Hearing before the
U.S. House of Representatives
Committee on Financial Services,
Subcommittee on Oversight and Investigations

"EXAMINING CONSTITUTIONAL DEFICIENCIES AND LEGAL UNCERTAINTIES IN THE DODD-FRANK ACT"

July 9, 2013

Statement of Amb. C. Boyden Gray

I am grateful for the opportunity to testify before the Subcommittee on the constitutional flaws inherent in Titles I and II of the Dodd-Frank Act.[1] I am counsel to several parties in a constitutional challenge to Titles I and II, as well as Title X and the "recess" appointment of Richard Cordray to direct the Consumer Financial Protection Bureau;[2] the president of State National Bank of Big Spring, my client in the lawsuit, testified before this Subcommittee last year.[3]

But my position on Dodd-Frank's unconstitutional provisions long predates the filing of that lawsuit. I have been writing and speaking about Dodd-Frank since its very

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

2 *State Nat'l Bank of Big Spring v. Lew*, No. 1:12-cv-01032 (D.D.C. filed June 21, 2012).

3 The hearing, held on July 19, 2012, was titled *Who's In Your Wallet? Dodd-Frank's Impact on Families, Communities and Small Businesses: Hearing Before the Subcomm. on Oversight & Investigations of the H. Comm. on Financial Servs.*, 112th Cong. 10 (2012) (statement for the record of Jim Purcell, CEO, State National Bank), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-112-ba09-wstate-jpurcell-20120719.pdf.

inception, beginning with a "white paper" published shortly after the bill was signed into law,[4] followed by many articles, speeches, and debates since then.[5]

When President Obama signed Dodd-Frank into law, he said that the law was based on "clear rules and basic safeguards," and that those rules would "make clear that no firm is somehow protected because it is 'too big to fail,' so we don't have another AIG."[6] I wish that that his assurances were true but, regrettably, they are false. As the Dallas Federal Reserve Bank succinctly stated in its 2011 annual report, "[f]or all its bluster, Dodd-Frank leaves" the problem of Too Big to Fail "*entrenched*."[7]

It is no mere coincidence that Dodd-Frank both entrenches the Too Big To Fail problem and violates the Constitution's system of checks and balances. Rather, those two problems are deeply intertwined: by giving regulators effectively unlimited power, and by removing the checks and balances that ordinarily prevent the abuse of power, Dodd-Frank fosters the very conditions that give rise to Too Big To Fail.

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4 C. Boyden Gray & John Shu, *The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?*, 11 ENGAGE: THE JOURNAL OF THE FEDERALIST SOCIETY'S PRACTICE GROUPS Dec. 2010, at 1, *available at* http://www.fed-soc.org/docLib/20101209_BoydenShuDoddFrankWP.pdf.

5 *See, e.g.*, C. Boyden Gray, *Congressional Abdication: Delegation Without Detail and Without Waiver*, 36 HARV. J. L. & PUB. POL'Y 41 (2013); C. Boyden Gray & Jim R. Purcell, *Why Dodd-Frank is Unconstitutional*, WALL. ST. J., June 22, 2012, *available at* http://online.wsj.com/article/SB10001424052702304765304577480451892603234.html; C. Boyden Gray, *'Too Big To Fail' Casts a Long Shadow*, WASH. TIMES, Apr. 18, 2012, *available at* http://www.washingtontimes.com/news/2012/apr/17/gray-too-big-to-fail-casts-a-long-shadow/.

6 President Barack Obama, Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act.

7 FEDERAL RESERVE BANK OF DALLAS, CHOOSING THE ROAD TO PROSPERITY: WHY WE MUST END TOO BIG TO FAIL—NOW, 2011 ANNUAL REPORT 21, *available at* http://www.dallasfed.org/assets/documents/fed/annual/2011/ar11.pdf (emphasis added).

