The Financial CHOICE Act: Policy Issues

Sean M. Hoskins, Coordinator
Specialist in Financial Economics

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Summary

The Financial CHOICE Act (FCA; H.R. 5983), sponsored by Chairman Jeb Hensarling, was ordered to be reported by the House Committee on Financial Services on September 13, 2016. The bill is a wide-ranging proposal with 11 titles that would alter many parts of the financial regulatory system. Much of the FCA is in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act; P.L. 111-203), a broad package of regulatory reform legislation that initiated the largest change to the financial regulatory system since at least 1999. Many of the provisions of the bill would modify or repeal provisions from the Dodd-Frank Act, although others would address long-standing or more recent issues.

This report highlights major proposals included in the bill but is not a comprehensive summary. In general, the changes proposed by the FCA can be divided into two categories: (1) changes to financial policies and regulations and (2) changes to the regulatory structure and rulemaking process.

Major policy-related changes proposed by the FCA include the following:

- **Leverage Ratio—**allowing a banking organization to choose to be subject to a higher, 10% leverage ratio in exchange for being exempt from risk-weighted capital ratios, liquidity requirements, and other regulations.
- **Regulatory Relief**—providing regulatory relief throughout the financial system to banks, consumers, and capital market participants, including by repealing the Volcker Rule, Durbin Amendment, and fiduciary rule.
- **Too Big To Fail**—repealing the designation of systemically important financial institutions and emergency assistance and replacing an option for winding down systemic institutions with a new chapter in the Bankruptcy Code that is tailored to financial firms.

The FCA also includes structural and procedural changes that affect the balance between regulator independence from and accountability to Congress and the judiciary, including

- **Leadership**—modifying the leadership structure of agencies with a single head to be bipartisan, multimember commissions.
- **Funding**—subjecting regulators that currently set their own budgets to the traditional congressional appropriations process.
- **Rulemaking—**requiring regulators to perform more detailed cost-benefit analysis when issuing new rules and to use cost-benefit analysis to review existing rules, as well as requiring congressional approval for a major rule to come into effect.
- **Judicial Review**—requiring courts to apply a heightened judicial review standard for agency actions taken by financial regulators rather than applying varying levels of deference to the agencies' interpretations of the law.
- **Enforcement**—increasing the maximum civil penalties that could be assessed for violations of certain banking and securities laws and restraining certain agency enforcement powers.
- **CFPB**—renaming the Consumer Financial Protection Bureau as the Consumer Financial Opportunity Commission and modifying its powers, leadership, mandate, and funding.

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Introduction

Representative Jeb Hensarling, chairman of the House Committee on Financial Services, released a discussion draft titled the Financial CHOICE Act (FCA) on June 23, 2016.[1] On July 12, 2016, the committee held a hearing titled, "Making a Financial Choice: More Capital or More Government Control?"[2] Much of the original draft text was introduced as H.R. 5983 on September 9, 2016. The committee held a markup on H.R 5983 on September 13, 2016, and agreed by a voice vote to an amendment in the nature of a substitute offered by Chairman Hensarling. No other amendments were offered.[3] The committee then voted to report the bill as amended by a vote of 30 to 26.

The FCA is a wide-ranging proposal with 11 titles that would alter many parts of the financial regulatory system. Many of the provisions can be categorized as providing regulatory relief to financial firms, investors, or borrowers. Other provisions alter the financial regulatory architecture or change the relationship between financial regulators and Congress or the judiciary. **Table 1** lists the federal financial regulators and their general responsibilities. Much of the FCA is in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[4] a broad package of regulatory reform legislation passed following the 2007-2009 financial crisis that initiated the largest change to the financial regulatory system since at least 1999. Many of the provisions of the bill would modify provisions from the Dodd-Frank Act, although others would address long-standing or more recent issues.

