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CONGRESSIONAL TESTIMONY

Opportunities to Reform the Federal Financial Regulatory System

Testimony before the Financial Institutions and Consumer Credit Subcommittee, Committee on Financial Services, United States House of Representatives

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Chairman Luetkemeyer, Ranking Member Clay, and Members of the Committee, thank you for the opportunity to testify at today's hearing. My name is Norbert Michel and I am a Senior Research Fellow in Financial Regulations at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

In my testimony I will argue that the U.S. financial regulatory framework is in dire need of an overhaul. The 2008 financial crisis is an obvious example of a poorly functioning financial sector, but not because it was deregulated. The opposite is true—it was, and still is, overregulated. Leading up to 2008, financial firms funded too much unsustainable activity largely because of the rules and regulations they faced, including the widespread expectation that federal rules had guaranteed safety and soundness and that the federal government would provide assistance to mitigate losses.

Yet, the dominant narrative that supported passage of Dodd–Frank in 2010 was that deregulation in financial markets, beginning in the 1990s, caused the crash. This story is wrong. There was no substantial reduction in the scale or scope of financial regulations in the U.S. Rather, the sheer number of financial regulations steadily *increased*. From the supposed deregulation in 1999, up until the Lehman Brothers failure in 2008, financial regulators issued 7,100 pages of regulations for more than 800 separate rules.[1]

Financial firms—not just banks—have long dealt with capital rules, liquidity rules, disclosure rules, leverage rules, special exemptions for rules, and the constant threat that regulators would make up new rules or enforce old rules differently. There is no doubt that, for decades, the U.S. regulatory framework has increasingly made it more difficult to create and maintain jobs and businesses that benefit Americans. One of the main reasons the regulatory regime has been counterproductive for so long is because it allows regulators to micromanage firms' financial risk, a process that substitutes regulators' judgments for those of private investors.

This approach provides a false sense of security because the government confers an aura of safety on all firms that play by the rules, and it is bound to fail for at least three reasons: (1) people take on more risk than they would in the absence of such rules; (2) people have lower incentives to monitor financial risks than they would otherwise; and (3) compared to other actors in the market, regulators do not have superior knowledge of future risks. In addition to these shortcomings, the U.S. regulatory framework, for at least a century, has repeatedly protected incumbent firms from new competition—the very market forces that drive innovation, lower prices, and prevent excessive risk-taking.

The result is that entrepreneurs have suffered from fewer opportunities, and consumers have suffered from fewer choices, higher prices, and less knowledge regarding financial risks. When the system crashes, as it has done on several occasions, people naturally tend to blame the excesses in the private sector while giving the government more power to stabilize the economy. In the end, this process is a perverse self-reinforcing cycle that fails to make the economy any safer as it chips away at economic freedom and the prosperity it fosters.

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[1]Norbert J. Michel and Tamara Skinner, "The Popular Narrative About Financial Deregulation Is Wrong," The Daily Signal, July 29, 2016, http://dailysignal.com/2016/07/29/the-popular-narrative-about-financial-deregulation-is-wrong/ (accessed April 3, 2017).

Government rules that profess to guarantee financial market safety create a false sense of security, lower private incentives to monitor risk, increase institutions' financial risk, and protect incumbent firms from new competitors. It is important to reverse these trends because competition in markets drives innovation, lowers prices, prevents excessive risk-taking, and allows people to invest their savings in the best investment opportunities. There are many policy solutions to begin restoring the competitive process and strengthening financial markets, such as consolidating and reorganizing federal financial regulators.

Consolidation Versus Competition

After the 2008 crisis, Congress considered creating a single consolidated financial regulator.[2] The ultimate product of that debate—the Dodd–Frank Wall Street Reform and Consumer Protection Act[3]—did not create such a super regulator. Still, Dodd–Frank has moved the financial system toward uniform regulation. It has increased the scope of the Federal Reserve's authority to include new powers, such as an explicit systemic-risk mandate, and supervisory authority over new entities, such as savings-and-loan holding companies, securities holding companies, and systemically important financial institutions (SIFIs).[4]

As of May 2016, the Federal Reserve had supervisory authority over approximately 25 percent (based on total assets) of the insurance industry.[5] The Federal Reserve is also active in international regulatory efforts to identify and establish regulatory standards for SIFIs,[6] and it has been actively advocating changes outside its normal regulatory sphere.[7] If these trends continue, the system may well end up under the

[2] Restoring American Financial Stability Act of 2009, discussion draft, http://thf_media.s3.amazonaws.com/2016/DoddSenateBankingMarkup.pdf (accessed November 22, 2016). The discussion draft included statutory language to create a single financial regulator called the Financial Institutions Regulatory Administration (FIRA).

