambassador Gray, enlighten me.

Mr. GRAY. The first think that comes to mind is the plaintiffs' bar, which—

Mr. DUFFY. I agree. The plaintiffs' bar.

Does anyone disagree with that?

Mr. Gupta, yes?

Mr. GUPTA. I do disagree with that. There is—

[laughter]

Mr. GUPTA. This is a—the CFPB's—

Mr. DUFFY. Credibility—

Mr. GUPTA. —study on arbitration is the most rigorous empirical study on the prevalence of arbitration in consumer contracts. You asked them—

Mr. DUFFY. Oh, I know your objection. Let me ask you a question, though. Do you think that the trial bar tried to communicate and impact the CFPB in regard to their decision with regard to class action lawsuits and arbitration?

Mr. GUPTA. Well, obviously.

Mr. DUFFY. Answer my question.

Mr. GUPTA. —obviously everyone weighed in on the study—

Mr. DUFFY. Of course, they did. And are you telling me special interests don't have an impact on the CFPB?

Mr. GUPTA. It is an empirical study, and it is really hard to argue with the conclusion of the study, which is that—

Mr. DUFFY. Who is going to—

Mr. GUPTA. —class action bans ban class action.

Mr. DUFFY. As Democrats in the Senate and the House lost their jobs when they were held accountable to the American people, who at the CFPB can be held accountable for bad decisions? Are any of them up for election? None of them.

And to argue that this is a better form of government, that you know what is best—that we have this debate today is incredibly frustrating.

The QM rule—that I have small credit unions and banks that—a banker wants to lend to a family that they know and they will take their risk on; they are not going to send it into the market. But they have known the family and the dad and the mom and the brothers and sisters. They want to take a risk on this family.

The CFPB says, "Oh no, you can't. And if you do, there is additional liability if that loan goes bad even though you have all the risk of the loan because it is on your books." Come on.

Mr. GUPTA. These are really arguments against consumer protection at all—

Mr. DUFFY. No, they are not.

Mr. GUPTA. —or administrative agencies.

Mr. DUFFY. No, they are—and we might have a debate on the administrative agencies, but not about consumer protection. I believe in disclosure. I believe people should know the deal. They should know what they are getting into.

But I also believe that if they know the deal, let them decide if it is right for them.

With regard to payday lending, you know what? If the credit unions and the banks won't give me a loan and you take away this source, where am I going to go? I am going to go to Vinny down the street or I am doing really bad things that affect our society.

Mr. GUPTA. Payday loans are often not that different from Vinny down the street. We are talking about interest rates that exceed $1,000 and that trap people in a cycle of debt.

Mr. DUFFY. I would love to have a better solution.

I am concerned that on the settlement side that it is not just going to victims; it is going to third-party groups, ACORN-esque groups that you will argue, oh, this is great for the American people, but you are going to drive money into third-party groups not funded through Congress, not funded through the appropriations process.

It is just like the DOJ's settlements with banks. It doesn't go to the Treasury. It doesn't go to victims, all of it. A great portion of it goes to left-wing community organization groups and not through the congressional appropriations process.

And I know my time is done, Mr. Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Pennsylvania, Mr. Fitzpatrick, chairman of our Terrorism Financing Task Force.

Mr. FITZPATRICK. Thank you, Mr. Chairman, for calling this hearing, "Dodd-Frank Five Years Later."

I think that most of the members of this committee probably were not in Congress when the law was passed for the reasons Mr. Duffy indicated. I was one who ended up here because of a series of bad laws and the voters in my district decided to send a new Representative.

And we feel that we have been robbed of the ability to make a lot of the decisions, even though they are tough decisions. These are tough votes that we should have been sent here to make.

And I do appreciate the acknowledgement of my colleague, Mr. Sherman, who indicated earlier—he said we punted in passing Dodd-Frank. Essentially, we punted to the bureaucracy.

So I want to talk a little bit about the regulatory branch of government and I want to discuss the amount of regulations that have been passed, rules and regulations under Dodd-Frank—not just those that have been passed but those that have been discussed, those have been threatened, those that have been noticed and are being discussed now, and the impact of not just those that have been passed but those that may be passed on institutions, and how do they affect Wall Street?

My understanding is Dodd-Frank was passed in order to rein in Wall Street, but we have heard several references today to Mr. Dimon's comment that a larger moat was created around him. Wall Street seems to be benefiting from Dodd-Frank 5 years later.

The impacts really seem to be on the small Main Street community institutions, the small community banks in districts like my district in Bucks County, Pennsylvania, and consumers, as well, and innovators.

And so, Professor Zywicki, perhaps you can start. Who really bears the brunt of this new massive wave of regulations that have come under Dodd-Frank that we haven't had a chance to vote on?

Mr. ZYWICKI. I haven't looked at all the methodology, but one estimate was that so far it has imposed $21.8 billion and 60.7 million paperwork hours on compliance costs. It is estimated that over the next 10 years it could be $895 billion in reduced gross domestic product and $3,346 per working-age person.

I haven't seen a lot of other estimates. I give that as some sense of at least what some economists think about this.

And I think you are exactly right, which is the cost of Dodd-Frank is falling on people with the least—the fewest options, the least flexibility in their budgets, and that sort of thing. We are driving people out of bank accounts; we are taking away people's credit cards; we are taking away people's mortgages.

And upper middle-class people largely can avoid that. We can carry the higher balances in order to keep a free bank account. Smaller people can't, or—and it is lower- and middle-class people who are really bearing the brunt of this law.

Mr. FITZPATRICK. Dr. Spalding, we have spoken at great length today about the impact of Dodd-Frank, and for good reason. But in many ways Dodd-Frank is a symptom of a larger disease, which is the growth of the—sort of the modern administrative state that Mr. Duffy spoke about.

You have written about this development and how it is a departure from our founding principles. Can you explain the difference between our founders' vision of the government and that of the progressives who have given us this modern bureaucracy?

Mr. SPALDING. Thank you for the question. My testimony does go to that answer to some extent.

In short, the American founders wanted to control the powers of government and make them responsible. That is why we have a Constitution in the first place, to get around the problems that the English kings had.

Powers were divided into branches. Branches operated the main functions of governing—lawmaking, executing, adjudicating.

Those are grants of powers from the sovereign people. That is why you can't delegate those powers to someone else. Someone else can't exercise the lawmaking power.

The problem with the modern administrative state—and I am launching a challenge to the modern administrative state. It is constitutionally illegitimate, and we have clearly crossed a Rubicon. Congress has lots of power to regulate. I don't object to regulations, per se.

But we are clearly operating in another world. These things that Dodd-Frank is doing, these are laws. They are passing laws that you have not approved.

That is practicing the lawmaking power. The courts might not say that it is delegation, but it clearly is, and the Legislative Branch must recognize that.

The idea is based upon the notion that, using modern science and using the best forms of efficiency and consistency, someone else can rule us better. You are our representatives to make sure that doesn't happen.

So it is a violation of delegation, but it is more largely a violation of the whole concept of the rule of law and the rule of laws rather than the rule of men.

Mr. FITZPATRICK. My time has expired. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

And thank you, to the witnesses, for appearing today.

Let me start by asking each witness this question, and you may respond by simply raising your hand if you agree: If you were a Member of Congress and you had an opportunity to vote to repeal Glass-Steagall—to repeal it; that would be the essence of your vote—would you vote to repeal Glass-Steagall? If so, would you kindly extend a hand into the air?

I am not sure about the gentleman on the end. I see four—all right. All right. Everybody would repeal Glass-Steagall.

All right. If you had an opportunity in Congress to repeal Dodd-Frank in its entirety, would you repeal Dodd-Frank?

One? All right. Two.

Mr. SPALDING. That depends on the definition of "entirety."

Mr. GREEN. Repeal it entirely—entirely as in entirely.

Mr. SPALDING. The Legislative Branch has the ability to—

Mr. GREEN. Okay, let me just go on. I really don't want to debate it with you. I trust that we can get back to it later.

So we have at least one person who would repeal it in its entirety. All right.

Now, let's do this. Let's just examine what has happened in this whole question of, are we more free. More free to do what?

More free to go back to 3/27s and 2/28s, when you had 2 years of fixed rates and 28 years of variable rates? Same thing with the 3/27s—go back to teaser rates that coincided with prepayment penalties so that if you tried to get out of a loan that you were in you would have to pay this huge penalty to get out, which most people couldn't do?

Go back to no-doc loans, such that people could come in and get a loan and walk away with a monthly payment that they couldn't afford because they didn't have the documentation to acquire the loan? Go back to liar loans, when you could literally fabricate a story that wouldn't be validated and get a loan that you couldn't pay?

Go back to the yield spread premium, when consumers were ripped off by persons who accorded them loans for higher rates than they qualified for? Literally, you could qualify for a loan at 5 percent and the person working with you that you had a great deal of confidence in would give you a loan for 8 percent and get a kickback.

All of that was legal because we allowed it to be legal. So go back to a time when people were free to just rip off the consumer, just take advantage of consumers, just do whatever you could to make money off of unsuspecting consumers.

Many people don't know that they were ripped off by the yield spread premium. And I use that highly technical term "ripped off" because we need to be clear and concise about this.

Consumers are being taken advantage of even today with other products that are out there, and the CFPB is doing its best to try to eliminate some of these products.

So we are talking about going back to a time when we could generate loans without liability. The people who were generating the loans knew that they were going to pass them on to someone else, the liability wouldn't remain with them, and as a result of being able to pass them on, they would take just about anything they could to get their numbers up so that they could make more money by passing more loans on to the secondary market.

And as a result, consumers would be—again, highly technical term—ripped off. A generation of wealth was lost. We had literally 9 million jobs lost as a result of this crisis; we had 5 million homes lost as a result of this crisis; $13 trillion of families' wealth was destroyed as a result of the crisis.

Dodd-Frank was the solution that we came up with that is not perfect, that we could tweak, that we could mend rather than end. Unfortunately, there are a good many people who want to see the demise of Dodd-Frank.

Dodd-Frank is not the problem. The problem is a Congress that is unwilling to work together to maybe amend some aspects of it, but not to end Dodd-Frank in its entirety.

I would say to you, my dear friends, as I close, I don't concur with you on Glass-Steagall. It took 66 years to eliminate Glass-Steagall. Glass-Steagall separated investment banking from commercial banking, and prevented people from gambling with consumer dollars that were federally-insured.

I don't know how long it is going to take, but people right here in this Congress are going to do everything that they can to end Dodd-Frank just like they ended Glass-Steagall.

Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Royce, chairman of the House Foreign Affairs Committee.

Mr. ROYCE. I appreciate the time here.

And a quick question, because when we travel overseas with the Foreign Affairs Committee, I often have conversations with foreign leaders about issues that go to the heart of the importance of rule of law and the role that it plays in encouraging foreign investment, and the role that it plays in political stability, and how badly these foreign nations need the rule of law, need the credibility that comes with it. So it is a little bit of a shock to me that on our own shores, we have blatant examples of discretionary choice and political influence running afoul of the rule of law.

In Europe in the 1930s, there was this concept of fluid law and it didn't work out very well. The rule of law for the United States has been sort of a cornerstone.

So you get into these areas with fluid law—the SIFI designation process is just one I would make an example of, and I appreciate several of my colleagues raising this issue this morning. I worry that the costs of what economists call here the cloud of political risk that comes into play—Professor Zywicki referenced this—this is one of the consequences, this is one of the mistakes in Dodd-Frank, one of the things that we did not get right.

And that effect could be permanent. It could be long-lasting.

And so, Mr. Gray, we have seen how the CFPB has strayed well outside of its legal boundaries, expanding its reach now into telecom companies and seeking information protected by attorney-client privilege, and even indirectly trying to regulate auto dealers and so forth. Given the agency's design, are you surprised by any of this behavior?

Mr. GRAY. I am not surprised, because there is nothing to constrain them. There is no check or balance. There is no operation of the separation of powers that would conduct an oversight role to rein them in.

The White House can't do anything about it. The Congress can hold hearings, but they are not supposed to review the budget. That statute, as I recall, actually says the Congress can't review the budget. I don't expect anyone is going to be arrested for doing so, but the budget is not in your hands, and that is where your power comes from.

The courts are required to defer to whatever the agency wants to do under the Chevron Doctrine. That is true even in the case of rulings, say, on what is abusive. The agency has refused to spell out what the law means by notice and comment rulemaking, which is the hallmark of American administrative law, one of the geniuses of post-war development.

It is going to be, "I know it when I see it." It is going to be an ad hoc decision made after the fact, and so nobody knows before they are zapped.

Mr. ROYCE. There is going to be fluid law that is constantly evolving, constantly requiring new interpretations by the regulatory community, constantly causing costs out there—compliance costs. This is one of the reasons I opposed Dodd-Frank.

But there is another aspect here which is—and the chairman is well aware of this, as well—the fact that the prudential regulators have the responsibility for safety and soundness, and taking them out of this equation and not allowing them to weigh in on these decisions also has a long-term risk in terms of the first responsibility, which is safety and soundness.

If we were smart, what we would have done was put this function underneath the prudential regulators. It might surprise some to know that every former prudential regulator that I talked to, whether Democrat or Republican, felt that this was a profound error in the legislation.

Mr. GRAY. Sir, if I might just sort of add—

Mr. ROYCE. Yes.

Mr. GRAY. —one thing about the rules about making mortgages, it is just a—I grew up in the South, and the South didn't have a lot of big banks until all of a sudden they did have some big-size banks. But the hallmark of the growth of the southern banking industry was making character loans, loans based on people's understanding of the character of the person who was borrowing, the knowledge of the family, knowledge of that person.

And there are Fed studies saying that character loans are better than the cookie-cutter loans that are now being required. But you can't make a character loan anymore.

Who benefits from that? Nobody.

Mr. ROYCE. We have choked off so many loans.

Mr. GRAY. Nobody.

Mr. ROYCE. Mr. Chairman, thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Virginia, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman.

I thank the Chair for continuing to focus on the anniversary of Dodd-Frank 5 years later.

And I thank each of the panelists for appearing today.

I represent Virginia's 5th District. It is a sprawling, rural district, south side, Central Virginia. Over the August break we were—had the chance to travel across the district and visit across the 23 counties and cities that I represent. Many, many Main Streets along the way.

And we had the opportunity to visit with families, small businesses, small farmers; had the opportunity to stop by several banks, community banks in Charlotte County, Fauquier County, Halifax County. These banks are important to these Main Streets because they provide a tremendous amount of capital that is necessary now, in a way, more than ever, because of the job losses that we have seen over the last several years. There was a recent study which indicated that 70 percent of loans made in the agricultural sector are made by community banks.

So as I talked to the bank presidents and the compliance officers at these institutions, I think, Mr. Gupta, they would be very surprised, maybe even relieved, to find out that actually Dodd-Frank has not been the cause of their decline. I think they would be relieved to know that their customers are really benefiting from Dodd-Frank and the Consumer Protection Bureau. And I appreciate Mr. Zywicki's responses to your statements.

And I won't pursue that any further and move on to something that is a little—is more in the big picture.

I wanted to ask Mr. Spalding and Mr. Gray about this: The Richmond Federal Reserve recently published something called a Bailout Barometer. I don't know if you are familiar with it, but it is an estimate that the financial safety net covers some $26 trillion in liabilities, or 60 percent of the total liabilities of the financial system.

And I was wondering from the standpoint of too-big-to-fail, and from the standpoint of moral hazard, what is the threat to the taxpayer when we have accumulated this amount of backstop by the Federal Government? What is the threat to the consumer? What is the threat to our free markets?

If Mr. Gray wants to go first, and then Mr. Spalding, I would love to have you address that.

Mr. GRAY. I think the threat is not first to the taxpayer but to the Fed. It is money they print; it is money they sort of manufacture. Their balance sheet is something totally unique in the history of America. I don't know how they are going to work their way out of it, but it is going to be inflationary, it is going to dilute, it is going to degrade the quality of the savings of most Americans in order to have this happen.

And banks are not going to do any more lending. They are probably going to do less lending than they would have without this crisis, and that is the basic issue. A complicated economic one, and I am not an economist, but this is a basic issue about when they should start raising interest rates.

And I think they got themselves in a fix, which is the direct result of the government's encouragement of loans that couldn't be repaid. And the reason loans couldn't be repaid is because the local banker wouldn't make a loan that he knew he couldn't repay or that would irritate his neighbor, because he would have to see his neighbor in church or at the Safeway.

No, the loans were made because Fannie Mae and Freddie Mac had an insatiable appetite to cook up any loan they could do, and so if you got a broker, going to make a loan, and is not then responsible for it because he shoved it off to the Federal Government or a Federal Government agency, it all—it is all easy to do. And why not? Why would you not do that?

So the government bears a huge responsibility for having caused all this. There is nothing in Dodd-Frank which does anything about Fannie Mae or Freddie Mac, or about any of the other practices that actually led to the crisis that we had and the crisis that we haven't gotten out of.

And I am sorry to say, I can't give you an answer for the Fed, because it is going to take years to work out.

Mr. HURT. Thank you, Mr. Gray.

Mr. Spalding?

Mr. SPALDING. That was a very good answer, and I defer to it. I would just, again, point out a general point. Vast operations of the administrative state of this magnitude going into large reaches of the economy, whether it is the health care economy or the financial economy, displaces and completely takes the place of market mechanisms. And in doing so, it prevents the market from making its natural adjustments. The rule—

Mr. HURT. And who suffers?

Mr. SPALDING. The average person suffers. I mean—

Mr. HURT. The consumer.

Mr. SPALDING. —the role of Congress is to uphold the rule of law, maintain contracts, make sure that there is a certain legal fairness in how it operates, watch out for the problems, but otherwise let it correct itself so that the real opportunity in the marketplace can serve the American people.

Mr. HURT. Thank you, Mr. Spalding.

My time has expired.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman.

Ambassador Gray, thank you particularly for your great service to our country over the last many decades. I remember meeting you a long time ago and I'm just grateful to have your expertise involved with us today.

I would like to ask you, as it relates to CFPB and how it has strayed out from its own legal boundaries, expanding into the telecom industry, impacting its own attorney-client protection privileges, regulating automobile dealers, is this a surprise to you?

And what do you envision in the future? It seems to me that we have relegated those—the laws to—in the hands of these individuals and other regulators, so would you kind of expand on that, please?

Mr. GRAY. I never underestimate the ingenuity of a bureaucrat to expand.

[laughter]

And I wouldn't really want to predict where they will go. But I do think the automobile lending issue is very instructive.

I happen to know—a very close friend of mine was head of the National Association of Auto Dealers, and they threw everything they could into this fight to get exempted. Now, you might argue that, boy, they really abused their monetary power or whatever to get this exemption, but they did get it.

But it is like Mr. Cordray said—or the President said when Mr. Cordray was rejected by the Senate the first time around, "I will not take no for an answer." So they have gone after the dealers anyway.

And that kind of defiance is what really scares me. We are at a point—and this is a slightly different point, but it encapsulates so much of what keeps me awake at night, frankly; not all nights, but some nights. The agencies have captured, have aggregated so much power—not just the ones you are talking about here and out in the financial industry, but EPA, one could—FDA, one could go on—they have so much power that they can threaten to go blackmail their subjects into submission, into accepting whatever they want to dish out to them.

They can threaten them not to seek judicial review, which has happened in the automobile industry. All of the regulations against the automobile industry, the auto industry had to promise not to challenge for 8 years of the Obama Administration.

It is hard to believe, but they had to make a promise—I have seen it in writing, and they have published it. The EPA has published it. Why they would be proud of it I don't know, but they got a promise from the Ford Motor Company, for example, that they would not challenge anything the DOT or the EPA ever did to them.

So this is the way it is going across the government, across the administrative state. You are dealing with a microcosm—a very big microcosm, a very good example. And if you can fix it and get the pendulum going just in the other direction, you would serve an enormous benefit to the American people because the administrative state is out of hand.

Mr. PITTENGER. Thank you, sir.

Ambassador Gray, you have also referred to how the moat is protecting against competition. Can you discuss further how the current regulatory barriers to entry are harming small businesses and institutions, while helping the largest ones?

Mr. GRAY. This is not a new problem of what is known in the administrative trade—perhaps you should ask Professor Zywicki, he may be more expert. He teaches where this doctrine was developed; so do I part time—George Mason.

But it is a common thing across the regulatory state that regulations help big business by creating barriers to entry to competition. It is as simple as that. And big government likes big business because the progressives like not to have to deal with 10,000 little guys; they are very happy to deal with 3 or 4 really big guys.

Mr. PITTENGER. Can you give us some examples, please, of how it has harmed the smaller institutions?

Mr. GRAY. I referred to it in my testimony and others have mentioned it. To me, the best example is the demise—not the demise yet, but the harm to consumer banks because of the inability to cope with the regulations that are the moat for their much, much bigger competitors like JPMorgan.

And that is, I think, the best example. There are others. There are many others that are like that.

Take the drug approval process; it takes much too long. The FDA asks for way too much information during these clinical trials when they know that once the drug gets out in the marketplace to millions of people, they will really then find out what the reactions are, and that is when they really do find out, and that is when they can make corrections.

But to think they can do that—it is arrogant to think they can do that in these relatively small clinical trials, compared to public approval or public distribution. And I am sorry to speak too long, but that hurts the small drug companies because they can't afford an 8-year, $2 billion drug trial.

Mr. PITTENGER. Thank you. My time has expired.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Pennsylvania, Mr. Rothfus.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Professor Zywicki, in a recent op-ed for The Wall Street Journal, former Senator Phil Gramm argued that President Obama's progressive legacy is destined to fail in the long run because he enacted vague laws and abused his executive power to impose policies that are unpopular with the American people. In making this case, Senator Gramm points out that all of the President's Executive Orders can be overturned by the next President, and that Dodd-Frank can be largely circumvented using exactly the same discretionary powers that President Obama used to implement it in the first place.

Do you agree with Senator Gramm?

Mr. ZYWICKI. Absolutely. That is the nature of the modern administrative state that we have been talking about.

And one of the things I—I think it is awful, but—

Mr. ROTHFUS. What sort of costs would this lingering uncertainty have for the U.S. economy?

Mr. ZYWICKI. Huge costs. In order to make a loan, you have to be able to predict the risk of the loan. To the extent that political risk in the regulatory environment is shifting around, that makes it more difficult to price the risk of the loan, and so you have to either raise interests rates or you have to reduce risk exposure.

Mr. ROTHFUS. Let's—

Mr. ZYWICKI. And so it impacts banks probably more than any other sector of the economy.

Mr. ROTHFUS. Let's translate that to people. All too often when Congress debates issues relating to the rule of law or government expansion and overreach, we tend to spend too much time on the underlying policy and lose focus on why the debate matters in the first place.

We need to be focused on the impact of Washington, D.C., on people—on the family who is trying to purchase their first home, on the entrepreneur with a promising startup, on the small business who wants to expand their operations and hire more of the local community. As we look back on 5 years of Dodd-Frank, how have average Americans been impacted?

Mr. ZYWICKI. I think a great example is when we—is the auto dealer attack that they are doing and this—we don't have scientific—the scientific and economic experiment, but what we discovered is exactly what we expected from what we know. The Wall Street Journal says that everybody has to pay more for a car loan now because of this uncertainty and this overreach by the CFPB.

Mr. ROTHFUS. So are Americans more or less free to pursue the American Dream as a result of Dodd-Frank?

Mr. ZYWICKI. Clearly, we are all less free as a result of this vagueness and this lack of rule of law.

Mr. ROTHFUS. Mr. Gupta, you claim on page 10 of your written testimony that Dodd-Frank and the CFPB work to protect the interests of smaller banks. I have to tell you, this committee hears from community bankers all the time, and they vigorously argue the precise opposite.

Are you really claiming that Dodd-Frank has enhanced the competitive position of community financial institutions?

Mr. GUPTA. I think the picture is complicated and—

Mr. ROTHFUS. Let me tell you, it is not complicated for a small community bank in my district which spent 2,000 hours going through a CFPB regulation. What would you say to that small community bank which has limited resources, versus a large bank which has lots of resources?

Mr. GUPTA. Yes. No, I sympathize with the plight of community banks. As I said earlier, I think they are facing a lot of challenges and—

Mr. ROTHFUS. Are there more or fewer community banks today than there were when Dodd-Frank—

Mr. GUPTA. There are certainly fewer, and that was happening already. That is an independent process that has been happening—

Mr. ROTHFUS. Has it accelerated the process?

Mr. GUPTA. —before Dodd-Frank, and I—

Mr. ROTHFUS. Has it accelerated the process?

Mr. GUPTA. No, I don't think that—

Mr. ROTHFUS. Professor Zywicki—

Mr. GUPTA. —the existence of the CFPB is accelerating that process.

Mr. ROTHFUS. I'm sorry, reclaiming my time, Mr. Zywicki, would you care to comment on that, whether Dodd-Frank may have accelerated the process?