Table 1. Overview of Federal Financial Regulators Discussed in this Report

Name/Acronym	Composition/General Responsibilities
Regulator	
Commodity Futures Trading Commission (CFTC)	Regulation of derivatives markets
Consumer Financial Protection Bureau (CFPB)	Regulation of financial products for consumer protection
Federal Deposit Insurance Corporation (FDIC)	Provision of deposit insurance, regulation of banks, receiver for failing banks
Federal Housing Finance Agency (FHFA)	Regulation of housing-government sponsored enterprises
Federal Reserve System (Fed)	Monetary policy; regulation of banks, systemically important financial institutions, and the payment system
National Credit Union Administration (NCUA)	Provision of deposit insurance, regulation of credit unions, receiver for failing credit unions
Office of the Comptroller of the Currency (OCC)	Regulation of banks
Securities and Exchange Commission (SEC)	Regulation of securities markets

[1] The House Committee on Financial Services has provided resources on the bill at http://financialservices.house.gov/choice/. For the minority's view, see House Financial Services Committee Democrats, "The "Wrong Choice Act" to Repeal Dodd-Frank," press release, July 12, 2016, at http://democrats.financialservices.house.gov/uploadedfiles/07.11.2016_wrong_choice_act_one_pager_final.pdf.

[2] U.S. Congress, House Committee on Financial Services, *Making a Financial Choice: More Capital or More Government Control?*, July 12, 2016, at http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=400862.

[3] Doug Sword, "Republicans Push Dodd-Frank Repeal Bill Through Committee," *CQ*, September 13, 2016, at http://www.cq.com/doc/news-4953884?0&srcpage=news&srcsec=ina.

[4] P.L. 111-203.

Name/Acronym	Composition/General Responsibilities
Other Federal Financial Entities	
Financial Stability Oversight Council (FSOC)	Council of financial regulators and state and industry representatives accountable for financial stability
Office of Financial Research (OFR)	Provides research support to FSOC
Federal Insurance Office (FIO)	Monitors insurance industry and represents federal interests in insurance

Source: Table compiled by the Congressional Research Service (CRS).

Notes: The FCA would rename the CFPB as the Consumer Financial Opportunity Commission; when discussing provisions of the FCA affecting the CFPB, this report will use the agency's current name. For more information on the roles, duties, and responsibilities of the federal financial regulators, see CRS Report R43087, *Who Regulates Whom and How? An Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets*, by Edward V. Murphy.

a. The Federal Reserve System is composed of the Board of Governors and 12 regional Federal Reserve banks. Unless otherwise noted, provisions of the FCA involving the Fed affect the Board of Governors.

This report highlights major policy proposals in the bill, but it is not a comprehensive summary of the bill. It provides context for these proposals in the form of background and policy debate. This report also includes an experts' contact list for FCA topics in the **Appendix**.

Regulatory Relief

As financial regulators have implemented the Dodd-Frank Act and other reforms, some Members of Congress argue that the pendulum has swung too far toward excessive regulation. As a result, they argue that additional regulatory burden—the cost associated with government regulation and its implementation—has stymied economic growth and restricted consumers' access to credit. Other Members, however, contend the current regulatory structure has appropriately strengthened financial stability and increased protections for consumers and investors. They are concerned that regulatory relief for financial institutions could negatively affect consumers and market stability.

In determining whether to provide regulatory relief, a central question is whether an appropriate tradeoff has been struck between the benefits and costs of regulation. In other words, can relief be provided while maintaining the stability of the financial system and ensuring consumers and investors are protected, or would relief undermine those goals? Regulatory relief is generally focused on the financial services providers—such as banks, broker-dealers, and other institutions—but what effect would relief have on consumers, investors, particular markets, and market stability more broadly? The answers to these and other policy questions will vary based on the particulars of the relief being proposed.

Relief for Lenders[5]

Background

In response to vulnerabilities that had arisen during the financial crisis, regulatory reforms stemming from the Dodd-Frank Act, Basel III, and other rules were intended to ensure the safe functioning of lenders and to protect consumers. Some of the new regulations applied to all

[5] This section was authored by Sean Hoskins. See **Appendix** for contact information.

lenders (i.e., banks, credit unions, and nonbank lenders) regardless of the lender's charter, whereas other provisions only applied to certain types of lenders.