[3] Public Law 111–203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 5, 7, 12, 15, 22, 26, 28, 31, and 42 U.S. Code).

[4] For a discussion of this expansion, see Hester Peirce and Robert Greene, "The Federal Reserve's Expanding Regulatory Authority Initiated by Dodd–Frank," Mercatus Center at George Mason University, November 13, 2013, http://mercatus.org/publication/federal-reserves-expanding-regulatory-authority-initiated-dodd-frank (accessed October 8, 2016).

[5] Daniel K. Tarullo, speech at the National Association of Insurance Commissioners' International Insurance Forum, Washington, DC, May 20, 2016, https://www.federalreserve.gov/newsevents/speech/tarullo20160520a.htm (accessed October 8, 2016).

[6] See, for example, Financial Stability Board, "About the FSB," http://www.fsb.org/about/ (accessed October 8, 2016). ("The FSB promotes international financial stability; it does so by coordinating national financial authorities and international standard-setting bodies as they work toward developing strong regulatory, supervisory and other financial sector policies. It fosters a level playing field by encouraging coherent implementation of these policies across sectors and jurisdictions.") The Federal Reserve, along with the Federal Insurance Office at the Treasury and state insurance regulators, represents the United States in the International Association of Insurance Supervisors, which is working on identifying and establishing regulatory approaches for globally systemically important insurers. International Association of Insurance Supervisors, "Financial Stability and Macroprudential Policy & Surveillance," http://www.iaisweb.org/page/supervisory-material/financial-stability-and-macroprudential-policy-and-surveillance (accessed October 8, 2016).

[7] See, for example, Daniel K. Tarullo, speech at the Brookings Institution, Washington, DC, November 17, 2015, https://www.federalreserve.gov/newsevents/speech/tarullo20151117a.htm (accessed October 8, 2016). Federal Reserve Governor Tarullo calls for "market regulation," which he illustrates by citing the

de facto control of a super regulator: the Board of Governors of the Federal Reserve. Though the U.S. financial regulatory structure needs reform, a single "super" regulator with a banking mindset and a ready safety net would not improve economic outcomes. Any structural reorganization should guard against the current tendency of bank regulation to seep into capital markets regulation.

There are many arguments for and against regulatory consolidation. Critics of consolidation believe that a structure based on multiple regulatory agencies is good because it allows regulators to specialize in particular types of institutions,[8] it allows regulatory experimentation and competition,[9] and it helps highlight one regulator's mistakes. Also, if a regulator does make an error, only the subset of entities it regulates will be directly affected. Finally, maintaining distinct capital markets and banking regulators provides speed bumps to banking regulators' efforts to apply bank-like regulation more broadly.[10]

One argument for consolidating regulators is to avoid "charter-shopping" or a "race to the bottom" among regulators.[11] This argument, however, assumes a degree of competition between financial regulators that is at odds with the existing regulatory system. During the recent financial crisis, contrary to the charter-shopping argument, banks failed at roughly similar rates across the various bank regulators.[12] Furthermore, as professors Henry Butler and Jonathan Macey have so aptly observed, competition among banking regulators is largely a myth.[13]

In surveying the literature of state corporate governance and banking laws, one recent article found that such competition did not generally lead to a "race to the bottom"

Federal Reserve's plans to "establish minimum haircuts for securities financing transactions (SFTs) on a market-wide basis, rather than just for specific classes of market participants." See also Stanley Fischer, Vice Chairman, Board of Governors of the Federal Reserve System, speech at the Debt and Financial Stability—Regulatory Challenges Conference at the Bundesbank and the German Ministry of Finance, Frankfurt, Germany, March 27, 2015, https://www.federalreserve.gov/newsevents/speech/fischer20150327a.htm (accessed October 8, 2016). Fischer calls for additional reforms in the non-bank financial sector.