Mr. ZYWICKI. The only study I know about this, and the one that everybody seems to think is a good study, is from the Kennedy School of Government, which says that community banks, the assets are shrinking at twice the rate they were before Dodd-Frank.

Mr. ROTHFUS. One of the things we see with the CFPB is that we have a single director.

Mr. Gupta, Chairman Frank thought that a five-member commission was an acceptable structure for the Bureau. Is he wrong?

Mr. GUPTA. I think—

Mr. ROTHFUS. Is he wrong?

Mr. GUPTA. I think you can have a legitimate debate about how to set up an agency. I think that the CFPB was set up in the right way. I think the problem with five-member agencies—

Mr. ROTHFUS. Originally, Chairman Frank thought a five-member commission was a good idea. Is he wrong?

Mr. GUPTA. I think he would support the current structure of the agency if you asked him today, and I think that was the right decision. And the reason I think it was the right decision is—

Mr. ROTHFUS. Reclaiming my time here, I would like to move over to Dr. Spalding—

Mr. GUPTA. Let me just finish. There are agencies in Washington that are five-member commissions that do nothing, like the Nuclear Regulatory Commission and the Federal Elections—

Mr. ROTHFUS. Are you saying that the SEC does nothing?

Mr. GUPTA. No, but I think a lot of agencies that have multimember commissions become deadlocked and incapable of doing anything, and that is the problem—

Mr. ROTHFUS. The CFTC does nothing?

Mr. GUPTA. I'm sorry?

Mr. ROTHFUS. Do you think the CFTC does nothing?

Mr. GUPTA. No. I don't think all multimember commissions are incapable of doing something, but it is a risk.

Mr. ROTHFUS. Yes, but Chairman Frank thought it was a good enough idea to put into his original legislation.

If I could go to Dr. Spalding, Mr. Gupta claims in his written testimony that the CFPB must carry out its work insulated from the "partisan vagaries of the appropriations process." He is arguing that the American people, through their elected Representatives, deserve no say in how their government spends their money and governs on their behalf.

This turns the American project on its head. Was that the founders' vision?

Mr. SPALDING. Absolutely not. The argument that I am hearing in defense of the administrative state appears otherwise—is the same you get from Woodrow Wilson forward about the modern administrative state: You must protect these decision-makers from the public, from Congress—

Mr. ROTHFUS. In the administrative state, where does sovereignty rest, in the people or in the government?

Mr. SPALDING. It rests in the government. The government both secures rights, and the court tells what those rights are—

Mr. ROTHFUS. Doesn't that turn the—

Mr. SPALDING. —and the administrators carry out those policies and tell us how to run our lives.

Mr. ROTHFUS. Doesn't that turn the American experiment on its head, where it shifts the sovereignty to the government instead of the people?

Mr. SPALDING. It completely turns it around.

Mr. ROTHFUS. Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the ranking member of the committee, the gentlelady from California, for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. Sorry I could not be here with the committee earlier today.

And I am just wondering if we have learned anything new. This is the third hearing we have had on Dodd-Frank reform, and when I came in, I asked my staff if we learned anything new today? And of course, they responded that we have not.

Let me just say, as I have said over and over again, that Dodd-Frank is the law, and we have the responsibility to enforce it.

We believe that on this side of the aisle, we have been very responsible in the way that we have handled all of those who do not think that Dodd-Frank should have been signed into law. We have said over and over again, where there are technical problems, where there is confusion, where there needs to be some modest modification, we are prepared to do that.

And we have demonstrated that in the way that we have worked. We have not attempted in any way to dismiss the concerns that have been raised.

But honestly, Mr. Chairman, I don't know if we are spending our time holding these hearings over and over again in a way that is productive for our constituents or for this House, et cetera.

I know these lawsuits have been filed. Let me just kind of go through a few of them.

The lawsuits that filed alleging the unconstitutionality of the CFPB tend to come from rather fringe actors in the financial marketplace.

The State National Bank of Big Spring is a $340 million Texas bank, and it was not supported by any amicus briefs, by any other parties when it filed its lawsuit. Morgan Drexen was a debt settlement firm which appears to have sued in retaliation for a CFPB enforcement action and now has filed for bankruptcy. ITT is a for-profit post-secondary school that has had regulatory run-ins with the CFPB, the SEC, and industry, where I have worked to correct abuses for much of my career.

So I don't think I am going to ask a question. I don't want to take these gentlemen through that.

I just want to say—I want to remind all of you what happened in this country when Lehman Brothers failed and all of a sudden we understood the impact that was going to have on all of the financial services industry, not only in this country, but offshore. And we were poised for disaster.

We ended up with a subprime meltdown. Many communities have been devastating by the exotic products that were on the market, where people signed up for mortgages they couldn't afford, they were not vetted properly, no-documentation loans, on and on and on.

We should all want to have to correct what took place in this country that took us into a recession, almost a depression. And so these attempts to somehow dismantle Dodd-Frank, and to talk about how it is unconstitutional, and to continue to hold these hearings, is a waste of time.

And so while I am here, and I respect the chairman for providing the leadership that he needs to provide on this committee, I just wish we could take up some—I need to talk about what is happening in America with the homeless population that just appears to be expanding—16 percent. I need to talk about the lack of affordable housing.

I need to talk about what we are going to do about real consumer issues and how this committee is going to look out for these consumers, who expect this Congress to work for them and not just the biggest, riches banks and financial institutions in America.

And so I have 20 seconds left, 19 seconds left, 18, 17, 16, 15, 14, 13, 12, 11, 10, 9, 8, 7, 6, 5, 4, 3, 2, 1. There is nothing left to be said.

Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Maine, Mr. Poliquin.

Mr. POLIQUIN. Thank you, Mr. Chairman. I appreciate it.

And thank you all very much for being here today.

I represent Maine's 2nd District, which is the real Maine; it is not northern Massachusetts. It is Western, Central, Northern, and Down East Maine. We have about 650,000 of the hardest-working people you could possibly imagine. They are honest.

I go back to the district every weekend, and what I hear all the time from our small business owners is that, "Please, Bruce, help us get the government off our back." I talk to our credit unions and our small community banks, and they are spending more time dealing with government regulations than they are expanding their businesses and pushing out credit and loans to folks who really need it.

And the problem with that, of course, is that your economy is not growing the way it should be and folks aren't getting the jobs they need so they are more dependent on the government. We have one heck of a problem now.

There is an outfit here in Washington, D.C., called the Competitive Enterprise Institute, if I get this right, and they have taken a look at all the regulations—now not at the State level, but at the Federal level—and they compute that the cost of regulations to the American economy is about $1.7 trillion per year. That is about one-tenth of our economic output.

Of course, businesses who have to suffer these regulatory costs pass along those costs in the prices that they charge for their goods and services. So if my math is right, every family in America is now paying about $15,000 per year for these Federal-only regulations.

Dodd-Frank is one of those problems. Now, I understand when the housing market collapsed because folks were pushing out the ability to buy homes even though you might not have a job, or you didn't have to put any money down, and you couldn't afford the homes but you were pushed into those homes. And that caused a real problem for our economy.

But now you have this big net—we do a lot of fishing up in Maine—and this big net is smothering everybody who should be able to swim through that net.

I will give an example. Let's say you have someone who is a great furniture-maker in Bangor, and they also run an organic farm. And they are trying to put aside about $100 a month to save for their retirement. And they have a fellow down in Lewiston who is a financial advisor who is helping them with that retirement savings.

And if you believe the study done by a fellow who used to run the CBO saying, if these investment management firms that are running these retirement plans come under the SIFI designation, too-big-to-fail, it means their costs are going to go up to run these accounts, the rates of return of what they can charge are going to go down to the tune of about 25 percent over the long run, and so the nest egg, the retirement nest egg for this organic farmer and the fellow who is also working in the family who is making furniture are going to go down, which means more dependence on the government and less freedom.

The bigger our government gets, the smaller the people get. And this is a real problem.

So this, in my opinion, is not fair. Government is supposed to work for our people. Where is the compassion in the fourth branch of government, these regulators who write the rules that we all have to live by and our businesses have to work by?

Ambassador Gray, you have done an awful lot of work on the SIFI designation, the too-big-to-fail, under the Dodd-Frank umbrella. And I would like to know what you think, sir, about an asset management firm, a pension fund investment firm that runs other people's money, represents no risk to the economy, if all of a sudden they are designated as too-big-to-fail, they have additional regulations, more costs, they offer less products for our savers, and the rates of return go down.

How does an investment firm—how does a pension fund management firm that is trying to help our retirees and kids going to college—how do they deal with a SIFI designation? How do they determine if, in fact, they are ever going to be designated so and how do they respond?

Mr. GRAY. Of course, in many ways that is a really good question, the $64,000 question. The vagueness of the charter of much of the CFPB's business model is so unclear that you wouldn't know.

There is no way a pension fund, a mutual fund, an insurance company can pose a systemic risk to anybody—except maybe to itself, but certainly not to a widespread community. And why that is included and why that is possible is only because the terms are so vague, and there is no accountability, and there is no court ability to say no, you can't do this. The courts are cut out of the key decision about whether or not there is a risk to the underlying economy.

I really can't answer your question except to say that it is just—something hypocritical about a comment I just heard about the implication that we on, say, my side, our side, your side, are representing big business, when I have been at the same time criticized for only having as a plaintiff to challenge some of this a little teeny $270 million bank in Big Springs, Texas, which no one had ever heard of, and must be useless. And why should it carry any weight, because it hasn't gotten any big-bank amicus briefs filed to support it, as if somehow it has no legitimacy as a small bank and can only be legitimate if it were joined by JPMorgan as an amicus.

I will tell you that we can't get any amicus briefs. It took 18 months to find Mr. Purcell, one of the great, great people I have met in Big Springs. Actually, I met him there; he has been here, and wowed this committee in testimony some months ago. The only reason we got him at all is because we were really lucky.

But my own law firm cheering me on, "Go. Go, Gray. Go, go, go, go, go." And I said, "You know, I don't need your money but I would like a face or two just to show your face to show"—no, no, no, no, no, no, no, no. We are not going to take that risk. We are not going to—one bank examiner's examination can knock out a bank in 24 hours, so I think we will just take a back seat.

But go to it. Go to it. You have all—you have everything at our back—at your back.

Thanks a lot, old firm.

But that is the problem. No one wants to help out in this because the power of the government is so intimidating. But we are going to prevail. We are going to prevail.

Mr. POLIQUIN. Thank you very much. Let's keep pushing back against this law. Thank you very much.

Chairman HENSARLING. The time of the gentleman has long since expired.

The Chair now recognizes the gentleman from Arkansas, Mr. Hill.

Mr. HILL. Thank you, Mr. Chairman.

And I thank our panel.

I particularly want to thank Ambassador Gray. I certainly think of a hallmark of my career as our service on the White House staff for President Bush 41, and thank you. I know you looked back fondly this summer with the commemoration of the Americans with Disabilities Act that you were such an instrumental leader on, in having that passed in the Congress.

Chairman Royce was talking about how the consumer protection rules were basically under the guidance of the prudential regulators, and for me that is no academic exercise, for I was a CEO of a consumer and commercial bank until December 31 of 2014, so this hearing, Mr. Chairman, is no academic exercise to me. I have run an institution under the first 5 years of Dodd-Frank, or 4½ years.

And to me, the CFPB really was a redundant exercise, and let me explain why, because I never once in over 2½ decades of commercial banking ever saw a State or a Federal regulator shirk their consumer protection responsibility under Federal law. So I just want to repeat that at every hearing; that is the way I feel very, very strongly.

And I heard today from both Mr. Green and the ranking member that where Dodd-Frank has gone too far, we should work in a bipartisan way to amend it, mollify it. I couldn't agree more, and I would like to thank the chairman and our bipartisan group who are working to take care of one of those things right now, which is this new HUD-1 RESPA form, the TRID form, and trying to get bipartisan support here in the House and the Senate to remove the penalties in the implementation of that Act.

Mr. Cordray has refused to do that in his own authority at the CFPB, and we have now had to ask Congress to delay the possible penalties to players on that rule of the CFPB.

And I want to side with the consumer here. Some 230,000 Americans refinance or buy a new home every month, and they are going to be the one who are victimized by this confusing rule that didn't get implemented properly either due to a technology reason or a misunderstanding at a real estate brokerage or a title company or a bank. So I hope we can get this bill passed before October 3rd so that our title and commercial banks, mortgage bankers, and real estate agents all have some confidence that they can go into this new closing regime but not be penalized either by the Federal Government or through civil liability.

And I want to thank Mr. Sherman, and certainly Mr. Pearce, for their help on this committee, and you, Mr. Chairman.

We can't defend bureaucratic intransigence at the expense of our home-buying public.

I love this hearing on the rule of law. It is exceptional.

I thank the chairman. I want to echo appreciate for it.

And I want to turn to Mr. Gray and Mr. Skeel.

The missing man in this formation—where the airplanes fly over at a funeral, the missing man formation—sort of in the Dodd-Frank Act, the missing man is reform of the GSEs, Fannie Mae and Freddie Mac. Mr. Gray referenced equal treatment for privately—or similarly situated creditors.

You were referring, I think, to GM in your testimony, but I think that might apply in the Fannie Mae and Freddie Mac conservatorships.

And, Mr. Skeel, you talked about the 100 percent sweep that is now in place between Treasury on Fannie and Freddie, the so-called third amendment to their conservatorship.

It struck me that it is—that may not even have been a legal action, given the conservatorship statute. I would like both of you to address that.

Ambassador Gray, if we could start with you?

Mr. GRAY. The actual example I was thinking of was the bailout of AIG, where certain creditors were treated differently than others, and some got paid 100 cents on the dollar, and others didn't. And in the Chrysler bankruptcy, the Indiana Pension Fund lost everything just because of the way the government played favorites.

And that kind of favoritism is what is codified in the OLA Title II section of Dodd-Frank, and I think it is a very dangerous way. The old-fashioned way of doing it is the right way: a level playing field, everybody gets treated the same. And I wish we could get back to that, and I think there is legislation pending in the Senate, as I may have said in my testimony, proposed by Senator Cornyn and others, that would try to resurrect the historic bankruptcy principles.

Mr. HILL. Dr. Skeel?

Mr. SKEEL. I do believe there were great problems with what was done in 2012. In 2008 Fannie and Freddie were taken over, they were put in conservatorship by the government, and they were left there for a period of years. And lo and behold, Fannie and Freddie started to make money again, and so Treasury changed the deal and basically made it impossible for private shareholders to get anything.

I am not a constitutional law scholar, but it sure looks like a taking to me. There is some litigation on this. The plaintiffs lost one hearing, but there is some other litigation going on.

The worst effect of this, in my view, is it has reduced any incentive for you all to do something about Fannie and Freddie. As long as they are sitting there in limbo and they are making money, there is no pressure to fix them, and Dodd-Frank did nothing to fix them.

Mr. HILL. Thank you, Mr. Skeel.

And thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

Professor Skeel, I understand that you have asked to be excused at this time, so we thank you for your testimony and you are excused.

The Chair now recognizes the gentleman from Minnesota, Mr. Emmer.

Mr. EMMER. Thank you, Mr. Chairman, and thanks for holding this hearing.

I appreciate all the witnesses being here this morning and sharing with us the benefit of your expertise.

As we have been reminded today, Dodd-Frank was drafted in response to the financial crisis of 2008 and 2009, during which the Federal Government bailed out a large number of financial firms at taxpayer expense. At the time of enactment, the law was 2,300 pages which required Federal regulators to create more than 400 new rules.

Forgetting for a moment that almost 40 percent of the rules needed to implement the 2,300 pages have yet to be finalized, my colleagues on the other side of the aisle argue that real GDP growth has rebounded since Dodd-Frank was signed into law. They say that despite the fact that our average GDP growth since 2010 is about 2 percent.

Now, forgetting for a moment also that if we look back in history at the history of economic recoveries after major economic crisis in this county, the rebound has been much stronger, I want to ask—and I guess I will ask Professor Zywicki—my understanding is the way we calculate GDP is we include government spending in that number.

Mr. ZYWICKI. That is correct, yes.

Mr. EMMER. And my understanding also is that government spending accounts for about 2 percent of that calculation—close to it, anyway.

Mr. ZYWICKI. I would have to take your word for that.

Mr. EMMER. All right. If that is true, regardless of the number, government spending is included. It doesn't give us an accurate view as to how our private economy or our private economic growth has occurred since 2010. Isn't that fair, Professor?

Mr. ZYWICKI. That is absolutely right, and pretty much all economists agree on that.

Mr. EMMER. And while there are many factors, including excessive regulation beyond the excessive and vague regulation created by Dodd-Frank and an overly burdensome tax system that contributes to the lack of private economic growth in this country, I have to say I am beyond surprised to hear Mr. Gupta say that an unaccountable, Soviet-style organization ruled by one appointed bureaucrat who isn't subject to judicial review should be considered the "crown jewel" of the Dodd-Frank experience.

Based on the facts and information I have received directly from my constituents, by the way—both involved in the financial industry providing opportunity, and the consumers who are looking for capital to buy cars, buy homes, to start businesses and create new opportunities—to suggest that there is absolutely no correlation between the actions of the Consumer Finance Protection Bureau and the problems faced by our community banks, credit unions, and, yes, our constituents, the consumers, who are losing access to the capital necessary to do these things I just described, frankly is out of touch with the reality that those of us who have been sent here to represent these folks—our experience outside of this academic bubble known as Washington, D.C.

In addition to all of the other problems with Dodd-Frank, we have an unelected, unaccountable political theocracy called the CFPB that is directly impacting the freedom of Americans to pursue their dreams.

Small banks are eliminating or planning to discontinue certain products and services, including residential mortgages, mortgage servicing, home equity lines of credit, and overdraft protection—just some of the most obvious ones. And nearly 64 percent of small banks that have been surveyed are actually making changes to the nature, mix, and volume of mortgage products as a direct result of Dodd-Frank and the dictates of the CFPB.

Also, as a direct result of the substantial additional compliance costs required by Dodd-Frank, we are losing smaller banks and credit unions at an alarming pace, as they either cease to exist or are absorbed into larger financial institutions.

And now the CFPB, that some seem to think is accountable and responsive to the needs of consumers and of this country, is going to eliminate credit access for those with little or no other reasonable option, and it is going to violate the principle of Federalism by invading the States with another misguided top-down Washington approach when it comes to payday lending and other opportunities that are available.

I really hope the members of this committee and Members of Congress, on both sides of the aisle, can find a way to correct the mistakes of Dodd-Frank and make the CFPB truly accountable before it causes even more serious damage to this country and, frankly, my constituents.

Thank you, Mr. Chairman. I yield back.

Mr. GUPTA. If I can, I just want to be on the record—

Chairman HENSARLING. Time—

Mr. GUPTA. I am opposed to Soviet-style dictatorships and political theocracies. I wanted to clarify that—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

And I would like to thank all of you for being here today and for your testimony, and also say hello to my friend, Ambassador Gray.

It is good to see you, and thank you for your service to our country.

This whole dialogue is really personal to me. I am a small-business owner. I have been in business for 44 years, a family business since 1939.

And in full disclosure, I am one of "them"—I am a car dealer. And so when you start talking about Dodd-Frank, you start talking about the CFPB, and you start talking Operation Choke Point, it gets personal with me.

So my first question to you, Mr. Zywicki is, in your testimony you stated, "Lacking the authority to reach the auto dealers, the CFPB came up with a creative solution—it decided to hold the financial institutions—the indirect lenders, in other words—responsible for any alleged discriminatory lending patterns by the auto dealers themselves."

You and I spoke about this before during your last testimony before this committee, but I think it bears me repeating.

We are currently seeing this play out with Ally Financial, who, although it has settled—I quote, "settled"—with the CFPB, has yet to actually pay out any funds to those who were discriminated against. In fact, the process for how funds from the settlement are being distributed is somewhat unknown and certainly definitely vague.

Now, you also highlighted the CFPB's allegations of discrimination by auto dealers as examples of regulators exceeding their bounds of the rule of law in order to force banks to do their bidding and limit consumer choice.

So, question: Aren't legal businesses entitled to due process, and should they, as in the case of auto dealers like me, understand that the process is being used to back up alleged discrimination?

Mr. ZYWICKI. That is exactly what is going on here is by evading anything that resembles the rule of law—there is no notice and comment rulemaking here; there is no study of the impact on consumers. Basically, what they have done is in this sort of nudge-nudge, wink-wink, backroom way in which Ambassador Gray indicated that they can push around the banks now because they are so interwoven with them, they are just imposing this rule on the auto dealers, and the auto dealers have no say in it, they have no opportunity to object to it.

And I think this is just an example of an out-of-control entity conscripting private financial institutions to do their bidding and to go after people that they don't like. And it is exactly like Operation Choke Point in that way.

Mr. WILLIAMS. And what they don't understand is the consumer tells us if we are doing a good job or a bad job, and the government doesn't understand that.

Mr. ZYWICKI. That is right. Yes.

And another thing with the auto dealers is they don't understand that you are selling cars, not loans, right? The financing and selling of the cars goes together.

It is a very complicated process, and they are just so obsessed with this one little part of it—of a larger transaction that those are the kind of—that is why we have notice and comment rulemaking, right, so you can point out to somebody, "You don't know what you are doing," right? It is an opportunity to basically explain the complexity of this transaction and explain the impact on consumers, and this is what happens when we remake the entire car dealer industry with a five-page informal guidance.

Mr. WILLIAMS. With that being said, we both mentioned Operation Choke Point. How does Operation Choke Point undermine the rule of law, in your opinion?

Mr. ZYWICKI. Operation Choke Point is one of the most frightening government initiatives I have seen, and one of the things—we have talked about the rule of law—that is awful about all this is they took an idea that was not necessarily unsound, but what we have seen again and again and again over the past several years is just the Executive Branch pushing things beyond any sort of reason, right?

And that is the case here, which is it is just blatant targeting of companies and industries that they don't like, and using this vague notion of reputational risk while there are other equally plausible targets that they are not going after purely because of political and ideological reasons.

Mr. WILLIAMS. I think most would agree competition and consumers should drive the economy, not these regulations we see from the Federal Government.

Mr. ZYWICKI. That is right. And that is what is awful about Dodd-Frank is that Dodd-Frank now basically is picking and choosing the winners and losers among banks based on who can best arbitrage, pull strings, and bear the regulatory burden, rather than the playing field of fair and free competition and markets.

And what it is doing is making the big banks bigger, killing the small banks, getting rid of innovation and consumer choice, and supplanting marketplace competition with the heavy hand of bureaucratic central planning.

Mr. WILLIAMS. And in the end, the consumer is the one who is affected.

Mr. ZYWICKI. That is right. They know best, not Washington.

Mr. WILLIAMS. In my short period of time, Dr. Spalding, quickly, Operation Choke Point—if you had to describe it to the Nation's Founders, what do you think their reaction would be?

Mr. SPALDING. The problem is that Cass Sunstein has this theory of nudging things along; this is a shove, all right, so push comes to shove. The problem is that this is government actively forcing people to do things and directing their behavior. It clearly violates the whole concept of self-government.

Mr. WILLIAMS. Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Utah, Mrs. Love.

Mrs. LOVE. Thank you, Mr. Chairman.

Mr. Zywicki—is that—did I pronounce that correctly?

Mr. ZYWICKI. That is great.

Mrs. LOVE. Okay, great.

We have heard a lot today about the centralization of power and how it has unleashed arbitrary regulatory discretion and empowered interest groups beyond any time in American history. Ultimately, this trend has succeeded in taking power out of the hands of people, and that is what I want to concentrate my questions on today.

A couple of things that you mentioned in your testimony are particularly concerning to me and my constituents—for example, the fact that the CFPB is data-mining American families' personal financial data. Obviously, my constituents don't want their credit card purchases to be tracked by Federal Government. Do you know what the CFPB is collecting this data for?

Mr. ZYWICKI. They have never explained what they are collecting it for, or why they need so much of it, or why they couldn't do with less. A while back, economist Thomas Stratmann submitted a letter where he estimated that the CFPB is collecting 70,000 percent more credit card accounts than they need for any legitimate regulatory purpose.

Mrs. LOVE. What was that percentage?

Mr. ZYWICKI. 70,000 percent, in order to get statistical significance, as an economist would say. And so, there may be a legitimate regulatory purpose, but is there a legitimate regulatory purpose why they need 991 million credit card accounts instead of 500 million or 2 million?

The answer is "no." They could do a couple million at most is all that is necessary.

Mrs. LOVE. Okay.

Do you have an answer for that, Mr. Gupta, as to why they are collecting this data—

Mr. GUPTA. I think—

Mrs. LOVE. —so much data?

Mr. GUPTA. —there is so much misinformation about this issue that has been put out.

Mrs. LOVE. Okay.