In that respect, Dodd-Frank is just the latest example of a trend that the nation has experienced many times: when we collapse the separation of powers and commit great authority to regulatory bureaucracies, it inherently favors big businesses over smaller ones. This bias against small business owes in part to the fact that bigger businesses are better able to shoulder large regulatory burdens—or, as JPMorgan Chase's CEO recently characterized Dodd-Frank, the regulatory burden creates a "moat" around big businesses, protecting them from competition by smaller aspiring rivals.[8] But the bias also owes to the fact that bureaucracy tends to expand its own control by dealing primarily, if not exclusively, with an industry's biggest players. No less than Justice Louis Brandeis stressed this, when he joined the Supreme Court's decision to strike down the National Industrial Recovery Act, the New Deal's central program for coordinating big government, big labor, and big business.[9]

The government's natural bias toward big businesses over small competitors can be restrained only by reinvigoration of the Constitution's separation of powers, its checks and balances. In the discussion that follows, I will lay out both the problem of "Too Big To Fail," which Dodd-Frank was supposed to correct, and Dodd-Frank's core constitutional flaws, which have only exacerbated and entrenched Too Big To Fail.

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[8] John Carney, *Surprise! Dodd-Frank Helps JPMorgan Chase*, CNBC.com (Feb. 4, 2013), *available at* http://www.cnbc.com/id/100431660.

[9] "It was Brandeis's old distaste for bigness—in government no less than in industry—summoned back into the open by his concern that the government had gone out of control." MICHAEL HILTZIK, THE NEW DEAL 282 (2011); *see also* MELVIN I. UROFSKY, LOUIS D. BRANDEIS 698 (2009) ("No part of the New Deal went so much against Louis Brandeis's beliefs as did the NIRA . . . The heart of the NIRA revolved around Roosevelt's belief that the crisis of the Depression could revive the spirit of cooperation that he believed marked business-government relations during the Great War. . . . Everyone had realized that the normal rules, such as antitrust laws, made no sense in wartime").

I. Dodd-Frank Entrenches "Too Big To Fail," Conferring Upon Big Banks a Subsidy Worth Billions of Dollars.

It is well established that several large financial institutions were seen as "too big to fail" prior to Dodd-Frank's enactment, and that their "TBTF" status bestowed upon them substantial advantages over their smaller competitors. Simply put, the market believed that certain banks were so big and interconnected that the federal government would intervene to keep them afloat in times of financial crisis. In other words, these "too big to fail" banks were seen as less risky, and their perceived safety enabled these banks to attract investment capital more cheaply than their competitors could.

To be clear, "too big to fail" status was not merely a figment of market imagination; rather, it was firmly rooted in national experience, as federal officials repeatedly intervened in recent decades to prevent the collapse of particular financial firms. In 1998, the Federal Reserve coordinated a rescue of Long Term Capital Management, a prominent hedge fund, in order to prevent shock waves from damaging Wall Street.[10] In 2008, the Federal Reserve bailed out AIG, once again in order to prevent large banks from being injured by the company's collapse.[11]

Indeed, the federal government's implicit protection of "too big to fail" banks was so well known that, during the financial crisis of 2007-2008, bank presidents actively urged the Treasury Secretary to protect them, particularly as Bear Stearns lunged towards collapse. As Secretary Paulson later recalled in his memoir:

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[10] *See, e.g.*, ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT 185-218 (2001); Roger Lowenstein, *Long-Term Capital: It's a Short-Term Memory*, N.Y. TIMES, Sept. 7, 2008, at BU1, *available at* http://www.nytimes.com/2008/09/07/business/07ltcm.html.

[11] *See, e.g.*, NEIL BAROFSKY, BAILOUT: AN INSIDE ACCOUNT OF HOW WASHINGTON ABANDONED MAIN STREET WHILE RESCUING WALL STREET 179-81 (2012).

> The first call I received was from Lloyd Blankfein, my successor as Goldman Sachs CEO. . . . Lloyd went over the market situation with me, providing a typically analytical and extraordinarily comprehensive overview, but I could hear the fear in his voice. His conclusion was apocalyptic.
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> The market expected a Bear rescue. If there wasn't one, all hell would break loose, starting in Asia Sunday night and racing through London and New York Monday.[12]

In short, the "too big to fail" banks received immense government financial and regulatory assistance in times of crisis.[13] But even in times of relative peace, big banks enjoyed direct benefits from their "too big to fail" status, in the form of a cost-of-capital advantage. That was an immense subsidy in and of itself, as documented by several economic studies.[14] In 2011, Moody's estimated that in the U.S. the "too big to fail" subsidy amounted to a 50-basis-point cost-of-capital advantage, worth $102 billion.[15] The International Monetary Fund, too, found that banks larger than $100 billion (*i.e.*, the pre-Dodd-Frank standard for implicit "too big to fail" status) enjoyed a 50-basis-point advantage.[16] Economists at the Philadelphia Federal Reserve Bank found that banks paid "at least $15 billion in added premiums" in merger deals to grow their banks above the $100

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12 HENRY M. PAULSON, JR., ON THE BRINK 106 (2010).