Two categories of regulatory changes for lenders in the Dodd-Frank Act are (1) prudential regulation and (2) consumer protection regulation. Prudential regulation (also referred to as safety and soundness regulation) is intended to ensure that a bank or credit union remains solvent. After hundreds of banks failed during the financial crisis, the reforms implemented in the wake of the crisis were intended to make banks less likely to fail. Most nonbank lenders are not subject to safety and soundness regulation.

The goal of consumer protection is to ensure that institutions comply with applicable consumer protection and fair lending laws. The Consumer Financial Protection Bureau[6] is a regulator created by the Dodd-Frank Act to provide an increased regulatory emphasis on consumer protection. The Dodd-Frank Act gave the CFPB new authority and transferred existing authorities to it from the banking regulators. Consumer protection applies to banks and nonbanks, but some activities and entities are statutorily exempted.

Policy Issues

As financial regulators have implemented the Dodd-Frank Act and other reforms through recent rulemakings, some in Congress argue that the increased regulatory burden on lenders is resulting in significant costs that restrain economic growth and consumers' access to credit.

Others, however, view the current regulatory structure as having achieved the appropriate tradeoff between the benefits and costs of regulation and are concerned that regulatory relief for banks or other financial institutions could negatively affect the cost and availability of credit to consumers, lender solvency, and market stability.

Provisions in the FCA

The FCA would provide regulatory relief to lenders through more than two dozen provisions.[7] Some of the proposals are aimed at assisting community banks and other small lenders, whereas others would apply to all institutions that perform certain regulated activities, regardless of size and whether they are banks or nonbanks. Many would modify or repeal rules stemming from the Dodd-Frank Act, whereas others target supervision or other long-standing regulatory practices.

Regulatory relief provisions can be divided into the same categories discussed above: prudential regulation and consumer protection. Examples of relief from prudential regulation that would be provided by the FCA include the following:

- Some provisions would modify or repeal prudential rules that regulators have issued. For example, the FCA would repeal Section 619 of the Dodd-Frank Act, also known as the "Volcker Rule." The Volcker Rule[8] has two main parts—it prohibits banks from proprietary trading of risky assets and from certain relationships with risky investment funds, including acquiring or retaining "any

[6] For an overview of the Consumer Financial Protection Bureau (CFPB), see, The Consumer Financial Protection Bureau (CFPB): A Legal Analysis, by David H. Carpenter.

[7] Many of these provisions have seen committee or floor action as stand-alone bills. For more information, see CRS Report R44035, *"Regulatory Relief" for Banking: Selected Legislation in the 114th Congress*, coordinated by Sean M. Hoskins.

[8] For more on the Volcker Rule, see CRS Report R43440, *The Volcker Rule: A Legal Analysis*, by David H. Carpenter and M. Maureen Murphy.

equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund."[9] The statute carves out exemptions from the rule for trading activities that Congress viewed as legitimate for banks to participate in, such as risk-mitigating hedging and market-making related to broker-dealer activities. It also exempts certain securities, including those issued by the federal government, government agencies, states, and municipalities, from the ban on proprietary trading.[10]

- Other provisions would modify the supervision of lenders for safety and soundness. For example, the FCA would require regulators to satisfy certain timelines for completing bank examinations and establish a new ombudsman to investigate bank complaints about supervisory exams. It would prohibit specific actions by the supervisor in retaliation for appealing. It would give banks the right to appeal exam results to the ombudsman or an administrative law judge, and would not allow the ombudsman or judge to defer to the supervisor's opinions. It would not permit further appeal by the supervisor, but would allow the bank to appeal this decision to appellate court.
- Other provisions would reduce regulatory compliance costs. For example, the FCA would require regulators to allow certain highly rated and well-capitalized lenders (that also satisfy other criteria set by the regulators) to report less regulatory information about health and performance every other quarter.