Mr. GUPTA. What the CFPB is doing is really no different from any of the existing regulators that all have been collecting similar data. This is—

Mrs. LOVE. So you are actually saying that pretty much all of the—

Mr. GUPTA. The prudential regulators, the ones that existed—

Mrs. LOVE. All of the regulators—

Mr. GUPTA. —before Dodd-Frank. And this is not transaction-level data; it is account-level data. It is anonymized. It doesn't have information about American citizens.

The reason to collect this data is not to spy on people or to collect—

Mrs. LOVE. So, what is it for?

Mr. GUPTA. —information about individuals. It is to get an aggregate picture of the market. We should want regulators to understand what is happening in the market.

Mrs. LOVE. Would you assess that most consumers actually know that this data is being collected?

Mr. GUPTA. This is data that mostly is already public. This is data about—

Mrs. LOVE. Okay.

Mr. GUPTA. —who owns automobiles, who owns—

Mrs. LOVE. So are you assessing—are you saying that most constituents—if I put this video up today, that most of my constituents, most of America knows that all of this data is actually being collected?

Mr. GUPTA. I think most of your constituents would know that mortgages are available in public land records—

Mrs. LOVE. Okay. Wait a minute. Hang on a second. Hang on one second. This is the problem.

Where you say most of my constituents would know, that is the problem with Washington. You don't know what my constituents think.

Every time I have had about five town hall meetings in the last week of August, not one constituent knew that their financial data was being collected.

What responsibility do you think the CFPB has to make sure that they know that their financial data is actually being collected, and what right do they have to actually collect that data?

Mr. GUPTA. I think the Bureau should be completely transparent about it.

Mrs. LOVE. I agree.

Mr. GUPTA. And I think they have been. And I think—what I was saying earlier is that I think your constituents would know that mortgages—that who owns what house and the mortgage data, that is available in public land records, and the same thing with automobile ownership records. I think they would understand that the DMV has that information about them.

The information that the CFPB is collecting is primarily that information that is already public. And to the extent it is information from financial institutions, it is anonymized, it is not transaction-level data—

Mrs. LOVE. And again, I still have heard no reason as to why this information is being collected, and I am telling you right now I think it is the responsibility of the CFPB to stop collecting this data or at least tell the American public why this is being collected.

Another question I wanted to ask is that we mentioned that the CFPB's intrusion on the business of auto dealers has, according to recent reports, resulted in higher interest rates for car loans for consumers.

Again, please explain to me, Mr. Zywicki, how that actually helps the poorest among us and those who are struggling to make ends meet?

Mr. ZYWICKI. Obviously it doesn't, and this is what happens when you make a regulation—or whatever this is; you can't call it a regulation because it is not—in the back rooms in the ways that they are doing here.

Just one note on the data-mining operation, as this committee will know, Director Cordray was once asked, "Why don't you notify consumers and give them a chance to opt out from having this information sent to the CFPB?" And he said, "Because nobody would participate and so the program wouldn't work."

So I think to say that people kind of implicitly understand it isn't very accurate.

Mrs. LOVE. My time is very short. I have 6 seconds.

But I just want to make a note and let every American who is watching this right now know that their information is actually being mined. Their financial information is being mined, and the CFPB has yet to tell us why it is being mined, why they need this information.

I again would like to make sure that we let the American public know that this government has gotten so big that we cannot navigate through that. They have no idea what people are collecting, why they are collecting it, and I think that this is something that every American should know, and I just want to make sure that we put that on record.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Kentucky, Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman. Thank you for holding this hearing examining the Dodd-Frank Act 5 years later, are we more free, and especially holding the hearing on Constitution Day, where we can examine whether or not the Dodd-Frank law is consistent with the Constitution's separation of powers and the rule of law enshrined in the Constitution.

In particular, I think it is timely to make this assessment or examination into the constitutionality of the Dodd-Frank law in light of the fact that the D.C. Circuit in July has revived a constitutional challenge to the structure of the agency and conferred a standing to a small $340 million community bank in Texas.

But I would like to first focus on this issue of the nondelegation doctrine. Mr. Gupta, in his testimony, dismissed the arguments against the constitutionality of the agency, saying that these were merely a thin-veiled attempt to breathe life into the nondelegation doctrine, which some of us believe actually is a pretty profound and important provision in Article I, Section 1 of the Constitution: "All legislative powers herein granted shall be vested in a Congress of the United States".

So I would like to ask Ambassador Gray and Dr. Spalding, as students of the Constitution, what the word "all" means, and whether or not "all" implies that Congress should be permitted to delegate legislative power to another branch of government.

Mr. GRAY. I believe, obviously, it clearly does not. My colleague to my left thinks that the nondelegation doctrine was buried in 1937 with the sick chicken case, the *Schechter Poultry* case. Cass Sunstein, the great Harvard-law Poobah, administrative-law Poobah, has once said nondelegation doctrine had 1 good year and 111 bad years.

But in fairness, there haven't been many statutes—or any statutes—thrown out since *Schechter,* but it has led to the creation of a very powerful doctrine of construction called the nondelegation canon of construction, and the courts have been using it to narrow statutes to avoid the problems of too much delegation. And this, I think, is something to bear very much in mind.

One of the recent cases, *Whitman* v. *American Trucking,* or vise-versa—Justice Scalia looked as though on the surface he was throwing out a nondelegation challenge but, in fact, he accepted the challenge, ruled that it was valid to the extent of saying that an agency can't act unless it has a significant risk that it is addressing. And that is a lot of what the CFPB does. It doesn't appear to be addressing any significant risk of anything.

Mr. BARR. So if I may just jump in here, when you look at the open-ended delegation and the unfettered discretion that Congress delegated these authorities to the CFPB, and when you see guidance that circumvents the Administrative Procedure Act (APA), that doesn't involve notice and comment rulemaking, where the agency is not listening to congressional feedback—bipartisan congressional feedback—do you believe that there is a nondelegation doctrine problem with the structure of the CFPB?

Mr. GRAY. Absolutely, and I have said so. The legislation says that the Congress has to defer to what the agency rules, but the *Whitman* case says equally clearly that in a case of nondelegation challenge, the agency has no say in—

Mr. BARR. In fact, you have circumstances where the CFPB is specifically circumventing the expressed intent of Congress by indirectly regulating auto dealers—not lenders, auto dealers—through the guidance that doesn't even involve notice and comment rulemaking.

Dr. Spalding, did you want to just quickly jump in on that?

Mr. SPALDING. No, I think—I completely agree with Ambassador Gray.

The thing I was going to point out is the underlying problem here is not nondelegation per se; it is a complete breakdown of the separation of powers. Just because the courts are unable to see the obvious, which is this nondelegation has really gone into a new form, does not mean Congress should not and must not protect its own legislative powers.

These regulatory agencies, this one in particular, are clearly exercising your lawmaking powers that "all" means all and they must stay in article one.

Mr. BARR. Professor Zywicki, really quickly, Mr. Gupta says that the CFPB comes before Congress and that the CFPB is bound by the APA.

To me, that is like saying King George is accountable to Thomas Paine simply because Thomas Paine is providing feedback to King George. Can you comment on Mr. Gupta's argument that the Bureau is, in fact, accountable?

Mr. ZYWICKI. I think the Constitution has this right. Congress has the power of the purse, and the Executive Branch—you have to be accountable somewhere in a real way, and they are not.

Mr. BARR. Thank you.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired. There are no other Members in the queue.

Thus, I would like to thank all of our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing stands adjourned.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

A P P E N D I X

September 17, 2015

FINANCIAL SERVICES COMMITTEE

Rubén E. Hinojosa Opening Remarks

"The Dodd –Frank Act Five Years Later: Are We More Free?"

September 17, 2015

Rayburn 2128

10:00 AM

Thank you Chairman Hensarling and Ranking Member Waters for holding this hearing and Thank you to the distinguished panel members for your testimony here today.

As we examine the Dodd-Frank Act five years after is passage, I think it is important to remember why we undertook the most impressive revamp of the financial system since the Great Depression. In 2007 and 2008 we faced an almost complete collapse of liquidity in our markets and solvency of our banks.

Despite worldwide market turmoil these past few weeks in response to fears of economic trouble in China, we have been *Free* from worry about the safety and soundness of our Financial System, largely thanks to the strengthening reforms undertaken by Dodd-Frank.

Moreover, the Dodd-Frank reforms have paved the way for solid economic growth by restoring confidence in our markets and allowing for the creation of 13 million private sector jobs over. 66 straight months - extending the longest streak in our history and reducing the unemployment rate to 5.1%, the lowest since April 2008.

Unfortunately, our economic recovery and the vibrancy of our manufacturing sector is in peril. Rather than embracing common sense policies that have contributed to our economic recovery, some of my colleagues insist on sticking to misguided ideology in refusing to reauthorize the Export-Import Bank.

The Ex-Im bank is an Un-equivocal market-driven success that supports hundreds of thousands of good paying American jobs, provides a surplus to the US Treasury, and helps us compete with countries like China, Germany and South Korea who have export-credit agencies that dwarf our own. We should not surrender American jobs, we should reauthorize the Export Import Bank now!

Hearing before the
United States House of Representatives,
Committee on Financial Services

The Dodd-Frank Act at Five Years:
Are We More Free?

September 17, 2015

Statement of Amb. C. Boyden Gray

I am grateful for the opportunity to testify before this Committee, on the fundamental constitutional problems inherent in the Dodd-Frank Act[1]—both in the Act's structure and in the manner in which federal agencies are administering it.

I have had the honor of testifying previously on these issues several times since Dodd-Frank was enacted five years ago. Just two months ago, for example, I testified before a subcommittee of the Senate Judiciary Committee on the constitutional flaws inherent in Title X of the Act, which created the Consumer Financial Protection Bureau (CFPB).[2]

And in 2013, for example, I addressed the similar structural constitutional flaws of Dodd-Frank's Title I (creating the Financial Stability Oversight Council, or "FSOC") and Title II (creating the Orderly Liquidation Authority, or "OLA"), before

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1 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

2 *The Administrative State v. The Constitution: Dodd-Frank at Five Years*, 114th Cong. (July 23, 2015), *available at* http://boydengrayassociates.com/ambassador-gray-testifies-on-the-constitutionality-of-dodd-frank-and-the-consumer-financial-protection-bureau/.

the House Financial Services Committee's Oversight and Investigations Subcommittee.[3]

But most importantly, I am co-counsel to several parties litigating a constitutional challenge to the CFPB, to Director Cordray's recess appointment, and to FSOC in federal court; alongside us in that case are States challenging the Orderly Liquidation Authority. The day after I testified in July as to the CFPB's unconstitutionality, the U.S. Court of Appeals for the D.C. Circuit issued a decision recognizing our legal standing to litigate the merits of our constitutional claims against the CFPB.[4] We look forward to finally reaching the substance of these crucial constitutional issues in court. But I also appreciate the opportunity to discuss them here today, in the hopes that Congress itself will remedy Dodd-Frank's constitutional violations.

It is no accident that a community bank is the lead plaintiff in our case: community banks have been hit very hard by the CFPB's unchecked powers, and unlike Wall Street banks they cannot simply hire an army of lawyers and lobbyists in perpetuity. Just as big government and bureaucratic discretion inherently favor the biggest businesses over small upstarts, so community banks—and the communities and Main Streets they serve—bear the brunt of the CFPB's regulatory onslaught.

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[3] *Examining Constitutional Deficiencies and Legal Uncertainties in the Dodd-Frank Act*, 113th Cong. (July 9, 2013), *available at* http://www.boydengrayassociates.com/examining-constitutional-deficiencies-and-legal-uncertainties-in-the-dodd-frank-act/.

[4] *State Nat'l Bank of Big Spring v. Lew*, 795 F.3d 48 (July 24, 2015).

Because I have already testified in detail as to Dodd-Frank's constitutional problems, I incorporate those testimonies by reference. (Their full text is available online, as noted above in footnotes 2 and 3.) As I explain there, each of those statutes violates the Constitution's separation of powers, its checks and balances, and each raises a host of other constitutional or practical problems. Let me briefly summarize the general constitutional issues here:

In Title X, Dodd-Frank creates the CFPB with an unprecedented combination of independence from both the Executive Branch and the Legislative Branch; it adds to that combination an open-ended delegation of regulatory power, and it orders the federal courts to give extra deference to the CFPB's interpretation of its statutory powers.

In Title I, Dodd-Frank creates the FSOC and vests it with open-ended powers with respect to "systemically important financial institutions" (SIFIs), while also severely limiting the courts' jurisdiction to review the FSOC's SIFI determinations. Indeed, Dodd-Frank expressly limits the courts to reviewing only whether FSOC's findings are "arbitrary and capricious,"[5] and thus seems to restrain courts from their normal, fundamental duty to review not merely whether an agency's work is "arbitrary and capricious" but also whether it is "in accordance with law."[6]

And in Title II, Dodd-Frank creates the OLA and vests the agencies administering it with unprecedented powers and discretion over the financial system. OLA replaces traditional court-managed bankruptcy with a process

[5] 12 U.S.C. § 5323(h).

[6] 5 U.S.C. § 706(2)(A).

controlled by executive branch officials and other unaccountable regulators. It subjects the process to aggressive gag rules preventing even investors from knowing what is happening to companies before it is too late. And it imposes draconian restrictions on judicial review: the courts may review only whether the company is a "financial company" and whether it is "in default or in danger of default"; the courts are *not* allowed to review the government's finding that the company's possible default would "have serious adverse effects on financial stability in the United States."[7] Furthermore, Dodd-Frank sets an infeasible 24-hour deadline for the district court to hear the case and decide whether to stop the government from liquidating the company; once that strict 24-hour clock expires without a district court decision (as it certainly will), the government automatically wins and may begin liquidation.[8] And in liquidation, the government does not need to honor the century-old laws guaranteeing the equal treatment of similarly situated creditors; the government instead can pick and choose winners and losers[9]—as it did in the Chrysler and GM crises, ultimately forcing the State of Indiana's pensions to swallow immense losses. This regulatory framework raises myriad constitutional problems: its combination of independence from Congress (which has no "power of the purse" over the OLA) and from the courts (which exercise no meaningful judicial review of the OLA), combined with the statute's grant of open-ended powers, raises significant separation-of-powers questions. It also raises serious questions under

[7] 12 U.S.C. § 5382(a)(1)(A)(iii).

[8] 12 U.S.C. § 5382(a)(1)(A)(v).

[9] 12 U.S.C. § 5390(b)(4).

the Fifth Amendment (which guarantees due process) and Bankruptcy Clause found in Article I, Section 8 of the Constitution (which requires that bankruptcy laws be "uniform").

In addition to these points about Dodd-Frank's structural unconstitutionality, I would like to add one more point regarding the nature of the agencies' regulatory approaches. As I discussed recently in the *George Mason Law Review*,[10] Dodd-Frank does not require the FSOC to justify its SIFI designations by demonstrating that the designated financial company poses a substantial *likelihood* of causing systemic financial harm; rather, it allows the FSOC to designate a financial company as a SIFI if it merely "*could* pose a threat to the financial stability of the United States."[11]

That open-ended grant of power, which fails to require the FSOC to show that its SIFI designations are actually necessary to avoid a significant risk of harm to the public, ignores the Supreme Court's emphatic admonition that statutes must not be construed to allow an agency to impose substantial regulations without evidence that such regulation is actually necessary to prevent significant risk of harm. To allow otherwise would be to "make such a 'sweeping declaration of legislative power' that it might be unconstitutional under" the Court's nondelegation precedents, as Justice Stevens' plurality opinion in the *Benzene*

[10] *The Nondelegation Canon's Neglected History and Underestimated Legacy*, 22 Geo. Mason L. Rev. 619 (2015).

[11] 12 U.S.C. § 5323(a)().

Case explained. "A construction of the statute that avoids this kind of open-ended grant should certainly be favored," he and his colleagues stressed.[12]

The Court reiterated this approach in *Whitman v. American Trucking Associations,* where it narrowly construed the Clean Air Act's Section 109(b)(1). That statute provides for the establishment of air quality standards that are "requisite" to protect public health. The Court, at Solicitor General Waxman's own urging, construed this as authorizing the EPA only to set standards that are "sufficient, *but not more than necessary*," to protect public health.[13]

The FSOC's regulatory approach, pursuant to Dodd-Frank's Title I, heeds none of these warnings. It recognizes no need to show actual, *significant* risk of systemic financial harm before designating new SIFIs—and its SIFI designations to date show no such significant risks of public harm actually being prevented. The FSOC claims power to make SIFI designations, with immense ramifications on our economy, based on *sheer speculation*—precisely the nondelegation violations that the Supreme Court warns emphatically against.

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Thank you, again, for the opportunity to testify on these crucially important issues. I welcome your questions.

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[12] *Industrial Union Department, AFL-CIO v. American Petroleum Institute ("Benzene Case")*, 448 U.S. 607, 646 (1980) (plurality op.). Justice Rehnquist did not join the plurality opinion, but he echoed the plurality's point regarding the prohibition against agencies claiming power to regulate insignificant risks, when he expressly agreed that the agency cannot claim power to "eliminate marginal or insignificant risks of material harm right down to an industry's breaking point." *Id.* at 683 (Rehnquist, J., concurring).

[13] *Whitman v. Am. Trucking Ass'ns*, 581 U.S. 457, 473-74 (2001) (emphasis added).

Testimony of Deepak Gupta
Founding Principal, Gupta Wessler PLLC, Washington, DC

Before the Committee on Financial Services
United States House of Representatives

"The Dodd-Frank Act Five Years Later: Are We More Free?"

September 17, 2015

Chairman Hensarling, Ranking Member Waters, and distinguished members of the Committee, thank you for inviting me to testify on the Dodd-Frank Wall Street Reform and Consumer Protection Act and the important watchdog agency created by that legislation: the Consumer Financial Protection Bureau (CFPB). My name is Deepak Gupta. I am the founding principal of Gupta Wessler PLLC, a law firm focusing on appellate and constitutional litigation. I previously served as Senior Counsel at the CFPB, where my duties included defending the new agency and its programs in court and advising its leadership on constitutional issues. My testimony today makes three basic points:

***First*, the CFPB, Dodd-Frank's crown jewel, has already proven that it is protecting consumers' freedom to achieve the American dream; Congress should resist efforts to gut the agency.** The agency has already returned $11 billion dollars for more than 25 million consumers harmed by illegal practices, and has reined in some of the worst abuses in the payday and installment-lending, credit-card, and mortgage industries. It has taken steps to level the playing field between consumers and banks, and between larger and smaller financial institutions. The Bureau is making Americans more, not less, free. Yet the

Bureau's opponents are trying to hamstring its efforts and alter its structure for the worse—not through the ordinary legislative process but through back-door appropriations riders, absent any debate.

***Second,* many of the main objections to the CFBP and Dodd-Frank—centering on accountability and the rule of law—are misplaced.** To be sure, democratic legitimacy is perhaps the central problem of administrative law, and we should always ask whether the administrative state has become unmoored from our democracy.[1] But the CFPB—which was specifically designed to resist capture by narrow industry interests—is at least as accountable to the public as were the existing prudential banking regulators, from which the CFPB inherited much of its authority over consumer protection. And in several respects, the Bureau is far *more* accountable: Its budget is capped; its rules can be vetoed by a committee of other regulators; and it is subject to a special small-business review process by which only EPA and OSHA are similarly constrained. Finally, the CFPB has also gone beyond legal requirements and conventions, using technology and public participation to make itself more directly responsive to the American consumer.

***Third,* the constitutional challenges that Dodd-Frank's detractors continue to press are meritless.** It has been five full years since Dodd-Frank's enactment. In that time, the Act's opponents have invoked every conceivable constitutional principle—from the separation of powers, to the void-for-vagueness doctrine, to procedural due process—in an effort to turn back the clock on financial

[1] *See generally* Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1678–80 (1975).

reform and consumer protection. These efforts have failed before every court to consider them. Tellingly, no reputable financial institution or major trade group has lent its name to the constitutional challenges to the CFPB. Indeed, not a single amicus brief was filed before the D.C. Circuit in *State National Bank of Big Spring v. Lew*, the most high-profile of the cases. These legal challenges are truly at the fringe. Unfortunately, however, they are emblematic of the unique historical moment in which we live, in which seemingly every major political disagreement—from health care to immigration—is constitutionalized and litigated. Consumer protection, apparently, is no exception.

The principal constitutional arguments against Dodd-Frank, based on the separation of powers, are at odds with at least eighty years of settled precedent. Most are really disguised "non-delegation" arguments—that is, arguments that Congress's delegation of power to an agency (such as the CFPB's authority to regulate unfair lending practices, or the Financial Stability Oversight Council's authority to designate entities as systemically risky) is too vague or broad. But that doctrine hasn't been successfully invoked since 1935—at the height of judicial resistance to the New Deal—and Dodd-Frank's standards are actually more specific than those that have been upheld. As the Supreme Court explained in a 2001 opinion by Justice Scalia, "even in sweeping regulatory schemes [the Court] ha[s] never demanded … a 'determinate criterion'" or "felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law."[2]

The challengers also argue that the President lacks sufficient control over the CFPB because its Director may be removed only for cause.[3] This argument likewise seeks to turn the clock back to before 1935—the year the Supreme Court approved identical for-cause removal protections for FTC commissioners.[4] That precedent applies with full force to CFPB.[5] As the age of the precedents reveal, these arguments are not really attacks on Dodd-Frank or the CFPB so much as attacks on the very foundations of the modern administrative state.

I. The CFPB Is Making American Consumers More Free and Leveling the Playing Field for Consumers and Financial Institutions Alike.

A. Protecting Consumers. In its short five years, the Bureau already has had tremendous success championing the rights of the American public. The agency has returned $11 billion dollars to more than 25 million consumers harmed by illegal practices—including $14 million that the Bureau won back from the payday lender Cash America for targeting and illegally overcharging members of the military.

[2] *Whitman v. American Trucking Ass'ns,* 531 U.S. 457, 474-75 (2001).

[3] 12 U.S.C. § 5491(c)(3) ("The President may remove the Director for inefficiency, neglect of duty, or malfeasance in office.").

[4] *Humphrey's Executor v. United States,* 295 U.S. 602, 619, 628, 632 (1935).

[5] *See Morrison v. Olson,* 487 U.S. 654, 692-93 (1988) (approving provision authorizing removal of independent counsel only for "good cause"); *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3161 (2010) (concluding that "a single level of good-cause tenure" preserved sufficient presidential oversight).

The Bureau's victories go beyond numbers: it has also made financial products more transparent and provided consumers with key resources to navigate among different financial options. Most importantly, its mere existence as a public watchdog serves as a powerful deterrent against predatory and exploitative industry practices.

Congress wrote Dodd-Frank and created the Bureau in response to a catastrophic crisis that touched the lives and livelihoods of millions of Americans. The housing market crash—a result of the very kinds of predatory and confusing lending schemes that the CFPB is now charged with regulating—set off a wave of millions of foreclosures that destroyed the wealth of American consumers, families, and communities. The U.S. Government Accountability Office has calculated that, between 2005 and 2011, American households collectively lost $9.1 trillion in home equity, largely a result of the systemic effects of predatory subprime lending.[6] More than 3.5 million home mortgages were either already in the foreclosure process or delinquent 90 or more days in the first quarter of 2011.[7] By wiping out the savings that owners had invested in their homes, these unchecked practices curtailed consumers' freedom to safely pursue one of the cornerstones of the American dream.

Designed in response to this crisis, the Dodd-Frank Act created important checks to protect the interests of consumers. For the first time, federal supervision

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[6] U.S. Gov't Accountability Office, GAO-13-180, Financial Regulatory Reform: Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act 21 (2013).

[7] U.S. Gov't Accountability Office, GAO-11-656, Mortgage Reform: Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market 1 (2011).

has been extended to payday lenders, who give out loans to 12 million Americans every year. The 30 million consumers with debts in collection can also feel safer knowing that larger debt collection companies are now under federal supervision. Already, 25 million consumers will receive relief because of aggressive enforcement actions against the worst actors in the marketplace.[8] Moreover, CFPB has laid down streamlined, simplified rules that allow ordinary Americans to enter the most important transactions of their lives confident in their knowledge of the system. Consumers no longer need worry that only experts can successfully navigate the processes of securing student loans, taking out a mortgage, or saving for retirement. Freed from this concern, they can thus focus on what matters most—from attending college, to moving into their first home, to enjoying their older years.

B. Leveling the Playing Field Between Banks and Consumers. One important area in which the CFPB is working hard to protect consumers is forced arbitration. Swaths of consumer contracts today contain mandatory arbitration clauses. These clauses rob consumers of the right to take a company to court, and instead force individuals to settle claims through private arbitrators, usually chosen by the company. Originally sanctioned by Congress as a mechanism for businesses of equal bargaining power to resolve contractual disputes, arbitration today has morphed into a routine device that companies can use against consumers

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[8] Consumer Financial Protection Bureau, Consumer Financial Protection Bureau: By the Numbers Fact Sheet, Sept. 14, 2015.

and workers, parties with vastly unequal bargaining power.[9] Unaware of the fine print, consumers routinely give up the freedom to choose how they can settle disputes with far more powerful companies.

