Hearing before the
United States Senate,
Committee on the Judiciary,
Subcommittee on the Constitution

THE ADMINISTRATIVE STATE V. THE CONSTITUTION: DODD-FRANK AT FIVE YEARS

July 23, 2015

Statement of Amb. C. Boyden Gray

I am grateful for the opportunity to testify before this Subcommittee, on the constitutional flaws inherent in the creation and operation of the Consumer Financial Protection Bureau, under Title X of the Dodd-Frank Act.[1] The CFPB's structural unconstitutionality is a matter of fundamental importance—as important today as it was on the day that President Obama signed it into law, or the day that he unconstitutionally appointed Director Cordray to lead it without the Senate's advice and consent. Indeed, the CFPB's unconstitutionality is all the *more* important today, because the passage of five years has only illustrated all the more clearly, in concrete terms, the harmful consequences of vesting a regulatory agency with effectively unchecked power.

I have had the honor of testifying previously on these issues. In 2012, I addressed the CFPB's unconstitutionality, and Cordray's unconstitutional "recess" appointment, before the House Oversight Committee[2]; and in 2013 I addressed the

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

[2] *Uncharted Territory: What Are The Consequences of President Obama's Unprecedented "Recess" Appointments?*, 112th Cong. (Feb. 1, 2012), *available at*

similar structural constitutional flaws of Dodd-Frank's Title I (Financial Stability Oversight Council) and Title II (Orderly Liquidation), before a subcommittee of the House Financial Services Committee.[3] I attach my testimony on Titles I and II as Appendix A.

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.[4] It is no accident that a community bank is the lead plaintiff in that 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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http://www.boydengrayassociates.com/uncharted-territory-what-are-the-consequences-of-president-obamas-unprecedented-recess-appointments/.

[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] And State plaintiffs are challenging Orderly Liquidation. *State Nat'l Bank of Big Spring v. Lew*, No. 1:12-cv-01032 (D.D.C. filed June 21, 2012), *appeal pending*, No. 13-5247 (D.C. Cir. filed Aug. 7, 2013). The president of State National Bank of Big Spring, my client in the lawsuit, testified before a subcommittee of the House Financial Services Committee. *The Adverse Consequences of the Dodd-Frank Act on Community Bank Customers and Borrowers: Hearing Before the Subcomm. on Oversight & Investigations of the H. Comm. on Financial Servs.*, 112th Cong. (July 19, 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.

In my prepared statement today, I would like to briefly reiterate the constitutional arguments that we are pressing in our litigation, and which I have written and spoken on elsewhere,[5] and to respond to the assertion that alternative forms of "oversight" somehow mitigate Dodd-Frank's nullification of constitutional checks and balances. Then I will examine two specific points highlighting the fruits of the CFPB's unconstitutional structure: its astonishingly aggressive efforts to sweep up Americans' personal financial information; and the trend toward further consolidation in the banking industry, which exacerbates the "too big to fail" (or "TBTF") problem.

As the Dallas Federal Reserve Bank has succinctly stated, "[f]or all its bluster, Dodd-Frank leaves TBTF *entrenched*."[6] Ironically, two days ago the *Wall Street Journal*'s front page reported: "Fed Tells Big Banks to Shrink or Else." I say that this is ironic because, as will be discussed at the end of my testimony, Dodd-Frank itself has helped to perpetuate and exacerbate Too Big to Fail, meaning the Federal Reserve is trying to fix a problem of the government's own making. If the Federal Reserve does impose stricter capital requirements on big banks, then there

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[5] *See*, *e.g.*, C. Boyden Gray & Jim R. Purcell, *Why Dodd-Frank is Unconstitutional*, WALL. ST. J., June 21, 2012; 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 (Nov. 2010), *at* http http://www.fed-soc.org/publications/detail/the-dodd-frank-wall-street-reform-consumer-protection-act-of-2010-is-it-constitutional; C. Boyden Gray, *Congressional Abdication: Delegation Without Detail and Without Waiver*, 36 HARV. J. L. & PUB. POL'Y 41 (2013).

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

would be all the less need for heavy-handed regulation of banks, especially community banks.

I. The CFPB Is Unconstitutional

Our Constitution separates the legislative, executive, and judicial powers precisely in order to limit government and preserve liberty. As Alexander Hamilton wrote in Federalist No. 9, the "regular distribution of power into distinct departments" and "the introduction of legislative balances and checks" were the first of several "means, and powerful means, by which the excellences of republican government may be retained and its imperfections lessened or avoided." By contrast, as James Madison (quoting Montesquieu) warned in Federalist No. 47, "[t]here can be no liberty where the legislative and executive powers are united in the same person, or body of magistrates." Thus, the Framers separated the powers in order "to divide and arrange the several offices in such a manner as that each may be a check on the other."[7]

Independent agencies pose a well-recognized challenge to the separation of powers, by vesting in the agencies not just executive but also "quasi-legislative" and "quasi-judicial" powers, while purporting also to remove them from full executive control. The Supreme Court famously endorsed such an agency structure in *Humphrey's Executor v. United States*.[8] Even if that case was rightly decided within the four corners of the issues before the Court in 1935, the subsequent eight decades have seen the proliferation of even more forms of agency "independence" or

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[7] Federalist No. 51 (Madison).