[8] Lawrence A. Cunningham and David Zaring, "The Three or Four Approaches to Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response," *George Washington University Law Review*, Vol. 78 (2009), pp. 1–56, http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1551&context=faculty_publications (accessed October 8, 2016).

[9] Ibid., p. 50.

[10] Former SEC Commissioner Daniel Gallagher has frequently discussed the importance of preventing bank regulators from taking over capital markets regulation. See, for example, Daniel M. Gallagher, "Bank Regulators at the Gates: The Misguided Quest for Prudential Regulation of Asset Managers," speech at the 2015 Virginia Law and Business Review Symposium, April 10, 2015, https://www.sec.gov/news/speech/041015-spch-cdmg.html (accessed November 22, 2016).

[11] Jessica Silver-Greenberg, "Small Banks Shift Charters to Avoid US as Regulator," *The New York Times*, April 2, 2012, http://www.nytimes.com/2012/04/03/business/small-banks-shift-charters-to-avoid-us-as-regulator.html (accessed November 22, 2016), and Sumit Agarwal et al., "Inconsistent Regulators: Evidence from Banking," *The Quarterly Journal of Economics*, Vol. 129, No. 2 (2014), pp. 889–938.

[12] U.S. Government Accountability Office, "Causes and Consequences of Recent Bank Failures," *Report to Congressional Committees*, GAO–13–71, 2013, http://www.gao.gov/assets/660/651154.pdf (accessed November 22, 2016).

[13] Henry Butler and Jonathan Macey, "The Myth of Competition in the Dual Banking System," *Cornell Law Review*, Vol. 73 (1988).

but rather a sorting into alternative regulatory systems.[14] Although full regulatory consolidation could harm financial markets, some streamlining is important because the current framework embodies inefficiencies and redundancies. The U.S. banking regulatory structure, for example, is complex, with responsibilities fragmented among the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Federal Reserve.[15] The following list summarizes these agencies' overlapping authorities.

- The FDIC, in charge of maintaining the Federal Deposit Insurance Fund, has backup supervisory authorities over all banks and thrifts that are federally insured; this responsibility creates overlap between the FDIC's authorities and those of the Federal Reserve and OCC as the primary prudential regulators of insured depository institutions.
- The NCUA supervises only federally chartered credit unions, but it is the deposit insurer for both federal credit unions and most state-chartered credit unions; its role as deposit insurer creates overlap with state credit union regulators.
- The Federal Reserve has consolidated supervision authority over most holding companies that own or control a bank or thrift and their subsidiaries; this authority creates overlap because the Fed's role is in addition to the oversight provided by the banks' primary federal regulator.
- State banking regulators share oversight of the safety and soundness of state-chartered banks with the FDIC and the Federal Reserve.

This fragmentation and overlap has a long history of creating inefficiencies in regulatory processes, as well as inconsistencies in how regulators oversee similar types of institutions. Even when these overlapping authorities do not lead to inconsistencies, coordination among agencies requires considerable effort that could be directed toward other activities. Inconsistencies create an uncertain operating environment for regulated entities, as well as an uncertain environment for regulators when their decisions are contradicted by those of other regulators. The following points summarize some of the best known historical examples of these inefficiencies and inconsistencies.[16]

- Differences in examination scope, frequency, documentation, guidance, and rules among the FDIC, OCC, and the Fed.

[14] Bruce G. Carruthers and Naomi R. Lamoreaux, "Regulatory Races: The Effects of Jurisdictional Competition on Regulatory Standards," *Journal of Economic Literature*, Vol. 54, No. 1 (2016), pp. 52–97.

[15] States also have their own banking regulatory agencies, and banks are subject to various rules and regulations promulgated by the Consumer Financial Protection Bureau (CFPB), the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), the Federal Housing Administration (FHA), the Federal Housing Finance Agency (FHFA), and the Department of Housing and Urban Development (HUD).

[16] U.S. Government Accountability Office, "Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness," GAO–16–175, February 2016, http://www.gao.gov/assets/680/675400.pdf (accessed April 4, 2017).