For years public advocates and corporate lawyers debated the effects of mandatory arbitration clauses, with each side issuing competing studies documenting how these clauses either harm or benefit the public. Congress gave the Bureau statutory authority to study the prevalence and effects of these clauses as a way to gather credible data and create a public record on the understudied yet rising use of forced arbitration.[10]

The CFPB undertook the process with methodological rigor and transparency. As a preliminary step, it published a Request for Information that sought comments on the appropriate scope, methods, and data sources for the study, and met with commentators to discuss their concerns. It then published preliminary results from the study in December 2013, and again met with various stakeholders—including industry actors—to hear their feedback.

In March of this year, the Bureau issued its final report.[11] The results were unambiguous: the financial industry uses arbitration clauses widely, these clauses notably suppress consumer complaints, and the tiny fraction of consumers who *do* bring claims fare far worse in arbitration than they would in class actions. Strikingly, *four* consumers with small claims received cash compensation through

[9] Lina Khan, *Thrown Out of Court*, WASH. MONTHLY, June/July/August 2014.

[10] 12 U.S.C. § 5301(a).

[11] Consumer Financial Protection Bureau, Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a), March 2015.

arbitration, whereas thirty-four million received compensation through class actions.[12] A case study comparing outcomes for consumers who had been swindled by banks through overdraft fees found that those without arbitration clauses were able collectively to recover hundreds of millions of dollars that were deposited straight to their bank accounts, while those facing enforceable arbitration clauses won back nothing.[13]

The Bureau also found that 50 percent of outstanding credit card loans contain forced arbitration clauses. (Were it not for a 2009 antitrust settlement that required some banks to eliminate temporarily these clauses, this number would be around 94 percent.) Between 85 and 100 percent of contracts with forced arbitration clauses additionally contain class action bans. Consumers, meanwhile, overwhelmingly have no idea: over 90 percent of consumers whose contracts for financial products include forced arbitration clauses were unaware that they could no longer sue. Between 2010 and 2012, only about 410 individual consumers brought arbitration claims against financial services companies.

The study also found that consumers generally fare much worse than companies do a significant percentage of the time: in cases initiated by consumers, arbitrators provided them some relief in around 20 percent of cases; by contrast, arbitrators awarded companies relief in 93 percent of cases that they filed.

[12] The arbitration claims were counted over a two-year period, while the class action claims over a five-year period. Needless to say, this discrepancy does not undermine the force of the disparity between four consumers and thirty-four million consumers.

[13] Consumer Financial Protection Bureau, Arbitration Study, at 39.

Moreover, consumers on average won 12 cents for every dollar that they claimed, whereas corporations on average won 91 cents for every dollar that they claimed.

In sum, the study shows that arbitration is starkly inferior to class actions as a vehicle for consumer relief. The next step for the Bureau is to consider rulemaking informed by this study.

Alarmingly, it's become clear that opponents are now trying to use the appropriations process to obstruct the agency's work. The 2016 House Appropriations Bill contains provisions that would tie the Bureau's authority to continue working on arbitration to a litany of additional requirements—instituting a form of paralysis by analysis.

Allowing CFBP to continue its arbitration work is vital for restoring a fair playing field for consumers and rectifying the gross imbalance of power between corporate interests and the public. Members of Congress should pay special attention to this attack—and fight it.

C. Leveling the Playing Field Among Financial Institutions. Moreover, Dodd-Frank and the CFPB have worked to level the playing field within the financial industry. For the first time, a single entity is in charge of setting the rules by which all players, from megabanks to nonbanks to small community institutions, must abide. No financial institution—be it a big bank or a payday lender—can gain an advantage based on who is in charge of regulating them.

Critics have repeatedly argued that CFPB oversight and regulation have particularly hurt community banks. But the law in fact explicitly works to protect the interests of these smaller actors, with special exceptions for institutions with less than $10 billion in assets. If anything, as Georgetown Law Professor Adam Levitin has argued, the CFPB has *helped* these smaller actors continue to compete against big banks. To be sure, community banks face increasing challenges for a variety of reasons. But let's be honest about what's really happening here: As Levitin puts it, "It's the big banks who are pushing for deregulation in the name of helping community banks."[14]

II. Accountability Critiques of CFPB

Over the last five years, the primary attack against CFPB has been that it is unaccountable to the public and democratically illegitimate. Critics target the fact that the agency is headed by a single Director rather than by a five-member commission, and that its funding is not subject to the appropriations process overseen by Congress. Alarmist appraisals by opponents such as Todd Zywicki—a majority witness at this hearing who describes the agency as combining "vast power and lack of public accountability" in unprecedented ways—are routine.[15]

These criticisms are not new: they echo the same attacks that opponents launched five years ago, after Congress created the agency.[16] Several facts show that these criticisms are also flatly unfounded. First, agency accountability was a

[14] Adam Levitin, *Size Matters: Community Banks' Real Problem*, Credit Slips, Feb. 10, 2015, at http://www.creditslips.org/creditslips/2015/02/size-matters-community-banks-real-problem.html.

[15] Todd Zywicki, *Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEORGE WASH. L. REV 856 (2013).

[16] Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15, 72-75 (2010); David Hirschmann, *Consumer Financial Protection Bureau needs more accountability*, POLITICO, Dec. 7, 2011, at http://www.politico.com/news/stories/1211/69992.html

central goal throughout both the conception and formation of the Bureau, and its structure today reflects fidelity to that priority. Second, the CFPB is accountable in all the ways that the Federal Reserve, the OCC, and the Federal Deposit Insurance Corporation (FDIC) are. Third, in important ways the Bureau's power is more constrained than those of these other regulators. And fourth, over its short existence CFPB has pioneered ways to involve citizens in its decision-making, to ensure its work reflects the challenges and needs of actual consumers, and to keep itself accountable to the public.

A. Accountable to the Public, Resistant to Industry Capture. I agree that the democratic legitimacy of independent agencies is of paramount importance and a central challenge of the administrative state. Ensuring that agencies adhere to the principle of the rule of law and stay accountable to the public isn't just an academic concern; we saw all-too-recently what can happen when regulators become unmoored from serving the public. As is now widely acknowledged, the 2007 financial crash was the result of gross oversight and neglect on the part of the independent agencies charged with overseeing the financial system. The Federal Reserve failed to stem the flow of toxic mortgages and neglected to read the myriad warning signs that foreshadowed the crisis.[17] The OCC and the Office of

[17] As the Financial Crisis Inquiry Commission noted in its final report, "Despite the expressed view of many on Wall Street and in Washington that the crisis could not have been foreseen or avoided, there were warning signs. The tragedy was that they were ignored or discounted." The red flags included "an explosion in risky subprime lending and securitization, an unsustainable rise in housing prices, widespread reports of egregious and predatory lending practices, dramatic increases in household mortgage debt, and exponential growth in financial firms' trading activities, unregulated derivatives, and short-term "repo" lending markets, among many other red flags. Yet there was pervasive permissiveness; little meaningful action was taken to quell the threats in a timely manner." THE FINANCIAL CRISIS INQUIRY COMMISSION REPORT, JAN. 2011, xvii.

Thrift Supervision (OTS), caught up in turf wars, preempted state regulators from reining in abuses and created incentives for a regulatory "race-to-the-bottom."[18] In many ways the failings of these agencies can be traced to a lack of democratic accountability, and to ideological and cultural capture by industry.[19]

The Consumer Financial Protection Bureau was created with these failures in mind. Observing that the existing regulatory framework left consumers entirely exposed to risky and predatory financial products, then-Professor Elizabeth Warren proposed the new agency to fill-in the gap.[20] Critically, the idea was to design an entity with both the authority and the incentives to police the safety of consumer credit products. Acutely aware of how vulnerable regulators remain to industry capture, the agency's supporters drew from scholarship on agency accountability, as well as from the practical lessons of agencies like the Consumer Products Safety Commission, whose structure provided a cautionary tale for how traditional markers of independence can fall short.[21]

The institutional framework of the CFPB was the focus of intense political debate.[22] Initially proposed as a free-standing cabinet-level agency, CFPB's

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[18] *Id.* at xiii.

[19] James Kwak, *Cultural Capture and the Financial Crisis*, in PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT, eds. Daniel Carpenter and David A. Moss, The Tobin Project, 2014.

[20] Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY (Summer 2007); Oren Bar Gill and Elizabeth Warren, *Making Credit Safer*, 157 U. PENN. L. REV. 101 (2008).

[21] Barkow, *Insulating Agencies*, at 65-71 (identifying various structural features of the CPSC that made it "one of the least politically independent and influential agencies in government").

[22] Sewell Chan, *Dodd Proposes Giving Fed the Task of Consumer Protection*, N.Y. TIMES, Mar. 2, 2010, at B2 ("[A]dvocates, mindful of fierce Republican opposition to a stand-alone agency, have said that they are less concerned about where the entity is housed than the scope of its authority and the independence of its leadership and budget.").

ultimate form was shaped by extensive negotiations in Congress. Tennessee Senator Bob Corker, a conservative Republican, proposed that the agency be housed within the Federal Reserve, insulating it from the appropriations process.[23] Compromises on both sides yielded the final result.

B. Just as Accountable as Other Financial Regulators. As numerous experts have noted, the CFPB is accountable to a host of government processes and bodies. Like other agencies, it is bound by the Administrative Procedure Act (APA), which means that it must inform the public of its proposed rules, offer citizens the opportunity to comment on proposals, and then consider public input when finalizing its rules. It is also subject to the Regulatory Flexibility Act, the Paperwork Reduction Act, and the Congressional Review Act.

Additionally, the CFPB's authority is uniquely bound by other regulators. When proposing rules to prohibit unfair, deceptive, or abusive practices, the CFPB is required to consult with federal banking agencies or other regulators to ensure that the rules are in line with "prudential, market, or systemic objectives administered by such agencies."[24] The CFPB is also obligated to consult prudential regulators and other agencies when proposing rules administering federal consumer financial laws.[25] Not only are regulators permitted to object to the rules, their written objections must be included in the rule-making record, along with the

[23] Rich Danker, *Corker stiffs anti-Fed Republicans again*, THE HILL, Mar. 6, 2012.

[24] 12 U.S.C. § 5301, § 1031(e).

[25] *Id.* at §1022(b)(2)(B).

Bureau's response to their concerns.[26] No other financial regulator faces these requirements.

An agency head who can only be removed by the president for-cause and an independent funding stream are features that the Bureau shares with the Federal Reserve, the FDIC, and the OCC.[27] Congress gave financial regulators this structure because it recognized that the safety and stability of the financial industry—a sector on which all other businesses depend—was too vital to subject to the vagaries of the political process. That the CFPB, a financial regulator, shares the basic design of other financial regulators is not anomalous.

C. More Accountable Than Other Financial Regulators. In important ways, Congress has placed additional limits on CFPB's authority. Unlike any other financial regulator, the Bureau is subject to the Small Business Regulatory Enforcement Fairness Act (SBREFA), which requires it to give small businesses a preview of new proposals and receive extensive feedback before giving notice to the broader public. The CFPB is also the only financial regulator whose books are annually audited by the Government Accountability Office (GAO).[28] Furthermore, the Bureau is subject to significant oversight by Congress: the CFPB Director must submit reports to and appear in committees in front of both houses of Congress twice a year.[29] Senior CFPB officials have already testified to Congress

[26] *Id.* at, §1022(b)(2)(C).

[27] Restraints on the President's ability to remove the Comptroller of the Currency is unclear and the OCC's organic statute does not address the issue.

[28] *Id.* at § 1017(a)(5)(B).

[29] *Id.* at § 1016(a).

fifty-five times since the agency's birth four years ago, an average of more than one appearance per month. That must be some kind of record.

Uniquely, CFPB's funding is capped. Unlike other financial regulators, CFPB cannot simply hike fees, increase revenue, and boost its activity levels. Its budget is capped at 12 percent of the Federal Reserve's 2009 operating expenses, with slight adjustment for inflation.[30] No other financial regulator has a budget ceiling written into law.

Lastly, all of the Bureau's regulations are subject to review by the FSOC, a body of cabinet-level and executive-appointed officials. The FSOC can veto any proposed rule on safety and soundness concerns with a two-thirds vote. The voting members of the FSOC consist of the Secretary of the Treasury, the Fed Chairman, the Comptroller of the Currency, the Director of the CFPB, the Chairman of the SEC, the Chairperson of the FDIC, the Chairperson of the Commodities Futures Trading Commission (CFTC), the Director of the Federal Housing Finance Agency (FHFA), the Chairman of the National Credit Union Administration (NCUA), and an independent member who has insurance expertise and who is appointed by the President and confirmed by the Senate. I am aware of no other independent agency whose regulations are subject to the veto power of regulators from other agencies.

D. Enhancing Public Participation. Not only is the Bureau as accountable as—and in key regards, even more constrained than—other financial regulators,

[30] *Id.* at § 1017(a)(2).

but it has pioneered new ways to solicit public participation in its decision-making and to ensure that its work reflects the actual needs of citizens. Since 2011 it has held over thirty public town halls and field hearings in cities across the country, from Itta Bena, Mississippi to Sioux Falls, South Dakota.[31] Even before its official launch, CFPB initiated an online campaign to seek public input through popular venues like Twitter, Facebook, and YouTube. Through these online channels, the Bureau has collected reams of information about the kinds of difficulties consumers face with various financial products, data that it uses to inform its priorities and policymaking.[32]

The Bureau's "Know Before You Owe" mortgage initiative exemplifies the agency's emphasis on public participation. Charged with the task of simplifying the convoluted information consumers receive under the Truth In Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA), CFPB redesigned the forms and conducted in-depth, one-on-one interviews with borrowers, lenders, and brokers to understand how well consumers and lenders were able to use various iterations. At the same time that the Bureau was testing each set of forms, it also posted them online with an interactive tool to gather public input about the designs. By recording where users clicked as they reviewed the draft disclosures, this tool let the Bureau compile "heat-maps" showing the parts of the disclosures that attracted the most and least attention. In addition, as a supplement to the

[31] Consumer Financial Protection Bureau, By the Numbers Fact Sheet, Sept. 14, 2015.

[32] Leonard J. Kennedy, Patricia A. McCoy, and Ethan Bernstein, *The Consumer Financial Protection Bureau: Financial Regulation for the Twenty-First Century*, 94 CORN. L. REV. 1140, 1159 (2012).

traditional public notice-and-comment process, the CFPB's interactive tool permitted targeted input on the portions of the design that were under investigation in that cycle. That input allowed Bureau staff to process the feedback quickly, iterate the forms, and then test them again in four weeks.[33]

The process fostered extensive public participation. The Bureau received over 220,000 unique page-views for KBYO, resulting in 27,000 comments over the first seven iterative cycles.[34] Seeking wide public input as it conducted consumer testing, rather than having a single public comment period on a formal proposal, has been central to the development and success of the Bureau's proposed form. Initial testing shows that the new disclosures have successfully reduced consumer confusion and are enabling comparison-shopping.[35] Drawing on this experience, the Bureau has expanded its KBYO initiative to cover student loans and credit cards—efforts that will make the costs and risks of these products easier for the public to understand.

The Bureau has also sought out extensive feedback from servicemembers. Under the leadership of Holly Petraeus, the Bureau has hosted numerous town hall meetings and roundtable discussions with military families and their advocates. These meetings have educated the Bureau about the financial products and services most affecting servicemembers, information the CFPB is now using to

[33] *Id.* at 1166.

[34] CONSUMER FIN. PROT. BUREAU, SEMI-ANNUAL REPORT OF THE CONSUMER FINANCIAL PROTECTION BUREAU: JULY 21-DECEMBER 31, 2011, at 13-14 (2012).

[35] Kennedy et al., *The Consumer Financial Protection Bureau*, at 1161.

shape financial education programs for servicemembers.[36]

These efforts showcase just some of the ways that the CFPB is using its mandate to ensure it stays accountable to the public. Not only are attacks on its accountability unfounded, but the Bureau's efforts to enhance its democratic responsiveness serve as a model that we should encourage other regulators to follow.

* * *

Numerous proposals from Congress now threaten the independence and accountability of the Bureau. The most recent House appropriations bill includes several riders that would, among other things, replace its single director with a five-member commission, subject agency rulemaking to additional compliance requirements, and change its funding source from Federal Reserve transfers to annual appropriations.[37] Most alarmingly, the House appropriations bill would introduce fresh obstacles to the Bureau's ability to review and reform pre-dispute mandatory arbitration—a task Congress charged it with in Dodd-Frank.

Each of these proposals would critically undermine the agency's structure and powers and should be fought off. The Bureau's efficacy and force as a public champion stems from its independence, and the fact that it can carry out its work insulated from the threat of industry retaliation and the partisan vagaries of the appropriations process. Undoing these key protections would be disastrous for

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[36] *Id.*, at 1168.

[37] Financial Services and General Government Appropriations Bill, 2016, 114th Cong., 1st sess., 47-51.

American consumers.

III. Constitutional Challenges to Dodd-Frank and the CFPB

The constitutional challenges to the Dodd-Frank Act and the CFPB thus far have recited a similar series of unsuccessful legal arguments. At least four federal courts have rejected these arguments on the merits.[38]

Rather than fully articulating a specific constitutional violation, these litigants partially construct several constitutional claims in the hopes that a "mosaic" will prevail.[39] These theories, which courts have uniformly rejected, allege that the structure and authority of CFPB or the Financial Stability Oversight Council (FSOC), as well as the Treasury's Orderly Liquidation Authority (OLA), are unconstitutional on separation-of-powers or due-process grounds. To adopt these arguments would be to overturn eighty years of settled precedent and, indeed, the foundations of the New Deal and the modern administrative state.

A. Lack of Mainstream Support. Before turning to the merits, however, it is worth saying a brief word about who's behind these challenges. Reputable financial institutions and mainstream trade associations have largely stayed clear of the fray. The highest profile challenge, *State National Bank of Big Spring v. Lew*—filed with great press fanfare in 2012 and billed as "a high-noon showdown between the Obama Administration … and the banking industry"—was

[38] *Consumer Fin. Prot. Bureau v. ITT Educ. Servs., Inc.*, No. 1:14-CV-00292-SEB, 2015 WL 1013508, *11, *13-14, *18, *20 (S.D. Ind. Mar. 6, 2015); *Consumer Fin. Prot. Bureau v. Morgan Drexen, Inc.*, 60 F. Supp. 3d 1082, 1089-92 (C.D. Cal. 2014); *Illinois v. Alta Colleges, Inc.*, 2014 U.S. Dist. LEXIS 123053, *8-13 (N.D. Ill. Sept. 4, 2014); *Illinois v. CMK Investments, Inc.*, 2015 U.S. Dist. LEXIS 84277, *8 (N.D. Ill. June 30, 2015).

[39] *ITT Educ. Servs., Inc.* at *11.

brought by a group of transparently politically oriented plaintiffs, organized through the Competitive Enterprise Institute and represented by one of today's majority witnesses, Ambassador C. Boyden Gray.[40] At a debate about the case, Ambassador Gray publicly admitted that he found it difficult to find any financial institution willing to join the challenge.[41] And, despite D.C.'s booming cottage industry of lawyers representing financial institutions on Dodd-Frank matters, not a single amicus brief was filed in the D.C. Circuit appeal in *Big Spring*.

Nonetheless, the constitutional challenges asserted by Big Spring against the CFPB mirror the claims pursued by the challengers in *Morgan Drexen* and *ITT*, who raised their challenges defensively, in the context of CFPB enforcement actions against them. The CFPB sued ITT for predatory lending to college students who were coerced into taking out private loans to pay for their tuition;[42] it sued Morgan Drexen for tricking consumers into paying thousands of dollars in illegal fees and misrepresenting its questionable debt-relief and bankruptcy services.[43] In both cases, the courts were therefore able to reject the constitutional arguments on the merits.[44]

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[40] Keith Goldberg, *Banking Cases to Watch in 2013*, LAW360, Jan. 1, 2013, http://www.law360.com/articles/397603/banking-cases-to-watch-in-2013.

[41] "The Constitutional Challenge to the Consumer Financial Protection Bureau: A Debate," Georgetown University Law Center, Washington, DC (March 21, 2013) (debate between Deepak Gupta and C. Boyden Gray, sponsored by the Georgetown Center on the Constitution, the Federalist Society, and Consumer Law Society). *See also* C. Boyden Gray, *Congressional Abdication: Delegation Without Detail and Without Waiver*, 36 HARV. J.L. & PUB. POL'Y 41, 47 (2013) ("Finding private plaintiffs has not been easy.").

[42] *See ITT Educ. Servs., Inc.* at *1-5.

[43] *Morgan Drexen, Inc. v. Consumer Fin. Prot. Bureau*, 979 F. Supp. 2d 104, 110 (D.D.C. 2013), *aff'd*, 785 F.3d 684 (D.C. Cir. 2015).

[44] *See Id.* at 1089-92; *ITT Educ. Servs., Inc.* at *11, 14, 18, 20.

In addition, in a pending case before the U.S. District Court in Washington D.C., MetLife, Inc. has brought a constitutional challenge to the FSOC's process for designating financial institutions "systemically important" under Dodd-Frank.[45] In relation to *Big Spring*, what's striking about MetLife's complaint is that it bases standing on the alleged harm incurred by the FSOC's designation.[46] Big Spring, in contrast, unsuccessfully asserted that its *lack* of FSOC designation places it at a competitive disadvantage with financial institutions that are designated "systematically important."[47] At the very least, this disagreement among the two sets of plaintiffs regarding whether FSOC-designation is a benefit or a burden cautions against a finding that the lack of designation confers standing.[48]

B. Challenges to the CFPB's Structure and Authority. Although Big Spring also aims to discredit the constitutionality of the OLA and the FSOC, its most extensive criticism is reserved for the CFPB. Weaving together a patchwork of disjointed allegations, Big Spring seeks to establish that, when taken together, "the overwhelming uncertainty inherent in the Title X's open-ended grant of power

[45] *See* Compl. at 2, *MetLife, Inc. v. Fin. Stability Oversight Council*, No. 1:15-cv-00045 (Jan. 13, 2015).

[46] *Id.* at 9.

[47] Compl. at 31-33, *Nat'l Bank of Big Spring*, No 1:12-cv-01032.

[48] *See Nat'l Bank of Big Spring*, 958 F. Supp. 2d at 137-138 (noting the "ambiguous consequences of SIFI designation" before rejecting the plaintiff's standing argument), *aff'd*, *State Nat'l Bank of Big Spring v. Lew*, 795 F.3d 48, 55 (July 24, 2015) (emphasizing that "any harm to State National Bank is simply too attenuated and speculative to show the causation necessary to support standing").

to the CFPB and the lack of checks and balances limiting the CFPB's exercise of that power" render it unconstitutional.[49]

1. ***Disguised Nondelegation Arguments.*** Big Spring first argues that the Dodd-Frank Act's failure to place meaningful restrictions on CFPB's authority to define and enforce "unfair, deceptive, or abusive actions or practices" contravenes the separation of powers.[50] Morgan Drexen and ITT made similar arguments, and both district courts rejected them. Noting that the Dodd-Frank Act explicitly restricts "abusive" practices to four circumstances,[51] the *Drexen* court found that the legislative guidance provided by the Act satisfies constitutional requirements because it is "at least as specific as other provisions held to constitute 'intelligible principles.'"[52] The *ITT* court applied a similar line of reasoning when it held that, in the context of the statute, the terms "abusive" and "unfair" are not unconstitutionally vague in violation of the Fifth Amendment's Due Process Clause.[53] Given that the Dodd-Frank Act's use of "unfair" reflects

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[49] Second Am. Compl. at 24, *State Nat'l Bank of Big Spring v. Geithner*, No. 1:12-cv-01032 (D.D.C. Feb. 19, 2013).

[50] First Am. Compl. at 15-22, *Nat'l Bank of Big Spring*, No 1:12-cv-01032.

[51] "The Dodd–Frank Act defines 'abusive' as either 'materially interfer[ing] with the ability of a consumer to understand a term or condition of a consumer financial product or service' or 'tak[ing] unreasonable advantage of—(A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.'" *Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1090 (quoting 12 U.SC. § 5531(d)).

[52] *Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1090 (citing *Yakus v. United States*, 31 U.S. 414, 414, 420, 426-27 (1944); *Am. Power & Light Co. v. S.E.C.*, 329 U.S. 90, 90, 104-06 (1946)).

