Dodd–Frank

Accretion of Power, Illusion of Reform

Charlotte Twight

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank or DFA) gained passage on the rationale that it would help the United States avoid future financial crises by creating new bureaucracies to fill regulatory gaps purportedly responsible for the crisis in 2008. This paper challenges both prongs of the crisis-prevention rationale: the "regulatory gaps" argument and the "beneficent new bureaucracies" contention. Citing pivotal DFA provisions, I describe the broad powers conferred on new federal bureaucracies: the Financial Stability Oversight Council, Office of Financial Research, and Consumer Financial Protection Bureau. I also examine changes to the federal housing finance bureaucracy made by the DFA. The goal is to clarify the unprecedented authority and reach of these new bureaucracies—the DFA's potent central core—not to analyze the statute's full sweep. The evidence provided throughout is actual statutory law enacted before and after passage of the DFA. That evidence shows that the statute, although presented as an instrument of reform, has chiefly increased government power, consistent with Robert Higgs's (1987) analysis of the link between crisis and the growth of government.

This article also identifies tactics federal officials used to make Dodd–Frank difficult and costly for the public to comprehend, resist, modify, or repeal—tactics consistent with the economic theory of "political transaction-cost manipulation."

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This theory explains in part the economic and political incentives that drive government officials' political behavior, policy initiatives, and regulatory and legislative language (Twight 1988, 1992, 1994, 2002). One example here is Dodd–Frank's sheer length and complexity—2,315 pages in bill form. Moreover, because the act is rife with references to other statutes, one cannot fully understand it without also researching its impacts on the laws it modifies. Yet even that research would be unavailing, for the statute empowers various governmental entities to create voluminous new regulations that ultimately will determine the law's effects, authorizing 398 separate rule makings (Davis Polk 2014, 2). Thus, the statute as passed was largely a blank check whose full impact on the economy and the public would be shaped by government officials who craft and enforce the regulations it authorizes.

A Fateful Misdiagnosis?

Although the Dodd–Frank Act of 2010 was promoted as an antidote to insufficient federal oversight, scholars have shown that it was in fact misuse of existing government power over U.S. financial institutions and housing markets that led to and exacerbated the 2008 crisis.[1] Indeed, U.S. statutory and regulatory developments over many decades had created both the governmental context and the private incentives that gave rise to the crisis (White 2008, 1). From the Federal Reserve Act (1913), the Federal Housing Administration (1934), and the Federal Deposit Insurance Corporation (FDIC), made permanent in 1935, to authorization of government-sponsored enterprises (GSEs) Fannie Mae (1938) and Freddie Mac (1970), creation of the Department of Housing and Urban Development (1965), and enactment of both the Community Reinvestment Act (1977) and the Federal Housing Enterprises Safety and Soundness Act (1992), a web of government powers over U.S. financial institutions and housing markets had emerged, powers whose exercise created public and private incentives for the imprudent borrowing and lending that undergirded the debacle in 2008.

As these laws accumulated, unforeseen consequences proliferated. Social, housing, and banking policies became intertwined. Beginning in 1992, the GSEs—whose original purpose was to provide liquidity to mortgage markets by purchasing and securitizing mortgages issued by savings and loan associations, banks, and other depository institutions—were required to purchase risky subprime or Alt-A loans in ever-increasing percentages to support federal "affordable-housing" policies (Calabria 2011). Banking institutions also had to comply with affordable-housing mandates via nonprime lending or be denied such things as the right to merge or open new branches. With pressure to issue ever more subprime loans, subprime mortgage-lending standards plunged in terms of down payment, income requirements,

1. See Liebowitz 2008; Sowell 2009; Taylor 2009; Lal 2010; McKinley 2011; Hendershott and Villani 2011, 2012; F. Mishkin 2011; Reinhart 2011; Allison 2013.

and credit history—the mainstays of sound mortgage lending. Further, GSE securitization of nonprime loans of varying and unascertainable quality built unprecedented risk into the mortgage-backed securities market.[2] Government policy concurrently caused certain major financial institutions' boards and major stockholders to believe that the government viewed them as "too big to fail," thus increasing the "moral hazard" they faced.

In retrospect, five partly overlapping structural elements set the stage for the crisis in 2007–2009: (1) national government controls over U.S. depository institutions and mortgage markets that encouraged imprudent risk taking; (2) implicit government guarantees of financial firms deemed "too big to fail" and perverse incentives thereby created; (3) government "affordable-housing" policies supporting home ownership despite borrowers' low incomes and poor credit histories; (4) discretionary Federal Reserve monetary policy, often supplying liquidity that sustained imprudent borrowing and lending; and (5) erosion of the rule of law arising from overbroad discretionary federal power.

I revisit these structural elements in the final section of this article, evaluating them in light of the DFA's provisions and reassessing Congress's "misdiagnosis." First, however, I examine the new entities and powers created by the DFA.

Financial Stability Oversight Council

The Dodd–Frank Act's Financial Stability Oversight Council (FSOC) is a powerful new body, chaired by the Treasury secretary, whose ten voting members include heads of the major U.S. financial regulatory entities.[3] I survey here the FSOC's statutory authority and duties, the wellspring of its nascent power.

FSOC Power and Duties: Regulating Nonbanks, Directing the Fed

Most significant is the FSOC's unprecedented authority to "identify risks to the financial stability of the United States *that could arise* from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or *nonbank financial companies,* or that *could arise outside* the financial services marketplace" (DFA 2010, §112(a)(1)(A), emphasis added).

The hypothetical nature of the risks postulated in the quoted statutory language highlights the breadth of the council's power—targeting risks that "could arise," not tangible present conditions. Congress similarly charged the FSOC with "respond[ing] to *emerging* threats to the stability of the United States financial system" (DFA 2010, §112 (a)(1)(C), emphasis added). Thus, by statute, the scope

2. See F. Mishkin 2011 regarding the transition from the subprime mortgage crisis to the global financial crisis.

3. DFA 2010, §111, 124 Stat. 1393–94.

of the council's power is made a function in part of FSOC members' idiosyncratic visions of "emerging" threats. Moreover, the council's statutory reach extends even to risks arising "outside" the financial services sphere.

The linguistic talisman, here and throughout the act, is reference to an undefined "threat to the stability of the U.S. financial system." Of course, no one would suggest that real threats be ignored: the issue is potential use of amorphous "threat" terminology as a pretext for expanding government power. As shown later, in the context of Dodd–Frank, that terminology provides a malleable concept readily used in hypothesizing "systemic risks" to the nation's financial system and creating a seemingly illimitable rationale for broadened central-government control of U.S. financial markets.

But the largest expansion of federal authority through the FSOC is the council's power over *"nonbank"* financial institutions, firms not previously subject to supervision by the Fed.

By statute, a "U.S. nonbank financial company" is defined—with many listed exclusions—as a company "incorporated or organized under the laws of the United States or any State; and predominantly engaged in financial activities" (DFA 2010, §102 (a)(4)(B) (i), (ii)). The "predominantly engaged" criterion requires that annual gross revenues of the nonbank financial institution (and its subsidiaries) attributable to financial activities constitute 85 percent or more of the company's consolidated annual gross revenues or that the company's consolidated assets related to financial activity represent 85 percent or more of the company's annual gross revenues (DFA 2010, §102(a)(6)).

The definition of these nonbank financial companies thus embraces many types of financial firms not previously subject to banklike regulation—companies neither licensed as banks nor providing depository and lending services, as banks do (DFA 2010, §102(a)(4)). Indeed, according to this definition, U.S. nonbank financial institutions potentially include a broad range of companies, from insurance firms, check-cashing services, payday-lending firms, securities firms, investment companies, hedge funds, and currency exchanges, to institutional investors such as pension funds and mutual funds, among others.

The FSOC's actual power over nonbank financial institutions gives it "authority to require supervision and regulation of certain nonbank financial companies" (DFA 2010, §113). With the approval of two-thirds or more of the FSOC's voting members (including an affirmative vote by the chairman), "[t]he Council . . . may determine that a U.S. nonbank financial company *shall* be supervised by the [*Federal Reserve*] *Board of Governors* and *shall* be subject to prudential standards . . . if the Council determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company *could* pose a threat to the financial stability of the United States" (DFA 2010, §113(a)(1), emphasis added).