[8] 295 U.S. 602 (1935).

"insulation,"[9] posing ever greater threats to the Constitution's limited, tripartite form of government.

Fortunately, the Supreme Court drew a line in the sand five years ago, in *Free Enterprise Fund v. Public Company Accounting Oversight Board.*[10] The Court held that although *Humphrey's Executor* and other cases allow Congress to place one layer of independence between the President and an agency, the Court has never allowed an agency to enjoy *more* independence than that. And thus the Court struck down the Sarbanes-Oxley Act's second layer of independence between the President and the Public Company Accounting Oversight Board.

"The added layer of tenure protection makes a difference," the Court explained.[11] "This novel structure does not merely add to the Board's independence, but transforms it."[12] "Indeed, if allowed to stand, this dispersion of responsibility could be multiplied. If Congress can shelter the bureaucracy behind two layers of good-cause tenure, why not a third?"[13] Ultimately, the Court recognized that we can preserve the Framers' republican government only by ensuring that the agencies remain meaningfully accountable to the people: we "can have a government that functions without being ruled by functionaries, and a government that benefits from

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9 *See*, *e.g.*, Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 Tex. L. Rev. 15 (2010).

10 561 U.S. 477 (2010).

11 *Id.* at 495.

12 *Id.* at 496.

13 *Id.* at 497.

expertise without being ruled by experts. Our Constitution was adopted to enable the people to govern themselves, through their elected leaders."[14]

The CFPB's structure runs afoul of the same basic constitutional principles. True, Dodd-Frank does not stack multiple forms of insulation between the President and the CFPB, as Sarbanes-Oxley did for the PCAOB. Instead of combining multiple forms of independence vertically, it does so *horizontally*—*i.e.*, by combining the CFPB's independence from the President[15] with the CFPB's additional independence from *Congress*, by nullifying Congress's power of the purse over the CFPB and funding it instead through automatic payments from the Federal Reserve—more than $600 *million* annually.[16] Furthermore, Dodd-Frank expressly decreases the judicial branch's power over the agency by mandating that courts give extra deference to the CFPB's statutory interpretations.[17] And in all of

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[14] *Id.* at 499.

[15] Dodd-Frank § 1011.

[16] *Id.* § 1017(a).

[17] *See id.* § 1022(b)(4)(B) ("DEFERENCE—Notwithstanding any power granted to any Federal agency or to the Council under this title, and subject to section 1061(b)(5)(E), the deference that a court affords to the Bureau with respect to a determination by the Bureau regarding the meaning or interpretation of any provision of a Federal consumer financial law shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law."). If the CFPB already were entitled to *Chevron* deference for its interpretation of the Federal consumer financial laws, then this provision would be superfluous. Rather, Dodd-Frank's framers evidently recognized that the CFPB is *not* entitled to such deference in interpreting these statutes, because the CFPB is not the only agency that administers these statutes. (Indeed, the CFPB's own proponents often urge that FSOC, too, is charged in part with administering them. *See* Part II, below.) If a statute is not committed to the CFPB's *exclusive* interpretive authority by Congress, then the CFPB is not entitled to *Chevron* deference. *See*, *e.g.*, *Dodge v. Comptroller of the Currency*, 744 F.3d 148,

this, the extraordinarily independent agency is delegated effectively unlimited regulatory powers.[18] Taken together, those features violate the Constitution's separation of powers by creating a regulatory agency far more "independent" and powerful than anything ever approved by the Supreme Court.

Dodd-Frank's nullification of Congress's appropriations power over the CFPB is particularly dangerous. As James Madison stressed in Federalist No. 58, the "power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance, and for carrying into effect every just and salutary measure." But Congress's purse is powerless over the CFPB, because the CFPB does not rely on appropriations. Instead, Dodd-Frank entitles the CFPB to more than **$600 million every year,** payable out of the Federal Reserve on the CFPB's demand.[19] Dodd-Frank goes so far as to order the relevant congressional committees not even to "review" the CFPB's automatic funds.[20]

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156 (D.C. Cir. 2014) ("the court owes no [*Chevron*] deference to" an agency's interpretation of a statute that "several agencies administer").

[18] Dodd-Frank § 1031 (empowering the CFPB to regulate and litigate "unfair," "deceptive," or "abusive" lending practices).