13 In addition to the aforementioned examples, the banks also lobbied for regulatory intervention—*e.g.*, to prevent "short sellers" from decreasing the price of their shares. *See* ROGER LOWENSTEIN, THE END OF WALL STREET 220 (2010).

14 In addition to the subsequently mentioned studies, the Bank of England summarized several other studies evaluating this trend. JOSEPH NOSS & RHIANNON SOWERBUTTS, THE IMPLICIT SUBSIDY OF BANKS, BANK OF ENGLAND FINANCIAL STABILITY PAPER NO. 15, at 6 (2012), *available at* http://www.bankofengland.co.uk/publications/Documents/fsr/fs_paper15.pdf.

15 ZAN LI, ET AL., MOODY'S ANALYTICS, QUANTIFYING THE VALUE OF IMPLICIT GOVERNMENT GUARANTEES FOR LARGE FINANCIAL INSTITUTIONS 14 (2011).

16 İNCI ÖTKER-ROBE, ET AL., INTERNATIONAL MONETARY FUND, THE TOO-IMPORTANT-TO-FAIL CONUNDRUM: IMPOSSIBLE TO IGNORE AND DIFFICULT TO RESOLVE 6 (2011), *available at* http://www.imf.org/external/pubs/ft/sdn/2011/sdn1112.pdf.

billion mark.[17] More recently, Bloomberg News calculated that the cost-of-capital advantage is worth $83 billion to the too-big-to-fail banks.[18] Such studies spurred Senators Vitter and Brown to ask the GAO to study the economic benefits that large banks "receive as a result of actual or perceived government support."[19]

Again, these were the very subsidies that Dodd-Frank supposedly ended. But, as the Dallas Fed stressed, Dodd-Frank did not end them—it *entrenched* them, in multiple ways:

First, Title I's creation of the Financial Stability Oversight Council (FSOC) turns "too big to fail" status—or, in Dodd-Frank's terms, "systemically important" status—from mere implication to actual, explicit government designation. We need not guess which financial companies are seen by the government as systemically important, because FSOC will tell us. The Connecticut Insurance Commissioner noted this in a recent speech to International Insurance Conference's annual seminar:

> Particularly on the life side, where people are buying a product for a 30- or 40-year promise, you want that financial stability; and if you say as a consumer this designation means the company has more supervision, that's a good thing. It has more capital. That's really good

17 Elijah Brewer III & Julapa Jagtiani, *How Much Did Banks Pay To Become Too-Big-To-Fail and To Become Systemically Important?*, 43 J FIN. SERVS. RESEARCH 1, 8 (2013), *available at* http://link.springer.com/content/pdf/10.1007%2Fs10693-011-0119-6.pdf.

18 *See, e.g.*, *Why Should Taxpayers Give Big Banks $83 Billion a Year?*," BLOOMBERG VIEW, Feb. 20, 2013, http://www.bloomberg.com/news/2013-02-20/why-should-taxpayers-give-big-banks-83-billion-a-year-.html; *Remember That $83 Billion Bank Subsidy? We Weren't Kidding*, BLOOMBERG VIEW, Feb. 24, 2013, http://www.bloomberg.com/news/2013-02-24/remember-that-83-billion-bank-subsidy-we-weren-t-kidding.html.

19 Letter from Senators Vitter & Brown to Gene Dodaro, Comptroller General of the United States (Jan. 1, 2013), *available at* http://www.fsround.org/fsr/dodd_frank/pdfs/Vitter-Brown-GAO-Study-Request-on-Megabanks.pdf.

> and, as it's potentially too big to fail, so the government is not going to let this company go.[20]

The Commissioner is right, and the proof is in the pudding: When news broke a few weeks ago that GE Capital, AIG, and Prudential had received preliminary "systemic importance" designations from the FSOC, their stock prices immediately *jumped*.[21]

The second way that Dodd-Frank entrenches "too big to fail" also pertains to Title I. The statute further expands the pre-Dodd-Frank universe of "too big to fail" companies by setting the statutory threshold at $50 billion in assets,[22] rather than the $100 billion threshold that previously was seen as the benchmark for implicit too-big-to-fail status.