That is, the council can require the Federal Reserve Board of Governors to supervise and impose heightened "prudential standards" upon any company that falls within the broad category of nonbank financial firms described earlier if the council asserts that the company "could pose" a "threat to the financial stability" of this country[4] based on an open-ended list of considerations.[5] As Peter Wallison states, "The DFA's standard for making the important decision about whether to regulate a particular nonbank financial firm is *so flexible as to be indistinguishable from complete discretion*" (2010, 2, emphasis added). An even broader provision appears in an antievasion section (DFA 2010, §113(c)).

Of course, although the statutory language is broad, its actual impact on nonbank financial companies will depend in part on the text of FSOC regulations and the implementation of the powers granted. To date, the FSOC has named three initial designees: American International Group, Inc., and General Electric Capital Corporation, Inc. (both July 8, 2013), as well as Prudential Financial, Inc. (September 19, 2013) (U.S. Department of the Treasury n.d.). In December 2014, the council added MetLife to the list, and in January 2015 MetLife filed suit in the U.S. District Court for the District of Columbia to attempt to reverse that designation (McGrane and Scism 2015). Actual designees are referred to colloquially as "nonbank SIFIs" (systemically important financial institutions).

FSOC Power and Duties: Trigger for Orderly Liquidation

The FSOC's powers over nonbank financial companies do not end with requiring them to be supervised by the Board of Governors. Once the council requires Fed supervision, that decision triggers other powers—including authority to force supervised nonbank financial companies into "orderly liquidation" outside bankruptcy courts and procedures. Thus, the ultimate question at issue is whether to place a targeted "financial company" in "receivership," appointing the FDIC as "receiver" and thereby initiating the "orderly liquidation" process. Although our immediate

4. Under Dodd–Frank, the FSOC's corresponding duties include requiring "supervision by the Board of Governors for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure" (2010, §112 (a)(2)(H)); "heightened prudential standards" (§112 (a)(2)(I)); and Board of Governors establishment of standards such as "risk-based capital requirements and leverage limits" as well as "liquidity requirements; overall risk management requirements; resolution plan and credit exposure report requirements, and concentration limits" (§165), among others.

5. The Dodd–Frank Act lists eleven "considerations" the FSOC must weigh in making its decision (leverage, off-balance-sheet exposures, interconnectedness, and the like), the last of which is "*any other risk-related factors that the Council deems appropriate*" (2010, §113(a)(2), emphasis added). A subsequent section sets forth the nature of the "enhanced supervision and prudential standards" to be imposed by the Board of Governors, consistent with the council's recommendation. The heightened standards are required to be "more stringent" than those applied to less-risky nonbank financial companies and may "increase in stringency" based on certain statutory criteria (DFA 2010, §115, "Enhanced Supervision and Prudential Standards for Nonbank Financial Companies Supervised by the Board of Governors and Certain Bank Holding Companies").

focus is on nonbank financial companies, other types of firms also may be targeted for orderly liquidation because the DFA's orderly liquidation rules apply to financial companies, and a "financial company" can be

- a nonbank financial company supervised by the Federal Reserve Board of Governors;
- a bank holding company; or
- a company "predominantly engaged" in financial activities, as determined by the Fed (DFA 2010, §201(a)(11)).

To proceed toward orderly liquidation, there must be an initial "systemic risk determination" (DFA 2010, §203(a)), requiring at least a two-thirds vote by the Federal Reserve Board of Governors and at least a two-thirds vote by the FDIC's board of directors. By statute, the resulting written recommendation must evaluate eight elements relevant to systemic risks posed by the targeted company.

The statute then requires a determination by the Treasury secretary in consultation with the president. It mandates that the secretary "shall take action" to proceed toward FDIC receivership if the secretary finds that the company is "in default or danger of default," that its failure and other forms of resolution "would have serious adverse effects on the financial stability of the United States," and that five other statutorily specified elements are satisfied (DFA 2010, §203(b)). The denouement is the act's section 204, "Orderly Liquidation of Covered Financial Companies," which specifies the procedures for implementing orderly liquidation of the nonbank financial company (or other financial company) involved in the particular case.

The statutory goal was resolution without bailout. Focusing on nonbank financial companies, attorneys from a prominent legal firm stated that the purpose of Orderly Liquidation Authority (OLA) was the "resolution of a failing systemically important 'non-bank' financial institution without a 'bailout'" by "permit[ting] the government to invoke a new form of resolution authority for non-bank financial institutions *instead of the Bankruptcy Code,* if the Treasury Secretary makes certain financial distress and systemic risk determinations" (Davis Polk & Wardwell 2011, 3–4, emphasis added).[6] These attorneys also noted that the FDIC has a receiver's

6. The process starts when the FDIC and the Federal Reserve Board of Governors (on their own or at the request of the Treasury secretary) decide to "consider whether to make a written recommendation" as to whether the Treasury secretary "should appoint the Corporation [the FDIC] as receiver for a financial company" (DFA 2010, §203(a)(1)(A)). If they do so, the written recommendation must consider seven listed items, including whether the company is "in danger of default," the impact of a default "on financial stability in the United States," a default's impact on "economic conditions or financial stability for low income, minority, or underserved communities," the "likelihood of a private sector alternative," and the like (DFA 2010, §203(a)(2)). If the Treasury secretary, based on the written recommendation, decides that the situation satisfies certain enumerated criteria—including belief that the company's failure would have "serious adverse effects on financial stability in the United States" (DFA 2010, §203(b)(1)–203(b)(7))—then, in consultation with the president, the secretary must commence orderly liquidation by notifying the FDIC as well as the affected firm and petitioning the District Court (DFA 2010, §202(a)(1)(A)).

"power to transfer some or all of [that firm's] assets or liabilities . . . without a creditor's consent or prior court review" (Davis Polk & Wardwell 2011, 6, 9).

Many concerns about the OLA process have arisen. They include the "[c]hallenge for any governmental agency to deal with a complex financial organization in a crisis situation"; "[l]ack of FDIC experience with SIFIs"; and what Davis Polk & Wardwell call the "Biggest Concern": the "fundamental proposition that a run on a systemically significant financial institution can be stemmed by the FDIC stepping in under OLA remains to be proven" and is "highly dependent on how discretion is exercised by the FDIC" (2011, 26–27). Nonetheless, some may argue that even partial regulatory success under OLA in closing unsound financial institutions would be preferable to the status quo ante.

While the OLA process is circuitous, the potential results are clear. Through these provisions of the Dodd–Frank Act, government officials are empowered—based on subjective criteria—to liquidate or "resolve" nonbank financial companies (of which there are tens of thousands in the United States), forcing them into FDIC receivership. Although the expected benefit from resolving truly insolvent nonbank financial companies is clear—indeed, taxpayers would prefer to close unsound firms rather than bail them out—the danger again is possible misuse of porous rules to target companies inappropriately, thus stretching federal government control beyond its intended bounds.

I next examine in greater detail the FSOC's authority to identify SIFIs—authority connoting the government's continuation of the "too big to fail" policies at the heart of the financial crisis in 2007–2009.

FSOC and "Too Big to Fail": Systemically Important Financial Institutions

One of the stated purposes of the FSOC is "to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such [large, interconnected bank holding or nonbank financial] companies that the Government will shield them from losses in the event of failure" (DFA 2010, §§112(a)(1)(A), (B)). Accordingly, a strong theme in the act's text is the intent to eliminate "bailouts" of failing firms. Yet the specter of bailouts permeates the act's focus on FSOC designation of SIFIs for Fed supervision and potential FDIC receivership and liquidation.

