Backgrounder

No. 2615
October 13, 2011

Published by The Heritage Foundation

Congress Should Promptly Repeal or Fix Unwarranted Provisions of the Dodd–Frank Act

David S. Addington

Abstract: *Congress enacted the Dodd–Frank Wall Street Reform and Consumer Protection Act in 2010 in the wake of a financial crisis followed by a serious economic recession. Regrettably, many of the provisions of the Dodd–Frank Act contravene basic American principles and inhibit rather than advance economic growth. Congress should review the Dodd–Frank Act and repeal or correct those provisions, starting with provisions that intrude upon the role of the states and shareholders in corporate internal governance, intrude into the functions of the judicial branch and deny companies a reasonable opportunity to defend themselves in court, hamper the effective functioning of mortgage markets, and create a largely unsupervised new federal agency to regulate consumer finance.*

Many provisions of the Dodd–Frank Wall Street Reform and Consumer Protection Act contravene America's basic principles of free enterprise, limited government, and individual freedom and place obstacles across the path to economic growth and job creation.[1] Congress should promptly repeal or correct all of them, starting with some of the most egregious provisions, which deal with government intrusion into internal corporate governance, government takeovers of financial businesses, government control of mortgage markets, and government regulation of consumer finance.

Talking Points

- In the wake of financial crises and economic recession, Congress enacted the 847-page Dodd–Frank Wall Street Reform and Consumer Protection Act that overregulates the American economy and limits American liberty.
- The Dodd–Frank Act includes many provisions that are inconsistent with a sound economy and a government of limited power, including provisions that intrude into the functions of state governments, federal courts, and corporate shareholders; deny companies a reasonable opportunity to defend themselves in court; weaken the already weak housing markets; and create a potential rogue agency to control consumer financial products and services.
- Congress should review the Dodd–Frank Act promptly and repeal or correct the many provisions that extend the federal government too far into the lives of Americans and foster excessive regulation that increases the costs of doing business, decreases investment, and inhibits the creation of jobs.

This paper, in its entirety, can be found at: *http://report.heritage.org/bg2615*

Produced by the Department of Domestic and Economic Policy

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Heritage Foundation
LEADERSHIP FOR AMERICA

Internal Corporate Governance

The Dodd–Frank Act intrudes into corporate governance matters traditionally left to the states in our federal system or to corporate shareholders.

Reflecting the American commitment to free enterprise and limited government, decisions about the structure and governance of corporations should be left largely to those who create and own them. Beyond providing the legal mechanisms for establishing corporations, state governments should intrude into corporate governance matters only rarely, and the federal government should do so even more rarely. Regrettably, the Dodd–Frank Act treats a number of matters of internal corporate governance as if they were suitable for federal regulation.

For most of the history of the United States, the laws of each state—rather than the federal government—generally have provided the mechanisms for establishment of corporations and basic rules for internal governance of corporations. The U.S. Supreme Court has recognized that:

> Large corporations that are listed on national exchanges, or even regional exchanges, will have shareholders in many States and shares that are traded frequently. The markets that facilitate this national and international participation in ownership of corporations are essential for providing capital not only for new enterprises but also for established companies that need to expand their businesses. This beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation. . . . It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.[2]

With the Dodd–Frank Act, Congress intruded excessively into the traditional role of the states in our federal system and the freedom of corporate shareholders to make decisions for their corporation consistent with state law. For example, with regard to corporations whose stock is publicly traded, Congress enacted detailed provisions that regulate non-binding shareholder resolutions on how much a corporation pays its executives;[3] restrict who can sit on a corporation's compensation committee of the board of directors, whom it can hire as its lawyer for the committee, and how much it can pay the lawyer;[4] determine whether an employee of a covered financial institution receives "excessive" compensation;[5] and determine when a corporation must give shareholders access to proxy solicitation