Third, Title I also expands too-big-to-fail to include not merely big banks, but also "nonbank financial companies" such as insurance companies, hedge funds, and other companies not previously assumed to have government backing.[23]

Fourth, Title II's "Orderly Liquidation Authority" allows the federal government to conduct "back-door bailouts" of too-big-to-fail banks that have invested in troubled financial companies. This is effectively a codification of the AIG episode: if a financial company faces the possibility of default, and that company's failure threatens big banks that have invested in it or are its counterparties, then Title II gives the Treasury

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20 Commissioner Thomas Leonardi's comments were quoted by Gavin Souter, *Stability, Higher Costs Seen in Systemic Designation for Insurers,* BUSINESS INS., June 19, 2013, http://www.businessinsurance.com/article/20130619/NEWS04/130619774.

21 Ian Katz & Zachary Tracer, *AIG, Prudential Named Systemically Important by Panel*, BLOOMBERG, June 4, 2013, http://www.bloomberg.com/news/2013-06-03/u-s-regulators-vote-to-label-some-non-banks-systemically-risky.html.

22 *See* Dodd-Frank Act, Pub. L. No. 111-203, § 165(a)(1), 124 Stat. 1376, 1423 (2010) (codified at 12 U.S.C. § 5365(a)(1)) (setting $50 billion benchmark for bank holding companies); *see also* FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637, 21643 (Apr. 11, 2012) (setting $50 billion benchmark for nonbank financial companies, under Dodd-Frank § 113).

23 Dodd-Frank Act § 113.

Secretary and FDIC effectively unlimited power to liquidate (*i.e.*, wind-down or reorganize) the company in a way that favors certain stakeholders over others—even treating some creditors better than other similarly situated creditors, an abrogation of one of the fundamental rules of bankruptcy law[24]—and to do so behind closed doors, completely hidden from public view.

II. Dodd-Frank Violates the Constitution's Separation of Powers by Giving Effectively Open-Ended Power to Unchecked Regulators.

It is no great surprise that big banks would seek to leverage their size, interconnectedness, and other qualities in order to obtain favor from the government. Indeed, that was one of the many great insights that Adam Smith offered in *The Wealth of Nations*: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."[25] Perhaps the law cannot prevent them from meeting and conspiring, but at the very least, Smith urged, "it ought to do nothing to facilitate such assemblies, much less to render them necessary."[26]

The solution is simple. The Constitution's separation of powers, its system of checks and balances, was intended to foster a rule of law that would limit government officials' discretion to bestow unlimited favor upon particular classes of businessmen or other interest groups.

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[24] *See, e.g.*, Dodd-Frank Act § 210(b)(4).

[25] ADAM SMITH, 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, ch. 10, part II (1776). The modern school of "Public Choice Theory," too, offers great insight into government officials' incentives in bailing out big banks. *See generally* J.W. Verret, *The Bailout Through a Public Choice Lens: Government-Controlled Corporations as a Mechanism for Rent Transfer*, 40 SETON HALL L. REV. 1521 (2010).

[26] SMITH, *supra* note 25, at ch. 10, part II.

Moreover, the separation of powers was intended to ensure that the government would remain fully accountable to the people, as Publius explained in Federalist 70:

> It often becomes impossible, amidst mutual accusations, to determine on whom the blame or the punishment of a pernicious measure, or series of pernicious measures, ought really to fall. It is shifted from one to another with so much dexterity, and under such plausible appearances, that the public opinion is left in suspense about the real author. The circumstances which may have led to any national miscarriage or misfortune are sometimes so complicated that, where there are a number of actors who may have had different degrees and kinds of agency, though we may clearly see upon the whole that there has been mismanagement, yet it may be impracticable to pronounce to whose account the evil which may have been incurred is truly chargeable.[27]

The Supreme Court reminded us of this most recently in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, in which the Court struck down the Sarbanes-Oxley Act's attempt to shelter a new independent agency (*i.e.*, the Public Company Accounting Oversight Board, or "PCAOB") within another independent agency (*i.e.*, the Securities and Exchange Commission).[28] As the Court explained, precedents dating back to the New Deal Era had long ago established that Congress could create agencies enjoying some independence from the President, by providing that members of independent commissions could only be removed "for good cause."[29] But those precedents, the Court stressed, marked the outer limits of "independence" that the Constitution allows. Sarbanes-

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[27] Federalist No. 70 (A. Hamilton).