One explicit reference is titled "Prohibition against Federal Government Bailouts of Swaps Entities," which states that "no Federal assistance may be provided to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity" (DFA 2010, §716). Further reflection of the antibailout theme appears in section 214, the "Boxer Amendment." It provides a "prohibition on taxpayer funding" requiring that "[a]ll financial companies put into receivership under this

title shall be liquidated" and that "[n]o taxpayer funds shall be used to prevent the liquidation of any financial company under this title" (DFA, §214(a)). The Boxer Amendment also requires the "recovery of funds" used in the liquidation from "disposition" of the firm's assets or "from the financial sector, through assessments" (§214(b)), and mandates that "[t]axpayers shall bear no losses from the exercise of any authority under this title" (§214(c)).

Despite this explicit language prohibiting bailouts, two analytical perspectives regarding the "too big to fail" issue have emerged. First, some analysts contend that by requiring identification of nonbank financial companies whose failure "could pose a threat to the financial stability of the United States," the Dodd–Frank Act (2010, §113(a)) raised serious doubts about whether such companies in fact will be allowed to fail. As Wallison puts it, "Can anyone imagine that one of these large financial institutions—securities firms, insurers, hedge funds, finance companies, and others—that will eventually come under the supervision of the Fed will ever be allowed to fail?" (2010, 3). Charles Calomiris and Allan Meltzer wrote that "Dodd–Frank institutionalizes too-big-to-fail protection by explicitly permitting bailouts via a 'resolution authority' provision at the discretion of government authorities, financed by taxes on surviving banks—and by taxpayers should these bank taxes be insufficient" (2014). Harvey Rosenblum expressed like concerns, noting in the Dallas Federal Reserve Bank annual report for 2011 that "[w]hile decrying TBTF [too big to fail], Dodd–Frank lays out conditions for sidestepping the law's proscriptions on aiding financial institutions." He added: "The pretense of toughness on TBTF sounds the right note for the aftermath of the financial crisis. But it doesn't give the watchdog FSOC and the Treasury secretary the foresight and the backbone to end TBTF by closing and liquidating a large financial institution in a manner consistent with Chapter 7 of the U.S. Bankruptcy Code" (2011, 20). His conclusion was succinct: "For all its bluster, Dodd–Frank leaves TBTF entrenched" (21).

A second perspective emphasizes the act's increased constraints on the Fed's broad and long-standing authority to provide emergency lending to certain "individuals, partnerships, or corporations" in "unusual and exigent circumstances" (Federal Reserve Act 1913, §13(3)). The act significantly revised this Fed authority and supplemented section 13(3) with "emergency–stabilization" measures authorizing federal guarantees of certain firms' obligations (DFA 2010, §§1101–1105).

Federal Reserve Act section 13(3) originally was enacted in 1932 in the aftermath of the Great Depression. Almost sixty years later—with little public attention—this section was greatly expanded through the FDIC Improvement Act of 1991. Walker Todd, then an attorney for the Federal Reserve Bank of Cleveland, unearthed the key provision, an "obscure amendment" to the FDIC Improvement Act, that "dramatically expanded the federal safety net, increasing the likelihood of taxpayer bailouts in the future" (Morgenson and Rosner 2011, 40–42). Despite Todd's published documentation, few noticed this amendment until the provision's logical consequences emerged in the financial crisis of 2008.

In 2010, however, the DFA significantly narrowed the Fed's section 13(3) emergency-lending authority, making it available only to a "participant in any program or facility with *broad-based eligibility*"—as opposed to its former broad availability to an "individual, partnership, or corporation" (DFA 2010, §1101, emphasis added). The idea was to prevent section 13(3) assistance from being used to "bail out" an isolated individual firm. Likewise, the act restricted federal *guarantees* of certain firms' obligations (§§1101–1105, emphasis added), making them available only to participants in "programs of broad applicability"—again seeking to prevent bailouts of identifiable firms.

The question is whether these restraints will prove sufficient. Although not completely shutting the door to bailouts, the changes to section 13(3) have made it more difficult to carry out an AIG-like bailout. Much will depend on future FSOC actions.

A critical step in implementing Dodd–Frank was the FSOC's issuance on April 3, 2012, of a "Final Rule and Interpretive Guidance" to implement its "authority to require supervision and regulation of certain nonbank financial companies." Published in the *Federal Register* on April 11, 2012, the Final Rule became section 1310 of the *Code of Federal Regulations* (FSOC 2012). As the FSOC explained in section 1301.1, "[T]he principal purposes of this part are to set forth the standards and procedures governing Council determinations under section 113 of the Dodd–Frank Act . . . including whether material financial distress at a nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company, could pose a threat to the financial stability of the United States, and whether a nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards in accordance with Title I of the Dodd–Frank Act." A May 2012 article in the *Banking Law Journal* called the FSOC Final Rule a "final rule for nonbank SIFI designations" and described it as "implementing Section 113 of the Dodd–Frank Act, the controversial provision that directs the federal government to identify systemically important financial institutions (SIFIs) outside the traditional banking sector that could pose a threat to the U.S. financial system" (Tarbert, Mayer, and Cephas 2012, 419).

Most fundamentally, the Final Rule implied that nonbank SIFIs would continue to be protected in ways that other nonbank financial companies would not be. Thus, despite enhanced regulation by the Fed under the DFA, heightened prudential standards, requirements for "resolution planning" by nonbank SIFIs, and increased reliance on quantitative analysis to evaluate potential SIFIs, the specter of "too big to fail" under the auspices of the Fed remains. In Wallison's judgment, "[T]he Oversight Council's designations will spread the too-big-to-fail problem beyond banking to every other financial industry," and "[c]rony capitalists and their government mentors will be the biggest winners" (2012).

Other scholars acknowledge these potential problems. Vern McKinley and Hester Peirce conclude that Dodd–Frank "has further enshrined too-big-to-fail" (2013b, 1).

Todd Zywicki notes the "deep irony" that "[n]o serious person believes that it [the Dodd–Frank financial reform legislation] will prevent the next financial crisis and . . . no one really believes that when that financial crisis hits that massive bailouts of financial institutions will not be forthcoming"—citing "bipartisan consensus that bailouts are here to stay and that the bailout culture is here to stay" (2013b, 1). In Zywicki's view, "by entrenching 'Too-Big-to-Fail' (TBTF) and 'systemic risk' as the operating assumptions of the American financial system, the long term impact of Dodd–Frank will likely make TBTF banks even bigger and the cozy relationships between Wall Street and Congress closer still" (2013b, 1).

Yet Americans were forewarned about the likely outcome of this legislation. Months before its enactment, economist Allan Meltzer wrote that through this act "the new financial regulations . . . only bring back too big to fail by authorizing a Systemic Risk Council headed by the Treasury Secretary" (2010, 1). And so it seems they have.

The Office of Financial Research

Another pillar of the Dodd–Frank Act is the Office of Financial Research (OFR), an entity James Rosen described as "the most powerful federal agency you've never heard of" (2012, 1). Established within the Treasury Department, the OFR functions as a powerful arm of the FSOC, designed to support and assist it. The OFR's significance and its primary power lie in its broad statutory authority to demand, collect, standardize, and disseminate data generated or used by private financial companies.

The OFR's statutory purpose is to "support the Council in fulfilling" its duties by "collecting data on behalf of the Council" and by performing applied and long-term research. The OFR accordingly encompasses two main units, the Data Center and the Research and Analysis Center. Other OFR duties include "risk measurement and monitoring" and "performing other related services" (DFA 2010, §153(a)). In addition, broad rule-making authority is given to the OFR to fulfill its various purposes and duties—along with authority to "*share data and information*, including software developed by the Office, with the Council, member agencies, and the Bureau of Economic Analysis" (§153(b), emphasis added).

Despite the breadth of these powers, the OFR is headed by a single director, who is given "sole discretion in the manner in which" he or she "fulfills the responsibilities and duties and exercises the authorities" conferred upon the director by statute (DFA 2010, §152(b)(5)). In consultation with the Treasury secretary, the director also determines the OFR's annual budget. Moreover, although the director is appointed by the president for a six-year term with the Senate's advice and consent, he or she may continue to serve for an indefinite time period thereafter until a new director is "appointed and confirmed"

(DFA 2010, §152(b)(2)). Several key aspects of the OFR's function and structure merit close public examination.