[53] *ITT Educ. Servs., Inc.* at *18, *20. The Dodd-Frank Act provides detailed definitions for both "unfair" and "abusive" acts or practices, thus constraining the Bureau's power far more than the Clean Air Act in *Whitman* constrained the EPA's. *See* 12 U.S.C. § 5531. These statutory definitions, moreover, are expressly couched in terms of limitations on the Bureau's powers, providing "[t]he Bureau shall have no authority" to declare acts unfair or unlawful except in

language used in the Federal Trade Commission Act (FTCA), regulated entities are sufficiently apprised of what practices are permitted and forbidden under the Act. As used in the FTCA, the phrase "unfair or deceptive acts or practices" has survived constitutional challenges and been subject to refinement and elaboration since the statute's enactment in 1914. Based on this history, a reasonable business entity should be able to infer the types of actions to which the CFPB might object.[54]

These arguments against the constitutionality of the CFPB are a thinly veiled attempt to breathe life into the non-delegation doctrine, which has not formed the basis for a successful constitutional challenge since 1935.[55] The Dodd-Frank Act's delegation of power to CFPB, moreover, is far narrower than other delegations that have been upheld. In 2001, for instance, in an opinion by Justice Scalia, the Supreme Court upheld a provision of the Clean Air Act granting the EPA authority to "set ambient air quality standards ... requisite to protect the public health."[56] In so doing, the Court in *Whitman v. American Trucking Associations* remarked that "even in sweeping regulatory schemes [it] ha[s] never

conformity with the Act's standards. *Id.* And the Bureau, drawing on the Dodd-Frank Act and established principles of consumer-protection law, has provided clear guidance on its own definitions of "unfair," "abusive," and "deceptive" practices. *See* CFPB, *Supervision and Examination Manual, Version 2*, at UDAAP 1-UDAAP 10 (2012).

[54] *ITT Educ. Servs., Inc.* at *18

[55] A non-delegation challenge to a federal statute has succeeded only twice in the Nation's history—both times in 1935, at the height of judicial hostility to the New Deal. *See Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

[56] *Whitman*, 531 U.S. at 465 (2001) (citing 42 U.S.C. § 7409(b)(1)). The Court said "requisite" meant "not lower or higher than is necessary" – hardly a precise definition. *Id.*

demanded … a 'determinate criterion'" for the standards set by statutes.[57] Thus, to hold that the CFPB is unconstitutional on non-delegation grounds would not just contradict settled precedent; it would open the door to inestimable constitutional challenges to agency delegations and, in turn, compromise the post-New Deal institutions on which our government and its citizens have come to rely.

2. ***Presidential Removal Power.*** Big Spring next contends that the CFPB's insulation from political control also constitutes a violation of the separation of powers. This argument revolves around the Dodd-Frank Act's alleged contravention of the President's removal power. Although the Dodd-Frank Act only permits the President to remove the Director of the CFPB for cause, courts that have addressed this issue in depth have held that *Humphrey's Executor v. United States*,[58] a 1935 case in which the Supreme Court upheld for-cause removal of Federal Trade Commissioners, controls.[59]

Under this standard, the relevant inquiry is whether limitations on the President's removal power "impede the President's ability to perform his constitutional dut[ies]."[60] The for-cause removal provided for by the Dodd-Frank Act satisfies this standard because the President retains "ample authority to assure that the Director is competently leading the CFPB," just as the President's

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[57] *Id.* at 475. The Court further explained that it has "'almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law.'" *Id.* at 474-75 (citing *Mistretta v. United States*, 488 U.S. 361, 416 (1989) (Scalia, J., dissenting)).

[58] 295 U.S. 602, 626-31 (1935).

[59] *Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1087; *see also ITT Educ. Servs., Inc.* at *8-9.

[60] *Id.* at * 9-11, 13-14 (quoting *Morrison v. Olson*, 487 U.S. 654, 691 (1988)).

for-cause removal power gives him ample authority to oversee the SEC and FTC—agencies that perform very similar functions.[61] As the district court in *ITT* summarized, "the structure and powers of the Bureau are sufficiently analogous to those of the FTC, SEC, and other regulatory agencies that the question of the constitutionality of CFPB's removal provision is settled by *Humphrey's Executor* and its progeny."[62]

Nor does the Dodd-Frank Act present the same "second layer of insulation" issue presented by the Public Company Accounting Oversight Board. Under the Sarbanes-Oxley Act, the Securities and Exchange Commission (SEC), whose members are removable by the President only for cause, appointed the public accounting board, whose members were likewise removable *by the Commissioners* only for cause.[63] In the 2010 case in which it held that this structure violates the separation of powers, *Free Enterprise v. Public Company Accounting Oversight Board*, the Supreme Court made clear that its holding rested on this "second layer of insulation," which did "not merely add to the Board's independence, but transform[ed] it" into an unconstitutional component of an otherwise constitutional independent agency.[64] Because the Dodd-Frank Act authorizes for-cause removal of the Director of the CFPB, it lacks the second layer of insulation that *Free*

[61] *Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1087.

[62] *ITT Educ. Servs., Inc.* at *14.

[63] *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3154 (2010).

[64] *Id.* at 3154.

Enterprise Fund concluded differentiated the accounting board from constitutionally permissible independent agencies.

Professor Neomi Rao—a vehement defender of the presidential removal power—has argued in her scholarship that any limitations placed on the President's removal power are unconstitutional.[65] In the wake of *Free Enterprise Fund,* Rao asserts, there is a consensus in legal scholarship that "every federal entity must be accountable to one of three branches."[66] The CFPB is nominally within the Federal Reserve System, but its Director is directly accountable to the President, and, with the exception of the Act's for-cause provision, the President is entirely unobstructed in exercising his or her authority over the CFPB. Despite advocating for courts to overturn the CFPB's for-cause removal provision as unconstitutional, Rao concedes that her approach marks a dramatic departure from existing precedent and would require courts to overturn *Humphrey's Executor.*[67]

Rao's scholarship also reveals that those who challenge Dodd-Frank's constitutionality do not agree even among themselves. Indeed, Rao's critiques are fundamentally incompatible with objections that one of today's majority witnesses, Ambassador Gray, has raised. Although she maintains that the Dodd-Frank Act's removal provision is unconstitutional, Professor Rao acknowledges that the CFPB

[65] Neomi Rao, *Removal: Necessary and Sufficient for Presidential Control,* 65 ALA. L. REV. 1205, 1208 (2014).

[66] *Id.* at 1230-31.

[67] Neomi Rao, *A Modest Proposal: Abolishing Agency Independence in* Free Enterprise Fund v. PCAOB, 79 FORD. L. REV. 2541, 2573-75 (2011).

would be constitutional without it. She thus concedes that the CFPB's basic structure and functions are otherwise constitutionally sufficient. Professor Rao's interpretation, in other words, forecloses Big Spring's and Ambassador Gray's grab-bag (or "mosaic") approach to establishing the constitutional infirmity of Dodd-Frank and the CFPB. As Professor Rao has noted, "there is no all-things-considered functional test to protect separation of powers," nor is there "any decision in which the Court has invalidated government action on functional separation of powers grounds."[68] Thus, Rao recognizes that the dissatisfaction that both proponents and opponents of the CFPB may find with her views "perhaps highlights the political aspects of the disagreement over how to regulate consumer finance, a disagreement that belongs in the political, not judicial arena."[69] On this last point, at least, Professor Rao and I agree.

Finally, it is worth noting that although some opponents of the Dodd-Frank Act's for-cause removal provision call for replacement of the CFPB's Director with a multi-member commission,[70] that structure might actually dilute the President's removal power. With a single agency head, the President is able to expediently remove incompetent leadership. A commission, on the other hand, presents the President with the issue of first identifying which members are responsible for issues that arise.

[68] *See* Rao, *Removal*, at 1272.

[69] *Id.* at 1275.

[70] *See, e.g., Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1086.

3. ***Remaining Constitutional Objections to the CFPB.*** Courts easily dispose of the hodgepodge of remaining constitutional complaints lodged against the CFPB, which include challenges to the deference afforded to CFPB's interpretations of federal consumer financial laws,[71] its funding through the Federal Reserve System, and the appointment of its Deputy Director. In connection with the first challenge, the *Morgan Drexen* and *ITT* courts held that the Dodd-Frank Act "merely prescribes that the Bureau's constructions of organic law in its subject area are to be given deference, in accordance with the well-established principles first enunciated in *Chevron*."[72] Both courts also summarily dismissed objections to the CFPB's exemption from congressional appropriations on the grounds that Congress is permitted to establish agencies with alternative funding structures.[73] Settled doctrine affirms that the Appropriations Clause only prevents the Executive Branch from spending public money without Congress's permission—it doesn't prevent Congress from providing funding in any manner it sees fit.[74] Although no court has decided whether the Director's authority to appoint the Deputy Director is constitutional, the court in *ITT* opined that the CFPB may be considered a "department" under the Court's definition in *Free*

[71] Under the Dodd-Frank Act, the CFPB's interpretations of federal consumer financial law receive the same deference that they would "if the Bureau were the only agency authorized to apply, enforce, and interpret, or administer the provisions of such Federal consumer financial law." 12 U.S.C. § 5512(b)(4)(B).

[72] *ITT Educ. Servs., Inc.* at *12; *see Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1091.

[73] *See Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1091; *ITT Educ. Servs., Inc.* at *12.

[74] *Morgan Drexen, Inc.*, 60 F. Supp. 3d at 1089.

Enterprise Fund, which would allow Congress to bestow the Bureau's Director with the power to appoint inferior officers.[75]

C. The FSOC and the Treasury's Orderly Liquidation Authority. Big Spring's complaint is comprehensive in its condemnation of the Dodd-Frank Act and incorporates challenges to the Treasury's OLA and the FSOC. With respect to the Orderly Liquidation provision, the complaint alleges that it violates separation of powers principles by providing the Treasury with unbridled discretion to identify companies for liquidation "without either useful statutory guidance or meaningful legislative, executive, or judicial oversight."[76] Moreover, according to Big Spring, the Treasury's procedures infringe companies' Fifth Amendment Rights and the uniformity requirement of Article I, Section 8, Clause 4 by precluding "notice and meaningful opportunity to be heard" and permitting the Treasury to "choose favorites among similarly situated creditors in implementing liquidation."[77]

Big Spring's criticism of the FSOC sounds in a similar register: by offering the FSOC unlimited discretion to designate institutions as "systemically important" and insulating this process from judicial review, the Dodd-Frank Act contravenes the separation of powers.[78] MetLife presents a parallel separation of powers argument in its complaint against the FSOC, which alleges that the Council

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[75] *ITT Educ. Servs., Inc.* at *11. The Constitution provides that Congress may vest the heads of Executive Departments with authority to appoint inferior officers. U.S. Const. Art. II, § 2, cl. 2.

[76] Compl. at 7, *Nat'l Bank of Big Spring*, No 1:12-cv-01032.

[77] *Id.* at 7-8.

[78] *Id.* at 6-7.

"conflat[es] the roles of advocate and adjudicator" by having the same individuals investigate and issue a final decision on eligibility.[79] It then proceeds to assert that the thresholds applied by the FSOC to determine eligibility are unconstitutionally vague in violation of the Fifth Amendment.[80]

These claims, which recall the separation of powers and Fifth Amendment challenges to the CFPB, are also largely disguised non-delegation arguments, and fail for much the same reasons. Furthermore, they are representative of an overarching theme embodied by the plethora of ill-conceived constitutional challenges levied against the CFPB and the Dodd-Frank Act, generally: wariness of the regulatory scheme's novelty. The court in *ITT* emphasized that the Bureau is "no venture into uncharted waters," but a "variation on a theme—the independent regulatory agency with enforcement power—that has been a recurring theme of the modern administrative state."[81] But the Dodd-Frank Act is, in many ways, undeniably innovative. In passing the Act, Congress aimed to prevent another Great Recession by overhauling financial regulation in the United States. By instituting the CFPB, it intended to establish the first agency designed to address regulatory capture. Achievement of these ambitious objectives required Congress to consider agency arrangements that deviated from traditional structures.

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[79] Cross-Motion for Summ J. at 67-68, *MetLife v. Fed. Stability Oversight Council*, No. 1:15-cv-45 (RMC) (D.D.C. June 16, 2015).

[80] *Id.* at 67.

[81] *ITT Educ. Servs., Inc.* at *13.

Novelty, however, is not in and of itself an indicator of unconstitutionality. As the *Mistretta* Court noted in upholding the structure of the Sentencing Commission, "constitutional principles of separated powers are not violated ... by mere anomaly or innovation."[82] Although it may signal that a court should exercise caution, "generalized assault[s] on the unprecedented nature of the Bureau proceed from the mistaken premise that that which is not specifically approved by precedent is forbidden."[83] By treating the Dodd-Frank Act's originality as a mark against its legality, its opponents compromise the presumption in favor of constitutionality and disincentivize innovation designed to make the government both more effective and responsive. We should be celebrating such innovation, not stifling it.

Thank you again for the opportunity to testify. I am happy to answer any of the Committee's questions.

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[82] *Mistretta v. United States*, 488 U.S. 361, 385 (1989).

[83] *ITT Educ. Servs., Inc.* at *11.

Written Testimony of David A. Skeel, Jr.

Before the Committee on Financial Services
United States House of Representatives
September 17, 2015

Chairman Hensarling, Ranking Member Waters, and distinguished members of the Committee, thank you giving me the opportunity to testify before you on "The Dodd-Frank Act Five Years Later: Are We More Free?" My name is David Skeel, and I am the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School. It is a great honor to appear before you today.

I'd like to start by applauding you for conducting this five year retrospective on the Dodd-Frank Act. The Dodd-Frank Act is still young. In fact, some of the estimated 280 rules that the Dodd-Frank Act instructed regulators to promulgate still are not in place. But it seems clear that the Dodd-Frank Act will be the centerpiece of American financial regulation for the next generation, so it's essential to make it as effective as possible.

In my view, the Dodd-Frank Act has a number of features that have significantly improved American financial regulation. More careful regulation of derivatives and other financial contracts was sorely needed, for instance. But its framework for regulating the largest financial institutions—often called systemically important financial institutions, or SIFIs—sharply departs from traditional rule of law principles, carrying forward some of the most problematic qualities of the 2008 bailouts. Today, I'm going to focus on these worrisome features of the Dodd-Frank Act.[1]

As I have written elsewhere, including in a book I finished shortly after the Dodd-Frank Act was enacted, key parts of the legislation reinforce the partnership between the government

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[1] I will not be talking about the Consumer Financial Protection Bureau, which is the principal focus of several other panelists' remarks. In my view, the Consumer Bureau has been a valuable and necessary innovation, though I recognize that it has raised rule of law concerns in some respects.

and the largest banks that was put in place during the financial crisis.[2] This partnership looks a lot like the European style of regulation that is known as corporatism. It is far removed from the rule of law virtues that have traditionally characterized American financial regulation.

In the remarks that follow, I'll briefly describe what I mean by the rule of law and then then quickly recount some of the departures from rule of law principles in 2008-2009. Rather than restoring the rule of law, as one might have expected, the Dodd-Frank Act created a corporatist framework for regulating American finance that invites continued departures from the rule of law. I will focus in particular on four major parts of the regulation: the process for designating financial institutions as systemically important; living wills and stress tests; the Orderly Liquidation Authority in Title II; and the Volcker Rule.

In my view, restoring the rule of law in these four areas would significantly improve the new regulatory framework, and would restore the values we have traditionally associated with American financial regulation.

The Rule of Law

A decade ago, the International Bar Association described the rule of law as "the foundation of a civilized society." The rule of law "establishes a transparent process accessible and equal to all. It ensures adherence to principles that both liberate and protect."[3]

In practice, our commitment to rule of law virtues is supposed to mean at least three things in the context of financial regulation. First, when regulators intervene, their intervention will be governed by legal rules, not simply by discretionary choice. Obviously, discretion exists, and it matters, but the key policy judgments should be made by those who *define* legal rules, not by those who *enforce* such rules. The second implication follows from the first: the provisions in question should have a reasonable measure of specificity. For law to rule, it must define the line between behavior that is permissible and behavior that isn't—not simply declare that the line

[2] DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS UNINTENDED CONSEQUENCES (2011).
[3] Resolution of the Council of the International Bar Association (2005)

exists and leave its definition to regulators and law enforcers. Third, when an individual or institution is alleged to have violated a particular rule, or where regulators intend to seize the institution or its property, the individual or institution must have a full and fair opportunity to respond. The right to due process must be honored.

As explained more fully below, the framework established by the Dodd-Frank Act violates each of these principles, especially in its oversight of systemically important financial institutions. It relies heavily on regulatory discretion, is insulated from effective oversight, and eschews transparency.

The Context: 2008-2009

To appreciate the corporatist tendencies of the Dodd-Frank Act, it is important to begin by briefly revisiting the handling of the 2008-2009 crisis by the Bush and Obama administrations. Many of the patterns established during the crisis, including its major departures from rule of law principles, have been replicated in the Dodd-Frank Act. In part this appears to reflect the remarkable fact that many of the same officials who bailed out several major financial institutions in 2008 also served as principal architects of the Dodd-Frank Act.

Bear Stearns

In March 2008, Bear Stearns, one of the nation's largest investment banks, suddenly collapsed. Bear Stearns' demise began when questions about its liquidity arose, triggered in part by a rumor that Goldman Sachs had refused to renew the daily repo loans it was making to Bear.[4] As hedge funds and other clients withdrew their money, Bear's CEO Alan Schwartz called superlawyer Rodgen Cohen, the chairman of Sullivan & Cromwell, who quickly contacted Timothy Geithner, then-president of the Federal Reserve Bank of New York.[5] After failing to line up new financing, Schwartz contacted the head of JPMorgan Chase and proposed a deal.

[4] *See, e.g.*, Kate Kelly, *Fear, Rumors Touched Off Fatal Run on Bear Stearns*, WALL ST. J., May 18, 2008.
[5] *Id.*

With heavy involvement by Geithner and Treasury Secretary Henry Paulson, including a $29 billion loan guarantee by the Fed, the parties hastily agreed to a purchase of Bear by JPMorgan.[6]

This was no ordinary arms length business transaction. As the two banks gravitated toward a price of $4-$5 per share, Paulson insisted that they lower the price, so that Bear Stearns wouldn't benefit from the bailout.[7] The Fed and Treasury also played an active role in structuring the transaction, which took the form of a merger in which JPMorgan acquired Bear Stearns' stock from its shareholders. To ensure that the government-endorsed transaction could not be disrupted, the parties added lockup provisions that clearly violated Delaware merger law.[8] The key provision promised JP Morgan 49% of stock even if its acquisition fell through, thus making it impossible for a competing bidder to obtain control.[9]

Fannie Mae and Freddie Mac

In July, 2008, then Treasury Secretary Treasurer Paulson urged Congress to pass legislation giving Treasury essentially a blank slate to intervene with Fannie Mae and Freddie Mac if necessary. He assured Congress that he did not expect to need to use the new powers in the foreseeable future. In August, 2008, Treasury gave a massive bailout to the two entities and placed them in conservatorship. Rather the shutting down or restructuring Fannie Mae and Freddie Mac, the government has kept them in conservatorship. In 2012, after Fannie Mae and Freddie Mac had begun earning profits again, the government restructured its agreement with the two entities, creating a "sweep" of the profits that would direct the profits to the Treasury and ensure that private shareholders did not benefit. Fannie Mae and Freddie Mac continue in this state of limbo today. With any profits going the U.S. Treasury, there is little pressure to reform and restructure them.

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[6] *Id.* Kate Kelly, *Bears Stearns Neared Collapse Twice in Frenzied Final Week*, WALL ST. J., May 29, 2008, at A1.

[7] The price was later renegotiated upward to $10 per share after the parties discovered a glitch in the terms of the merger agreement, which could be read as an open-ended commitment by JPMorgan to guarantee Bear Stearns' obligations.

[8] The provisions and the deal are analyzed in detail in Marcel Kahan and Edward B. Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity*, 58 EMORY L.J. 713 (2009).

[9] *Id.*

The AIG Bailout

Two days after Lehman Brothers filed for bankruptcy,[10] AIG, the giant insurance and financial services company, threatened to collapse.[11] The Treasury and Federal Reserve put together a $85 billion bailout package (later expanded to $182.5 billion) to avert a default.[12] The rescue financing had a number of unusual features. Most important for present purposes, it appeared to give the New York Federal Reserve control of nearly 80% of AIG's stock, through trusts set up to facilitate the rescue.[13] The stock feature was noteworthy because the Federal Reserve's emergency lending powers permit it to make loans, but not to buy or sell stock.[14] The Federal Court of Claims recently held that this structure violated the Federal Reserve Act.

TARP and the Car Bailouts

In late September, Treasury Secretary Paulson asked Congress to enact legislation giving the Treasury Department $700 billion to purchase troubled assets held by the banking industry.[15] The direness of Paulson's warnings, and the paucity of details about Treasury's specific plans, terrified the markets.[16] After the House initially rejected the proposed legislation, jolting the markets once again, both houses approved it and President Bush signed the $700 billion Troubled Asset Relief Program into law on October 3, 2008.[17] Although the Treasury

[10] In my view, the biggest mistake of the 2008 crisis was the decision to bail out Bear Stearns rather than allowing it to file for bankruptcy six months before the Lehman Brothers collapse. If Bear Stearns had not been bailed out, Lehman Brothers almost certainly would not have assumed that it could expect a bail out too. Lehman would have prepared for the possibility of bankruptcy, and its filing would not have been nearly so disruptive. *See* SKEEL, THE NEW FINANCIAL DEAL.

[11] The most extensive scholarly analysis of the AIG collapse and bailout is William K. Sjostrom, *The AIG Bailout*, 66 WASH. & LEE L. REV. 943 (2009).

[12] *Id.* at 944-45.

[13] *Id.* at 966.

[14] *See, e.g.*, Eric A. Posner & Adrian Vermeule, *Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of* 2008, 76 U. CHI. L. REV. 1613, 1629-30 (2009).

[15] *See, e.g.*, ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM AND THEMSELVES 490-97 (2009)(paperback 2010).

[16] *See, e.g.*, JOHN B. TAYLOR, GETTING OFF TRACK (2009).

[17] *See, e.g.*, DAVID WESSEL, DAVID WESSEL, IN FED WE TRUST: BEN BERNANKE'S WAR ON THE GREAT PANIC 226-227 (2009)(paperback edition 2010).

Department originally planned to purchase bank's mortgage related assets, it used the funds to provide capital to each of the largest banks.[18]

Paulson insisted that none of the TARP funds would be used to bail out the auto industry. "The TARP is aimed at the financial system," he assured Congress a few weeks after its enactment. "[I]n terms of autos, I have said it would not be a good thing."[19] After an auto bailout proposal was swatted away by Congress, he and the Bush administration changed their minds. They made $17 billion in loans to General Motors and Chrysler, enough to ensure that neither company ran out of cash before the end of the Bush administration and transition to a new administration.[20]

At the outset of his administration, President Obama set up an Auto Task Force to deal with General Motors and Chrysler.[21] After reviewing the companies' own proposals for rejuvenation, the administration ushered each through a "quick rinse" bankruptcy.[22] Rather than use the ordinary restructuring process, which requires a creditor vote and a variety of other protections, each company "sold" its most important assets to a new company set up for this purpose.[23] To finance the process, the Treasury Department lent additional TARP funds to each company. Many commentators, including me, believe that the Chrysler transaction violated basic bankruptcy law doctrine and that its approval set a dangerous precedent for American bankruptcy law.[24]

Dodd-Frank Act Departures from the Rule of Law

[18] *Id.* at 227.
[19] *See, e.g.*, Wendy Jones, *Paulson, Bernanke Testify, Get Grilled*, FIRST READ (NBC), Nov. 18, 2008, *available at* http://firstread.msnbc.msn.com/_news/2008/11/18/4425489-paulson-bernanke-testify-get-grilled (quoting Paulson testimony).
[20] *See, e.g.*, Michael Giusti, *Automakers Receive $17 Billion in Bush Bailout*, BANKRATE.COM, *available at* http://www.bankrate.com/finance/auto/automakers-receive-17-billion-in-bush-bailout-1.aspx.
[21] For a somewhat self-serving inside account of the Auto Task Force's work by its head, see Steve Rattner, *The Auto Bailout: How We Did It*, FORTUNE, Oct. 21, 2009.
[22] *Id.*
[23] The Chrysler transaction is described and criticized in considerable detail, and General Motors more briefly, in Mark J. Roe & David Skeel, *Assessing the Chrysler Bailout*, 108 MICH. L. REV. 727 (2010).
[24] *See, e.g., id.*; David A Skeel, Jr., *From Chrysler and General Motors to Detroit*, 24 WIDENER L.J. 121 (2015).

It is perhaps inevitable that the executive and other branches will be tempted to take liberties with the rule of law during a major financial crisis.[25] But rule of law principles usually are quickly restored after the crisis passes. That didn't happen after the 2008-2009 crisis. The Dodd—Frank Act reinforced many of the patterns established during the crisis. Of most concern, the legislation creates a corporatist-style partnership between the government and the largest banks that seriously undermines the rule of law. These departures have been extremely costly, and could magnify the consequences of the next crisis.