[28] 130 S. Ct. 3138 (2010). To be clear, the Court did not specifically hold that the SEC itself is an "independent agency"; the SEC's organic statute does not expressly insulate the Commissioners from the President's control. Nevertheless, the parties to that case all agreed that the SEC Commissioners do enjoy that degree of independence, and the Court therefore "decide[d] the case with that understanding." *Id.* at 3149.

[29] *Id.* at 3146-47 (citing *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), *United States v. Perkins*, 116 U.S. 483 (1886); *Morrison v. Olson*, 487 U.S. 654 (1988)).

Oxley's double layer of independence, by contrast, required the Court to consider "whether these separate layers of protection may be combined."[30] The answer to that question was, emphatically, "no":

> As explained, we have previously upheld limited restrictions on the President's removal power. . . . The Act before us does something quite different. It not only protects Board members from removal except for good cause, but withdraws from the President any decision on whether that good cause exists. That decision is vested instead in other tenured officers—the Commissioners—none of whom is subject to the President's direct control. The result is a Board that is not accountable to the President, and a President who is not responsible for the Board.
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> The added layer of tenure protection makes a difference. . . . *This novel structure does not merely add to the Board's independence, but transforms it.* Neither the President, nor anyone directly responsible to him, nor even an officer whose conduct he may review only for good cause, has full control over the Board.[31]

"The added layer of tenure protection makes a difference"; the PCAOB's "novel structure"—its double layer of independence—"does not merely add to the Board's independence, but transforms it." This analysis, which led the Court to strike down Sarbanes-Oxley's unprecedented independent-agency-within-an-independent-agency (and which last week led the D.C. Circuit to strike down a statute delegating legislative power to a private corporation[32]), also counsels in favor of striking down the parts of Dodd-Frank that combine multiple forms of independence to create new agency structures insulated from oversight by *multiple* branches of government. As the plaintiffs urge in *State National Bank of Big Spring v. Lew*, that includes the FSOC and the Orderly Liquidation Authority (OLA), as well as the Consumer Financial Protection Bureau (CFPB). These agencies do not enjoy

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[30] *Id.* at 3147.

[31] *Id.* at 3153-54 (emphasis added).

[32] *Ass'n of Am. Railroads v. U.S. Dep't of Transp.*, No. 12-5204, at pp. 11-14 (D.C. Cir. July 2, 2013).

multiple layers of independence from a single branch of government, as PCAOB did, but they do enjoy layers of independence from multiple branches of government, in a manner that far outpaces anything that the Supreme Court has previously approved.

I have written in detail on the multiple forms of independence that the FSOC, OLA, and CFPB respectively enjoy.[33] But let me briefly summarize the OLA's and FSOC's multiple layers of independence:

A. OLA

The OLA is an inter-agency framework administered primarily by the Treasury Secretary, who commences an "orderly liquidation," and by the FDIC, which carries it out. The Treasury Secretary serves at the pleasure of the president, of course. Of the FDIC's board, one member certainly enjoys the traditional hallmark of independence from the President: the CFPB Director, who enjoys an *ex officio* seat on the FDIC board, may only be removed "for inefficiency, neglect of duty, or malfeasance in office."[34] The remaining four members—three appointed by the President with the Senate's advice and consent, and the *ex officio* Comptroller of the Currency—are not expressly made independent from the President, although they are all appointed for fixed terms and elsewhere in the Code are identified collectively as an "independent regulatory agency."[35]

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[33] Gray & Shu, *supra* note 4; *see also* Second Amended Complaint at ¶¶ 67-255, *State Nat'l Bank of Big Spring v. Lew*, No. 12-1032 (D.D.C. filed Feb. 13, 2013).

[34] 12 U.S.C. § 1812(a)(1)(B) (placing the CFPB director on the FDIC); Dodd-Frank Act, Pub. L. No. 111-203, § 1011(c)(3), 124 Stat. 1376, 1964 (2010) (codified at 12 U.S.C. § 5491) (removal).