- First, as noted, the OFR functions as an arm of the FSOC, required to serve it, do its bidding, and obtain its approval at critical junctures—potentially blurring responsibility for OFR actions.
- Second, the OFR has broad statutory power to collect data and "share" (for example, with all members of the FSOC) the data it collects and the software it develops, provided the Treasury secretary (as chairperson of the FSOC) approves the data sharing. The OFR Data Center's data-collection powers are huge, empowering the OFR to "require the submission of periodic and other reports from *any financial company* for the purpose of assessing the extent to which a financial activity or financial market in which the financial company participates, or the financial company itself, poses a threat to the financial stability of the United States" (DFA 2010, §154(b)(1)(B)(i), emphasis added). Similarly extensive powers are wielded by the OFR's Research and Analysis Center, whose focus is on developing "independent analytical capabilities and computing resources" aimed at detecting "systemwide risk levels" and changes therein through "stress tests" and other means (§154(c)).
- Third, despite occasional allusion to privacy concerns, the DFA does not provide credible, reliable privacy protections for the OFR's planned data acquisition. Indeed, the statutory language regarding OFR confidentiality and privacy issues is at times internally contradictory and/or dependent on OFR officials' discretionary judgments, as in the following statement: "The Office shall, after consultation with the member agencies, provide certain data *to industry participants and to the general public* to increase market transparency and facilitate research on the financial system, to the extent that intellectual property rights are not violated, business confidential information is properly protected, and the sharing of such information poses no significant threats to the financial system of the United States" (DFA 2010, §154(b)(6), emphasis added).
- Fourth, Congress retained no budgetary authority—no "power of the purse"—with which to control the OFR. Instead, the OFR's budget was paid by the Federal Reserve for the first two years of its existence and subsequently is to be paid through "assessments" (taxes) levied by the OFR on large financial companies and bank holding companies. As Rosen stated, there is "no limit on the growth of OFR's budget, nor on the taxes the agency can impose on big banks to fund it" (2012; see also DFA 2010, §155(b)(c)). Moreover, revenues that come to the OFR are to be paid into a new "Financial Research Fund" created by the Dodd–Frank Act—funds that "shall not be construed to be Government funds or appropriated moneys" and "shall not be subject to apportionment" (DFA 2010, §155(b)(2); §155(b)(3)).

- Fifth, as with the FSOC, so too the OFR will subject large private financial companies to a degree of federal oversight and intrusion previously accorded only to large banks and bank holding companies, a dramatic expansion of the national government's purview. The act also gives the OFR director broad subpoena power, authorizing the director to "require from a financial company, by subpoena [enforceable by U.S. District Courts], the production of the data requested" under other provisions of the act (DFA 2010, §153(f)). Rosen described this power as "virtually unlimited subpoena power . . . [that] can compel just about any company in America to turn over to the federal government sensitive internal data, even proprietary information" (2012, 2).

In short, through the Office of Financial Research, the Dodd–Frank Act created another vehicle granting the national government broad and inadequately defined power to control U.S. financial firms.

But the OFR's role in amassing and distributing data provides just a sampling of the broad data collection authorized elsewhere in the DFA—in particular through the Consumer Financial Protection Bureau, to which we now turn.

The Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (CFPB) is the final cornerstone of the Dodd–Frank Act, an entity created by Congress as an "independent" bureau that would serve as an executive agency embedded within the Federal Reserve. In authorizing the CFPB's creation, the act stated in broad terms, "There is established in the Federal Reserve System, an independent bureau to be known as the 'Bureau of Consumer Financial Protection,' which shall regulate the offering and provision of *consumer financial products or services* under the *federal consumer financial laws*" (DFA 2010, §1011, emphasis added). Zywicki calls the CFPB "an independent agency inside another independent agency, presided over by a single director who is insulated from presidential removal" (2013a, 856).

The CFPB possesses enormous unaccountable power. Indeed, Hester Peirce and James Broughel describe the new agency as "the remarkably unaccountable Consumer Financial Protection Bureau (CFPB) within the Fed . . . [which is] shielded from accountability to Congress, the president, and the American people" (2012, 14). Representative Jeb Hensarling (R.–Tex.), chairman of the House Committee on Financial Services, labeled it "arguably the single most powerful and least accountable federal agency in the history of America . . . designed to operate outside the usual system of checks and balances that applies to almost every other government agency." In opening remarks at the committee's hearing on the CFPB on September 12, 2013, Hensarling added that the CFPB "[d]irector can unilaterally declare virtually any financial product or service as unfair or abusive, at which point Americans will be denied that product or service—even if they need it, and understand it, and

want it"—and that the CFPB wields power that is "unilateral, unbridled, and unparalleled" (2013). I first probe the nature and sources of the CFPB's power and then highlight its ongoing uses.

Vortex of Unaccountable Power

The scope of the CFPB's power begins to emerge through statutory definitions of the italicized phrases in the "establishment" section (§1011) quoted earlier. For example, the definition of the "financial products or services" that the CFPB regulates occupies three full pages of single-spaced small print in the statute (DFA 2010, §1002(15)(A)). Among other things, the term includes "extending credit and servicing loans"; "providing financial advisory services, real estate settlement services, or check cashing and check collection services"; "engaging in deposit-taking activities"; and "collecting debt related to any consumer financial product or service." The list's final entry abandons any hint of constraint, giving the CFPB open-ended power to regulate "such other financial product or service as may be defined by the Bureau, by regulation."[7]

And the "federal consumer financial laws" that the CFPB administers? They include, inter alia: (*a*) the "enumerated consumer laws," (*b*) Dodd–Frank provisions pertaining to the CFPB, and (*c*) "any rule or order prescribed by the Bureau" pursuant to the act's CFPB section (DFA 2010, Title X, §1002(14)). The act further defines "enumerated consumer laws" to include, with qualifications and exceptions, seventeen major statutes, including the Alternative Mortgage Transaction Parity Act, the Consumer Leasing Act, the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Credit Billing Act, the Fair Credit Reporting Act, and eleven others (§1002(12)). Further, the CFPB is given "exclusive rulemaking authority" in cases where another federal agency's regulatory purview overlaps that of the CFPB, and courts are required to treat the bureau's interpretation of the meaning of a consumer financial law in such cases *"as if the Bureau were the only agency* authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law" (§1022(b)(4), emphasis added).[8]

That Congress designed the CFPB to be unaccountable is an ineluctable truth. Zywicki (2013a) has shown that in creating the bureau Congress by statute blocked traditional mechanisms that previously restrained bureaucratic agencies' excesses. For instance, the act removed Congress's appropriation power over the bureau, instead requiring the Federal Reserve Board of Governors to fund the CFPB in accordance with limits established by the DFA (2010, §1017). Congress explicitly provided for the

7. The statute's definition of "*consumer* financial products or services" explains that they include the categories listed in the text, provided that the product or service is "offered or provided for use by consumers primarily for personal, family, or household purposes" (DFA 2010, §1002(5)).

8. See DFA 2010, §1061(b)(5)(E), for special provisions pertaining to the Federal Trade Commission.

"autonomy of the bureau," prohibiting the Federal Reserve Board of Governors from intervening in CFPB matters or structure (§1012(c)(2)). It also put a single director in charge of the CFPB rather than a multimember bipartisan board resembling those long proven useful in tempering agencies' actions. Further, the act severely limited executive-branch control over the bureau by allowing the president to remove the CFPB director only "for cause," meaning "inefficiency, neglect of duty, or malfeasance in office" (§1101(c)(3)). The FSOC's ability to control the CFPB also was constrained, allowing the FSOC to overturn a CFPB regulation only by a two-thirds vote and only with an official finding by the home department of each CFPB member voting against the regulation that it "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" (§1023(c)(3)). Zywicki concludes:

> [I]f one were to sit down and design a policymaking agency that embodied all of the pathologies scholars of regulation have identified over the past several decades, one could hardly do better than the CFPB: an unaccountable body, headed by a single director, insulated from both removal by the President and budgetary oversight by Congress, and charged with a tunnel vision mission to pursue one narrow goal that carries the potential for substantial harm to the economy and to consumers. So flawed is the CFPB's design, and so similar is it to the regulatory agencies of an earlier era, that the problems it will manifest and the harm it will impose on the economy are entirely predictable (2013a, 858–59).