---

1. Public Law 111-203 (July 21, 2010). Many, but not every one, of the provisions of the Dodd–Frank Act run contrary to the principles of free enterprise, limited government, and individual freedom or discourage job-creating investment. An example of a sensible provision in the Act is section 989G(a), codified at 15 U.S.C. 7262(a). Section 989G(a) exempted smaller companies with publicly traded stocks from the requirement for annual external auditor's attestation to the company management's assessment of internal controls under section 404(b) of the Sarbanes–Oxley Act of 2002 (Public Law 107-204, July 30, 2002). Section 989G was only one of many steps needed to relieve the economy of the unwarranted cost and burden imposed by section 404(b) of the Sarbanes–Oxley Act. See David S. Addington, "Congress Should Repeal or Fix Section 404 of the Sarbanes–Oxley Act to Help Create Jobs," Heritage Foundation *WebMemo* No. 3380 (September 30, 2011), available at *http://thf_media.s3.amazonaws.com/2011/pdf/wm3380.pdf.*
2. *CTS Corporation v. Dynamics Corporation of America*, 481 U.S. 69, 90–91 (1987).
3. Section 14A of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1), enacted by section 951 of the Dodd–Frank Act.
4. Section 10C of the Securities Exchange Act of 1934 (15 U.S.C. 78j-3), enacted by section 952 of the Dodd–Frank Act.
5. Section 956(a)(1)(A), Dodd–Frank Act.

materials when the shareholders seek to have particular nominees elected as corporate directors.[6]

With the Dodd–Frank Act, Congress intruded excessively into the traditional role of the states in our federal system and the freedom of corporate shareholders to make decisions for their corporation consistent with state law.

Congress should repeal unwarranted corporate internal governance provisions of federal law and leave the subjects they address to the shareholders of corporations and, if necessary, to the states in which the corporations were organized.[7]

Government Takeovers of Financial Businesses

Dodd–Frank Act provisions for government takeovers of financial institutions grossly intrude into the functions of the judicial branch and fail to provide reasonable protection for the institutions.

Title II of the Dodd–Frank Act, ominously captioned "Orderly Liquidation Authority," provides for government takeovers of failing financial companies either by the consent of the company's board of directors or, failing that, by court order.[8] The purpose of Title II is "to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard."[9]

Regrettably, the Dodd–Frank Act's government takeover provisions trample upon the judicial branch, conceal court proceedings from the public, and deny financial institutions a reasonable opportunity to defend themselves in court. The Dodd–Frank Act compels the district court to proceed in absolute secrecy, gives businesses less than 24 hours to prepare to defend themselves in court, commands the court to make its decision within 24 hours, and purports to prohibit appellate courts from considering constitutional issues.

Under the Dodd–Frank Act, the government takes over a financial company in three steps.[10]

First, the Federal Deposit Insurance Corporation (FDIC or Corporation) and the Board of Governors of the Federal Reserve System make a specified written recommendation that the Secretary of the Treasury should appoint the FDIC as a receiver for a financial company.[11]

6. Section 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)), enacted by section 971(a), Dodd–Frank Act, and sections 971(b) and (c) of the Dodd–Frank Act. Although the Securities and Exchange Commission had authority to prescribe proxy access rules prior to enactment of the Dodd–Frank Act, section 971 of the Act expanded that authority.
7. State legislatures and courts are well able to handle the subjects addressed in sections 951, 952, and 956 of the Dodd–Frank Act. See, for example, 8 Del. C. 122(5) (corporate power to provide suitable compensation of employees and agents); 122(15) (corporate power to carry out incentive and compensation plans for directors, officers, and employees); and 141(h) (corporate power to compensate directors). *See In re Tysons Food, Inc. Consolidated Shareholder Litigation*, 919 A. 2d 563, 589 (Delaware Chancery 2007) ("Plaintiffs' complaint as to the approval of the compensation amounts to a claim for excessive compensation. To maintain such a claim, plaintiffs must show either that the board or committee that approved the compensation lacked independence (in which case the burden shifts to the defendant director to show that the compensation was objectively reasonable), or to plead facts sufficient to show that the board or committee lacked good faith in making the award. Assuming that this standard is met, plaintiffs need only allege some specific facts suggesting unfairness in the transaction in order to shift the burden of proof to defendants to show that the transaction was entirely fair.") (footnotes omitted).
8. In most situations, the Secretary of the Treasury and the distressed financial institution likely will reach agreement for a government conservatorship, and there will be no need to resort to the courts. In reaching such a consented conservatorship, the Secretary and the distressed financial institution can proceed at whatever pace and with whatever degree of confidentiality they wish, consistent with applicable law.
9. Section 204(a), Dodd–Frank Act (12 U.S.C. 5384(a)).
10. Sections 202 and 203, Dodd–Frank Act (12 U.S.C. 5382 and 5383).
11. Section 203(a), Dodd–Frank Act (12 U.S.C. 5383(a)).