[35] 44 U.S.C. § 3502(5) (defining "independent regulatory agency" to include the FDIC); *see also* 12 U.S.C. § 2 (making the Comptroller of the Currency removable by the President "upon reasons to be communicated by him to the Senate"); 12 U.S.C. § 1812 (identifying FDIC board members to include the Comptroller of the Currency and the Director of the CFPB).

The OLA's multiple layers of independence pertain, instead, to its independence from Congress and the courts. Congress exercises no "power of the purse" over the OLA process, which is funded instead either by the assets of the liquidated financial company or by assessments on the financial sector.[36]

And most importantly, Title II imposes truly draconian limitations on judicial oversight. The Treasury Secretary's initial decision to liquidate a company is effectively immune from judicial review in the district courts: a court has only 24 hours to hear the initial appeal of his liquidation decision, and if the court does not issue a final decision on the merits before that time limit expires, then the government wins by default.[37] The public, including the liquidated company's bondholders and shareholders, are categorically prohibited from even knowing that the liquidation process has commenced, until after the case leaves the district court.[38] Once the case leaves the district court, the liquidation process cannot be stayed; the FDIC can liquidate the company while subsequent appeals are still being litigated,[39] which may in practice mean that any appeal will be rendered moot before the Supreme Court gets to consider the case, as happened in the Chrysler reorganization.[40] And throughout all of this, judicial review is truncated not merely in time, but also in scope: the courts may only consider whether the Treasury Secretary was arbitrary and capricious in determining that the liquidated company was "a financial company" and that it was "in

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[36] Dodd-Frank Act § 214(b).

[37] *Id.* § 202(a)(1)(A)(v).

[38] *Id.* § 202(a)(1)(A)(iii).

[39] *Id.* § 202(a)(1)(B).

[40] *Indiana State Police Pension Trust v. Chrysler LLC*, 130 S. Ct. 1015, 1015 (2009).

default or in danger of default."[41] The courts are thus denied even their fundamental power to decide whether the Treasury Secretary's decision was unlawful or unconstitutional.

Finally, creditors are deprived even of their ultimate constitutional backstop, the Tucker Act, which traditionally protects the right to just compensation for the government's taking of private property.[42] They must instead plead their cause to the FDIC as receiver, which in turn can limit their recovery to the amount that they theoretically would have received had the company been liquidated under Chapter 7 of the Bankruptcy Code, an utterly hypothetical, alternative-universe framework that offers no meaningful right to financial compensation.[43] Similarly, if the creditor appeals the FDIC's decisions in federal court, then the creditor's recovery is limited to the same artificially capped amount.[44]

In addition to this truly unprecedented combination of independence from Congress and the courts, the OLA also incorporates an effectively open-ended grant of statutory power. The Treasury Secretary administers statutory provisions that are either supremely vague (*e.g.*, the determination whether a company is "in default or in danger of default") or altogether lacking in an intelligible principle (*e.g.*, the determination whether a company's failure would "have serious adverse effects on financial stability").[45] Similarly, the FDIC enjoys unfettered discretion to discriminate among similarly situated creditors,[46] and to repudiate any contracts that it deems "burdensome."[47]

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41 Dodd-Frank Act § 202(a)(1)(A)(iv).

42 *See generally Regional Rail Reorganization Act Cases*, 419 U.S. 102, 125-36 (1974).

43 Dodd-Frank Act § 210(d)-(e).

44 *Id.* § 210(d)(2), (e).

45 *Id.* § 203(b).

46 *Id.* § 210(b)(4).

47 *Id.* § 210(c)(1).

Any one of these features, taken in isolation, might be held constitutional under the Supreme Court's precedents. But taken together they are unprecedented and unconstitutional. And, as the constitutional challenge to Title II further argues, the OLA process's combination of draconian restrictions on judicial review and its lack of any binding uniformity violates both the Fifth Amendment's Due Process Clause and the Constitution's Bankruptcy Clause.

B. FSOC

The FSOC's independence, like the OLA's, is less a matter of presidential oversight than of congressional and judicial oversight. Of the FSOC's ten voting members,[48] one expressly cannot be removed by the President at will (*i.e.*, the CFPB Director), others certainly can be removed at will (*e.g.*, the SEC Chairman, who can be removed from the chairmanship at will), and others fall somewhere in between (*e.g.*, the aforementioned Comptroller of the Currency).[49] Nevertheless, the FSOC also has five nonvoting members, including three selected by *state* authorities,[50] which raises substantial questions under the Constitution's Appointments Clause.