- Inconsistent methods for assessing loan loss reserves.
- Inconsistent guidance and terminology for Bank Secrecy Act examinations *and* compliance.
- Inconsistencies with oversight and compliance of federal consumer financial protection laws (such as fair lending laws).
- The Fed and other primary regulators have not, though they have tried, successfully coordinated their supervision and examination responsibilities.
    - Duplication in the examinations of financial holding companies, despite the OCC's and the Fed's efforts to coordinate.
- Conflicting guidance from the Fed and the OCC.
- Prudential regulators requiring regulated entities to report the same data in different formats.

It makes sense to fix these problems by having one federal banking regulator, but that banking regulator should not be the Federal Reserve.

Remove the Federal Reserve's Regulatory and Supervisory Powers

As the United States central bank, the Federal Reserve's primary role is, and should remain, monetary policy. The Federal Reserve Act directs the central bank to "maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates."[17] The Federal Reserve has struggled to fulfill these macroeconomic responsibilities, and its supplementary regulatory and supervisory responsibilities—particularly as they have expanded since the financial crisis[18]—are simply unnecessary for conducting monetary policy.

Dodd–Frank, in conjunction with increasing the responsibilities it placed on the Federal Reserve, established a new, Senate-confirmed position—Vice Chairman for Supervision.[19] This as-yet-unfilled position is to be filled by one of the Federal Reserve Governors, whose ability to focus on monetary policy would therefore be attenuated. Perhaps worse, allowing the same entity to exercise regulatory and monetary functions gives rise to unnecessary and potentially dangerous conflicts of interest. A central bank that is also a regulator and supervisor could be tempted to use monetary policy to compensate for mistakes on the regulatory side, and financial stability concerns could lead to regulatory forbearance.

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[17] Federal Reserve Act § 2A, 12 U.S. Code 225a.
[18] Peirce and Greene, "The Federal Reserve's Expanding Regulatory Authority Initiated by Dodd–Frank." Also see Patrick McLaughlin, Chad Reese, and Oliver Sherouse, "Dodd–Frank and the Federal Reserve's Regulations," Mercatus Center at George Mason University, February 4, 2016, http://mercatus.org/publication/dodd-frank-and-federal-reserve-s-regulations (accessed October 8, 2016).
[19] Dodd–Frank § 1108(a).

The current system is far from ideal, and the Fed's responsibilities overlap with those of other financial regulators.[20] The overlap results in inconsistencies and duplicative efforts by both regulators and regulated entities.[21] Efforts at inducing coordination, including the Federal Financial Institutions Examination Council (FFIEC)[22] and the Financial Stability Oversight Council's (FSOC's) mandate to encourage cooperation among regulators, have not addressed this problem adequately. Removing the Federal Reserve's regulatory and supervisory powers would allow it to focus on monetary policy, and shifting the Fed's regulatory and supervisory responsibilities to either the OCC or the FDIC would reduce duplicative regulations.

Merging the SEC and the CFTC

Similar to the consolidation of federal banking regulators, it makes sense to have one federal capital markets regulator. And, in fact, Congress has, on several occasions, contemplated merging the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) into one capital markets regulator.[23] The SEC and CFTC regulate markets that have increasingly blurred into one another over the years, and yet the two agencies have approached their regulatory responsibilities in different and sometimes conflicting ways.[24] There is a theoretical case for allowing the two regulators, which historically have taken very different regulatory approaches,[25] to exist side by side. If one regulator's approach is flawed, for instance, regulated entities may be able to migrate to the markets in the other

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[20]See, for example, U.S. Government Accountability Office, "Financial Regulation," p. 28, which explains that "[a]ll forms of consolidated supervision by the Federal Reserve create overlap with authority of the primary regulators of the holding company's regulated subsidiaries."