Second, the Secretary of the Treasury determines that the financial company "is in danger of default"; the company's failure "would have serious adverse effects on financial stability in the United States"; "no viable private sector alternative is available"; "any effect on the . . . interests of creditors, counterparties, and shareholders of the financial company and other market participants . . . is appropriate, given the impact . . . on financial stability . . ."; receivership would "avoid or mitigate such adverse effects"; a federal regulatory agency has ordered the company to convert its convertible debt instruments; and the company meets the statutory definition of a "financial company."[12]

Third, having made such a systemic risk determination, the Secretary notifies the FDIC and the financial company of the determination and, if the company's board consents, appoints the FDIC as the receiver of the company. If the company's board does not consent, the Secretary of the Treasury petitions the U.S. District Court for the District of Columbia for an order for the Secretary to appoint the FDIC as receiver.[13] Upon appointment as a receiver for a financial company, the FDIC has broad authority with respect to the company, including all rights, titles, powers, and privileges of the covered financial company and its assets, and of any stockholder, member, officer, or director of such company.[14]

The proceeding initiated by the Secretary in the U.S. District Court for a non-consensual government takeover of a financial company is, to put it mildly, no ordinary court proceeding. The Secretary files the petition under seal, which means the public cannot see it.[15] The Dodd–Frank Act requires the court to conduct the entire proceeding in absolute secrecy: "On a strictly confidential basis, and without any prior public disclosure, the Court, after notice to the covered financial company and a hearing in which the covered financial company may oppose the petition, shall determine whether the

The Dodd–Frank Act's government takeover provisions trample upon the judicial branch, conceal court proceedings from the public, and deny financial institutions a reasonable opportunity to defend themselves in court.

12. Section 203(b), Dodd–Frank Act (12 U.S.C. 5383(b)).
13. Section 202(a), Dodd–Frank Act (12 U.S.C. 5382(a)).
14. Section 210, Dodd–Frank Act (12 U.S.C. 5390).
15. Normally, the decision whether to seal materials filed in judicial proceedings is left to the courts. *United States v. Brice*, 649 F.3d 793 (D.C. Cir. 2011) ("The decision whether to seal a judicial proceeding under the common-law standard is 'left to the sound discretion of the trial court, a discretion to be exercised in light of the relevant facts and circumstances of the particular case.'") (citation omitted).

determination of the Secretary . . . is arbitrary and capricious."[16]

The requirement that the District Court civil proceeding go forward in strict secrecy is unusual.[17] But the requirement to maintain secrecy in the District Court proceedings is nothing to trifle with; stiff criminal penalties back up the secrecy requirement.[18]

The Act limits the Court to 24 hours after the Secretary files the petition in which to consider the matter; if the Court has not made a determination by the end of 24 hours, the Secretary's petition is

16. Section 202(a)(1)(A)(iii), Dodd–Frank Act (12 U.S.C. 5382(a)(1)(A)(iii)). The "arbitrary and capricious" standard of review, common in judicial review of agency final actions under the Administrative Procedure Act (5 U.S.C. 706), is deferential to the Secretary's determination. An agency decision is not "arbitrary and capricious" if it is "rational, based on consideration of the relevant factors and within the scope of the authority delegated to the agency by the statute." *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 43–44 (1983) ("The scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency. Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.' In reviewing that explanation, we must 'consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.' Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. The reviewing court should not attempt itself to make up for such deficiencies: 'We may not supply a reasoned basis for the agency's action that the agency itself has not given.' We will, however, 'uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.' ") (citation omitted).