The CFPB director has broad discretionary authority to "prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof" (DFA 2010, §1022(b)). The act even empowers the director to determine the bureau's funding by requiring that "the Board of Governors *shall transfer* to the Bureau . . . the amount *determined by the Director to be reasonably necessary* to carry out the authorities of the Bureau under Federal consumer financial law," an amount rising to a cap of 12 percent of the Federal Reserve System's total operating expenses in fiscal year 2013 and every year thereafter (§1017(a), emphasis added).

Vague statutory language further extends the bureau's unprecedented and undefined powers. Most notable is a key section that prohibits "*unfair, deceptive, or abusive acts or practices*" (DFA §1031). Although the terms *unfair* and *deceptive* appear in other consumer laws and have received considerable judicial and regulatory interpretation, the term *abusive* adds an utterly new and potentially unconstrained source of additional government power. Zywicki notes the possibility that bureau designation of such "abusive" practices might "give the CFPB power to deem certain products inherently dangerous and remove them from the market—even if they were neither 'unfair'

nor 'deceptive'—no matter how well the risks were disclosed and no matter how well the consumer understood the risks," potentially "impos[ing] on the lender a duty to both understand and act in the 'best interest' of the consumer" (2013a, 919–20).

Researchers have judged the bureau harshly. Hester Peirce, for example, writes: "In constructing the new CFPB, Congress delegated enormous power over a large portion of our economy to a single person who is unaccountable to the Congress, the president, or the public," adding that the CFPB "may use these powers in a way that neither helps the consumers Title X intended to protect nor enhances the nation's financial stability" (2012, 116). Similarly, Ilya Shapiro and Carl DeNigris call the CFPB "yet another entity subject to little oversight and given the ability to define its own authority" (2012, 1112). Wallison puts it more starkly: "The CFPB probably has the widest reach into the U.S. economy of any agency in Washington" and is "answerable to no one" (2010, 1, 4).

The CFPB's aggressive initial actions revealed much about its nature, its purview, and its likely future direction. Director Richard Cordray moved quickly to advance rule-making governing debit cards, debt collection, payday lending, and more (B. Mishkin 2013). As discussed later, by 2013 Cordray's CFPB had supported a bevy of regulatory actions to expand the bureau's reach—through both "disparate impact" analysis and illicit CFPB surveillance that breached specific statutory limitations on its authority.

CFPB Overreach: "Disparate Impact"

First, using the rationale of protecting consumers from "unfair, deceptive, or abusive acts and practices and from discrimination" (DFA 2010, §1021(b)(2)), the CFPB unilaterally broadened the definition of "discrimination" so as to increase its control over consumer financial product and service providers. *Intent* to discriminate has traditionally been an essential element of a discrimination charge. However, under the CFPB's "disparate impact" theory, a finding of discrimination in the provision of such products or services instead might rest solely on statistical evidence of different *outcomes* for different groups of people, even if those outcomes could be fully explained by differences in economically relevant variables such as credit history, risk, income, and the like.[9]

The CFPB, in a partnership with the Department of Justice (DOJ) described in a Memorandum of Understanding, is actively pursuing disparate-impact antidiscrimination enforcement actions (CFPB and DOJ 2012). Nonetheless, the CFPB continues to conceal its methods, making it difficult for lenders to know what it might construe as unintentional discrimination. As Representative Hensarling revealed in a letter to CFPB director Cordray in 2014, even a "nine-month, bipartisan

9. Current information about the CFPB's ongoing activities can be found in the *CFPB Monitor* at http://www.cfpbmonitor.com. See, for example, Kaplinsky 2013 and Willis 2013a, 2013b.

[congressional] effort to get the bureau (CFPB) to explain how it calculates disparate impact" was unavailing (qtd. in *Wall Street Journal* 2014). As Jonathan Keim writes, "[I]t is hard to see justice in a scheme where the government writes the rules, enforces the rules, and won't tell anyone what the rules mean" (2014).

The bureau's aggressive use of the disparate-impact concept even extended to overt efforts to circumvent specific congressional restrictions on CFPB actions. A key case involved automobile dealers and the financing of consumer automobile purchases. During congressional consideration of the DFA, automobile dealers demanded and secured an explicit exemption from CFPB. The exemption became section 1029, titled "Exclusion for Auto Dealers." DFA section 1029 specifies that, regarding the "Sale, Servicing, and Leasing of Motor Vehicles, . . . *the Bureau may not exercise 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*" (emphasis added). Three exceptions followed, described in near impenetrable prose. Yet whatever one's interpretation of the fine print, few could have imagined how the CFPB would find a way to impose severe restrictions on the very people whom section 1029 supposedly excluded from the bureau's regulatory reach.

Novel techniques of financing auto loans provided the key. Several players are typically involved. An auto dealer often initially makes arrangements for a bank (called an "indirect auto lender") to supply the desired funding. The bank's officials specify an interest rate at which the bank would agree to "buy the contract" (i.e., supply the loan), called the "buy rate." Once agreement is reached on the buy rate, the auto dealer may then add an additional amount to that interest rate, sometimes called a "dealer's markup," to compensate the dealer for services rendered in securing the purchase agreement, handling paperwork, and the like. In turn, the bank may agree to remit some portion of the markup to the auto dealer. Such loan transactions soon became the target for CFPB regulation.

Forbidden to regulate the auto dealers directly, the CFPB proceeded indirectly, trying to control the dealers by controlling their banks (the indirect auto lenders). The statutory authority undergirding the ensuing enforcement action was the bureau's power and duty under the DFA to enforce the Equal Credit Opportunity Act (ECOA) of 1974—a fair-lending law that forbids lenders to discriminate on the basis of race, sex, ethnicity, national origin, and other prohibited categories—and its implementing regulation, Regulation B. Although enforcement of ECOA through Regulation B previously had been the Federal Reserve's responsibility, the DFA transferred that responsibility to the bureau (CFPB 2013c, Regulation B).

Based on disparate-impact theory, the CFPB threatened to sue banks that provided the funds loaned to car buyers, claiming in its auto-lending "guidance" document (CFPB 2013d; see also CFPB 2013b) that auto dealer markups might be racially discriminatory (in a disparate-impact sense), violating ECOA and therefore justifying action against the banks acting as indirect auto lenders. Of course, most

of the business decisions underlying the loan transaction were those of the very auto dealers ostensibly exempted from CFPB regulation. The case thus illustrates the bureau's willingness to stretch its already copious powers so far as to control indirectly a group the DFA explicitly exempted from CFPB control.[10]

Beyond any specific case such as auto dealers, however, there is a contradiction at the heart of CFPB's fair-lending enforcement mandate. Because the ECOA and Regulation B generally prohibit nonmortgage lenders from collecting information about a borrower's race and ethnicity, it is difficult for CFPB to assess whether a nonmortgage lender is engaged in discrimination based on borrowers' race or ethnicity. It has accordingly sought proxies for the forbidden data. The bureau itself described the dilemma succinctly: "[The CFPB] is charged with ensuring that lenders are complying with fair lending laws and addressing discrimination across the consumer credit industry. Information on consumer race and ethnicity is required to conduct fair lending analysis of non-mortgage credit products, but auto lenders and other non-mortgage lenders are generally not allowed to collect consumers' demographic information. As a result, substitute, or 'proxy' information is used to fill in information about consumers' demographic characteristics" (2014, 3).[11] The bureau therefore developed a statistical model to estimate the actual values.