Before I describe these problems in greater detail, I should note that several parts of the Dodd-Frank Act reflect a genuine effort to restore rule of law principles. The Dodd-Frank Act limits the emergency power of the Federal Reserve under section 13(3) of the Federal Reserve Act by prohibiting the Fed from making emergency loans to individual institutions. This limitation is designed to discourage the kinds of bailouts the Fed made in 2008. I worry that the provision will not have its intended effect, but it clearly was designed to reinstitute rule of law principles in this context.

In addition, the Dodd-Frank Act has introduced new clearing and exchange trading requirements, as well as other oversight, for over-the-counter derivatives. These requirements are not perfect, but they have significantly enhanced the transparency and regulatory oversight of derivatives and related financial contracts.

In the discussion that follows, I will focus on four specific areas whether the corporatist structure of the Dodd-Frank Act has invited serious departures from rule of law principles. There are other problem areas, but these are four of the most serious.

Title I designation and oversight

[25] *See, e.g.*, Eric A. Posner & Adrian Vermeule, *Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of* 2008, 76 U. CHI. L. REV. 1613, 1629-30 (2009).

Title I gives bank regulators the authority to designate financial institutions as systemically important. (Although there is no simple definition of systemically important, it generally means that the institution's failure could create a crisis for the broader financial system). Bank holding companies that have more than $50 billion in assets are automatically deemed to be systemically important, and so far, regulators have designated four others as systemically important: AIG, Prudential, GE Capital, and Metropolitan Life.

The designation process raises two serious problems from a rule of law perspective. The first is its direct contribution to the Dodd-Frank Act's corporatist tendencies. Once an institution qualifies as systemically important, regulators are given sweeping oversight authority over it. In theory, these institutions will be subject to stricter regulation, including requirements to fund more of their assets with cash rather than debt. But they also will be singled out for special treatment, and will have a special relationship with bank regulators. This is exactly how corporatism works: the government has sticks that it can use to whack a favored institution if it gets out of line, but in return for doing the government's bidding, the favored institutions are protected from competition.

The second problem is that the designation process is highly arbitrary. The Federal Systemic Oversight Council has unfettered discretion which institutions to designate as systemically important. Although the FSOC has promulgated a rule outlining its designation procedures, the rule imposes few real constraints on the FSOC. The potential abuse of the rule is has been most evident in the FSOC's consideration in the past two years whether to designate large mutual funds or hedge funds as systemically important. Although mutual funds do not appear to create a real threat of systemically destructive consequences, nothing prevents regulators from designating them as systemically important.

The designation process is currently being challenged by Metropolitan Life, which argues that the process by which it was designated is legally flawed.

Living Wills and Stress Tests

Another key feature of Title I is a requirement that institutions that have been designated as systemically important prepare a rapid resolution plan each year. The rapid resolution plan, colloquially known as a "living will," the financial institution must outline how it would pursue an orderly bankruptcy if it falls into financial distress, and minimize the likelihood that its failure could cause systemic harm.

I have been a proponent of living wills, and I continue to support this feature of the Dodd-Frank Act. I believe that the living will process may produce genuine benefits, such as at least a limited simplification of the structures of the largest financial institutions.

But the living will process has been highly opaque. Regulators—in this case the Federal Reserve and the FDIC—have complete discretion whether to accept an institution's living will, or to punish the institution for noncompliance. Although each institution releases a public statement about its living will, the public statements have consisted largely of boilerplate discussion that gives few details about the specifics of the institution's plan.

In the last several years, stress tests and living wills appear to have been the principal regulatory tool used by the Federal Reserve to regulate the largest view. In my view, some of the regulation that has been effected through this process has been quite desirable.[26] But it is regulation that is far removed from the rule of law. There has been almost no transparency. The regulation reflects the priorities and considerations of the regulators themselves, largely detached from any formal, public legal framework.

Title II Resolution

Title II, or the Orderly Liquidation Authority, is designed to give regulators the authority to take over a financial institution whose impending default could cause systemic damage. Based on the FDIC's authority to resolve ordinary banks, Title II gives regulators sweeping discretion whether and when to take over a troubled financial institution, and how to resolve the

[26] For example, the Fed and FDIC appear to have forced the largest banks and the International Swaps and Derivatives Association (ISDA) to incorporate into their derivatives contracts a short standstill on the termination of the derivative in the event an affiliate enters bankruptcy or insolvency proceedings. *See* ISDA 2014 Resolution Stay Protocol (Nov. 4, 2014).

financial distress once regulators have intervene. The discretion vested in regulators in both contexts is far removed from traditional rule of law virtues, and the initiation framework is probably unconstitutional.

At the outset, Treasury is the quarterback of the new resolution process. If the Treasury, backed by two-thirds votes of the Federal Reserve and the FDIC, concludes that a financial company is on the verge of default, or has defaulted, and that its failure "would have serious adverse effect on financial stability in the United States," it can trigger resolution by filing a petition in federal court in Washington, D.C. Judicial review is extremely limited. The court has only twenty-four hours to rule on the petition, the hearing is secret, and the court must approve the petition so long as it was not "arbitrary and capricious" for regulators to determine 1) that the institution was a financial company, and 2) that it was in default or in danger of default. Given that any financial institution that is taken over by regulators will be in danger of default the moment the intervention becomes publicly known, even if it was still healthy the day before the takeover, it will be essentially impossible for any financial institution to challenge the regulators' intervention. The secrecy and speed of the decision makes an effective challenge even more unlikely. The absence of any meaningful opportunity for the financial institution to contest the regulatory takeover appears to violate the U.S. Constitution's Due Process Clause.[27]

After the petition is approved, the FDIC is appointed receiver (other than with investment banks, where the SEC is receiver; and insurance companies, whose receiver is the new federal insurance regulator), and is given extensive authority to borrow money and to take over the company's operations during the receivership. On the surface, Title II seems to have a clear priority structure that limits bank regulators' ability to pick and choose which creditors get paid and which do not. The FDIC is instructed to "ensure that unsecured creditors bear losses in accordance with the priority of claim provisions," and to wipe out shareholders unless all creditors are paid in full.[28] Title II also borrows a cluster of other provisions from bankruptcy, each of which has related rule of law concerns in mind.

[27] For a detailed analysis, see Kenneth E. Scott, *Dodd-Frank: Resolution or Expropriation?*, in BANKRUPTCY *NOT* BAILOUT: A SPECIAL CHAPTER 14 at 199 (Kenneth E. Scott & John B. Taylor, eds, 2012).
[28] Dodd-Frank Act § 206.

Unfortunately, the apparent constraints are a mirage. The priority rules only apply to claims that the FDIC leaves behind-- the ones that it has not decided to pay in full. As with ordinary bank resolution, Title II gives the FDIC blanket authority to pay claims in full if it wishes. Title II also gives the FDIC the authority to abandon the priority rules and make ad hoc payment decisions if the regulators concludes this is necessary for systemic stability. The framework leaves the FDIC free to do nearly anything it wishes.

In the past three years, the FDIC has devised a strategy for resolving systemically important financial institutions that has become known as a "single point of entry" approach. Under single point of entry, the FDIC would put only the holding company of a systemically important financial institution into resolution. It would recapitalize the holding company by transferring the holding company's assets and short term liabilities to a new bridge bank, leaving the holding company's stock and longterm debt behind. This strategy deviates quite significantly from the traditional priority structure, which would treat short-term and longterm debt as equivalent claims, each expected to bear losses.

Although the new strategy strikes me as superior to the rules of Title II as actually written, it is problematic in two respects. First, if the FDIC were more serious about incorporating rule of law virtues into the resolution process, it would disclaim its discretion to pick and choose which creditors to pay, and would commit to the priority structure implied in the single of entry process. But the FDIC has refused to limit its discretion.

Second, Title II explicitly requires that the resolution provisions be used to liquidate troubled financial institutions, not to reorganize them. The "thou shalt liquidate" provision is perhaps the single clearest mandate in the entire Dodd-Frank Act, introduced with much fanfare late in the legislative process. Yet the single point of entry process quite clearly would reorganize the troubled bank, not liquidate it.

The Volcker Rule

A fourth provision that seriously undermines rule of law principles is the Volcker Rule. The Volcker Rule, named for former Federal Reserve Chairman Paul Volcker, who is justly lionized for his role in helping tame inflation in the 1970s, is designed to replicate the New Deal separation of commercial and investment banking by prohibiting bank holding companies from engaging in proprietary trading—that is, trading activities for the bank's own account—and by sharply limiting their investments in hedge funds and equity funds.

Whatever one thinks of the wisdom of the Volcker Rule in theory, it has been disastrous in application and sharply at odds with the rule of law. The central problem is that it is nearly impossible to distinguish proprietary trading from very similar activities such as market-making and trading for clients' accounts that nearly everyone believes bank holding companies should be permitted to engage in. The rule is further hampered by the fact that five different agencies have a role in its implication.

These concerns about Volcker Rule have been amply confirmed by its history since the enactment of the Dodd-Frank Act. Regulators' initial attempt to craft a rule implementing the Dodd-Frank Act included several hundred questions and did not even purport to provide a proposed rule. The Dodd-Frank Act ostensibly required regulators to complete the rule by summer 2012, two years after the enactment of the legislation. The rule was more than a year late, fills well over a hundred pages of the Federal Register, and did not go formally into effect until this summer.

The rule has already proven enormously costly. Many of the largest banks now have new departments devoted largely to Volcker Rule compliance. The Office of the Comptroller of the Currency has estimated that the Volcker Rule will cost $4.3 billion to the institutions that are subject to the regulation, and $413 million to implement.[29] Not only is the Volcker Rule costly in an absolute sense, but the costs fall disproportionately on comparatively smaller banks. The largest banks already have substantial compliance departments, so they are much better able to bear the costs than smaller banks that are subject to the rule.

[29] *See, e.g.*, Jesse Hamilton, *Volcker Rule Will Cost Banks Up to $4.3 Billion, OCC Says*, BLOOMBERG.COM, March 21, 2014.

In the short time that the Volcker Rule has been in place, there already have been reports of illiquidity in the markets for some bonds, since the major banks no longer have nearly as large a portfolio of bonds on hand. Although the seriousness of the problem is debated, it is evidence that the rule is already having negative unintended consequences.

Costs of Departing from the Rule of Law

The costs of these departures from rule of law principles are enormous. Let me briefly mention five.

The first is the costs of the uncertainty created by imprecise regulations and a regulatory framework that depends heavily on regulators' discretion. The financial institutions that are subject to the regulations cannot be sure how they will be applied. As a result, they will incur significant costs trying to protect themselves, and may steer clear of products and transactions that could later be subject to challenge.

Second, there is a real risk that the activities that bank holding companies shed or begin to do less of—such as market making after the promulgation of the Volcker Rule—will end up being pushed into the shadow banking system and performed by entities that are subject to far less regulatory oversight.

Third, the adjustments the banks are making to avoid regulatory complaints appear to be highly inefficient. In my view, the largest financial institutions control too large a portion of the financial services industry. One of the most dangerous consequences of the handling of the 2008 financial crisis, in my view, was a further concentration of an industry that was already highly concentrated. The Dodd-Frank Act has forced the largest banks to shed some of their business—most notably their proprietary trading business. This is a form of downsizing. The problem is that it's the wrong kind of downsizing. Systemically important banks are being forced to retreat from businesses like market making and client services that they handle effectively. Rather than forcing the banks to abandon services they perform efficiently, it would be far better to induce the banks to decide themselves how best to downsize. The Dodd-Frank Act forces the banks to downside both inefficiently and insufficiently, and the risk of regulatory intervention gives the banks a strong incentive to be nontransparent about their operations. Transparency invites intrusion.

Fourth, although the principal target of many of the features of the Dodd-Frank Act that abandon rule of law principles is systemically important financial institutions, a significant portion of the burden falls on the small and medium sized banks that play such an essential role in our economy. Some have pointed to the numerous exceptions the Consumer Financial Protection Bureau has made from its regulatory requirements for small banks as evidence that these banks have not been harmed by the Dodd-Frank Act. In my view, the exceptions have precisely the opposite implication. They confirm that the legislation is highly burdensome for small and medium sized banks. The exceptions reduce a small portion of the burden, but potentially crippling costs remain. As I have already noted, the Volcker Rule also will disproportionately hurt banks that are not systemically important.

The overall imbalance between the largest banks and smaller financial institutions creates serious distortions in the financial services industry. It is likely to discourage innovation. And because small and middle sized banks are the ones that lend to small and middle-sized businesses, it is likely to limit loans to these businesses and act as a drag on the economy.

Finally, the corporatism enshrined in the Dodd-Frank is sharply at odds with the commitment to transparency and competition that has always been the hallmark of American financial regulation. Even apart from the adverse economic effects, it offends our sense of fair play when regulation takes place behind closed doors and with little opportunity for meaningful scrutiny.

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Let me conclude by emphasizing that I would not favor repealing the Dodd-Frank Act. Although I have been very critical of many of its features, both here and elsewhere, I believe that other features have improved American financial regulation. My hope is that you will seriously consider amending the parts of the legislation that are most at odds with traditional rule of law principles, and produce a regulatory framework that will serve us as well as its New Deal predecessor did.

CONGRESSIONAL TESTIMONY

The Rule of Law

and the

Rise of Bureaucratic Government

in the United States

Testimony before the

Committee on Financial Services

United States House of Representatives

September 17, 2015

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Thank you, Mr. Chairman. I commend the committee for holding this series of hearings on the fifth anniversary of Dodd-Frank Wall Street Reform and Consumer Protection Act, and I am honored to testify to you today about the rule of law and the rise of bureaucratic government on the 228th anniversary of the signing of the United States Constitution.

The very meaning and structure of our Constitution embody the great foundational principle of the rule of law. It is fair to say that the rule of law may be the most significant and influential accomplishment of the long history of human liberty. And yet here we are today, covered by a vast web of rules and regulations, endless policies and programs, all emanating from government, mostly the work of vast agencies and bureaucracies that largely operate outside our rule of law structure.

It is no exaggeration to say that the greatest political revolution in the United States since the establishment of the Constitution has been the shift of power away from the institutions of republican government to an oligarchy of unelected experts who rule over virtually every aspect of our daily lives, ostensibly in the name of the American people but in actuality by the claimed authority of science, expertise, and administrative efficiency. In assuming more and more tasks in more and more areas for which it is less and less accountable, modern government has done great damage to American liberty and self-government.

A principle that is quite old and long predates the United States, the rule of law is the general concept that government as well as the governed are subject to the law as promulgated and that all are to be equally protected by the law. Its roots can be found in classical antiquity. The vast difference between the rule of law as opposed to that of individual rulers and tyrants is a central theme in the writings of political philosophers from the beginning. In the works of Plato and as developed in Aristotle's writings, it implies obedience to positive law as well as rudimentary checks on rulers and magistrates.

Throughout most of human history, the rules by which life was governed were usually determined by force or fraud: Those who had the power—whether military strength or political dominance—made the rules. The command of the absolute monarch or tyrannical despot *was* the rule, and had the *coercive* force of the law. Rulers made up false stories of inheritance and rationalizations such as "divine right" to convince their subjects to accept their rule without question. This is still the case in many parts of the world, where the arbitrary rulings of government are wrongly associated with the rule of law.

One only need read Shakespeare to see that Anglo-American history of a thousand years is replete with the often violent back and forth between despotic rule and the slowly developing concept of the rule of law. Impatient English kings regularly sought to evade the rudimentary process of law by exercising the prerogative power and enforcing their commands through various institutions such as the King's Council, the Star Chamber, or the High Commission.

It was Magna Carta in 1215 that first challenged this absolutism and forced the monarch to abide by the mechanisms of law. In its famous thirty-ninth clause, King John of England promised to his barons that "[n]o free man shall be taken, imprisoned, disseized, outlawed, or banished, or in any way destroyed, nor will he proceed against or prosecute him, except by the lawful judgment of his peers and the Law of the Land." The idea that the law is superior to human rulers is the cornerstone of English constitutional thought as it developed over centuries and directly informed the American Constitution.

The Glorious Revolution of 1688 established parliamentary supremacy over the monarch, a crucial step in the development of political liberty. But when that supremacy came to mean complete parliamentary sovereignty and acts of parliament came to be synonymous with the rule of law itself there was no longer any higher, fundamental law to which that legislature was subject and against which its legislation could be judged and held accountable. This became more and more apparent in the decades leading up to the American Revolution. In the Declaratory Act of 1766, Parliament declared it "had, hath, and of right ought to have, full power and authority to make laws and statutes of sufficient force and validity to bind the colonies and people of America, subjects of the Crown of Great Britain, *in all cases whatsoever*." That marked another break with the older principle that the rule of law was above government and provided an overall restraint on government, legislatures just as much as monarchs.

The idea of the rule of law was transferred to the American colonies through numerous writers and jurists, and can be seen expressed throughout colonial pamphlets and political writings. Thomas Paine reflected this dramatically in *Common Sense*:

> But where says some is the king of America? I'll tell you Friend, he reigns above, and doth not make havoc of mankind like the Royal of Britain. Yet that we may not appear to be defective even in earthly honors, let a day be solemnly set apart for proclaiming the charter; let it be brought forth placed on the divine law, the word of God; let a crown be placed thereon, by which the world may know, that so far as we approve of monarchy, that in America THE LAW IS KING. For as in absolute governments the King is law, so in free countries the law ought to be king; and there ought to be no other. But lest any ill use should afterwards arise, let the crown at the conclusion of the ceremony be demolished, and scattered among the people whose right it is.

The classic American expression of the idea comes from the pen of John Adams when he wrote the Massachusetts Constitution in 1780, in which the powers of the commonwealth are divided in the document "to the end it may be a government of laws, not of men."

Over time, the rule of law has come to be associated with four key components.

First, the rule of law means a formal, regular process of law enforcement and adjudication. What we really mean by "a government of laws, not of men" is the rule of men bound by law, not subject to the arbitrary will of others. The rule of law means general rules of law that bind all people and are promulgated and enforced by a system of courts and law enforcement, not by mere discretionary authority. In order to secure equal rights to all citizens, government must apply law fairly and equally through this legal process. Notice, hearings, indictment, trial by jury, legal counsel, the right against self-incrimination—these are all part of a fair and equitable "due process of law" that provides regular procedural protections and safeguards against abuse by government authority. Among the complaints lodged against the king in the Declaration of Independence was that he had "obstructed the administration of justice, by refusing his assent to laws for establishing judiciary powers," and was "depriving us in many cases, of the benefits of trial by jury."

Second, the rule of law means that these rules are binding on rulers and the ruled alike. If the American people, Madison wrote in *Federalist* 57, "shall ever be so far debased as to tolerate a law not obligatory on the legislature, as well as on the people, the people will be prepared to tolerate any thing but liberty." As all are subject to the law, so all—government and citizens, indeed all persons—are equal before the law, and equally subject to the legal system and its decisions. No one is above the law in respect to enforcement; no one is privileged to ignore the law, just as no one is outside the law in terms of its protection. As the phrase goes, all are presumed innocent until *proven* guilty. We see this equal application of equal laws reflected in the Constitution's references to "citizens" and "persons" rather than race, class, or some other group distinction, as in the Fifth Amendment's language that "[n]o person shall . . . be deprived of life, liberty, or property, without due process of law." It appears again in the Fourteenth Amendment's guarantee that "[n]o State shall . . . deny to any person within its jurisdiction the equal protection of the laws." The rights of all are dependent on the rights of each being defended and protected. In this sense, the rule of law is an expression of—indeed, is a requirement of—the idea of each person possessing equal rights.

Third, the rule of law implies that there are certain unwritten rules or generally understood standards to which specific laws and lawmaking must conform. There are some things that no government legitimately based on the rule of law can do. Many of these particulars were developed over the course of the history of British constitutionalism, but they may be said to stem from a certain logic of the law. Several examples can be seen in the clauses of the U.S. Constitution. There can be no "ex post facto" laws—that is, laws that classify an act as a crime leading to punishment after the act occurs. Nor can there be "bills of attainder," which are laws that punish individuals or groups without a judicial trial. We have already mentioned the requirement of "due process," but consider also the great writ of "habeas corpus" (no person may be imprisoned without legal cause) and the rule against "double jeopardy" (no person can be tried or punished twice for the same crime.) Strictly speaking, none of these rules are formal laws but follow from the nature of the rule of law. "Bills of attainder, ex-post facto laws and laws impairing the obligation of contracts," Madison wrote in *Federalist* 44, "are contrary to the first principles of the social compact, and to every principle of sound legislation."

Lastly, even though much of its operation is the work of courts and judges, the rule of law ultimately is based on, and emphasizes the centrality of, lawmaking. This is why, although we have three coequal branches of government, the legislature is the first. But as those who make law are themselves subject to some law above them, this gives rise to the idea that there are different types of laws, some of which are more significant and thus more authoritative than others. The rule of law—especially in terms of key procedural and constitutional concepts—stands above government. By definition and by enforcement it is a formal restraint on government. It judges government in light of a higher standard associated with those ideas. The more authoritative or fundamental laws have an enduring nature. They do not change day to day or by the whim of the moment, and cannot be altered by ordinary acts of government.

This sense is captured in Magna Carta's reference to "the Law of the Land," a phrase written into all eight of the early American state constitutions, as well as the Northwest Ordinance of 1787. It is reflected in the supremacy clause of the United States Constitution: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land." The deep importance of this supremacy is seen in the fact that the oaths taken by those holding office in the United States—the president, members of Congress, federal judges—are oaths not to a king or ruler, or even to an executive or to Congress, but to the United States Constitution and the laws.

The full implications of the constitutional development of the rule of law first appear in the principles and institutions of the American Founding. The key turn in constitutional thinking came with the recognition, initially by John Locke and others but most famously expressed in the Declaration of Independence, of inalienable rights that belong to each person by nature and that legitimate governments are organized and structured to protect according to the consent of the governed. And so the Founders' created a strong, energetic government of limited authority, its powers enumerated in a written constitution and separated into functions and responsibilities, further divided between national and state governments in a system of federalism, all designed to leave ample room for republican self-government.

Liberty is assured not by the anarchy of no government, on the one hand, or the arbitrary rule of unlimited government, on the other, but through a carefully designed and maintained structure of government to secure rights and prevent tyranny through the rule of law. The very form of the Constitution separates the branches in accordance with distinct powers, duties, and responsibilities stemming from the primary functions of governing: to make laws, to execute and enforce the laws, and to uphold (judge or adjudicate) the rule of those laws by applying them to particular individuals or cases. No branch is higher or lower than any other, and no branch controls the others; each is vested with independent authority and unique powers that cannot be given away or delegated to others. The legislative branch is the first among equals, not only because it is the branch most directly representative of popular opinion (being the closest to the people, it best reflects their consent) but also because the very essence of governing according to the rule of law is centered on the legitimate authority to make laws.

The Constitution further supports the rule of law by dividing and checking power. "The accumulation of all powers," Madison explains in *Federalist* 47, "legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny." Because it was not enough to divide power and hope that it remained nicely confined within the written barriers of the Constitution, there needed to be an internal check to further limit the powers of government. But rather than create another coercive authority for that purpose (a dubious proposition to say the least), the Founders divided power and then set it against itself. This separation of powers, along with the further provisions for checks and balances, creates a dynamism within the workings of government that uses the interests and incentives of those in government to enforce constitutional limits beyond their mere statement.

For sure, the Founders understood the need for the good administration of government — an important aspect of their "improved science of politics." But the administration of things was subordinate to the president and more importantly the laws of Congress, and thus responsible to the people through election. As Alexander Hamilton points out in Federalist 68, it is a "heresy" to suggest that of all forms of government "that which is best administered is best." Their objective was to break free of the old despotisms, characterized by the arbitrary will of the stronger, and to establish the rule of law, of limited constitutional government based on consent, and secure the unalienable rights with which man is endowed by "the Laws of Nature and Nature's God."

We can trace the concept of the modern state and its "new science of politics" to the likes of the French philosophes and continental utopians who were deeply enamored with the endless promises of reason and modern science to solve all aspects of the human condition. Just as science brought technological changes and new methods of study to the physical world, so it would bring great change and continuous improvement to society and man. The late-19th-century Progressives took this argument, combined it with ideas from German idealism and historicism, and Americanized it to reshape the old constitutional rule of law model—which was seen as obsolete, inefficient, and designed to stifle change—into a new, more efficient form of democratic government which they called the "administrative state."