17. *Publicker Industries, Inc. v. Cohen*, 733 F.2d 1059, 1070–71 (3d Cir. 1984) (". . .[T]o limit the public's access to civil trials there must be a showing that the denial serves an important governmental interest and that there is no less restrictive way to serve that governmental interest.") (". . .[T]he public and the press possess a First Amendment and a common law right of access to civil proceedings; indeed, there is a presumption that these proceedings will be open."); *Westmoreland v. CBS*, 752 F.2d 16, 23 (2d Cir. 1984), cert. denied sub nomine *CNN v. U.S. District Court*, 472 U.S. 1017 (1985) (". . . [W]e agree with the Third Circuit in *Publicker Industries*, . . .that the First Amendment does secure to the public and to the press a right of access to civil proceedings. . .") (citation omitted). See Judicial Conference of the United States, "Judicial Conference Policy on Sealed Cases" (September 13, 2011) ("sealing an entire case file is a last resort"). Repeal of the requirement in section 202 of the Dodd–Frank Act that the district court always proceed in secrecy would not prevent the government from seeking in a given proceeding to persuade the district court to close the proceeding to serve an important governmental interest that cannot be served in a less restrictive way. For example, the Secretary of the Treasury might argue to the district judge in a given case that public awareness of the proceedings would trigger a national economic collapse and that the judge could not avoid that damage to the country except by deciding to conduct the proceedings in secret.

18. A person "who recklessly discloses a determination of the Secretary under section 203(b) or a petition of the Secretary . . . or the pendency of court proceedings. . . shall be fined not more than [$]250,000, or imprisoned for not more than 5 years, or both." Section 202(a)(1)(C), Dodd–Frank Act (12 U.S.C. 5382(a)(1)(C)). It is not entirely clear from the statute whether the requirement to maintain secrecy applies only while the matter is pending in the District Court, or also when the matter is pending in the Court of Appeals or the U.S. Supreme Court.

automatically granted and the Secretary appoints the FDIC as a receiver for the financial company.[19]

Although the Secretary and the Secretary's lawyers have whatever amount of time they choose to take in preparing their petition and legal arguments before they file the petition, the financial company and its lawyers receive the petition and have no preparation time. The financial company and its lawyers must deal immediately with a hearing held within 24 hours of the Secretary's filing of the petition, and the Court has but 24 hours after receiving the Secretary's petition to hold a hearing, make a decision, and furnish written reasons for the decision to the Secretary and the financial company.

If the District Court within 24 hours upholds the Secretary's determination, the Court must issue an order that authorizes the Secretary to appoint the FDIC as receiver of the company. If the District Court within 24 hours finds the Secretary's determination arbitrary and capricious, the Court must give the Secretary an opportunity to amend and refile the petition, presumably in an effort to correct its shortcomings to the satisfaction of the Court.[20]

If the District Court's final decision is that the Secretary's determination was arbitrary and capricious, the Secretary can appeal to the U.S. Court of Appeals for the District of Columbia Circuit and, if unsuccessful there, seek review by the U.S. Supreme Court. The Dodd–Frank Act directs the Court of Appeals and the Supreme Court to proceed on an "expedited basis" and prohibits them from considering any issues in the case except whether the Secretary's determination was arbitrary and capricious, which at least purports to exclude constitutional issues.[21]

In enacting Title II of the Dodd–Frank Act containing these extraordinary provisions, Congress barely bothered to explain itself. There is but one legislative report relating to the provision, and it is limited to the following four sentences, none of which even addresses the subject of the Act's extraordinary grants of authority to regulatory agencies and commands to the courts:

> Title II establishes an orderly liquidation authority that may be used only if the Secretary of the Treasury (in consultation with the President), based on the written recommendation of two other federal regulators, agrees that doing so is necessary to mitigate serious adverse effects on financial stability in the United States. When the authority is used, the FDIC is appointed receiver and must liquidate the company in a manner that mitigates significant risks to financial stability and minimizes moral hazard. All costs of an orderly liquidation under this title are borne first by shareholders and unsecured creditors, and, if necessary, by risk-based assessments

19. Section 202(a)(1)(A)(v) of the Dodd–Frank Act (12 U.S.C. 5382(a)(1)(A)(v)) provides in full:

    (v) PETITION GRANTED BY OPERATION OF LAW.—If the Court does not make a determination within 24 hours of receipt of the petition—

    (I) the petition shall be granted by operation of law;
    (II) the Secretary shall appoint the Corporation as receiver; and
    (III) liquidation under this title shall automatically and without further notice or action be commenced and the Corporation may immediately take all actions authorized under this title.