In any event, the FSOC's primary layers of independence pertain to the courts, and to the breadth of its statutory mandate. As with the OLA, the FSOC is not subject to meaningful judicial review. Companies designated as "systemically important" cannot challenge the legality of the FSOC's determination; rather, they may only question whether the FSOC's determination is "arbitrary and capricious."[51] Even more importantly, third

[48] *Id.* § 111(b)(1).

[49] *See supra* note 35.

[50] Dodd-Frank Act § 111(b)(1).

[51] *Id.* § 113(h).

parties—*e.g.*, competitors who want to prevent a company from being deemed "too big to fail"—have *no* right of judicial review under Title I.

And as with the OLA, the FSOC's statutory mandate is effectively unlimited. While Title I specifies some vague factors that FSOC may consider in deciding whether a particular nonbank financial company is "systemically important,"[52] the statutory provision concludes by stressing that its list is non-exhaustive: the FSOC may designate a nonbank financial company as systemically important based on "any other risk-related factors that the Council deems appropriate."[53]

As with the OLA, any one of these features, taken in isolation, might be held constitutional under the Supreme Court's precedents. But taken together they are unprecedented and unconstitutional.

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We can be thankful that circumstances have not yet given the Treasury Secretary and FDIC an opportunity to fully enforce the OLA,[54] and the FSOC is only now completing its initial round of systemic-importance designations[55] Nevertheless, evidence of

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52 *Id.* § 113(a)(2).

53 *Id.* § 113(a)(2)(K).

54 This is not to say that Title II does not already impart injuries. As the States explain in their constitutional lawsuit, Title II's express abrogation of their previous rights as creditors is an actual injury that gives them standing to challenge Title II in court.

55 According to news reports, the FSOC has internally designated GE Capital, AIG, and Prudential as the first systemically important nonbank financial companies. Although those designations have yet to be finalized, GE Capital and AIG announced last week that they will not contest their designations; Prudential will request that FSOC internally reconsider its designation. *See* Kate Linebaugh & Erik Holm, *AIG, GE Capital Won't Appeal 'Systemically Important' Label*, WALL ST. J., July 2, 2013, http://online.wsj.com/article/BT-CO-20130702-710096.html.

what problems can arise from their unprecedented independence can be found in the conduct of the other independent agency created by Dodd-Frank: the CFPB.

First, the CFPB, like the OLA, enjoys complete immunity from Congress's power of the purse. (It funds itself by taking hundreds of millions of dollars from the Federal Reserve Board of Governors; Congress is prohibited by statute from even reviewing its budget.[56]) And as this subcommittee knows from experience, the CFPB has not hesitated to wield its independence, refusing to comply with the previous Chairman's justified and reasonable requests for the CFPB's financial statements and forecasts.[57]

Second, without meaningful oversight by either Congress or the courts, the CFPB has had much incentive to interpret its own powers expansively. In a January 24, 2012 hearing before the House Oversight Committee, Director Cordray announced that the CFPB will not attempt to define one of its core statutory terms—"abusive" lending practices—through notice-and-comment rulemaking, and instead will define the term on a case-by-case, *ex post facto* basis.[58] More recently, it was revealed that the CFPB has undertaken a massive "data grab," either spending millions of dollars on consumer financial data purchased from third parties, or by simply demanding that banks to turn data over for

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[56] Dodd-Frank Act § 1017(a)(2).

[57] *See* Rep. Randy Neugebauer, *A $447 Million Consumer Alert*, WALL ST. J., Sept. 20, 2012, http://online.wsj.com/article/SB10000872396390444620104578006182400443070.html.