[21]See, for example, U.S. Government Accountability Office, "Financial Regulation," p. 36, which noted that "the Federal Reserve's data requests can be very similar to the OCC's requests and that often the two requests will ask for the same data but in different formats." See also Office of the Inspector General to the Board of Governors of the Federal Reserve System, "2015 List of Major Management Challenges for the Board," *Memorandum*, September 30, 2015, https://oig.federalreserve.gov/reports/board-management-challenges-sep2015.pdf (accessed October 8, 2016). Among the items in the list was "maintaining effective relationships with other regulators." The Inspector General noted: "While the Board has taken steps to improve interagency collaboration and cooperation…continued coordination with other federal supervisory agencies, such as the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, is crucial to implementing the financial stability regulatory and supervisory framework." Ibid., p. 6.

[22]The FFIEC is "a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the" Board of Governors, FDIC, National Credit Union Administration, OCC, and CFPB.

[23]House Financial Services Chairman Barney Frank (D–MA) proposed legislation to merge the SEC and CFTC. See Sarah N. Lynch, "Retiring US Lawmaker Barney Frank Seeks SEC–CFTC Merger," Reuters, November 29, 2012, http://www.reuters.com/article/sec-cftc-merger-idUSL1E8MTGFA20121129 (accessed November 24, 2016).

[24]See, for instance, U.S. Government Accountability Office, "Financial Regulation," p. 41, which observes: "Over time, separate regulation of the securities and futures markets has created confusion about which agency has jurisdiction and has raised concerns about duplicative or inconsistent regulation of entities that engage in similar activities."

[25]Historically, the CFTC applied a principles-based approach to regulation, whereas the SEC's approach was more rule-based. The two agencies' approach is now very similar, particularly since Congress passed the 2010 Dodd–Frank Act.

regulator's purview. In practice, however, the bifurcated responsibility has resulted in tense regulatory battles and duplicative effort by regulators and market participants.

Periodic attempts to address the problem have helped calm some of the interagency fighting, but the agencies' closely related mandates promise continued discord.[26] For example, the Shad–Johnson Jurisdictional Accord of the early 1980s brought a measure of peace, but jurisdictional disputes continued. Dodd–Frank, which awkwardly split regulatory responsibility for the over-the-counter derivatives market between the two agencies, only compounded the problem with overlapping authorities.[27] The CFTC, although built on the hedging of agricultural commodities, now is primarily a financial markets regulator. The markets it regulates are closely tied—through common participants and common purposes—with SEC-regulated markets. The U.S. is unusual in having separate regulators for these markets.

A merged SEC and CFTC might be better able to take a holistic view of the capital and risk-transfer markets. A single regulator could conserve resources in overseeing entities that are currently subject to oversight by both the SEC and CFTC. In addition, a unified regulator would eliminate discrepancies in the regulatory approaches that can frustrate good-faith attempts by firms to comply with the law. Consolidating regulatory authority in one federal banking regulator and one federal capital markets regulator, respectively, would help improve the U.S. regulatory framework. However, there are still many other ways to improve the U.S. financial regulatory system.

The CFPB: Unnecessary for Protecting Consumers

The Consumer Financial Protection Bureau (CFPB) was designed specifically to determine which financial products people may choose rather than allow consumers to make their own choices. This design is primarily to protect consumers from themselves by standardizing financial products.[28] As a result, the CFPB constrains access to credit and erodes Americans' financial independence. Furthermore, the CFPB is unaccountable to the public in any meaningful way, and raises serious due process and separation of powers concerns. A three-judge panel of the Circuit Court of Appeals for the District of Columbia recently ruled that the Bureau's single-director model is unconstitutional. The court ruled that the unilateral power wielded by the CFPB Director "represents a gross departure from settled historical practice" and "poses a far greater risk of arbitrary decision making and abuse of power, and a far greater threat to individual liberty, than does a multi-member independent agency."[29]

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[26]For a discussion of cooperative efforts over the years, see U.S. Government Accountability Office, "Financial Regulation," pp. 43 and 44.

[27]See, for instance, Annette L. Nazareth and Gabriel D. Rosenberg, "The New Regulation of Swaps: A Lost Opportunity," *Comparative Economic Studies*, Vol. 55, No. 3 (September 2013), pp. 535–548.

[28]In the words of Oren Bar-Gill and Elizabeth Warren, the academic architects of the CFPB, borrowers suffer "cognitive limitations" and borrowers' "learning is imperfect." Oren Bar-Gill and Elizabeth Warren, "Making Credit Safer," *University of Pennsylvania Law Review*, Vol. 157, No. 1 (November 2008), https://www.law.upenn.edu/live/files/112-bargillwarren157upalrev12008pdf (accessed December 21, 2016).