    Congress ought to examine carefully the constitutionality of the statutory command that the district court must decide the case in 24 hours or the government automatically wins. See generally *United States v. Klein*, 80 U.S. 128, 147 (1871) (discussing "limit which separates the legislative from the judicial power.").
20. Section 202(a)(1)(A)(iv)(II), Dodd–Frank Act (12 U.S.C. 5382(a)(1)(A)(iv)(II)).
21. Section 202(a)(2), Dodd–Frank Act (12 U.S.C. 5382(a)(2)).

on large financial companies. Taxpayers specifically are protected from losses associated with use of this authority.[22]

Congress showed poor judgment in riding roughshod, and with little explanation, over the process of judicial decisionmaking and the protections normally afforded companies defending themselves from government action in the courts.

Section 202 of the Dodd–Frank Act intrudes to an extraordinary degree into the functioning of the judicial branch. Congress should amend section 202 to respect the constitutional functions of the judiciary, afford at least minimal reasonable procedural protections to a financial company defending itself against the government in takeover proceedings, and take appropriate account of the economic consequences to the United States of a delay in deciding whether to impose a conservatorship on a financial company.[23]

Government Control of Mortgage Markets

The Dodd–Frank Act unreasonably distorts residential mortgage markets.

Section 941(b) of the Dodd–Frank Act added a new section 15G to the Securities Exchange Act of 1934 to require in certain circumstances that organizations issuing asset-backed securities retain an economic interest in a portion of the credit risk involved, giving them an economic incentive to reduce that risk. Section 15G(e)(4) directed a group of six federal agencies jointly to issue regulations exempting qualified residential mortgages from the risk retention requirement.[24] Congress gave the six agencies the authority to define what constitutes a

---

22. Joint Explanatory Statement of the Committee of Conference, H. Rept. No. 111–517, "Dodd–Frank Wall Street Reform and Consumer Protection Act," Conference Report to Accompany H.R. 4173, 111th Congress, 2d session, pp. 865–866 (June 29, 2010).

23. To correct the shortcomings in section 202, Congress could enact the following provision:

    SEC. ___. Section 202 of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) is amended—

    (1) in subparagraph (a)(1)(A)(ii), by inserting ", except that the Court may order the petition disclosed for good cause shown" after "under seal";
    (2) in subparagraph (a)(1)(A)(iii), by inserting "unless and to the extent otherwise ordered by the Court for good cause shown" after "On a strictly confidential basis";
    (3) by striking subparagraph (v) and inserting in lieu thereof "(v) EXPEDITED CONSIDERATION.—The District Court shall consider and decide the petition filed by the Secretary on as expedited a basis as possible, ensuring a reasonable opportunity to present a defense and taking appropriate account of the economic consequences to the public of delay.";
    (4) in paragraph (a)(1)(C), by (A) inserting "unless the determination or petition has been disclosed by order of the Court" after "petition of the Secretary under subparagraph (A)"; and (B) inserting "except to the extent the proceedings were not on a strictly confidential basis" after "provided for under subparagraph (A)";
    (5) by striking paragraphs (a)(2)(A)(iv) and (a)(2)(B)(iv); and
    (6) in subsection (b)(1), by striking ", including rules and procedures to ensure that the 24-hour deadline is met and that the Secretary shall have an ongoing opportunity to amend and refile petitions under subsection (a)(1)".

    For a complete alternative to section 202, Congress could repeal section 202 and replace it with a new chapter in the federal bankruptcy code (title 11, United States Code) tailored to deal with the problems of financial institutions whose impending failure poses systemic risks. David C. John, "Using Bankruptcy and Capital Standards to Address Financial Institutions That Are 'Too Big to Fail,'" Heritage Foundation *Backgrounder* No. 2343 (November 24, 2009), p. 2, available at *http://thf_media.s3.amazonaws.com/2009/pdf/bg2343.pdf*.

24. The six agencies are the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the FDIC, the Securities and Exchange Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency. Section 15G(a) and (e)(4)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-11(a) and (e)(4)(B)).

"qualified residential mortgage" for purposes of the exemption, "taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default. . . ."[25]

The authority Congress granted to the six agencies on credit risk retention was too broad, yielding proposals to interfere with the effective functioning of mortgage markets and give anti-competitive advantages to Fannie Mae and Freddie Mac.

The authority Congress granted to the six agencies on credit risk retention was too broad, yielding proposals to interfere with the effective functioning of mortgage markets and give anti-competitive advantages to Fannie Mae and Freddie Mac.