The resulting thirty-seven-page document is titled *Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment* (CFPB 2014). It describes a Bayesian Improved Surname Geocoding method that combines publicly available surname-based racial distribution information with publicly available geographical information on racial distribution by state to generate "a single proxy probability for race and ethnicity" that the bureau deems more accurate than models that use either variable alone. Although not currently mandated for CFPB-regulated entities, the model clearly reflects the bureau's effort to reconcile the conflicting demands it faces. Nonetheless, these developments—combined with Regulation B's provision that "if applicable, certain information will be collected based on visual observation or surname if not provided by the applicant or other person" (CFPB 2011)—raise the specter of bureaucratic decision making based on little more than arbitrary assumptions about people's race and ethnicity.

CFPB Overreach: Warrantless Surveillance

Notwithstanding provisions in the Dodd–Frank Act that bar the CFPB from collecting personally identifiable information about consumers, so far the bureau has

10. Analyst Carter Dougherty (2013) noted that bureau letters threatening banks with lawsuits showed a CFPB willing to sanction banks over markups by auto dealers who were explicitly excluded from the bureau's supervision in the Dodd–Frank Act.

11. See also CFPB Regulation B, 12 *Code of Federal Regulations,* Sec. 1002.5, "Rules Concerning Requests for Information," §§(b)–(d) (CFPB 2011).

circumvented those restraints. The CFPB consumer-privacy provisions are explicit: "The Bureau *may not obtain* from a covered person or service provider any *personally identifiable financial information about a consumer* from the financial records of the covered person or service provider except—(i) if the financial records are reasonably described in a request by the Bureau and the consumer provides *written permission for the disclosure* of such information . . . to the Bureau; or (ii) as may be specifically permitted or required under other applicable provisions of law" (DFA 2010, §1022(c)(8), emphasis added).

The DFA defines "covered person" as "any person that engages in offering or providing a consumer financial product or service" and certain affiliates of such covered persons (2010, §1002). Thus, the quoted provision prohibits CFPB acquisition of personally identifiable consumer financial information from the financial records of CFPB-regulated firms except in the listed circumstances.

Another key DFA restriction prohibits CFPB interference with licensed attorneys' practice of law, specifically shielding matters that are "within the scope of the attorney–client relationship." The provision states: "Exclusion for Practice of Law—(1) . . . [T]he *Bureau may not exercise any supervisory or enforcement authority* with respect to an *activity engaged in by an attorney as part of the practice of law* under the laws of a State in which the attorney is licensed to practice law" (2010, §1027(e), emphasis added).

The DFA thus makes two things clear: (1) the CFPB cannot legally obtain personally identifiable consumer financial information from a provider of consumer financial services without the consumer's written consent or explicit statutory authority; and (2) it cannot legally use its authority in ways that interfere with an attorney's practice of law, including matters within the domain of attorney–client relationships. As shown in the next section, however, the Consumer Financial Protection Bureau has violated both of these restrictions.

Data Mining: Personally Identifiable Financial Information

Data mining that targets consumer credit card transactions has provided one avenue for warrantless CFPB acquisition of consumer financial information. A key breakthrough in documenting this activity occurred when a watchdog group, Judicial Watch, received responses to its Freedom of Information Act requests for CFPB documents. In April 2013, Judicial Watch received documents from the CFPB "revealing that the agency has spent millions of dollars for the *warrantless collection and analysis of Americans' financial transactions*" and that "CFPB contractors may be required to share the information obtained with 'additional government entities'" (Judicial Watch 2013b, emphasis added). As Judicial Watch explained, the CFPB "has spent millions to track—down to the neighborhood level—the financial activity of unwitting Americans without their permission" (2013a).

The documents revealed, among other things, the CFPB's "[o]verlapping contracts with multiple credit reporting agencies and accounting firms to gather, store, and share credit card data" (a $2.9 million contract) as well as an "'indefinite delivery, indefinite quantity' contract with Experian worth up to $8,426,650 to track the daily consumer habits of select individuals . . . without their awareness or consent" (Judicial Watch 2013a). The CFPB specifically stipulated contractor acknowledgement that "the Contractor may obtain access to *non-public, confidential information, Personally Identifiable Information (PII), or proprietary information*" and that the "Contractor may be required to share credit card data collected from the Banks with additional government entities as directed by the Contracting Officer's Representative" (qtd. in Judicial Watch 2013b, 2, emphasis added).

Another document obtained by Judicial Watch explained the CFPB's purpose: "The CFPB seeks to acquire and maintain a nationally representative panel of credit information on consumers for use in a wide range of policy research projects. . . . The panel shall be a random sample of consumer credit files obtain[ed] from a national database of credit files" (qtd. in Judicial Watch 2013b). The CFPB also described the magnitude of its credit analysis: "The panel 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. The initial sample shall be drawn from current records and historical data appended for that sample as well as additional samples during the intervening years to make the combine[d] sample representative at each point in time" (qtd. in Judicial Watch 2013b, emphasis added).

Although the CFPB asserted that it receives only anonymized data, its own contractual stipulations, quoted earlier, indicate otherwise, as does a private firm's lawsuit alleging CFPB demands for detailed "personal financial information" about its clients, "including names, addresses, attorney notes, and income information" (Brock 2013).[12]

The CFPB's credit-card-monitoring activities further contradict its assertion. In mid-September 2013, journalist Richard Pollock reported that through a "markets monitoring" program, CFPB officials were "seeking to monitor four out of every five *U.S. consumer* credit card transactions this year—up to 42 billion transactions"—and that Richard Cordray "said his agency is monitoring credit card usage at 110 banks, including Morgan Chase, Bank of America, Capital One, Discover and American Express" (2013a, emphasis added). Moreover, while the CFPB's stated goal for 2013 was to monitor 80 percent of all credit card transactions, it also "hope[d] to monitor up to 95% of all mortgage transactions" according to a CFPB "strategic planning document" (Pollock 2013a).

12. Filed in the U.S. District Court for the District of Columbia, the lawsuit was brought by the data-archiving firm Morgan Drexen, whose interaction with the CFPB is discussed in the next section. The firm alleged that the CFPB had "demanded [that] Morgan Drexen release personal information of bankruptcy clients," including the information cited in the text (Brock 2013).

A January 2014 letter from Thomas Stratmann, professor of economics at George Mason University, to Representative Scott Garrett (R–N.J.), chairman of the House Capital Markets and Government-Sponsored Enterprises Subcommittee, further underscored the ongoing data sweep. Quoting a letter from the House Committee on Financial Services, Stratmann wrote that the bureau's "combined data collected from the eighteen card issuers represent approximately 85–90% of the outstanding card accounts"—likely yielding "account-level data on at least 991 million credit card accounts, which would correspond to roughly 60% of the adult U.S. population." Stratmann described such broad data collection as "both expensive and risky," explaining to Representative Garrett how, through well-designed statistical sampling, a mere "one percent sample will achieve the CFPB's goals while alleviating concerns about consumer privacy and costs" (Stratmann 2014).

More revelations were to come.

The National Mortgage Database Project

Public disclosure in 2014 of the proposed National Mortgage Database Project (NMDP) documented the quest for yet more extensive warrantless data acquisition by the CFPB. The NMDP is a joint project involving the CFPB and the Federal Housing Finance Agency (FHFA), an agency created by the Housing and Economic Recovery Act of 2008. As successor to previous government entities, FHFA became, among other things, the new regulator of Fannie Mae and Freddie Mac. In that capacity, FHFA placed these GSEs in conservatorship in 2008 to strengthen and rebuild them (Jickling 2008). Evidence of FHFA's push for massive data collection and sharing with the CFPB came later.