[19] Specifically, the CFPB is entitled to up to 12 percent of the Federal Reserve's operating expenses. Dodd-Frank § 1017(a). According to the CFPB, this equals $618.7 million in FY2015, and $631.7 million in FY2016. CFPB, *The CFPB Strategic Plan, Budget, and Performance Plan and Report* 11 (Feb. 2015), *available at* http://files.consumerfinance.gov/f/201502_cfpb_report_strategic-plan-budget-and-performance-plan_FY2014-2016.pdf.

[20] Dodd-Frank § 1017(a)(2)(c). A related provision further states that the Office of Management and Budget does not have "any jurisdiction or oversight over the affairs or operations of the Bureau." *Id.* § 1017(a)(4)(E).

Moreover, the CFPB can keep funds that it collects via "civil penalties." Specifically, if "victims cannot be located or such payments [to victims] are otherwise not practicable, the Bureau may use such funds for the purpose of consumer education and financial literacy programs."[21] To date, the CFPB claims to have collected $286 million in civil penalties, but of that amount nearly $40 million has not been returned to victims,[22] an apparent windfall to the CFPB.

And the CFPB is not afraid to boast its independence from Congress (at least not when such boasts suit its purposes). The agency has crowed that its statutory entitlement to "funding outside the congressional appropriations process" ensures its "*full independence*" from Congress.[23] The Framers would be stunned, to say the least, to hear that a regulatory agency enjoys "full independence" from Congress.

The Supreme Court correctly (and unanimously) held that President Obama's original attempt to appoint CFPB Director Cordray without the Senate's advice and consent was unconstitutional.[24] Director Cordray's eventual reappointment, with Senate confirmation, means that he is no longer unconstitutionally appointed—but

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21 *Id.* § 1017(d)(2); *see also Consumer Financial Civil Penalty Fund*, 78 Fed. Reg. 26489 (May 7, 2013).

22 "Consumer Financial Protection Bureau: By The Numbers" (July 15, 2015), *available at* http://files.consumerfinance.gov/f/201507_cfpb_factsheet-by-the-numbers.pdf.

23 CFPB, *The CFPB Strategic Plan, Budget, and Performance Plan and Report* 81 (Apr. 2013) (emphasis added), *available at* http://files.consumerfinance.gov/f/strategic-plan-budget-and-performance-plan-and-report-FY2012-14.pdf.

24 *NLRB v. Noel Canning*, 134 S. Ct. 2550 (2014) (striking down the NLRB members appointed with Director Cordray).

he still directs an unconstitutional agency.[25] Congress must not wait for the Supreme Court to act again; it must undertake the work of restructuring the agency according to constitutional limits.

II. The CFPB's Structural Unconstitutionality Cannot Be Cured By Other Forms of "Oversight" That Its Proponents Inaccurately Invoke

Despite the CFPB's unprecedented status as a regulatory agency independent from both the President and Congress, insulated from judicial review and wielding open-ended powers, its proponents have attempted to confuse the issue by asserting that the agency's unconstitutionality is mitigated by other forms of "oversight." This is epitomized by a chart published[26] on the "Credit Slips" blog:

Comparison of Oversight of Selected Federal Regulatory Agencies

	CFPB	EPA	FDIC	FRB	FTC	OCC	OTS	SEC	SSA
APA Rulemaking	X	X	X	X	X	X	X	X	X
APA Adjudication	X	X	X	X	X	X	X	X	X
Budget Subject to Appropriations		X			X			X	X
Budget Capped	X								
OIRA Review of Economically Significant Regs		X			X	X	X		X
OIRA SBREFA Review	X	X							
FSOC Veto	X								
Annual GAO Audit	X								
Term in Office <5 Years		X							
5-member Commission			X	X	X			X	
Bipartisan Representation Requirement			X		X				
Presidential Removal without Cause		X				?	?		
Congressional Oversight	X	X	X	X	X	X	X	X	X

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[25] After Cordray received Senate confirmation, he published a one-paragraph announcement purporting to "affirm and ratify" the CFPB's pre-confirmation actions. 78 Fed. Reg. 53734 (Aug. 30, 2013). But neither the "de facto officer doctrine" nor other doctrines empower Cordray to singlehandedly cure the unconstitutionality of his own past actions by simply waving that *pro forma* wand. To cure the unconstitutionality of rulemakings that the CFPB issued under its then-unconstitutionally-appointed director, it must rescind and re-promulgate those regulations with a full opportunity for public comment and judicial review.