Although the residential housing market is weak,[26] the six federal agencies have proposed to define "qualified residential mortgage"—what will become in effect the gold standard of the residential mortgage market—to require a buyer of a one-to-four family property to make a down payment at closing of at least 20 percent of the purchase price (or have equivalent equity from a previous home).[27] About 75 percent of the homebuyers who bought homes in 2010 would not have qualified for such a loan.[28] In its effort with the Dodd–Frank Act to make the securities market based on residential mortgages less risky, Congress cannot have meant to increase the difficulty of financing a home for three-quarters of those seeking homes.

The six agencies also have proposed to give the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) favorable treatment when it comes to risk retention. They have proposed that the guaranty provided by Fannie Mae and Freddie Mac operating under the conservatorship or receivership of the Federal Housing Finance Agency (FHFA) will satisfy the risk retention requirements. In essence, organizations issuing asset-backed securities must retain an economic interest in a portion of the credit risk involved in the securities they issue—except that the rule would not apply to Fannie Mae and Freddie Mac. With Fannie Mae and Freddie Mac under the conservatorship of FHFA, the six agencies have essentially proposed to put the government's interests as a conservator ahead of the economic interests of the American people, which lie in a competitive mortgage marketplace.

Congress gave too much authority to the six agencies to define the "qualified residential mortgage" and to give preferential treatment to Fannie Mae and Freddie Mac. Congress should retrieve some of the authority it delegated and restore the operation

25. Section 15G(e)(4)(B), Securities Exchange Act of 1934 (15 U.S.C. 78o-11(e)(4)(B)).

26. Elizabeth A. Duke, Member, Board of Governors of the Federal Reserve System, at the Federal Reserve Policy Board Forum: "The Housing Market Going Forward: Lessons Learned from the Recent Crisis," p. 2, Washington, D.C. (September 1, 2011) (". . . [W]e need to deal with the unprecedented number of loans in or still entering the foreclosure pipeline, the disposition of properties acquired through foreclosure, and the effect of a high percentage of distressed sales on home prices. Regardless of how we got here, we, as a nation, currently have a housing market that is so severely out of balance that it is hampering our economic recovery."), available at *http://www.federalreserve.gov/newsevents/speech/duke20110901a.pdf* (visited October 3, 2011).

27. Notice of Proposed Rulemaking on "Credit Risk Retention" published jointly by the six agencies, 76 *Fed. Reg.* 24090 (April 29, 2011).

28. David C. John, "Qualified Residential Mortgage Regulations Threaten the Housing Market," Heritage Foundation *WebMemo* No. 3270 (May 25, 2011), p. 2, available at *http://thf_media.s3.amazonaws.com/2011/pdf/wm3270.pdf*.

of the principles of free enterprise and limited government in the residential mortgage market.[29]

Government Regulation of Consumer Finance

The Dodd–Frank Act's Consumer Financial Protection Bureau has a misguided mission, structure, and funding mechanism.

Title X of the Dodd–Frank Act establishes "in the Federal Reserve System" an independent "Bureau of Consumer Financial Protection" to "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."[30] The Act creates a Consumer Financial Protection Bureau with too broad a mission, too little supervision, and a funding mechanism free of nearly all controls.

The Act sets forth the purpose of the Bureau. The Bureau "shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent and competitive."[31] The Bureau regulates, with respect to consumer financial goods and services, any covered person[32] who provides mortgage services, is a "larger" participant in a market for consumer financial products or services, is determined by the Bureau after receiving complaints to engage in conduct posing risks to consumers with respect to consumer financial products or services, offers a private education loan, offers a consumer a payday loan,[33] is an insured depository institution or credit union with assets greater than $10 billion,[34] or in certain circumstances is an insured depository institution or credit union with assets of $10 billion or less.[35] The Bureau also has broad authority to prevent a covered person or service provider[36] from committing an "unfair, deceptive,

---

29. Congress could prevent the proposed requirement for 20 percent down payments and the proposed preferential treatment of Fannie Mae and Freddie Mac by enacting the following provision:

    SEC. ___. Section 15G(e)(4)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-11(e)(4)(B)) is amended by—