While the Founders went to great lengths to preserve consent and limit government through republican institutions and the separation of powers, the progressives held that the Founders' barriers had to be removed or circumvented and government strengthened and expanded through a combination of powers which would concentrate its authority and direct its actions toward achieving progress. And while seeming to advocate more democracy, the first progressives — under a Republican president, Theodore Roosevelt, and then a Democratic one, Woodrow Wilson — pursued the opposite when it came to government action. "All that progressives ask or desire," Wilson wrote in 1912, "is permission — in an era when 'development,' 'evolution,' is the scientific word — to interpret the Constitution according to the Darwinian principle; all they ask is recognition of the fact that a nation is a living thing and not a machine." To encourage democratic change while directing and controlling it, progressives posited a sharp distinction between politics and what they called "administration." Politics would remain the realm of expressing opinions, but the real decisions and details of governing would be handled by administrators, separate and immune from the influence of politics.

The particulars of accomplishing the broad objectives of reform—the details of regulation and many rule-making functions previously left to legislatures—were to be given over to a new class of professionals who would reside in the recesses of agencies like the FCC (Federal Communications Commission), the SEC (Securities and Exchange Commission), the CPSC (Consumer Product Safety Commission), or OSHA (Occupational Safety and Health Administration). As "objective" and "neutral" experts, so the theory went, these administrators would act above petty partisanship and faction, making decisions mostly unseen and beyond public scrutiny to accomplish the broad objectives of policy reform.

The United States has been moving down the path of administrative government in fits and starts for some time, from the initial Progressive Era reforms through the New Deal's interventions in the economy. But the most significant shift and expansion occurred more recently, under the Great Society and its progeny. Whereas initial regulations dealt with targeted commercial activity – railroads, trucking, aviation, banking – there was a turn in the 1970s to broader "social regulation" concerning areas such as the environment, employment, civil rights, and healthcare. The expansion of regulatory activities on a society-wide scale in the 1960s and 1970s led to vast new centralizing authority in the federal government. This new approach, what Daniel Patrick Moynihan called "the policy approach" to governing, now dominates. In its current phase everything — from financial restructuring to environmental regulation to immigration reform — must be dealt with comprehensively, meaning centrally, uniformly, and systemically by an administrative apparatus that is more complicated and expansive than ever.

The Affordable Care Act is a perfect example. Massive regulatory authority over one-sixth of the American economy, not to mention over most health-care decisionmaking, is transferred to a collection of more than 100 federal agencies, bureaus, and commissions, along with new federal programs and an unprecedented delegation of power to the Secretary of Health and Human Services. Little or nothing will be allowed outside the new regulatory scheme — no alternative state programs, no individuals or businesses that choose not to participate, no truly private market alternatives.

Likewise, the Dodd-Frank Wall Street Reform and Consumer Protection Act. Its 2,300 pages require administrative rule-makings reaching not only to every financial institution but well in to every corner of the American economy. Its new bureaucracies, like the Consumer Financial Protection Bureau and the Financial Stability Oversight Council, operate outside of the public eye and are subject to virtually none of the traditional checks. The CFPB is literally outside the rule of law: it has an independent source of revenue, insulation from legislative or executive oversight, and the broad latitude and discretion to determine and enforce its own rulings—as so define the limits of its own authority—based on vague terms left undefined.

The primary function of modern government is to regulate. When Congress writes legislation, it uses very broad language that turns extensive power over to agencies, which are also given the authority of executing and usually adjudicating violations of their regulations in particular cases. The result is that most of the actual decisions of lawmaking and public policy—decisions previously the constitutional responsibility of elected legislators—are delegated to bureaucrats whose "rules" there is no doubt have the full force and effect of laws passed by Congress. In 2014, Congress passed and the President signed about 220 pieces of legislation in to law, amounting to a little over 3,000 pages of law, while federal departments and agencies issued 79,066 pages of new and updated regulations. The modern Congress is almost exclusively a supervisory body exercising limited oversight over administrative policymakers. The rise of the new imperial presidency—acting by discretion, creative interpretation, and executive orders more than legislative direction—should not be surprising given the overwhelming and tempting amount of authority that has been delegated to decision-making actors and bodies ostensibly under executive control.

Modern administrative forms of governing consolidate the powers of government by exercising the lawmaking power, executing their own rules and then judging their application in administrative courts, binding individuals not through legislative law or judicial decision but through case-by-case rulemaking based on increasingly broad and undefined mandates, with more and more authority over an ever wider range of subjects, all the while less and less apparent and accountable to the political process and popular consent.

This idea of enlightened administration is not merely an aspect of modern political life — an extension of the Founders' recognition of the need for good administration, or a necessary adaptation of the existing structure to unanticipated conditions of modern life. It is a new and all-encompassing form of political organization. It represents, as Max Weber and others have argued, the final rationalization of politics. As such, administrative government is not a symptom of modern government. It is the problem.

Nevertheless, in the end, this is not an altogether new form of rule as much as it is the modern equivalent of a very old form that the American Revolution was meant to overthrow. Indeed, 800 years after England's barons forced King John to sign Magna Carta, we are seeing, as Philip Hamburger of Columbia Law school has powerfully argued, the institutionalization of the very forms of prerogative power once practiced by feudal monarchs against which the whole development of the rule of law was directed. The problem with such arbitrary, comprehensive, unchecked power is that it is not administration at all but rule outside of the law, outside of the Constitution and its checks and balances, and outside of and thus not responsive to our democratic institutions of government. We should all – Republicans and Democrats alike – recognize and fear this new state of things, whether it takes the particular form of Dodd-Frank Act or any other policy matter coming from the Left or the Right. If the administrative rule now threatening to overwhelm American society becomes the undisputed norm — accepted not only among the academic and political elites, but also by the American people, as the defining characteristic of the modern state — it could well mark the end of our great experiment in self-government.

Thank you.

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Founded in 1844, Hillsdale College is an independent, coeducational, residential, liberal arts college with a student body of about 1,400. Its four-year curriculum leads to the bachelor of arts or bachelor of science degree, and it is accredited by the Higher Learning Commission. Its doors are open to all, regardless of race or religion. It was the first college in Michigan, and the second in the United States, to admit women on par with men. Its cosmopolitan student body is assembled from homes in 47 states and 8 foreign countries.

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GEORGE MASON UNIVERSITY SCHOOL OF LAW

LAW & ECONOMICS CENTER

THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE FREER?

September 17, 2015

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Unites States House of Representatives
Committee on Financial Services

Thank you chairman Hensarling, ranking member Waters, and members of the committee. It is my pleasure to testify this morning on the question of "The Dodd-Frank Act Five Years Later: Are We Freer?"

Freedom and an effective financial services system go together. Freedom to gain access to capital to start and grow a business, freedom to buy a home and provide for your family's financial security, freedom to choose those whom you entrust with your hard-earned money provide the means for pursuing the American dream.[1]

The recent financial crisis reveals four lessons that highlight the importance of upholding the rule of law during periods of financial crises in order to preserve individual freedom:

- Adherence to the rule of law during the crisis is crucial to allow the economy to restore coordination after a period of eocnomic dislocation.
- Adherence to the rule of law during the crisis is necessary to restrain opportunism by politicians and special interests tempted to use the opportunity presented by the crisis to piggyback satisfaction of their own narrow—and often unrelated—interests.
- Once discretion and political favoritism are unleashed during the crisis, history tells us that the dissipation of the crisis does not bring with it a restoration of the rule of law. Instead there is a sort of "ratchet effect," by which the power seized during the crisis is entrenched in the post-crisis regulatory regime.
- Once discretion and the government's power to pick winners and losers arbitrarily is entrenched, this institutional framework creates moral hazard for policians and

[1] *See* THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN, AND TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY (Oxford, 2014).

special interests that creates the conditions for the next crisis, to be met by similar means.

The world of Dodd-Frank exemplifies this progression. The freedom to plan your financial future, buy a home, or open a bank account, is being crushed under an avalanche of costly and arbitrary rules and a regulatory system so complex that only well-lawyered multi-billion dollar banks can survive. On issues ranging from which financial insitutions are considered "Too-Big-To-Fail" to the loan terms of your new car, a handful of unelected Washington bureaucrats are prying into your wallet and bank account to make those decisions for you.

The Impact of Dodd-Frank on Freedom: The Regulatory Burden

In the new world of Dodd-Frank, the success of a financial institution no longer is determined by which banks can serve you best in a competitive market. Instead, it is determined by which institutions can best wind their way through the labyrithian halls of Congress and the Federal Reserve Board.

According to one widely-cited estimate, Dodd-Frank requires 398 new rulemaking by federal agencies[2] and as of July 2014 (when one-quarter of the rulemakings were still left to be completed) Dodd-Frank was estimated to have imposed $21.8 billion and 60.7 million paperwork hours in compliance costs to date[3]. Projecting forward, it is estimated by one economist that over the next 10 years the full compliance costs of Dodd-Frank will result in $895 billion in reduced Gross Domestic Product or $3,346 per working-age person.[4] And these compliance cost estimates do not include all of the costs and burdens of complying with the various guidances, informal actions, and other measures that federal regulators impose on financial institutions and their customers.

But to consider only the economic costs of Dodd-Frank doesn't consider another more intangible cost: Americans are *less free* as a result of Dodd-Frank and what it has spawned. In particular, the financial crisis and the legislation and regulation that has followed in its wake have weakened the rule of law, centralized vast amounts of authority in the hands of unaccountable political bureaucracies, unleashed arbitrary regulatory discretion, and empowered interest groups beyond any time in American history. Moreover, not only did the unleashing of political discretion help to create and worsen the last crisis, by entrenching rather than limiting political discretion, Dodd-Frank and the regulatory norms it embodies, has created moral hazard that is laying the foundation for the next financial crisis.

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[2] Davis Polk, *Dodd-Frank Progress Report*, http://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/.
Robert Romano, *Dodd-Frank's Regulatory Morass*, PENN PROGRAM ON REGULATION REGBLOG (Nov. 10, 2014), *available in* http://www.regblog.org/2014/11/10/romano-dodd-frank-consequences/.
[3] Andy Winkler, Ben Gitis, and Sam Batkins, *Dodd-Frank at 4: More Regulation, More Regulators, and a Sluggish Housing Market* (July 15, 2014), *available in* http://americanactionforum.org/research/dodd-frank-at-4-more-regulation-more-regulators-and-a-sluggish-housing-mark.
[4] Douglas Holz-Eakin, *The Growth Consequences of Dodd-Frank* (May 6, 2015), *available in* http://americanactionforum.org/research/the-growth-consequences-of-dodd-frank.

Why the Rule of Law Matters During a Financial Crisis

To make a loan, a bank must be able to do two things.[5] It must be able to price the risk of the loan accurately in light of its risk of loss, such as by adjusting the interest rate, downpayment, or other terms of the loan. If the lender cannot price the risk of loss accurately, then the lender must reduce its risk expoosure, either by limiting those to whom it lends (such as refusing to lend to higher-risk borrowers) or by lending less to the same people (such as by reducing available credit lines).

Economic uncertainty interferes with the ability of lenders and borrowers to accurately assess the full risk and cost of making loans and conducting commerical activity. As a result, economists have uniformly found that adherence to the rule of law is an essential condition for economic prosperity, democratic governance, and civil liberties.[6] Moreover, the rule of law serves as a barrier to government corruption and rent-seeking by powerful special interest groups. By ensuring equal and transparent treatment of everyone, the rule of law constrains the discretion to arbitrarily pick winners and losers that provides the engine and incentives for political corruption.[7]

Adherence to the rule of law is especially important during periods of economic dislocation, such as during the financial crisis. Duting such times, billions of decentralized individual decision-makers need to reestablish coordination of their affairs, to make decisions to work, invest, hire, and the like. When other elements of the economic system are in greater flux, adherence to the bedrock predictability of the rule of law takes on special institutional significance.

Instead, the federal government responded erratically and unpredictably during the financial crisis, thereby exacerbating uncertainty and confusion, such as by deciding to bail out Bear Stearns but not Lehman Brothers and attaching different and arbitrary conditions to each subsequent bailout. In so doing, the government's departure from rule of law values worsened the financial crisis and continues to hamper the economy's return to economic stability. As David Skeel has shown, one reason for the catastrophic nature of Lehman Brothers' failure was that the firm—counting on a government bailout—rejected a merger offer as insufficiently generous.[8] Indeed, as several prominent scholars have observed, it likely was not Lehman's failure that spooked the markets, but rather Treasury Secretary Hank Paulson's panicked response to Lehman's failure.[9] As noted by Richard Kovacevich, CEO of Wells Fargo during the financial crisis, prior to TARP and a month after the Lehman bankruptcy, "markets had declined but were still behaving

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[5] *See* Todd J. Zywicki, *Economic Uncertainty, the Courts, and the Rule of Law*, 35 HARV. J. OF L. & PUB. POL'Y 195 (2012).

[6] *See* Todd J. Zywicki, *The Rule of Law, Freedom, and Prosperity*, 10 S. CT. ECON. REV. 1 (2003).

[7] *Id.*

[8] DAVID A. SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES (2011).

[9] PETER J. WALLISON, BAD HISTORY, WORSE POLICY: HOW A FALSE NARRATIVE ABOUT THE FINANCIAL CRISIS LED TO THE DODD-FRANK ACT (2013); JOHN B. TAYLOR, GETTING OFF TRACK: HOW GOVERNMENT ACTION AND INTERVENTIONS CAUSED, PROLONGED, AND WORSENED THE FINANCIAL CRISIS (2009).

reasonably well, except for those financial institutions that were having liquidity issues."[10] It was only when TARP was announced—and critically, when the government strong-armed *all* big banks into taking bailout money, even those that didn't want it—that "isolated liquidity issues turned into a tsunami impacting all banks and all industries." In short, the TARP *created* the very panic that bailout apologists contend that the TARP supposedly stemmed.[11]

Political Opportunism and the Rule of Law

Adherence to the rule of law is especially important during periods of crisis because that is the time when potential for political opportunism by politicians and interest groups is most dangerous. The actual operation of the government's response to the financial crisis shows the reality of how politicians and special interests use power and political connections unrestrained by the rule of law for their benefit.

Consider the infamous TARP program, which was authorized to provide a temporary bail out for illiquid banks that needed short-term help, but not insolvent banks. The task of distinguishing between illiquid and insolvent banks, however, was not an easy one and required great discretion by those making those decisions. Several economists have subsequently studied how bail out funds were allocated and they have uniformly reached the same conclusion: that bailout funds were directed to banks with "political clout, not those most in need of liquidity."[12] Banks that lobbied the most, contributed the most money to political campaigns, or had former banking regulators or Treasury Department officials on their boards of directors were significantly more likely to receive bailout funds than less-politically connected banks, even where those other banks ostensibly met the TARP's requirements more closely.[13]

Similarly, as I have discussed elsewhere, the entire taxpayer loss in the illegal diversion of TARP funds to General Motors and Chrysler is attributable to preferential treatment provided in those bankruptcy proceedings to the United Auto Workers and various other politically-powerful labor unions that had nothing to do with furthering the financial recovery of those companies.[14] Moreover, the government's intervention in the auto bailouts provided a field day for political opportunism. Politicians used the strings supplied by taxpayers' largesse to influence ordinary business decisions ranging from preventing the closure of particular obsolete manufacturing facilities that happened to be

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[10] Richard J. Kovacevich, *The Financial Crisis: Why the Conventional Wisdom Has It All Wrong*, 34(1) CATO J. 541 (2014).
[11] *See* Todd J. Zywicki, *The Rule of Law During Times of Economic Crisis* (Aug. 26, 2015), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2651893.
[12] Jim F. Couch, Mark D. Foster, Keith Malone, and David L. Black, *An Analysis of the Financial Services Bailout Vote*, 31 Cato Journal 119 (2011), online at http://object.cato.org/sites/cato.org/files/serials/files/cato-journal/2011/1/cj31n1-8.pdf.
[13] For a summary of these studies, *see* Todd J. Zywicki, *Rent-Seeking, Crony Capitalism, and the Crony Constitution*, SUP. CT. ECON. REV. (Forthcoming 2016), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2651587 (Aug. 26, 2015).
[14] *See* Todd Zywicki, *The Corporatist Legacy of the Auto Bailouts*, LAW & LIBERTY BLOG (Jan. 13, 2014), *available in* http://www.libertylawsite.org/2014/01/13/the-corporatist-legacy-of-the-auto-bailouts/.

located in a particular politician's electoral district; to the identity of suppliers of raw materials; to providing secret financial incentives for Fiat to manufacture "green" cars after the government ordered Chrysler to be given away for free to the Italian automaker.[15] Although American automakers have returned to profitability since they were bailed out, this has been *despite* the government's influence, as low gasoline prices have driven a boom in sales of pickup trucks and other larger vehicles, not the small cars urged by government central planners during the bailout process.[16]

The case study of the auto bailouts also provides a particularly illuminating illustration of why upholding the rule of law matters to both short-term and long-term freedom and prosperity. The primary losers from the government's intervention in the Chrysler bankruptcy case were holders of Chrysler's secured corporate bonds, including the Indiana state teachers and police retirement funds. While secured creditors typically would be paid in full before unsecured creditors, in that case secured creditors received only 29 cents on the dollar while UAW's underfunded health-care VEBA plans received over 40 cents on the dollar.[17]

But the full cost of the government's intervention was not just the direct costs to investors such as Indiana's taxpayers and public employees, there was also an *indirect* cost to the economy from this egregious violation of the rule of law. As I wrote at the time,

> By stepping over the bright line between the rule of law and the arbitrary behavior of men, President Obama may have created a thousand new failing businesses. That is, businesses that might have received financing before but that now will not, since lenders face the potential of future government confiscation. In other words, Mr. Obama may have helped save the jobs of thousands of union workers whose dues, in part, engineered his election. But what about the untold number of job losses in the future caused by trampling the sanctity of contracts today?[18]

Unfortunately my prediction has proven sound: subsequent economic analysis of the long-term effects of plundering Chrysler's secured creditors found that in the wake of the government's action, firms in heavily-unionized industries saw decreased bond prices and increased bond yields, "consistent with the government's intervention in the Chrysler bankruptcy increasing lenders' assessment of the risk of lending to firms with a strong

[15] Todd Zywicki, *The Auto Bailouts and the Rule of Law*, 7 NATIONAL AFFAIRS (Spring 2011), *available in* http://www.nationalaffairs.com/publications/detail/the-auto-bailout-and-the-rule-of-law.
[16] *See* Zywicki, *Corporatist Legacy*, *supra* note 14.
[17] *See* Zywicki, *supra* note 15. This also ignores the still-unexplained decision of bailout operatives to terminate the pension plans of Delphi's white collar employees as part of that company's bankruptcy case. *See* SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM, TREASURY'S ROLE IN THE DECISION FOR GM TO PROVIDE PENSION PAYMENTS TO DELPHI EMPLOYEES (Aug. 15, 2013), *available in* https://www.sigtarp.gov/Audit%20Reports/SIGTARP_Delphi_Report.pdf.
[18] *See* Todd J. Zywicki, *Chrysler and the Rule of Law*, WALL ST. J. (May 13, 2009).

labor presence, leading to a signficiant increase in borrowing costs for those firms."[19] By destabilizing contracts to benefit a powerful special interest, the government created a cloud of political risk over financial markets and the economy.

The End of the Crisis Does Not Bring About the Restoration of the Rule of Law

Still another cost of deviations from the rule of law *during* a financial crisis in the name of claimed "emergency" is that the abatement of the crisis does not bring about a subsequent restoration of the rule of law. Instead, as we have seen, the post-crisis period produces a codification and consolidation of government discretion, making it a long-term element of the economy and society. Although having the superficial appearance of a statute, Dodd-Frank's 2,300 pages of legislation largely enshrines much of the arbitrariness and lawlessness that characterized the government's activities during the crisis. For example, it gives the government virtually unreviewable authority to seize what it deems to be failing financial institutions and to deem certain institutions but not others to be "systematically risky"—although it nowhere defines the criteria that qualify a firm as "systemically risky" and provides limited judicial review of the government's actions.

Three striking examples of the post-crisis regulatory environment illustrate the erosion of the rule of law: the adverse effect of Dodd-Frank on small banks, the execution of Operation Choke Point which limited access to financial services for politically disfavored industries, and the activities of the Consumer Financial Protection Bureau (CFPB).

Disappearing Small Banks

One well-documented effect of Dodd-Frank has been to promote consolidation of the banking industry by driving out smaller community banks that comparatively lack the resources to comply with Dodd-Frank's crushing and ham-fisted regulatory burden. For example, a recent study by scholars at the Kennedy School of Government found that in the period since Dodd-Frank was enacted, the asset bases of smaller banks have shrunk twice as fast as those of large banks, a result that they attribute to the high regulatory costs imposed by Dodd-Frank.[20] In addition, a detailed Mercatus Center study of the impact of Dodd-Frank on smaller banks has found that the law has imposed huge compliance costs on small banks and that they have been less able to bear those costs than large banks.[21]

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[19] Bradley Blaylock, Alexander Edwards, and Jared Stanfield, *The Role of Government in the Labor-Creditor Relationship: Evidence from the Chrysler Bankruptcy*, 50(3) J. OF FINANCIAL AND QUANTITATIVE ANALYSIS 325, 327 (June 2015).

[20] Marshall Lux and Robert Greene, *The State and Fate of Community Banking*, M-RCBG Associate Working Paper No.37 (February 2015) online at http://www.valuewalk.com/wp-content/uploads/2015/02/Final_State_and_Fate_Lux_Greene.pdf.

[21] Hester Pierce, Ian Robinson and Thomas Stratmann, *How Are Small Banks Fairing under Dodd-Frank?*, George Mason University Mercatus Center Working Paper No. 14-05 (February 2014) online at http://mercatus.org/publication/how-are-small-banks-faring-under-dodd-frank; *see also*

By replacing fair and free marketplace competition for consumer loyalty with competition to best engage in regulatory arbitrage, Dodd-Frank is restricting consumer freedom of choice and innovation. This impact is most noticeable with respect to mortgages. According to the Mercatus Center study, 64 percent of small banks reported that they were making changes to their mortgage offerings because of Dodd-Frank and 15 percent said that they had either exited or were considering exiting residential mortgage markets entirely.[22] Nearly 60 percent of small banks reported that the CFPB or the qualified mortgage rule had a "significant negative impact" on their mortgage operations. Nearly 60 percent said that the CFPB has had a significant negative effect on bank earnings and more than 60 percent said that changes in mortgage regulations had had a significant negative effect on bank earnings.

Moreover, by imposing a one-size-fits-all mechanical underwriting system for mortgages, the Qualified Mortgage rule has deprived community banks of a significant competitive advantage against megabanks: their intimate familiarity with their customers and their ability to engage in relationship lending with their customers. Consumers face a market with fewer choices, less innovation, and less competition than before.

As smaller banks have been disappearing and exiting certain markets, large banks have grown still larger and Dodd-Frank has increased their insulation from competitive pressures. In fact, large banks have admitted as much. For example, JP Morgan Chase CEO Jamie Dimon observed that the aggregate costs of complying with all of the rules, regulations, and capital costs associated with Dodd-Frank has built a "bigger moat" to protect his bank from competition from smaller rivals.[23] Similarly, Goldman Sachs CEO Lloyd Blankfein announced in 2010 that the bank would be "among the biggest beneficiaries" of Dodd-Frank as its regulatory costs and regulatory-created profit opportunities would be particularly advantageous to large banks that could bear those costs more easily than smaller competitors.[24]

Targeting Businesses by Operation Choke Point and the CFPB

In the post-Dodd-Frank era, the vast, ill-defined sway that regulators exercise over banks has enabled them to not only pick winners and losers in the financial system but to also use their clout to force banks to do their bidding outside of the formal regulatory process. Indeed, in some instances government regulators have essentially deputized banks as arms of the federal government, directing banks to attack private parties engaged in legal activities—without evidence of wrongdoing or the public scrutiny that a direct government action would bring. Consider two examples that demonstrate the point:

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[22] *Id.*

[23] Rick Rouan, *Dimon says Dodd-Frank puts 'bigger moat' around JPMorgan Chase*, COLUMBUS BUSINESS FIRST (Feb. 5, 2013), *available in* http://www.bizjournals.com/ columbus/blog/2013/02/dimon-says-dodd-frank-puts-bigger.html.

[24] Timothy P. Carney, *Goldman and JPMorgan sit safely behind the walls of Dodd-Frank*, WASHINGTON EXAMINER (Feb. 12, 2015), *available in* http://www.washingtonexaminer .com/goldman-and-jpmorgan-sit-safely-behind-the-walls-of-dodd-frank/article/ 2560179.

Operation Choke Point and the Consumer Financial Protection Bureau's initiative against auto dealers for purported disparate impact in lending rates.[25]

Operation Choke Point

Consider first the shadowy initiative known as Operation Choke Point, which seems to have been spearheaded by the Department of Justice and the Federal Deposit Insurance Corporation (FDIC). Under Operation Choke Point, government regulators targeted myriad legal, but politically unpopular industries, such as firearms dealers, coin dealers, pornography, sellers of "racist materials," home-based charities, and most intensely, payday lending.[26] The FDIC, of course, had no jurisdiction over these industries and absent any demonstrable wrongdoing, the DOJ could not outlaw them either. Yet these limitations did not stop them.