[26] http://www.creditslips.org/creditslips/2011/05/cfpb-oversight.html

As you can see, Prof. Levitin's chart attempts to show that the CFPB is actually subject to *more* oversight than other federal agencies. But his chart is deeply flawed. Its significant inaccuracies include the following:

"Budget Capped": The chart says that the CFPB's budget is "capped." But that is not true. The CFPB receives its aforementioned, automatic payments from the Federal Reserve—in FY2016 that will be $631 million, as noted above, in addition to the civil penalties that the CFPB keeps. And the CFPB can ask Congress for even *more* money, if it finds itself unable to make ends meet on more than $600 million per year. But if an automatic grant of $631 million is a "capped" budget, then "capped" has lost any real meaning.

"FSOC Veto": The CFPB's proponents often note that the Financial Stability Oversight Council, an inter-agency council, has veto authority over the CFPB. But they rarely admit that this is a "veto" only nominally:

First, the "veto" applies only to the CFPB's "*final regulations*"—not to enforcement or supervisory actions, not to investigations, not to agency "guidance," and not to any other means by which the CFPB governs the regulated community.[28]

Second, even in the narrow context of final regulations, the FSOC cannot veto the CFPB unless its regulation "would put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk"—a criterion so extreme that it likely will never be triggered.[29] (If the

[28] Dodd-Frank § 1023(a).

[29] *Id.*

CFPB's proponents have ever identified a CFPB regulation—either actual or hypothetical—that would meet that standard, then I have never heard of it.)

Last, but not least, even if the FSOC were confronted with a CFPB regulation that actually meets that extreme statutory standard, it still cannot veto the rule unless the FSOC members endorse the veto by a two-thirds supermajority.[30] With FSOC's ten voting members, that would require a 70% supermajority. But more importantly, *the CFPB is one of the FSOC's ten voting members*, which means that the FSOC cannot veto the rule unless *seven of the other nine members vote for a veto*—a 78% supermajority of non-CFPB members.

In short, the FSOC has a nominal "veto" that will never actually be used.

"Congressional Oversight": Finally, the aforementioned chart asserts that the CFPB is subject to "Congressional Oversight." That, too, is truer in theory than in reality. As noted above, Congress does not actually have any power of the purse over the agency, which means that the agency is largely free to disregard Congress.

And that is precisely what the CFPB has done and continues to do, rebuffing Congress's good-faith questions in almost comical fashion—as Rep. Neugebauer, former chairman of the House Financial Services Committee's Oversight Subcommittee noted in 2012.[31] The CFPB's defiance of congressional oversight—or, as mentioned above, what the CFPB calls its "full independence" from Congress—is epitomized by Director Cordray's refusal to answer Congress's questions on the

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[30] *Id.* § 1023(c)(3).

[31] Rep. Randy Neugebauer, *A $447 Million Consumer Alert*, WALL ST. J. (Sept. 19, 2012), *available at* http://www.wsj.com/articles/SB10000872396390444620104578006182400443070.

CFPB's overspending of hundreds of millions of dollars on its new headquarters—or, as he told Congress, "*why does that matter to you?*"[32]

Similarly, Director Cordray has told Congress that he does not find it "useful" to define "abusive" lending practices in advance, and instead he will define it on a case-by-case basis.[33] He also claims that the agency has power ("exception authority") to nullify statutes that conflicted with the CFPB's own priorities.[34]

Those are not the statements of an agency that sees itself as subject to meaningful "oversight" by Congress.

III. The CFPB's Lack of Constitutional Checks and Balances Is Exemplified By Its Massive, Secret Collection of Americans' Financial Information

As noted above, the Framers believed that constitutional checks and balances would protect individual liberty and promote good government. Especially Congress's power of the purse, which Madison believed was "the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people." The absence of such tools of accountability leaves the

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[32] http://www.youtube.com/watch?v=5IxSfJ638cs; Michael Leahy, *CFPB Director Swats Down Congressional Question About $215 Million Spent On New HQ: 'Why Does That Matter to You?'*, BREITBART.COM (Mar. 5, 2015), *at* http://www.breitbart.com/big-government/2015/03/05/cfpb-director-swats-down-congressional-question-about-215-million-spent-on-new-hq-why-does-that-matter-to-you/.

[33] *How Will The CFPB Function Under Richard Cordray*, Hrg. before the House Oversight Committee, Subcomm. on TARP, Financial Servs., and Bailouts of Public and Private Programs, 112th Cong. 69 (Jan. 24, 2012).

[34] *Holding the CFPB Accountable: Review of Semi-Annual Report to Congress*, Hrg. before the Senate Committee on Banking, Housing, and Urban Affairs, 112th Cong. 8 (Sept. 13, 2012).

CFPB free to undertake reckless policies. This is especially evident in the CFPB's collection of scandalous amounts of personal financial information.