    (1) striking the comma after "for purposes of this subsection" and inserting a period in lieu thereof; and
    (2) striking "taking into consideration" and inserting in lieu thereof "In doing so, they shall not specify a minimum percentage of the purchase price as a down payment, shall ensure that the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation are subject to the risk retention requirements of this subsection in the same manner and to the same extent as others performing a similar market function, and shall take into consideration".
30. Section 1011(a), Dodd–Frank Act (12 U.S.C. 5491(a)).
31. Section 1021(a), Dodd–Frank Act (12 U.S.C. 5511(a)).
32. A "covered person" is "any person that engages in offering or providing a consumer financial product or service" and any affiliate that acts as a service provider to such person. Section 1002(6), Dodd–Frank Act (12 U.S.C. 5481(6)).
33. Section 1024(a), Dodd–Frank Act (12 U.S.C. 5514(a)).
34. Section 1025(a), Dodd–Frank Act (12 U.S.C. 5515(a)).
35. Section 1026(a), Dodd–Frank Act (12 U.S.C. 5516(a)).
36. A "service provider" is "any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service. . . ." Section 1002(26), Dodd–Frank Act (12 U.S.C. 5481(26)).

or abusive act or practice" in connection with consumer financial products and services.[37]

The Act creates a Consumer Financial Protection Bureau with too broad a mission, too little supervision, and a funding mechanism free of nearly all controls.

The Bureau has general authority to grant exemptions from Title X of the Dodd–Frank Act. The Act provides that:

> The Bureau, by rule, may . . . exempt any class of covered persons, service providers, or consumer financial products or services, from any provision of this title. . . as the Bureau determines necessary or appropriate to carry out the purposes and objectives of this title, taking into consideration. . . the total assets of the class of covered persons; ...the volume of transactions involving consumer financial products or services in which the class of covered persons engages; and. . . existing provisions of law which are applicable to the consumer financial product or service and the extent to which such provisions provide consumers with adequate protections.[38]

The structure of the Bureau makes it a loose cannon on deck. A director appointed by the President, by and with the advice and consent of the Senate, for a term of five years heads the Bureau.[39] Although the Act places the Bureau within the Federal Reserve System, it states explicitly that the Board of Governors of that System "may not . . . intervene in any matter or proceeding before the Director . . . unless otherwise specifically provided by law"; may not "appoint, direct, or remove any officer or employee of the Bureau"; and has no authority to delay, review, or approve any Bureau rules.[40] Further, the law restricts the President's ability to remove the director from office; the President "may remove the Director for inefficiency, neglect of duty, or malfeasance in office."[41] Thus, absent inefficiency, neglect of duty, or malfeasance, the Bureau director has a five-year job with almost no supervision.

Congress has turned the Bureau loose from the requirement, applicable to most agencies, to seek appropriations each year from Congress. Congress has provided that the Board of Governors of the Federal Reserve System shall transfer to the Bureau from the Federal Reserve System's earnings "the amount determined by the Director to be reasonably necessary to carry out the authorities of the Bureau under Federal consumer financial law. . . ," subject to an upper limit of an amount stated as a percentage of the expenses of the Federal Reserve System, automatically increased annually with the employment cost index.[42]

37. Section 1031(a), Dodd–Frank Act (12 U.S.C. 5531(a)). Although the terms "unfair" and "deceptive" have acquired defined meanings in the context of section 5 of the Federal Trade Commission Act (15 U.S.C. 45) and court decisions under that Act, which the Bureau and the courts should follow in implementing section 1031(a) of the Dodd–Frank Act, the undefined term "abusive" gives the Bureau a new authority whose limits are not clear. See Diane Katz, "Reforming Consumer Financial Protection Bureau Necessary to Protect Consumers," Heritage Foundation *WebMemo* No. 3216 (April 7, 2011), p. 2, available at *http://thf_media.s3.amazonaws.com/2011/pdf/wm3216.pdf*.
38. Section 1022(b)(3), Dodd–Frank Act (12 U.S.C. 5512(b)(3)).
39. Section 1011(b), Dodd–Frank Act (12 U.S.C. 5491(b)).
40. Section 1012(c), Dodd–Frank Act (12 U.S.C. 5492(c)). The Financial Stability Oversight Council established by section 111 of the Dodd–Frank Act (12 U.S.C. 5321) may, by two-thirds vote, set aside a final regulation or provision thereof prescribed by the Bureau if the Council decides that the regulation or provision 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." Sec. 1023, Dodd–Frank Act (12 U.S.C. 5313).
41. Section 1011(c)(3), Dodd–Frank Act (12 U.S.C. 5491(c)(3)).
42. Section 1017(a), Dodd–Frank Act (12 U.S.C. 5497(a)). If the Director determines that the sums otherwise available to the Bureau will not suffice to carry out the Bureau's authorities for the upcoming year, the Director may seek appropriations from Congress for up to $200 million for each fiscal year through fiscal year 2015. Sec. 1017(e), Dodd–Frank Act (15 U.S.C. 5497(e)).