The FCA would also provide relief from several consumer protection regulations, including the following:

- Modifying mortgage-related rulemakings adopted after the housing crisis related to manufactured housing, escrows, mortgage servicing, and the Qualified Mortgage rule to ensure that borrowers had an *ability to repay*.
- Repealing Section 1075 of the Dodd-Frank Act, also known as the Durbin Amendment. Under the Durbin Amendment, the Federal Reserve capped the interchange fee[11] that debit card issuers with more than $10 billion in assets can charge merchants for payment processing.[12] The Durbin Amendment requires the Federal Reserve to ensure that the fee is "reasonable and proportional to the cost incurred by the issuer with respect to the transaction."[13]
- Allowing states and federally recognized Indian tribes to opt out for five years of a final CFPB rule related to payday loans, vehicle title loans, and other similar small-dollar loans so that the CFPB's rule would not apply within the state or territory during the period of the waiver. The CFPB has not issued a final rule

[9] P.L. 111-203, §619. For more information, see CRS Legal Sidebar WSLG767, *What Companies Must Comply with the Volcker Rule?*, by David H. Carpenter.

[10] For a summary of the Volcker Rule, see Federal Reserve, "Final Rules to Implement the 'Volcker Rule,'" at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a3.pdf.

[11] "Debit card interchange fees are established by payment card networks and ultimately paid by merchants to debit card issuers for each electronic debit transaction." According to Federal Reserve, press release, June 29, 2011, at https://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm.

[12] For more on the Durbin Amendment, see CRS Report R41913, *Regulation of Debit Interchange Fees*, by Darryl E. Getter and Federal Reserve, press release, June 29, 2011, at https://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm.

[13] P.L. 111-203, §1075.

related to payday and other small-dollar loans, but it issued a proposed rule on June 2, 2016.[14]

Leverage Ratio as an Alternative to Current Bank Regulation[15]

Background

With more than 500 banks failing between 2007 and 2014,[16] strengthening prudential regulation has been a major goal of post-crisis financial reforms. Prudential regulation covers a broad set of a bank's activities, including assessing whether a bank will be able to meet its obligations during a market downturn, evaluating the quality of its assets and management team, and other factors. One of the main areas of focus is bank capital.

Capital is the difference between the value of a bank's assets and its liabilities and is an indicator of a bank's ability to absorb losses. If a bank has $100 worth of assets and $90 of liabilities, then the bank has capital of $10. If the value of the assets decreases by $5 to $95 and the bank still has $90 in liabilities, then the $5 decline in asset value would be absorbed by the capital, which would decrease from $10 to $5.

Capital is often measured as the ratio of capital to the bank's assets. A 10% capital ratio, for example, would imply $10 of capital for every $100 of assets. Banks are required to satisfy several different capital ratios, but the ratios fall into two main categories: (1) a leverage ratio and (2) a risk-weighted asset ratio. Failure to satisfy the required ratios could lead to regulators taking corrective action against a bank, including ultimately shutting the bank down.

Under a leverage ratio, all assets regardless of riskiness are treated the same and, as in the previous example, the ratio is calculated by dividing capital by assets. Under a risk-weighted asset ratio, each asset is assigned a risk weight to account for the fact that some assets are more likely to lose value than others. Riskier assets receive a higher risk weight, which requires banks to hold more capital—and so be better able to absorb losses—to meet the ratio requirement.

Leverage Ratio and Risk-Weighted Ratio Sample Calculations

$$\text{Leverage Ratio} = \frac{\text{Capital}}{\text{Assets}}$$

$$\text{Risk-Weighted Ratio} = \frac{\text{Capital}}{(\text{Risk Weight for Asset 1}) \text{ x } (\text{Asset 1}) + (\text{Risk Weight for Asset 2}) \text{ x } (\text{Asset 2})}$$

The specifics of the capital ratios—what the minimum levels are, what qualifies as capital, what the asset risk weights are, what is included in total assets—were proposed by the Basel Committee on Bank Supervision and then implemented by the U.S. financial regulators.[17] The

[14] For more on the proposed rule, see CRS Legal Sidebar WSLG1613, *CFPB Issues Proposal to Regulate Payday, Car Title, and Other Small-Dollar Loans*, by David H. Carpenter.

[15] This section was authored by Sean Hoskins. See **Appendix** for contact information.

[16] For more on bank failures, see CRS In Focus IF10055, *Bank Failures and the FDIC*, by Raj Gnanarajah.

[17] For more on the Basel III regulations, see CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by Darryl E. Getter.