A. Consumer Credit Cards, Mortgages, and Credit Reports Data

On March 13, 2012, the CFPB signed a contract with Argus Information and Advisory Services LLC for the "collection, transmission, validation, aggregation, reporting, storage, and analysis of credit card data."[35]

For a year, the CFPB operated this program under the public radar. But on April 17, 2013, Bloomberg reported that the CFPB was "gearing up to monitor how millions of Americans use credit cards, take out mortgages and overdraw their checking accounts."[36] It reported that the CFPB's contract with Argus, worth $15 million, involved credit-card information from nine unnamed banks.[37] It further reported that the CFPB had promised to pay Experian, a Dublin-based credit-monitoring company, $8.4 million "to provide data on 5 million to 10 million consumers."[38] The CFPB's own assistant director for research was quoted as saying,

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[35] *Argus Information and Advisory Services LLC CFP12C00001*, USASPENDING.GOV, *available at* https://www.usaspending.gov/transparency/Pages/TransactionDetails.aspx?RecordID=B614ECF5-E6B8-3C2A-5A42-F922A0DB3571&AwardID=16177347&AwardType=C.

The contract was a fixed-priced contract for one year with four, one-year options. *Credit Card Data Analysis Services*, FEDERAL BUSINESS OPPORTUNITIES (Mar. 14, 2012), *available at* https://www.fbo.gov/index?s=opportunity&mode=form&tab=core&id=64043f84f1b0fa0ccb4d3fc819d0712d.

[36] Carter Dougherty, *U.S. Amasses Data on 10 Million Consumers as Banks Object*, BLOOMBERG BUSINESS (April 17, 2013), *available at* http://www.bloomberg.com/news/articles/2013-04-17/u-s-amasses-data-on-10-million-consumers-as-banks-object.

[37] *Id.*

[38] *Id.*

"'I understand that people don't want firms [accumulating massive data repositories], so why would you want the government doing it?' . . . 'It seems invasive.'"[39]

A few days after the Bloomberg article, CFPB Director Richard Cordray appeared before the Senate Banking Committee, where several Senators pressed him on the CFPB's data grab. Under questioning from Senator Crapo, Director Cordray attempted to justify the data-gathering by stating that high-quality data would enable the CFPB to do high quality cost benefit analysis of its regulations.[40] Further, he argued, "big data" is already extensively used in the private sector, and the CFPB is merely trying to "keep up" with the private sector by purchasing already available information.[41] Finally, he attempted to assure the committee members that all of the data that the CFPB received was anonymous.[42] But when Sen. Crapo pressed him to answer whether the CFPB could dig into to the data to get personal information, Director Cordray could not answer that personal information cannot be identified—instead, he said only that the CFPB had no interest in personal information.[43]

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[39] *Id.*

[40] *The Consumer Financial Protection Bureau's Semi-Annual Report to Congress Before the S. Comm. On Banking, Housing, and Urban Affairs*, 113th Cong. 7 (Apr. 2013).

[41] *Id.*

[42] *Id.* at 8.

[43] *Id.*

In answer to questioning from Senator Johanns, Director Cordray explained that the CFPB was collecting three types of data: credit card data, national mortgage data, and credit record data.[44] The credit card data was purchased from Argus, which was already used by other institutions for similar data.[45] The national mortgage data was obtained from the Federal Housing Finance Agency (FHFA), which in turn collected the data in real time.[46] Lastly, the credit record data was purchased from the same source from which the Federal Reserve Board of New York purchased its data.[47] Senator Johanns noted that the CFPB's data collection seemed "downright creepy."[48]

As a result of the committee hearing, many became concerned with the nature and the extent of the CFPB's data collection.[49] Judicial Watch submitted a FOIA request and received documents listing contracts with Argus, Experian, and Deloitte Consulting for gathering, storing, and sharing credit card data, as well as

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[44] *Id.* at 10.

[45] *Id.*

[46] *Id.* at 10–11.

[47] *Id.* at 11.

[48] *Id.* at 11.

[49] *See, e.g.,* Steven Nelson, *CFPB Accused of Targeting 5 Million Americans for 'Warrantless' Financial Surveillance*, U.S. NEWS (June 27, 2013), *available at* http://www.usnews.com/news/blogs/washington-whispers/2013/06/27/government-targets-5-million-americans-for-warrantless-financial-surveillance-watchdog-says; Tom Fitton, *Obama Admin's Consumer Financial Protection Bureau Collecting Credit Card Data*, BREITBART.COM (July 8, 2013), *available at* http://www.breitbart.com/big-government/2013/07/08/is-the-obama-administration-collecting-your-confidential-credit-card-data/.

an "indefinite delivery, indefinite quantity" (IDIQ) contract with Experian.[50] The documents also revealed that the contract with Argus contained a provision acknowledging that the contractor "may obtain access to non-public, confidential information, Personally Identifiable Information (PII), or proprietary information."[51] The contract also stated that Argus may be required by the CFPB "to share credit card data collected from the Banks with additional government entities as directed by the Contracting Officer's Representative (COR)."[52]