On April 16, 2014, FHFA posted in the *Federal Register* a "Notice of Revision of an Existing System of Records" that described the FHFA's proposed National Mortgage Database Project (FHFA-21), including CFPB participation in the project and receipt of its data (FHFA 2014a). The scope of personal information that FHFA and CFPB officials are amassing appears in a section of the notice labeled "Categories of Records in the System." The target is "loan-level data" for single-family home loans issued since 1998, including:

1. "*Borrower/co-borrower information* (name, address, zip code, telephone numbers, date of birth, race/ethnicity, gender, language, *religion*, social security number, education records, military status/records, employment status/records);
2. "*Financial information* (account number, financial events in the last few years, *life events* in the last few years, other assets/wealth);
3. "*Mortgage information* (current balance, current monthly payment, delinquency grid, monthly payment . . .);
4. "*Credit card/other loan information* (account type, credit amount, account balance amount, account past due amount . . .);

5. "*Household composition* (. . . [including] presence of *children by various age categories,* number of wage earners in household, household income, credit score(s) of borrower/co-borrower at origination . . . , deceased indicator, marital status);
6. "*Property Attributes* (property type, number of bedrooms and bathrooms, square footage, lot size, year built/age of structure, units in structure, most recent assessed value . . .);
7. "*Real Estate Transaction Attributes* (sales price, down payment, occupancy status (own, rent), new versus existing home, county, census tract/block, latitude/longitude and date purchased);
8. "*Mortgage Characteristics* (mortgage product and purpose, origination date, acquisition date, amount of mortgage, refinanced amount, amount of down payment, term of mortgage, interest rate of mortgage, source of mortgage/mortgage channel, mortgage insurance type, loan to value at origination . . .); and
9. "*Information collected from consumers as part of surveys*, randomized controlled trials, or through other mechanisms" (FHFA 2014).

As this list shows, much more than loan-related information is being collected. Consider the policy implications of FHFA and CFPB officials' collection of information about each person's religion, children, military records, employment records, and recent "life events." Journalist Richard Pollock noted that "[a]s many as 227 million Americans may be compelled to disclose intimate details of their families and financial lives—including their Social Security numbers" as part of this database (2014), something Representative Hensarling and Senator Mike Crapo (R–Idaho) described as an "unwarranted intrusion into the private lives of ordinary Americans" (qtd. in Pollock 2014). But CFPB violations of explicit DFA mandates extend far beyond this warrantless surveillance.

The Drive to Breach Bankruptcy Attorneys' Records

Circumventing another DFA constraint, the CFPB also has maneuvered to obtain data from attorneys about people involved in bankruptcy litigation. On one level, its actions are an extension of its data mining. Yet on another level these actions carry potentially graver implications due to apparent CFPB attempts to interfere with practicing attorneys in violation of explicit DFA restrictions. In light of those prohibitions, one would expect that any CFPB route to circumvent them would be circuitous—and so it has been.

The CFPB could not simply require bankruptcy attorneys to turn over their client records because, as noted, section 1027(e) of the Dodd–Frank Act denies the bureau any "supervisory or enforcement authority" over practicing attorneys. So the CFPB proceeded by indirection, apparently persuading a U.S. bankruptcy attorney serving as a member of the U.S. Trustee Program (USTP) to try to obtain those documents on its behalf.

The USTP is the part of the DOJ that "is responsible for overseeing the administration of bankruptcy cases and private trustees" (USTP n.d.). Consisting of twenty-one regional offices in addition to its executive office in Washington, D.C., the USTP is designed to be a guarantor of integrity in bankruptcy litigation, "responsible for overseeing the administration of bankruptcy cases and private trustees" (USTP n.d.). The DOJ website explains the organization's purpose as follows: "The USTP's mission is to promote integrity and efficiency in the nation's bankruptcy system by enforcing bankruptcy laws, providing oversight of private trustees, and maintaining operational excellence" (U.S. DOJ n.d.).

Despite that mission and USTP's reputation as a neutral watchdog, evidence emerged in 2013 that a U.S. bankruptcy trustee serving as part of the USTP might have assisted a CFPB attempt to obtain protected bankruptcy files. The controversy involved the USTP, the CFPB, and a private firm, Morgan Drexen, that archives the files of private attorneys, including bankruptcy attorneys. If successful, such a bureau stratagem involving the USTP could enable the CFPB to acquire protected files in spite of statutory prohibitions. Journalist Richard Pollock explained: "Serious allegations are being raised in the legal community that the Consumer Financial Protection Bureau has recruited the U.S. Trustee Program to collect bankruptcy data on its behalf to aid a controversial data-mining program. . . . If USTP is aiding CFPB's data-mining program in any manner, bankruptcy authorities argue it would constitute an 'unprecedented' violation of the organization's reason for being and destroy its independence" (2013b). A "former federal bankruptcy judge" affirmed the impropriety of such a USTP–CFPB connection, stating that "[d]oing the bidding of another government agency would be inconsistent with the mission of the U.S. Trustee's role" (qtd. in Pollock 2013b).

But what evidence suggested such a CFPB effort to circumvent the law? Consider the following sequence of events. In April 2012, the CFPB initiated a "non–public law enforcement action" against Morgan Drexen. On April 13, 2012, the CFPB "requested all" of Morgan Drexen's "internal business documents and its document management database 'in which Morgan Drexen has electronic records relating to Debt Settlement'" (Pollock 2013b). As Pollock noted, the requested information would include "millions of private documents of financially distressed Americans" (2013b, 3).

On May 11, 2012—a month after CFPB's initial action against Morgan Drexen—the USTP bankruptcy trustee for Region 21 (Florida and Georgia) filed what observers called an "unusual discovery request" before the Tampa, Florida, bankruptcy court. The U.S. trustee "asked for millions of unrelated bankruptcy files nationwide that were in the possession of Morgan Drexen" (Pollock 2013b). The U.S. trustee sought to obtain all Morgan Drexen cases from January 1, 2008, forward in which it "was at any time assisting an attorney for a debtor in a bankruptcy proceeding" (qtd. in Pollock 2013b). Significantly, although filed in Florida,

the U.S. trustee's discovery request encompassed Morgan Drexen documents for cases throughout the United States.

The U.S. trustee's request was followed on July 18, 2012, by what Steven M. Berman, a bankruptcy attorney representing Morgan Drexen in Florida, considered clear confirmation of the interplay between the USTP and the CFPB: an email from the USTP's Region 21 bankruptcy trustee to Berman, noting "a separate CFPB request" for Morgan Drexen's documents and asking that the U.S. trustee receive the same documents (Pollock 2013a). Although the push continued in and out of court, in November 2012 the Florida bankruptcy judge, Caryl E. Delano, severely restricted the U.S. trustee's access to Morgan Drexen's files, allowing access to documents pertaining to "only seven Florida bankruptcy cases" (Pollock 2013b).

Whatever the eventual outcome of legal battles between the CFPB and Morgan Drexen (Brock 2013), the key concern here is the CFPB's ongoing effort to use third parties to neutralize the DFA's restrictions on its activities. As Wallison observes, through the CFPB "the act abandons a fundamental principle of the U.S. Constitution, in which Congress retains the power to control the agencies of the executive branch," instead, as noted, creating an entity "answerable to no one" (2010, 1).

Federal High-Risk Mortgage Initiatives under Dodd–Frank

Although oversight of Fannie Mae and Freddie Mac increased after their conservatorship began in 2008, the DFA did not eliminate or fundamentally reform the GSEs, nor did it curtail government involvement with high-risk mortgages. Not reforming the GSEs was a major omission. Yet even as the GSEs remain in conservatorship, the DFA is now facilitating the shifting of high-risk mortgage initiatives to the Federal Housing Administration (FHA). As Peter Wallison and E. J. Pinto describe it, the DFA "allows the administration to substitute the FHA for Fannie and Freddie as the principal and essentially unlimited buyer of low-quality home mortgages," thereby "quietly shift[ing] most federal high-risk mortgage initiatives to FHA, the Government's original subprime lender" (2010, 2–3). Affordable-housing initiatives thus continue to thrive.

This was accomplished indirectly by DFA section 941(b), which amended the Security Exchange Act of 1934 (15 U.S. Code 78a) by adding section 15G's "credit risk retention" provisions to the 1934 act. Section 15G provides for "*total or partial exemption* (from risk retention) *of any securitization, as may be appropriate*" and authorized "a total or partial exemption from risk retention for the securitization of an asset issued or *guaranteed by the United States or an agency of the United States*" (which clearly swept the FHA into the exempted classification). Fannie Mae and Freddie Mac, in contrast, are summarily declared "not agencies of the United States" (DFA 2010, § 941(b), 124 Stat 1893, emphasis added).