[29]*PHH Corporation, et al., Petitioners v. Consumer Financial Protection Bureau, Respondent*, U.S. Court of Appeals, District of Columbia Circuit, October 11, 2016, https://assets.documentcloud.org/documents/3131047/Cfpb-Dccircuit-20161011.pdf (accessed March 31, 2017).

CFPB advocates claim that the agency is vital for protecting consumers in financial markets, but there simply was no shortage of consumer protection against fraudulent companies prior to the Dodd–Frank Act. In fact, if Congress eliminated the CFPB, Americans would be just as protected against unfair and deceptive fraudulent practices as they are today. The main reason is that Title X of Dodd–Frank created the CFPB by transferring enforcement authority for 22 specific consumer financial protection statutes to the new agency.

These federal statutes were administered by seven federal agencies, and layered on top of state laws and local ordinances too numerous to count. For decades, this framework governed the offering of consumer credit and outlawed deceptive and unfair practices in financial products and services. Congress can improve the efficiency of financial regulation by consolidating enforcement authority for these traditional consumer protection statutes with the Federal Trade Commission (FTC), the one agency with decades of experience in promoting the welfare of consumers *and* market competition.

Dodd–Frank also codified a new, ill-defined, type of consumer protection. Under the traditional framework, it was illegal for businesses to engage in *deceptive* or *unfair* practices when marketing their offerings to consumers.[30] Title X of Dodd–Frank empowers the CFPB "to exercise its authorities under Federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services, consumers are protected from unfair, deceptive, *or abusive* acts and practices."[31] The statute does not define the term abusive, and the agency has issued neither guidance nor rules to define abusive practices. Furthermore, officials have not shown much willingness to provide clarity. During a 2012 hearing of the House Financial Services Committee, for example, when asked by lawmakers to define "abusive," CFPB Director Richard Cordray said that

> the term abusive in the statute is…a little bit of a puzzle because it is a new term…. We have been looking at it, trying to understand it, and we have determined that that 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

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[30]Historically, the FTC was the primary federal consumer protection agency outside of banking, while banking regulators were primarily responsible for consumer protection in depository institutions. The Federal Trade Commission Act (15 U.S. Code 41 et seq.) was amended in 1938 to prohibit "unfair or deceptive acts or practices." See, generally, Federal Trade Commission, "Bureau of Consumer Protection," https://www.ftc.gov/about-ftc/bureaus-offices/bureau-consumer-protection (accessed November 4, 2016). Federal banking regulators, including the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board, the Comptroller of the Currency, and the National Credit Union Administration, had authority to enforce unfair or deceptive acts or practices in or affecting commerce under their statutes in a manner consistent with carefully crafted FTC limiting principles applicable to unfairness and deception. See 15 U.S. Code § 45(n) (defining "unfairness"); Federal Trade Commission, FTC Policy Statement on Unfairness, 104 F.T.C. 949, 1070 (1984), https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness (accessed March 31, 2017); and Federal Trade Commission, FTC Policy Statement on Deception, 103 F.T.C. 110, 174 (1984), https://www.ftc.gov/public-statements/1983/10/ftc-policy-statement-deception (accessed March 31, 2017). See also, e.g., FDIC Compliance Manual, Chapter 7 (Federal Trade Commission Act, Section 5 Unfair or Deceptive Acts or Practices), https://www.fdic.gov/regulations/compliance/manual/7/VII-1.1.pdf (accessed March 31, 2017).

[31]Dodd–Frank, Section 1021, 12 U.S. Code § 5511. (Emphasis added.)

> try to define a term like that in the abstract; we are going to have to see what kind of situations may arise.[32]

Under this framework, financial firms must operate under a vague legal standard to which they might never be able to adhere. Aside from the near impossibility of complying with such a fleeting standard for abusive acts or practices, there is no objective way to measure a consumer's ability to understand terms and conditions of financial products and services.[33] Regardless, forcing financial firms into such a role, where they are effectively required to verify consumers' understanding of terms rather than merely disclosing relevant information, goes well beyond the long-established consumer protection framework.