The CFPB's collection and storage of personal data raises grave privacy concerns. Documents describe the original plan: "The [accounts analyzed] shall include 5 million consumers, and joint borrowers, co-signers, and authorized users. The initial panel shall contain 10 years of historical data on a quarterly basis."[53] While "names, addresses and full account numbers of the 5 million study subjects will be 'masked to preserve confidentiality,' . . . ZIP codes, Census block numbers, birth dates and ages of subjects will be recorded."[54] The "anonymized" study subjects will also have "a persistent consumer identifier making it possible to follow consumers over time."[55]

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50 Fitton, *supra* note 49.

51 *Id.*

52 *Id.*

53 Nelson, *supra* note 49.

54 *Id.*

55 *Id.*

In the next semi-annual Senate committee hearing, Senator Crapo again raised concerns about the depth and extent of the CFPB's data collection.[56]

> SENATOR CRAPO: The bureau, as I understand it, has set a goal of monitoring 80 percent of the U.S. credit card market. Just extrapolating from that, using the U.S. Census Bureau data, that goal would represent about **900 million credit card accounts.** Is that an accurate reflection of the Bureau's goals and their activities in terms of reviewing credit card activity?
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> DIRECTOR CORDRAY: Again, the bureau is not about reviewing any number . . . of individual consumer accounts. What we are doing instead is illustrated by what we just did a month ago. Congress required us to do a report on the credit card industry and the credit card market to examine how the CARD Act has affected that market and to be able to report to you, you as a member of Congress . . . on how you can make policy around this and how you did with the CARD Act. we cannot do that without data.
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> . . .
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> SENATOR CRAPO: And would the number of accounts be approximately 900 million credit card accounts?
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> DIRECTOR CORDRAY: I do not know what the number of the accounts is, and, again, that is not our focus. It is to oversee the number of credit card issuers, not . . . monitor the behavior of individual—
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> SENATOR CRAPO: I understand your stated purpose, but the point is that in order to achieve the purpose you describe, you are collecting individualized information on, as we calculate it, about 900 million accounts. I just want you to acknowledge whether that is correct.
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> DIRECTOR CORDRAY: What I want to say to you is we are not doing anything new. The notion . . . that we are coming up with some brand new database or some brand-new data or it is somehow different in kind—it is not.
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> . . .

[56] *The Consumer Financial Protection Bureau's Semi-Annual Report to Congress Before the S. Comm. On Banking, Housing, and Urban Affairs*, 113th Cong. (Nov. 2013) (emphasis added).

> SENATOR CRAPO: I take your answer to be that is accurate and that other institutions and private sector entities are doing the same thing. Is that your answer?
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> DIRECTOR CORDRAY: I do not dispute—I do not dispute what you are saying, but I think it is important to understand, again, this is not about monitoring individual consumer behavior. I do not care about any individual, and we are not tracking anybody's credit card spending of any sort. What we are trying to do is, if I am going to oversee the largest financial institutions in this country and be able to take enforcement actions as we have done against a number of credit card issuers we have to know what they are doing; we have to know what the effect is on the market; we have to know whether laws are being complied with.
>
> I make no apologies. We need the data to do that, and we cannot do it without the data, nor could we report to you what is happening in the credit card market so that you could consider whether you want to make adjustments on the CARD Act or not.[57]

Privacy concerns are compounded by fears of potential security breaches. Some have voiced concern that information compiled in these extensive databases could be "reverse engineered" by hackers to identify individual records.[58] The CFPB has done nothing to assuage these fears. In testimony before the House Financial Services Committee, CFPB Director Cordray was unable to guarantee that consumer information could be kept safe.[59]

The CFPB's refusal to guarantee the security of consumers' personal financial information is a major red flag, given the Office of Personnel Management's

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57 *Id.* at 8–9.

58 Richard Pollock, *Federal Consumer Bureau Data-Mining Hundreds of Millions of Consumer Credit Card Accounts, Mortgages*, WASHINGTON EXAMINER (Jan. 29, 2014), *available at* http://www.washingtonexaminer.com/federal-consumer-bureau-data-mining-hundreds-of-millions-of-consumer-credit-card-accounts-mortgages/article/2543039.

59 *Id.*

disastrous failure to secure government employees' personal information. Hackers targeted OPM because it had collected vast quantities of personal information and stored them in a single place—the perfect target. The CFPB's immense collection of personal financial information is just as lucrative of a target.