[58] *How Will the CFPB Function Under Richard Cordray: Hearing Before the Subcomm. on TARP, Financial Services, and Bailouts of Public and Private Programs of the H. Comm. on Oversight and Government Reform*, 112th Cong. (2012) (statement of Richard Cordray) ("[W]e have determined that [the definition of 'abusive'] is going to have to be a fact and circumstances issue; it is not something we are likely to be able to define in the abstract. Probably not useful to try to define a term like that in the abstract.").

free.[59] The Chamber of Commerce's recent letter to the CFPB describes the substantial legal questions raised by the data grab.[60]

Finally, the CFPB has taken steps to expand its authority still further beyond its statutory limits, attempting to regulate aspects of auto loans that Title X expressly excluded from the CFPB's reach. Despite Title X's prohibition against the CFPB "exercis[ing] any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both,"[61] the CFPB recently issued a "bulletin" detailing how it will regulate "indirect auto lenders."[62]

The CFPB's attempt to regulate auto dealers engaged in indirect financing is troubling for several reasons. First and foremost, this appears to be a plain attempt to nullify Congress's express protection for auto dealers, who certainly will be affected by this "exercise" of the CFPB's "authority." Second, the CFPB's decision to implement this new policy through a "bulletin," rather than through notice-and-comment rulemaking, subverts the regulatory process itself, by purporting to make new law without an opportunity for the

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59 *See, e.g.*, Carter Dougherty, *U.S. Amasses Data on 10 Million Consumers as Banks Object*, BLOOMBERG, Apr. 17, 2013, http://www.bloomberg.com/news/2013-04-17/u-s-amasses-data-on-10-million-consumers-as-banks-object.html; Carter Dougherty, *Richard Cordray and the CFPB Are Monitoring Your Banking Habits*, BLOOMBERG BUSINESSWEEK, Apr. 25, 2013, http://www.businessweek.com/articles/2013-04-25/richard-cordray-and-the-cfpb-are-monitoring-your-banking-habits.

60 Letter from David T. Hirschmann, President and CEO, U.S. Chamber of Commerce, to Richard Cordray, Director, Consumer Financial Protection Bureau (June 19, 2013), *available at*http://www.cfpbmonitor.com/files/2013/06/chamber-cfpb-data-letter.pdf.

61 Dodd-Frank Act § 1029(a).

62 CFPB Bulletin 2013-02 (Mar. 21, 2013), *available at* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

public to express its views, and by attempting to prevent regulated parties from directly appealing the policy in court. Third, by failing to undertake a public notice-and-comment rulemaking, the CFPB offers the public no indication of what its own data and models are; consumers and auto dealers are left instead to conduct their business under the shadow of the CFPB's black box. Finally, the CFPB's unilateral action offers no evidence that the agency is coordinating with the Federal Trade Commissioner and the Federal Reserve Board of Governors, as required by Section 1029 of Dodd-Frank.[63]

I am aware that Members of this Committee recently wrote to Mr. Cordray, expressing their concern over the CFPB's actions, and asking Mr. Cordray for answers to specific questions regarding the CFPB's data and methodology.[64] I am also aware, unfortunately, that Mr. Cordray's response to that letter failed to answer their specific questions.[65] And I am aware of other Members' June 20, 2013 letter to the CFPB's Assistant Director in the Office of Fair Lending and Equal Opportunity, raising questions regarding the CFPB's auto loan guidance, and I look forward to the CFPB's response (if any) with great interest.

But in all of this, I hope that this Subcommittee, and the Committee on Financial Services as a whole, will take the CFPB's conduct as an example of what we may expect from Dodd-Frank's other creations, the FSOC and the OLA. When agencies are

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63 Dodd-Frank Act § 1029(e) (requiring FTC and the Federal Reserve to coordinate with CFPB's Office of Service Member Affairs to educate service members and their family about financial products offered by motor vehicle dealers).

64 Letter from Rep. Terri A. Sewell, et al., to Director Richard Cordray (May 28, 2013), *available at* http://www.cfpbmonitor.com/files/2013/05/130530_cfpb_auto_dealer_letter.pdf.

65 *See* Letter from Director Richard Cordray to Rep. Terri A. Sewell, et al. (June 20, 2013), *available at* http://www.cfpbmonitor.com/files/2013/06/06-21-13_CFPB-Letter-on-Auto-Lending1.pdf.

freed from the Constitution's system of checks and balances, when they are not directly and fully accountable to the Executive, Legislative, and Judicial Branches, those agencies will almost certainly attempt to expand their powers, evade judicial review, and produce regulatory actions that simply lack the quality of regulations promulgated through the rigors of notice-and-comment rulemaking under the watchful eye of congressional and judicial oversight.

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