Perhaps worse, this change, based on a hostile view of free enterprise, comes dangerously close to absolving one party in a financial contract from any real responsibility. The U.S. did not need a new type of consumer financial protection, and it certainly did not need another federal regulator (especially one with supervisory authority) to add to the already overly burdensome regulatory system. Congress should eliminate the CFPB (along with the new abusive practices concept of consumer protection), and transfer enforcement authority for the statutes enumerated in Title X of Dodd–Frank to the FTC.

Presidential Reorganization Authority

Many of the changes discussed here will be contentious and difficult for Congress to implement. One approach that might help facilitate these changes is to revive the reorganization authority codified at 5 U.S. Code §§ 901 et seq. that has been used by past Presidents of both parties. Granting this authority is a flexible way to enable the Executive branch to propose government reorganization plans that improve the efficiency and effectiveness of government regulators in financial markets. Given that the Trump Administration has issued an executive order calling for "efficient, effective" financial regulations, Congress could grant the President the authority to reorganize all—or some—of the federal financial regulatory agencies.[34]

Granting this authority, consistent with prudent protections, would require the Trump Administration to submit reorganization plans for consideration by Congress. Reorganization authority under 5 U.S. Code §§ 901 et seq. has been granted many times

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[32]"How Will the CFPB Function Under Richard Cordray," transcript of hearing before the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, Committee on Oversight and Government Reform, U.S. House of Representatives, January 24, 2012, http://oversight.house.gov/wp-content/uploads/2012/06/01-24-12-Subcommittee-on-TARP-Financial-Services-and-Bailouts-of-Public-and-Private-Programs-Hearing-Transcript.pdf (accessed March 31, 2017).

[33]See Katz, "Title X and the Consumer Financial Protection Bureau: Limiting Americans' Credit Choices"; Todd Zywicki, "The Consumer Financial Protection Bureau: Savior or Menace?"; and Diane Katz, "The CFPB in Action: Consumer Bureau Harms Those It Claims to Protect," Heritage Foundation *Backgrounder* No. 2760, January 22, 2103, http://www.heritage.org/housing/report/the-cfpb-action-consumer-bureau-harms-those-it-claims-protect#_ftn11.

[34]The White House, Presidential Executive Order on Core Principles for Regulating the United States Financial System, February 3, 2017, https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states (accessed March 27, 2017).

between 1932 and 1984, with some plans being enacted and others rejected.[35] Congress can easily grant this authority now to target specific agencies within a specific time frame under any rules it deems necessary.[36] For example, under the first reauthorization of the 1949 reorganization act, which finally expired in 1973, 52 reorganization plans were submitted to Congress, eight of which were rejected.[37] The following is a list of organizations that were established under the act:[38]

- The Department of Health, Education and Welfare;[39]
- The Environmental Protection Agency;[40]
- The National Oceanic and Atmospheric Administration in the Department of Commerce;[41] and
- The Drug Enforcement Administration in the Department of Justice.[42]

Another example is President Jimmy Carter, who asked Congress for a four-year renewal of the Reorganization Act of 1949, with certain modifications. Congress ultimately decided to enact an entirely new statute, the Reorganization Act of 1977, based largely on the 1949 statute.[43] The new law made several procedural changes to the manner in which plans could be submitted or amended, and "a prohibition against establishing, abolishing, transferring, or consolidating departments was expanded to prohibit also the abolition or consolidation of independent agencies."[44] There are many ways that reorganization authority could be used to improve the efficiency and effectiveness of the financial regulatory framework.