Section 941 also introduced a new mandate designed to reduce risk in mortgage-loan markets by requiring securitizers of certain "asset-backed securities," including

those collateralized by residential mortgages, to retain "*not less than 5 percent of the credit risk* for any asset that is *not* a qualified residential mortgage,"[13] subject to certain exemptions. This was envisioned as a general rule significantly deterring risky mortgage lending. Indeed, the only way securitizers of residential mortgage-backed securities could avoid Dodd–Frank's 5 percent risk-retention requirement was to securitize only assets collateralized by Qualified Residential Mortgages (QRMs).

Implementing the risk-retention rules thus required codifying what would constitute a QRM, a daunting undertaking for the six agencies (hereafter "the agencies") charged with that task (Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, FDIC, Securities and Exchange Commission, FHFA, and Department of Housing and Urban Development). Political and economic interests favoring a rigorous definition of QRM, making it difficult to achieve QRM status and avoid risk retention, emphasized risk retention's importance in avoiding future defaults and mortgage-lending crises. Those favoring a looser definition stressed the economic burden that the 5 percent risk retention would impose. Disagreements regarding the definition of a QRM thus reflected the larger battle over how widely and rigorously to apply the DFA risk-retention provisions. Further complicating the situation was the CFPB's responsibility, under the Truth in Lending Act (sec. 129C(c)(2)), for defining a "qualified mortgage" (QM) to satisfy the very different requirements of the Truth in Lending Act.

The conflict between the agencies' QRM and the CFPB's QM was resolved during the agencies' rule-making process by two factors: (1) a provision in the DFA section 15G specifying that the definition of QRM could be "*no broader than*" that of QM and (2) the agencies' decision to "align" the two definitions.[14] That "alignment" meant that the more stringent definitions of QRM would be interpreted so as to match the CFPB's looser, less-rigorous definition of QM. With QRM's standards rendered more easily achievable, many more firms would be exempt from risk retention, undermining the very strategy intended to be DFA's bulwark against excessive risk taking and future mortgage-lending crises.

Passions were strong following the agencies' rulings. One official participant, Daniel M. Gallagher, commissioner of the Securities and Exchange Commission, described the powerful interest-group pressures involved and the likely results of the agencies' rule making. He criticized "[t]he definition of QRM which the agencies have disgracefully abdicated to the Consumer Financial Protection Bureau by linking it to their definition of 'qualified mortgage.'" Referring to the "fundamentally cronyistic system" around them, Gallagher cautioned that the agencies should "have the wisdom and courage to take into account the nature and motives of the commenters and the

13. DFA 2010, §941(b), 124 Stat. 1891–96, adding section 15G to the Securities Exchange Act, at 124 Stat. 1891–92, emphasis added. See also Quinones (2011).

14. DFA 2010, 124 Stat. 1895 ("no broader than"). Final Rule, Credit Risk Retention, *Federal Register*, Vol. 79, No. 247, December 24, 2014, 77607 (alignment of QRM, QM).

special interests that some of them represent" and predicted that the "present rule making will ensure that the currently suffocating private mortgage market will continue to be stagnant or finally die off in favor of ensuring that the overwhelming majority of mortgages will be owned or guaranteed by the same federal housing agencies that led the country down the path to destruction over the past several decades" (2014).

The redefinition of QRM was key. Gallagher stated that with the loosened rules "we are not only reverting to the meaningless standards of the past but also placing a new government imprimatur on mortgages that meet those low standards. By applying the government's QRM label—with its unambiguous declaration that a loan is 'qualified'—to virtually any residential mortgage, we render the new standard meaningless at best, deleterious at worst" (2014).

And, indeed, FHA moved into additional "affordable-housing" initiatives, such as its new Blueprint for Access program (FHA 2014).

Thus, provisions ostensibly curtailing use of high-risk mortgage-backed securities, just like other provisions of the Dodd–Frank Act, do not deliver the risk reduction and transparency that the act's advocates so ardently promised. The contrast between what the DFA promised and what it delivered could not be more stark.

Conclusion

Despite explicitly stated legislative intentions to the contrary, the powers of the DFA's Financial Stability Oversight Council, Orderly Liquidation Authority, Office of Financial Research, and Consumer Financial Protection Bureau are expanding and reinforcing the very structural elements that contributed to the financial crisis of 2007–2009. So too are DFA's changes to the federal housing-finance bureaucracy. Moreover, as this article has documented, many of the new DFA-spawned powers extend far beyond the factors commonly asserted to have caused the financial crisis.

Revisiting the key structural precursors of the crisis enumerated at the outset, this paper has shown that with the Dodd–Frank Act:

- Arbitrary federal power over U.S. financial markets and depository institutions is now broader, more complex, and more intrusive, including new federal authority over "nonbank" firms and firms labeled SIFIs.
- Implicit government guarantees of private firms continue, with a mere change in label as the new SIFI appellation has superseded former "too big to fail" terminology.
- Government policies fostering "affordable housing" remain intact, with a shift in predominant backing of mortgage loans from Fannie Mae and Freddie Mac to the FHA (Wallison and Pinto 2010).[15]
- New strategies such as risk retention to curtail risky mortgage lending have been eroded.

15. For an excellent analysis of housing finance under the DFA, see Wallison 2011.

- The "rule of law" has been undermined further by DFA-mandated increases in discretionary government power wielded through the FSOC and CFPB, preventing affected individuals from knowing how the act applies to them and shielding federal officials from public oversight and control.

In short, key federal interventions of the types that generated the financial crisis remain in place, augmented and fully capable of triggering another financial debacle. As Peirce and Broughel state, the DFA "not only fails to achieve many of its stated goals, but it also reinforces dangerous regulatory pathologies that became evident during the last crisis and creates new pathologies that could lay the groundwork for the next crisis" (2012, 16).

We have seen how lawmakers' strategic use of language facilitated this outcome. The DFA's authors wrapped each of their new bureaucratic creations in the language of arbitrary power, using statutory words and phrases that sound appealing but establish few objective limits on powers granted to the new regulatory entities. The very names of the new entities embrace language designed to hinder resistance to them. Congress promoted the DFA as a means to achieve "Wall Street reform and consumer protection." Vast discretionary powers wielded by the FSOC were labeled matters of "financial stability oversight." Unprecedented powers conferred upon the CFPB were wrapped in the mantle of "consumer financial protection." With the act's objectives thus framed in benign-sounding generalities, nonspecialists easily overlook the absence of objective statutory limits on bureaucrats' actions authorized under these banners. Indeed, that is the purpose of such language.[16]

Near the beginning of this article, the section titled "A Fateful Misdiagnosis?" noted lawmakers' assertions that the financial crisis of 2008 resulted from gaps in government oversight—gaps that purportedly would be eliminated with the DFA's new bureaucratic structures. However, as this article has shown, the crisis did not arise from lack of federal regulation, and the new bureaucracies both exacerbate problems that generated the crisis in the first place and assert new and as yet incompletely defined authority over private-market activities not cited as precipitating the crisis. Such a mismatch between the actual causes of the crisis and the purported "cure" raises an important question: Could it be that key architects of the act did not, in fact, make a misdiagnosis at all? Could it be instead that the DFA's language, expanding federal powers without correcting known problems, largely reflected political opportunism wrapped in the language of reform?[17] More fully answering that question must await future research.

16. In economic terms, that language again exemplifies the "political transaction-cost manipulation" mentioned earlier, a concept denoting strategies that political actors use to raise the costs to others (the public, other politicians) of resisting a measure such as the DFA (Twight 1994).

17. If so, it would reflect political transaction-cost manipulation of the highest order. See note 16.

That issue aside, the tactics described here sufficed to obscure and soften the language of arbitrary power now shaping the Dodd–Frank Act's implementation. As implementation continues, the central government's expanded power will become increasingly evident, exposing ever more clearly the new political and economic risks the act portends for U.S. businesses, investors, property owners, and other ordinary Americans.

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