In addition to worries over credit information, there are concerns about the CFPB's joint effort with FHFA to "collect data on 53 million residential mortgages originated between 1998 and 2014."[60] Even the FHFA's own project manager for its national mortgage database acknowledges, "[i]t is easy to reverse engineer and identify the people in our data base."[61]

As a result of these concerns, Senator Crapo requested that the U.S. Government Accountability Office (GAO) launch an investigation into the CFPB, and GAO compiled a report to Congress in September of 2014.[62] The report compiled a list of the major CFPB data collections, which included 10.7 million individual consumer credit reports collected on a monthly and quarterly basis, more than 500 million credit card accounts collected on a monthly basis, and 29 million active mortgages and 173 million total mortgages collected on a monthly basis.[63]

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[60] Matt Doffing, *Banks in a Bind on CFPB Tracking of Customer Data*, CFPB JOURNAL (Feb. 4, 2014), *available at* http://cfpbjournal.com/issue/cfpb-journal/article/banks-in-a-bind-on-cfpb-tracking-of-customer-data.

[61] *Id.*

[62] GOVERNMENT ACCOUNTABILITY OFFICE, CONSUMER FINANCIAL PROTECTION BUREAU: SOME PRIVACY AND SECURITY PROCEDURES FOR DATA COLLECTIONS SHOULD CONTINUE BEING ENHANCED 3 & n.6 (2014).

[63] *Id.* at Highlights 2.

While finding that other regulatory agencies gather similar data,[64] the report stated that because it did not initiate the data collections through notice-and-comment rulemaking, the CFPB has not shown any cost-benefit analysis for collecting the data from either the agency's or the regulated institutions' perspective,[65] and that the CFPB's data collection may impose greater costs on banking institutions than other regulators.[66] In the end, the GAO reported several ways that the CFPB needs to improve its security and privacy protection.[67]

The CFPB recently said that it would crack down on banks that amass "big data," because the collection of such data can harm consumers.[68] How ironic.

B. FIS, Fiserv, and Jack Henry Overdraft Data

In November of 2014, the CFPB ordered several data processing institutions, primarily Fiserv, FIS, and Jack Henry, to submit data in regards to their overdraft services.[69] Fiserv and FIS responded to the order in May.[70] Fiserv stated that it relied on the CFPB's assurance that it was only using the data for research

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[64] *Id.* at Highlights 1.

[65] *Id.* at 33.

[66] *Id.* at 35.

[67] *Id.* at Highlights 1–2.

[68] Allison Grande, *FTC, CFPB Setting Sights on 'Big Data' Enforcement*, LAW360 (May 11, 2015), *available at* http://www.law360.com/articles/654132/ftc-cfpb-setting-sights-on-big-data-enforcement.

[69] Roy Urrico, *CUNA, ABA Dispute CFPB Overdraft Order*, CREDIT UNION TIMES (June 8, 2015), *available at* http://www.cutimes.com/2015/06/08/cuna-aba-dispute-cfpb-overdraft-order.

[70] *Id.*

purposes in turning over the information.[71] According to Fiserv, the information, which covered 60 data points, does not include "institution name, location or other identifying information," and "[t]here was no personally identifiable consumer information involved in the order's data request."[72] FIS likewise claims to have removed all identifying information from the data they sent to the CFPB.[73] But Fiserv warns that the cost of providing the overdraft data to the CFPB will "require thousands of hours of effort across its organization."[74] Fiserv, therefore, warned its customers of potential price increases resulting from the additional burden on the company.[75]

The CFPB's assertion of authority over banks' overdraft protections is yet another example of the agency increasing its jurisdiction well beyond even the broad powers granted to it by Dodd-Frank. As the Independent Community Bankers of America (ICBA) recognizes, the overdraft protections that banks offer their customers are "services to their customers as a convenience to them because it

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71 Roy Urrico, *Fiserv Responds to CFPB Overdraft Order*, CREDIT UNION TIMES (May 26, 2015), *available at* http://www.cutimes.com/2015/05/26/fiserv-responds-to-cfpb-overdraft-order.

72 Roy Urrico, *CFPB to Fiserv: Hand Over Overdraft Data*, CREDIT UNION TIMES (May 17, 2015), *available at* http://www.cutimes.com/2015/05/17/cfpb-to-fiserv-hand-over-overdraft-data?page=1..

73 Roy Urrico, *CFPB Orders Overdraft Data From FIS*, CREDIT UNION TIMES (May 18, 2015), *available at* http://www.cutimes.com/2015/05/18/cfpb-orders-overdraft-data-from-fis.