For instance, the SEC currently operates under Reorganization Plan No. 10 of 1950.[45] That plan transferred from the Commission (composed of five Commissioners) to the Chairman of the Commission power over "(1) the appointment and supervision of personnel employed under the Commission, (2) the distribution of business among such personnel and among administrative units of the Commission, and (3) the use and expenditure of funds."[46] However, the plan reorganized the Commission so that "the

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[35]Ronald C. Moe, "The President's Reorganization Authority: Review and Analysis," Congressional Research Service, March 8, 2001.
[36]Also see David Walker, U.S. General Accounting Office, "Executive Reorganization Authority: Balancing Executive and Congressional Roles in Shaping the Federal Government's Structure," testimony before the Committee on Government Reform, U.S. House of Representatives, April 3, 2003, and Henry B. Hogue, "Presidential Reorganization Authority: History, Recent Initiatives, and Options for Congress," Congressional Research Service, December 11, 2012.
[37]Hogue, "Presidential Reorganization Authority," p. 25.
[38]Ibid., pp. 25–26.
[39]Reorganization Plan No. 1 of 1953 (67 Stat. 631).
[40]Reorganization Plan No. 3 of 1970 (84 Stat. 2086).
[41]Reorganization Plan No. 4 of 1970 (84 Stat. 2090).
[42]Reorganization Plan No. 2 of 1973 (87 Stat. 1091).
[43]The Reorganization Act of 1977, as amended, is not presently operative for execution because it expired on December 31, 1984. Moe, "The President's Reorganization Authority."
[44]Hogue, "Presidential Reorganization Authority," p. 28.
[45]Title 5, U.S. Code, Appendix, Reorganization Plans, 15 U.S. Code 78d-2, http://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title5a-node84-leaf114&num=0&edition=prelim (accessed April 4, 2017).
[46]Ibid., section 1(a).

appointment by the Chairman of the heads of major administrative units under the Commission shall be subject to the approval of the Commission."[47]

In practice, this change means that the Chairman of the Commission has almost unrestricted power over how the Commission is run and its agenda. The four other commissioners have little influence over its agenda or its operation. One of the reasons to have a bipartisan, multi-member commission is to allow various perspectives to have weight in the agency's operation and agenda. Granting the President reorganization authority could be used, narrowly, to restore balance to the Commission. The plan could, for example, ensure that any two members would have the ability to place an item on the agenda and, if it relates to a rule-making, receive adequate staff support to develop an idea to the point where the Commission can vote on whether to instruct the staff to develop a proposed rule.

Congress could easily tailor reorganization authority to solicit several broader plans from the Trump Administration.[48] For instance, these plans could:

- Establish a single capital markets regulator by merging the SEC and the CFTC;
- Establish a single bank and credit union supervisor and regulator by merging the OCC, the FDIC, the NCUA, and the Federal Reserve's bank supervisory and regulatory functions; and
- Revise the structure, mission, and functions of the CFPB.

Conclusion

The U.S. financial regulatory framework is in dire need of an overhaul. Prior to 2008, U.S. financial markets were overregulated, not deregulated. Leading into the 2008 crisis financial firms funded too much unsustainable activity largely because of the rules and regulations they faced, including the widespread expectation that federal rules had guaranteed safety and soundness and that the federal government would provide assistance to mitigate losses. For decades, the U.S. regulatory framework has increasingly made it more difficult to create and maintain jobs and businesses that benefit Americans, and these trends must be reversed.

One of the main reasons the regulatory regime has been counterproductive for so long is because it allows regulators to micromanage firms' financial risk, a process that substitutes regulators' judgments for those of private investors. There are many policy solutions to begin restoring the competitive process and strengthening financial markets, such as consolidating and reorganizing federal financial regulators. There is no good reason, for example, to have seven federal financial regulators (the Federal Reserve, the FDIC, the OCC, the NCUA, the SEC, the CFTC, and the CFPB) and individual state

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[47]Ibid., section 1(b)(2).

[48]It is likely that a major difference for any reauthorized versions of this authority is that any plan would now have to be ratified by Congress, rather than automatically going into effect but for exercise of a Congressional veto. In response to *INS v. Chadha*, 642 U.S. 919, the U.S. Supreme Court (*Process Gas Consumers Group v. Consumer Energy Council*, 463 U.S. 1216) summarily affirmed the DC Circuit's decision in *Consumer Energy v. FERC*, 673 F.2d 425, which provided that "a rule issued pursuant to a one-house veto scheme cannot have a different legal status from a rule issued pursuant to a two-house veto scheme." Even if a two-house veto satisfies the bicameralism requirement, it fails the presentment requirement and is presumptively unconstitutional.

regulatory agencies. Congress should work with the Trump Administration to improve the effectiveness and efficiency of the U.S. financial regulatory system.

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