Congress has turned the Bureau loose from the requirement, applicable to most agencies, to seek appropriations each year from Congress.

Further, Congress established a Bureau of Consumer Financial Protection Fund in the Federal Reserve to hold the money transferred to the Bureau from the Federal Reserve System, with the money invested and the interests and proceeds on the investments kept by the Fund.[43] Then, in a breathtakingly broad grant of authority, the Act says that "[f]unds obtained by, transferred to, or credited to the Bureau Fund shall be immediately available to the Bureau and under the control of the Director, and shall remain available until expended, to pay the expenses of the Bureau in carrying out its duties and responsibilities."[44] As if the Bureau's fiscal autonomy were not already excessive, the Act makes clear that none of the rules that normally apply to public money will apply to the money in the Bureau fund: "Funds obtained by or transferred to the Bureau Fund shall not be construed to be Government funds or appropriated monies."[45]

Congress should repeal Title X of the Dodd–Frank Act and abolish the Consumer Financial Protection Bureau. At the very least, Congress should restrict the Bureau's mission and adjust its structure and funding so that the normal safeguards that protect the American people against the potential for rogue agencies apply.[46]

Congress Should Repeal or Fix Dodd-Frank Weaknesses Quickly

Many agencies of the U.S. government implementing the Dodd–Frank Act are headed in the wrong direction—the direction set for them by the flawed provisions of the Dodd–Frank Act. Congress should act promptly to correct the flawed provisions of the Dodd–Frank Act. As time passes,

43. Section 1017(b)(1), Dodd–Frank Act, (12 U.S.C. 5497(b)(1)).

44. Section 1017(c)(1), Dodd–Frank Act (12 U.S.C. 5497(c)(1)).

45. Section 1017(c)(2), Dodd–Frank Act (12 U.S.C. 5497(c)(2)).

46. Congress needs to repeal or rewrite in its entirety Title X of the Dodd–Frank Act dealing with the Bureau of Consumer Financial Protection. However, to correct some of its most egregious flaws promptly, while Congress undertakes a thorough review and revision of Title X, Congress could enact the following provision:

SEC. ___. (a) SEPARATE AGENCY WITHIN THE DEPARTMENT OF THE TREASURY.—The Bureau of Consumer Financial Protection shall be a part of the Department of the Treasury.
(b) APPOINTMENT, REMOVAL AND LENGTH OF SERVICE OF DIRECTOR.—The Bureau shall be appointed by the President, by and with the advice and consent of the Senate, to serve at the pleasure of the President for the time being.
(c) FUNDS.—No funds available to the Bureau shall be obligated or expended by the Bureau, except for funds appropriated to the Department of the Treasury or to the Bureau by a law enacted after the effective date of this section and to the extent provided by that law. Section 3302 of title 31, United States Code, shall apply to the Bureau.
(d) DEFINITIONS.—The terms—
(1) "unfair" and "deceptive" as used in Title X of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) and any amendment made by Title X of that Act shall have the same meaning as those terms have under section 5(a) of the Federal Trade Commission Act (15 U.S.C. 45);
(2) "fair" as used in section 1021(a) of the Dodd–Frank Wall Street Reform and Consumer Protection Act shall mean "consistent with law"; and
(3) "abusive" as used in Title X of the Dodd–Frank Wall Street Reform and Consumer Protection Act and any amendment made by Title X of that Act shall mean "contrary to law".
(e) EFFECTIVE DATE.— This section shall take effect thirty days after the date of enactment of this section.
(f) SUPERSEDURE.—This section shall apply notwithstanding any other provision of law, including any provision of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) and any amendment made by that Act.

Dodd–Frank inflicts more damage on the economy, and agency implementation makes later correction more difficult and costly. The principles of free enterprise, limited government, and individual freedom require Congress promptly to review the provisions of the Dodd–Frank Act and repeal or correct them as needed.

—***David S. Addington*** *is Vice President for Domestic and Economic Policy at The Heritage Foundation*