74 Roy Urrico, *supra* note 72.

75 *Id.*

is a service they request and use."[76] But for the CFPB to have jurisdiction over overdraft protections, the agency had to recharacterize overdraft protections as actually loans in disguise.[77] This was (as the ICBA put it) an "extreme example of government overreach under the guise of market monitoring authority,"[78] and one that may ultimately cost bank customers money due to the additional burdens imposed on the banks by the CFPB through the data processors.[79]

The American Bankers Association (ABA) joined the ICBA in criticizing the CFPB's order. In a memo dated June 2, 2015, the ABA argued that the order demonstrates problems with the CFPB's overly broad powers.[80] The memo contended that the order shows that the CFPB's powers under Dodd-Frank violate due process because financial institutions have no means to challenge the order, unlike subpoenas.[81] The ABA also expressed frustration that the CFPB was placing expensive burdens on financial institutions by ordering them to perform work that it was fully capable of performing itself.[82]

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[76] Evan Weinberger, *Community Banks Bash CFPB Overdraft Info Request*, LAW360 (June 1, 2015), *available at* http://www.law360.com/articles/662391/community-banks-bash-cfpb-overdraft-info-request.

[77] PYMNTS, *Fiserv Responds to CFPB Overdraft Order*, PYMNTS.COM (May 27, 2015), *available at* http://www.pymnts.com/news/2015/fiserv-responds-to-cfpb-overdraft-order/#.VaOxjvlVhHx.

[78] Evan Weinberger, *supra* note 76.

[79] *Id.*

[80] Memorandum from Virginia O'Neill and Jonathan Thessin, American Bankers Association, to State Associations (June 2, 2015), *available at* http://www.cfpbmonitor.com/files/2015/06/OverdraftMemo2015.pdf.

[81] *Id.*

[82] *Id.*

Simply put, the CFPB's actions raise grave questions of privacy and agency overreach. The CFPB would not take such actions against American people and businesses if the agency were actually accountable to the people's representatives.

IV. The CFPB Exacerbates The "Too Big to Fail" Problem

When President Obama and the Democratic-controlled Congress created Dodd-Frank in 2010, they asserted that it would help eliminate the problem of "Too Big to Fail." In fact, the opposite is true. As the Dallas Federal Reserve concluded in 2011, "[f]or all its bluster, Dodd-Frank leaves TBTF *entrenched*."[83] Indeed, that may be too kind to the CFPB—if anything, the CFPB *exacerbates* Too Big to Fail.

Since 2007 the five biggest banks have only become bigger, controlling ever-greater shares of the financial industry's assets.[84] A team of Harvard scholars finds that "since the second quarter of 2010–around the time of the passage of the Dodd-Frank Act–[community banks'] share of U.S. commercial banking assets has declined at a rate almost double that between the second quarters of 2006 and 2010."[85] They trace the problem, at least in part, to the new regulatory environment.

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

[84] *See*, *e.g.*, Shayndi Raice, *Biggest Lenders Keep On Growing*, WALL ST. J. (Jan. 3, 2014), *available at* http://www.wsj.com/articles/SB10001424052702303640604579298830697671324.

[85] Marshall Lux & Robert Greene, *The State and Fate of Community Banking*, Harvard Kennedy School, M-RCBG Associate Working Paper Series No. 37, *at* http://www.hks.harvard.edu/content/download/74695/1687293/version/1/file/Final_State_and_Fate_Lux_Greene.pdf.

The cause of this worrisome trend should not be difficult to ascertain. The CFPB is imposing immensely burdensome new regulatory requirements on banks, and the biggest banks can more easily shoulder those regulatory burdens because they can disperse those burdens over a larger customer base. This hits small banks much harder than big banks.

For that very reason, JPMorgan Chase's CEO recently said that federal regulations create a "moat" around big banks, protecting them from competition by smaller aspiring rivals.[86] More recently, Goldman Sachs's CEO said that "[m]ore intense regulatory and technology requirements have raised the barriers to entry higher than at any other time in modern history." He added, "[t]his is an expensive business to be in, if you don't have the market share in scale."[87]

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 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.[88]

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

[87] *Regulation Is Good For Goldman*, WALL ST. J. (Feb. 11, 2015), *available at* http://www.wsj.com/articles/regulation-is-good-for-goldman-1423700859.

[88] "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

The biggest banks will continue to benefit from the Dodd-Frank regulatory environment—and community banks and their communities will suffer—if the CFPB is not subjected to significant reforms. First and foremost, it needs to be reconstituted in a manner that actually complies with the Constitution's system of checks and balances.

Again, all of these constitutional problems and regulatory overreaches are unnecessary. The Too Big To Fail problem can be solved through capital requirements and market mechanisms. With those solutions in place, there is no need for heavy-handed regulations that disproportionately hurt community banks.

* * *

Thank you, again, for the opportunity to testify on these crucially important issues, as well as the similar constitutional problems inherent in Title I (Financial Stability Oversight Council) and Title II (Orderly Liquidation). I welcome your questions.

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cooperation that he believed marked business-government relations during the Great War.").

Appendix A

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.
>
> 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

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[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.
>
> 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

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[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.