Instead, the FDIC instructed regulated banks to cease providing banking services to these particular industries, with special attention paid to payday lenders, to "choke off the air" needed for these firms and industries to function.[27] Without the ability to clear checks and process electronic payments, payday lenders and other targeted firms simply could not exist and conduct business. Notably, the government's instructions were issued without any evidence that any of the industries on the affected list had done anything illegal, with no due process to the adversely affected firms, and, indeed, with a complete lack of transparency, including a reluctance to even admit except under pressure that the initiative even existed. Equally notable was the selective nature of the government's list of controversial industries that created "reputation risk" for banks, which included industries such as firearms sales but ignored other controversial industries such as abortion clinics. In one particularly colorful example of the lawless nature of the program, a senior official in the Division of Depositor and Consumer Protection instructed that any communications by FDIC Chairman Martin Gruenberg "always mention pornography when discussing payday lenders and other industries, in an effort to convey a 'good picture regarding the unsavory nature of the businesses at issue.'"[28] Aggressive oversight by Congress eventually persuaded FDIC to withdraw its list of

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[25] The following discussion draws from Zywicki, *supra* note 13.

[26] The entire list of targeted industries was promulgated informally by the FDIC in U.S. House, Committee on Oversight and Government Reform, *The Department of Justice's "Operation Chokepoint": Illegally Choking Off Legitimate Businesses?* Staff Report 113th Congress at 11 (May 29, 2014) online at http://oversight.house.gov/wp-content/uploads/2014/05/Staff-Report-Operation-Choke-Point1.pdf.

[27] See, e.g., Letter from M. Anthony Lowe, Director, FDIC Chicago Regional Office to Board of Directors of [Redacted] Bank (Feb. 15, 2013), *available at* http://oversight.house.gov/wp-content/uploads/2014/10/Regional-Director-Letter.pdf (stating that providing banking services to payday lending companies "carries a high degree of risk to the institution, including third-party, reputational, compliance, and legal risk" and that as a result "activities related to payday lending are unacceptable for an insured depository institution").

[28] U.S. House, Committee on Oversight and Government Reform, *Federal Deposit Insurance Corporation's Involvement in "Operation Choke Point,"* Staff Report 113th Congress at 1 (December 8, 2014) online at http://oversight.house.gov/wp-content/uploads/2014/12/Staff-Report-FDIC-and-Operation-Choke-Point-12-8-2014.pdf.

target industries and to formally claim that it was terminating Operation Choke Point,[29] but news reports indicate that it might still be continuing and that its implementation has simply shifted to the CFPB[30].

CFPB and Alleged Discrimination by Auto Dealers

A second example is the effort of the CFPB to enforce fair lending laws on auto dealers for the loans that they issue. Fair lending laws that prohibit discrimination in making loans apply to auto dealers. It is equally clear, however, that Dodd-Frank prohibits the CFPB from exercising jurisdiction over loans made by auto dealers, leaving that responsibility by implication to other federal agencies such as the Federal Trade Commission and DOJ.[31]

Lacking the authority to reach the auto dealers, the CFPB came up with a creative solution—it decided to hold the financial institutions (the indirect lenders) responsible for any alleged discriminatory lending patterns by the auto dealers themselves. Indirect lenders bear this responsibility even though they have no interaction with the borrower, information about the borrower's race, or any reason to believe that the dealers is engaged in discriminatory lending patterns. Moreover, the indirect lenders would be held responsible according to the theory of "disparate impact," making the indirect lenders responsible for any statistical anomalies that seemed to exist, regardless of the lack of any evidence of intentional discrimination.[32]

Both of these examples demonstrate the hazards of the absence of the rule of law in the modern financial regulatory system as the federal government has essentially weaponized America's financial institutions to carry out policies that it couldn't otherwise accomplish. Moreover, much of the policymaking is done in back rooms with no other formal protections or transparency. For example, Operation Choke Point was a secretive government program the very existence of which proved difficult to confirm, much less its details and implementation (it isn't even clear today whether the program continues

[29] See Kent Hoover, *FDIC removes Operation Choke Point's 'hit list,' clarifies guidance to Banks*, The Business Journals (July 29, 2014) online at http://www.bizjournals.com/bizjournals/washingtonbureau/2014/07/fdic-removes-operation-choke-points-hit-list.html.

[30] See Rachel Witkowski, *CFPB Launches Its Own Choke Point-Style Operation*, American Banker (April 8, 2015) online at http://www.americanbanker.com/news/law-regulation/cfpb-launches-its-own-choke-point-style-operation-1073659-1.html.

[31] Dodd-Frank Wall Street Reform and Consumer Protection Act § 1029(a), Pub.L 111-203, H.R. 4173 (2010).

[32] Lacking information on the borrower's race, the CFPB has instead relied on a statistical technique known as Bayesian Improved Surname Geocoding, which has been demonstrated to be statistically invalid in a highly analogous context. *See* Arthur P. Baines and Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market*, American Financial Services Association (November 19, 2014), *available in* http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf. The absence of any demonstrable victims of discrimination has also created difficulties for the CFPB in deciding to whom do distribute the proceeds of its various legal settlements under this theory. See *Do Two Half Victims Make a Whole Case?*, WALL ST. J. (Apr. 13, 2015), *available in* http://www.wsj.com/articles/do-two-half-victims-make-a-whole-case-1428966741.

and if so, which agency is executing it). The CFPB's attack on indirect auto lenders was issued through a five page "Guidance" document that provided no information about the basis for the CFPB's charge of discrimination or, originally, any methodology for determining liability, no opportunity for public comment or other due process protections, and no assessment of the impact on consumers.[33] In fact, according to a recent report in the *Wall Street Journal*, by narrowing the range over which dealers and consumers can bargain, the overall effect of the CFPB's micro-managing of the auto finance market has resulted in higher interest rates on car loans for consumers.[34] Meanwhile, those entities that are politically disfavored, such as payday lenders and firearms dealers, are crushed with no due process and no opportunity to defend themselves in any transparent regulatory proceeding.

The arbitrary exercise of regulatory authority has real-world consequences for consumers and the economy. For example, the complexity and risk under the Qualified Mortagages rule when combined with the threat of "put back" liability for loans based on trivial technical violations has led several leading mortgage lenders to exit the market for borrowers with lower credit scores.[35] As John Sumpf, the chief executive of Wells Fargo stated, "If you guys want to stick with the programme of 'putting back' any time, any way, whatever, that's fine, we're just not going to make those loans and there's going to be a whole bunch of Americans that are underserved in the mortgage market."[36] Similarly, Federal Reserve Chairwoman Janet Yellen has observed, "Banks, at this point, are reluctant to lend to borrowers with lower FICO scores. They mention in meetings with us consistently their concerns about put-back risk, and I think they are—it is difficult for any homeowner who doesn't have pristine credit these days to get a mortgage."[37]

Government power unconstrained by the rule of law also has direct implications for consumers by cultivating an environment of bureaucratic hubris at the expense of the rest of us. Consider the CFPB's extraordinary data mining program of American families' financial accounts. According to a report by the Government Accountability Office, the CFPB collects information on 10.7 million individual consumer credit reports on a monthly and quarterly basis, more than 500 million credit card accounts on a monthly basis, and 29 million active mortgages and 173 million total mortgages on a monthly

[33] Consumer Financial Protection Bureau, *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act*, CFPB Bulletin 2013-02 (March 21, 2013), *available in* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

[34] *See* Annamaria Andriotis & Gautham Nagesh, *Crackdown on Racial Bias Could Boost Drivers' Costs for Auto Loans*, WALL ST. J. (Aug. 31, 2015), http://www.wsj.com/articles/crackdown-on-racial-bias-could-boost-drivers-costs-for-auto-loans-1441038864. The CFPB ignores other important elements of the inquiry especially that, unlike many other credit transactions, a car loan from an auto dealer is not a stand-alone transaction but is linked to the purchase of a car. For example, auto dealers offer promotional financing deals on particular car models in order to move inventory (rather than cutting the sticker price), which can result in spurious implications of differential pricing overall.

[35] *See* Camilia Hall, *Wells Chief Warns on Mortgage Lending* (Aug. 26, 2014), *available in* http://www.ft.com/intl/cms/s/0/cdfe20f8-2a2d-11e4-a068-00144feabdc0.html#axzz3lZKUva3B.

[36] *Id.*

[37] *Id.*

basis.[38] Moreover, because this data-mining program was not initiated according to any sort of formal notice and comment rulemaking procedure, it is not subject to cost-benefit analysis or any other evaluation as to whether such extensive snooping is necessary to further any legitimate regulatory purpose. In fact, George Mason University economist Thomas Stratmann has estimated that the number of credit card accounts for which the CFPB wants to collect consumer information is some 70,000 times greater than is necessary for the agency to execute its regulatory mission.[39] Indeed, the Bureau itself has refused to permit consumers an opportunity to opt-out of the program, admitting that if consumers were permitted to withdraw consent to the program the government would be unable to obtain the data.[40]

But the costs of CFPB's demand for information do not fall solely on the banks that must provide it. While the CFPB claims that this data is anonymous, every bit of information increases the risk to consumers of identity theft and other misuse of their information. In fact, testifying before this committee last year, CFPB director Richard Cordray admitted that the information the CFPB collects is not 100 percent secure and could be hacked.[41] Moreover, according to a recent article in *Science*, using only three months of anonymous credit card data, the researchers were able to reidentify 90 percent of individuals, with women being more readily reidentifiable than men.[42]

While the unnecessary acquisition and retention of troves of Americans' information is troubling enough in itself, it is especially worrisome in light of repeated rebukes of the CFPB's faulty data security systems.[43] Following massive data security breaches and compromising of personal information by the Internal Revenue Service and Office of Personnel Management, it is inexplicable that the CFPB continues to insist on vacuuming up excessive amounts of consumer data without considering the privacy threat to consumers. Leaving aside the risk of creating a massive trove of financial data for private hackers to target, Americans also have a fundamental interest in not having their purchases tracked by the federal government and an expectation that the government should not demand any more personal financial data than is necessary to advance its legitimate regulatory purposes.

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[38] GOVERNMENT ACCOUNTABILITY OFFICE, CONSUMER FINANCIAL PROTECTION BUREAU: SOME PRIVACY AND SECURITY PROCEDURES FOR DATA COLLECTIONS SHOULD CONTINUE BEING ENHANCED (2014).
[39] *See* Letter of Professor Thomas Stratmann to Congressman Scott Garrett (Jan. 23, 2014), *available in* http://mercatus.org/sites/default/files/StratmannCFPBStatisticMethods.pdf.
[40] *See* Richard Pollock, *Federal Consumer Bureau Data-Mining Hundreds of Millions of Consumer Credit Card Accounts, Mortgages*, WASHINGTON EXAMINER (Jan. 29, 2014), *available in* http://www.washingtonexaminer.com/consumer-bureau-data-mining-hundreds-of-millions-of-consumer-credit-card-accounts-mortgages/article/2543039.
[41] *Id.*
[42] Yves-Alexandre de Montjoye, Laura Radaelli, Vivek Kumar Singh, and Alex "Sandy" Pentland, *Unique in the Shopping Mall: On the Reidentifiability of Credit Card Metadata*, 347 SCIENCE No. 6221 536-39 (Jan. 30, 2015).
[43] *See* Government Accountability Office, *Consumer Financial Protection Bureau: Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced* (Sept. 2014); Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Office of Inspector General, *Security Control Review of the CFPB's Cloud Computing–Based General Support System*, 2014-IT-C-010 (Washington, D.C.: July 17, 2014).

Moral Hazard and the Rule of Law

The erosion of the rule of law creates a problem for the future: because of the government's demonstrated unwillingness to abide by the rule of law—and the courts' unwillingness to force it to do so in the midst of a financial crisis[44]—the government is unable to credibly commit itself to *not* use its authority to intervene in the economy, to bail out large banks, and to exercise its authority in a political fashion.

Thus, at the same time that smaller banks are being ground under Dodd-Frank's regulatory wheel, there is a general consensus that Dodd-Frank has failed to address the most fundamental regulatory problem highlighted by the financial crisis: financial institutions that are considered "Too-Big-To-Fail" are backed by an implicit government guarantee. Instead of resolving or mitigating that problem, Dodd-Frank has entrenched the TBTF problem. A report by the Government Accountability Office concluded that while Dodd-Frank may have reduced the size of the so-called "TBTF subsidy" for large banks it did not eliminate it, indicating that large banks still retain an implicit government guarantee.[45] A study by the International Monetary Fund concluded that the subsidy to TBTF banks in the United States amounts to some $70 billion per year in lower capital costs and that in turn the existence of an implicit government guarantee promotes the moral hazard problem of greater risk-taking by large banks.[46]

Despite the elaborate procedures concocted in Dodd-Frank for the resolution of financial distress by banks, the fundamental problem is that these procedures simply are not considered credible by market actors. No one seriously believes that a future President and future Congress will feel themselves bound to abide by Dodd-Frank's requirements when it comes to the resolution of distress by financial firms. This disbelief reflects the erosion of the rule of law and, in this sense, the expectation that large banks will be bailed out effectively becomes a self-fulfilling prophecy—just as last time Treasury Secretary Hank Paulson's primary justification for bailing out banks was that the market "expected it."[47]

More generally, in the post-Dodd-Frank world, the combination of vast, unaccountable political power combined with the increased clout of powerful special interests to use the regulatory process has—unsurprisingly—led to an explosion of lobbying activity by financial services firms to avoid the imposition of the crushing burden of heavy and arbitrary government action. In other cases, lobbying reflects rent-seeking activity and

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[44] *See* Zywicki, *supra* note 5.

[45] GOVERNMENT ACCOUNTABILITY OFFICE, LARGE BANK HOLDING COMPANIES: EXPECTATIONS OF GOVERNMENT SUPPORT (July 2014).

[46] International Monetary Fund, *Big Banks Benefit from Government Subsidies*, Global Financial Stability Report (2014) online at http://www.imf.org/external/pubs/ft/survey/so/2014/POL033114A.htm. Other studies reach different conclusions on the continued existence of the TBTF subsidy. For a summary of the literature as well as a caveat on the conclusions that can be drawn, see Todd J. Zywicki, *The Rule of Law During Times of Economic Crisis*, *supra* note 11.

[47] *See* Todd J. Zywicki, *The Next Financial Crisis: What Will the Market 'Expect'?*, LAW & LIBERTY BLOG (May 19, 2013), *available in* http://www.libertylawsite.org/book-review/the-next-financial-crisis-what-will-the-markets-expect/.

efforts by some firms to influence the political and regulatory process to gain a competitive advantage over rivals. In addition, the power of politicians to pick winners and losers arbitrarily has created greater opportunities for rent-extraction by politicians who can threaten to impose new regulations unless bought off by lobbying efforts and campaign contributions.[48]

Little wonder that the financial services industry spends tens of millions of dollars every year on lobbying expenditures to seek special treatment under the law or to protect themselves from arbitrary regulation. In a world where government officials hold the power to hand out billions of dollars of regulatory prizes and punishments with no accountability and no need to justify its actions according to any coherent principle—other than political expediency—powerful special interests are going to try to influence that process to their advantage.[49] The virtue of the rule of law is to restrain the discretionary power of the government to draw these sorts of arbitrary distinctions that permit some interests to benefit politically at the expense of others.[50]

What the Rule of Law Means for the Rest of Us

In this world of lawlessness and arbitrary regulatory authority clout is king. What does that mean for the rest of us? It is not often appreciated, but it is the average American or small business that benefits the most from upholding the rule of law. Big financial firms can survivie—indeed, even thrive—in a world devoid of settled rules and transparent governance. They can afford to hire the lawyers and lobbyists to wend their way through the arcane political and regulatory processes.

But everyone else—small businesses and ordinary families trying to get ahead in life—don't have access to expensive, well-connected lawyers and lobbyists. When we have to pay more for a car loan or can't obtain a credit card, mortgage, or small business loan to make our families' lives better, we can't find a high-priced lobbyist to grease the skids for us. When our government spies on our credit card accounts without our conent and seeks to "choke off" banking services for legal businesses, we are less free. Dodd-Frank has interjected the tentacles of the federal regulatory state into every aspect of our financial system, and as a result we are less free to obtain the means to make our lives better.

Thank you.

[48] *See* Zywicki, *supra* note 13 (citing example of threats to impose new comprehensive regulations on hedge funds); *see also* Timothy P. Carney, *Schumer's Racket: Lobbyists and Hedge Funds*, WASHINGTON EXAMINER (May 26, 2010), *available in* http://www.washingtonexaminer.com/article/13668.
[49] *See* Gordon Tullock, *The Welfare Costs, of Tariffs, Monopoly, and Theft*, 5(3) WESTERN ECON. J. 224 (June 1967).
[50] *See* Zywicki, *supra* note 11.

HFSC Hearing entitled "The Dodd-Frank Act Five Years Later: Are We More Free?"
September 17, 2015

Questions for the Record from Congressman Hultgren (R-IL)

Mr. Todd Zywicki

One of the points in your written statement really stood out to me. You wrote: *"In the new world of Dodd-Frank, the success of a financial institution no longer is determined by which banks can serve you best in a competitive market. Instead, it is determined by which institutions can best wind their way through the labyrithian halls of Congress and the Federal Reserve Board."*

1. Do you believe the federal government should be in the business of picking winners and losers?

   I do not. I think that the growing propensity of the federal government in picking winners and losers is bad for consumers, the financial system, and the economy. The best-run and most consumer-friendly banks should be the ones that prevail in the free marketplace, not those with the most political clout.

2. So when we are talking about the ability to innovate, are community banks and other lenders at a competitive disadvantage to those companies not trapped in the regulatory labyrinth you have described?

   Absolutely yes. Dodd-Frank and the Consumer Financial Protection Bureau have imposed a blanket of uniformity over the consumer financial system through rules such as the Qualified Mortgage rule and other similar rules. This falls particularly hard on community banks, whose competitive model rests on knowing their customers well and provided tailored services based on their knowledge of their customers.

3. In the long-term, is a market full of comparative disadvantages, created by the federal government, conducive to affordable access to consumer credit?

   The impact of Dodd-Frank and the CFPB is already leading to higher costs and reduced choices for consumers. Bank accounts, credit cards, and other products have all become more expensive and less available for consumers. This has interfered with the ability of consumers to use credit to improve their lives, start small businesses, and obtain the goods and services that they need to thrive.

In your written testimony you also noted *"consumers face a market with few choices, less innovation, and less competition than before."* As you know, Section 1031 of the Dodd-Frank Act provided the CFPB with authority to prohibit so-called Unfair, Deceptive, Abusive Acts, and Practices. However, the Bureau has declined to provide much clarity for how it will use this authority. Financial services providers are now compelled to hire lawyers to read the tea leaves of CFPB enforcement actions in a nearly impossible effort of trying to comprehend the Bureau's intentions. This leaves many honest companies simply hoping they are not in the Bureau's crosshairs.

1. Can you discuss the impact of this broad and ambiguous authority on access to consumer credit?

To make a loan, a lender must be able to either price the risk of the loan accurately or reduce their risk exposure. Have broad, vaguely-defined standards of liability reduces the certainty that lenders need to be able to make loans. As a result, they will lend less and charge more. Higher-risk borrowers, such as younger and lower-income borrowers, will be most adversely affected by this.

2. Why would the Bureau decline to provide more clarity other than they are wary of providing a reasonable scope for this unprecedented regulatory authority?

I cannot provide any explanation. In addition, this broad, undefined authority permits the Bureau to potentially engage in unfair and arbitrary prosecutions and to treat different parties differently, potentially based on improper or invidious distinctions. Given the vast authority that the CFPB can exercise under this provision it is even more important for those rules to be clearly defined.

3. What steps can Congress take, if any, to make sure the Bureau is not abusing its Section 1031 authority?

The best option would be for Congress to repeal the CFPB's authority to regulate "abusive" acts and practices. The time-tested standards of "unfair and abusive" are efficient and adequate and allowing the prohibition of "abusive" acts and practices adds little benefit for consumers and much cost in terms of higher uncertainty. If that term is not repealed Congress should mandate that the CFPB engage in some sort of Rulemaking or Policy Statement defining the term. In 1980, for example, the Federal Trade Commission adopted a "Policy Statement" on unfairness that reigned in the FTC after a period of extreme lawless activism. Such a process of formal rulemaking or at least a policy statement could help to reign in the lawlessness of the CFPB in implementing this standard.

Congressman Patrick E. Murphy
Questions for the Record
House Financial Services Committee
Hearing: "The Dodd-Frank Act Five Years Later: Are We More Free?"
September 17, 2015

Question for Todd Zywicki, Foundation Professor of Law and Executive Director of the Law and Economics Center, George Mason University School of Law

Mr. Zywicki, as you know the Office of Financial Research was set up under Title I to assist FSOC in its work. However, there are concerns that it has not been functioning as well as it was intended. FSOC members have been critical of OFR research, from inaccuracy in its findings to its failure to consult with Council members. This case is particularly troubling because OFR was established specifically to serve as an informational resource for the Council. If members of the Council are relying on inaccurate information, I fear that unintentionally harmful regulations could ensue and pose harm to businesses and consumers.

What can be done to improve the quality of the OFR's performance and to improve coordination between the Office and FSOC regulators?

Response:

In my opinion, the OFR suffers from a number of the same structural problems as the CFPB. For example, OFR has an unaccountable director, who is appointed by the President to a six-year term with budget authority for the OFR and FSOC. This structure, lacking as it is in accountability to anyone outside of the OFR, does not form the basis for high quality work by the OFR. Not surprisingly, the OFR has come under criticism for, among other things, its report on asset management, which many observers believe mischaracterized key aspects of the industry. Structural changes—such as subjecting the OFR to the congressional appropriations process and making it clear that the director serves at the pleasure of the President and can be removed by the President—could help to improve OFR's performance and to encourage coordination with other regulators.

Question from
Congressman Patrick E. Murphy

Committee on Financial Services
United States House of Representatives
Hearing of September 17, 2015

You asked whether I think that the $50 billion SIFI threshold for bank holding companies has imposed unnecessary burdens on regional and community banks, and whether I have any thoughts on whether this threshold could be changed "in order to assist these businesses without allowing for additional risk to the financial system."[1]

I do think that the $50 billion threshold, which triggers enhanced oversight under Title I of the Dodd-Frank Act, has imposed unnecessary burdens, and I would favor increasing it. In my view, the $50 billion threshold is much too low. Of the thirty-eight U.S. bank holding companies that currently meet the $50 billion threshold, nine have between $50 billion and $100 billion in assets. These bank holding companies do not meet any reasonable definition of systemically important. In my view, only the largest bank holding companies would pose a significant rise of systemic damage if they were to fail.

The costs to a smaller bank holding company of being subject to the enhanced oversight of Title I are potentially crippling. These institutions face the prospect of higher capital requirements; they are required to prepare "living wills" demonstrating that they could be resolved in bankruptcy without causing systemic harm; and they are subject to enhanced oversight in other respects. Although regulators have discretion to adjust some of these requirements, the costs for any bank holding company that is subject to Title I's enhanced oversight are substantial.

Unlike their smaller peers, the largest banks already had substantial compliance departments prior to the 2008 crisis, and they can easily handle the enhanced oversight imposed

[1] Since the $50 billion threshold for subjecting bank holding companies to enhanced regulation under Title I of the Dodd-Frank Act is the principal focus of your question, that will be my emphasis here. I have different concerns about the designation process for nonbank financial institutions; I briefly describe those concerns in my written testimony.

under Title I. As a result, the $50 billion threshold puts middle-sized banks (that is, banks that have $50 billion or more in assets, but are not systemically important) at a major competitive disadvantage. The $50 billion threshold thus reinforces one of the most problematic features of the Dodd-Frank Act, its tendency to create a partnership between government and the largest banks that reinforces the dominance of these banks and hobbles the small and medium-sized banks that are the principal lenders to America's small and medium-sized businesses.

In my view, the best solution to this problem would be to alter the $50 billion threshold. Senator Shelby recently introduced legislation (S. 1484) that would only subject bank holding companies that have between $50 billion and $500 billion in assets to Title I oversight if the Financial Stability Oversight Council affirmatively voted to include them. I think this adjustment would be a significant improvement. Another alternative might be simply to adjust the threshold upward, and to fully exclude bank holding companies with, say, less than $250 billion in assets.[2] By limiting Title I to institutions that are genuinely systemically important, Congress could enhance competition in the financial services industry without creating a risk of systemic harm.

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[2] *See, e.g.*, Paul H. Kupiec, *Three Easy Fixes to Dodd-Frank*, WALL ST. J., Nov. 6, 2014, available at http://www.wsj.com/articles/paul-h-kupiec-the-way-is-clear-for-three-easy-dodd-frank-fixes-1415232976.