Basel Committee "is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters."[18] The most recent proposed comprehensive reform proposal is referred to as Basel III.

The capital ratios that a bank must satisfy and how those levels are computed varies based on a bank's size and complexity. The largest banks are required to hold more capital than smaller, less complex banks.[19] In regards to the simple leverage ratio, most banks are required to meet a 4% leverage ratio.[20] Large banks are subject to a supplementary leverage ratio ranging from 3% to 6% depending on their size and the type of bank charter they hold.[21] The supplementary leverage ratio is more expansive than the leverage ratio to which smaller banks are subject because it takes into account certain off-balance sheet assets and exposures.

The required risk-weighted ratios depend on bank size and capital quality (some types of capital are considered to be less effective at absorbing losses than other types, and so considered lower quality). Most banks must meet a risk-weighted ratio of 4.5% for the highest quality capital and of 6% and 8% for lower quality capital.[22] Banks are then required to have an additional 2.5% of high quality capital on top of those levels as part of the "capital conservation buffer."[23] The eight U.S. banks that have been designated as global systemically important banks (G-SIBs)[24] face a capital surcharge that can range from 1% to 4.5%.[25] Although currently set at zero and not yet fully phased in, a large bank also could be subject to a countercyclical buffer of up to 2.5% of risk-weighted assets if regulators deem it necessary.[26]

Policy Issues

Some economists argue that it is important to have both a risk-weighted ratio and a leverage ratio because the two complement each other.[27] A basic tenet of finance is that riskier assets have a higher *expected* rate of return to compensate the investor for bearing more risk. Without risk

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[18] Bank for International Settlements, *About the Basel Committee*, September 30, 2015, at https://www.bis.org/bcbs/about.htm?m=3|14|573.

[19] The largest banks are also referred to as "advanced approaches banks" (referring to the different approach for capital regulation to which they are subject), which are institutions with at least $250 billion in consolidated assets or on-balance sheet foreign exposures of at least $10 billion.

[20] Federal Reserve Board, *Final Rule on Enhanced Regulatory Capital Standards - Implications for Community Banking Organizations*, July 2013, at http://www.federalreserve.gov/newsevents/press/bcreg/commbankguide20130702.pdf.

[21] Federal Deposit Insurance Corporation (FDIC), Federal Reserve System, and Office of the Comptroller of the Currency (OCC), "Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio," 79 *Federal Register* 57725, September 26, 2014.

[22] Federal Reserve Board, *Final Rule on Enhanced Regulatory Capital Standards - Implications for Community Banking Organizations*, July 2013, at http://www.federalreserve.gov/newsevents/press/bcreg/commbankguide20130702.pdf.

[23] Ibid.

[24] For more on G-SIBs and the designation process, see CRS Insight IN10388, *Designation of Global 'Too Big To Fail' Firms*, by Rena S. Miller and James K. Jackson.

[25] Federal Reserve System, "Regulatory Capital Rules: Implementation of Risk-Based Capital," 80 *Federal Register* 49082, August 14, 2015.

[26] Federal Reserve System, "Regulatory Capital Rules: The Federal Reserve Board's Framework," 81 *Federal Register* 5661, February 3, 2016.

[27] See Chair Yellen comments during U.S. Congress, House Committee on Financial Services, *Monetary Policy and the State of the Economy*, 114th Cong., 2nd sess., June 22, 2016, at http://www.cq.com/doc/congressionaltranscripts-4915133?2.

weighting, banks would have an incentive to hold riskier assets because capital is costly and the same amount of capital must be held against riskier and safer assets. But risk weights may prove inaccurate. For example, banks held highly rated mortgage-backed securities (MBSs) before the crisis, in part because those assets had a higher expected rate of return than other assets with the same risk weight. MBSs then suffered unexpectedly large losses during the crisis. Thus, the leverage ratio can be thought of as a backstop to ensure that incentives posed by risk-weighted capital ratios to minimize capital and maximize risk within a risk weight do not result in a bank holding insufficient capital.

Others argue that the risk-weighted system provides “needless complexity” and is an example of “central planning.”[28] The complexity benefits those largest banks that have the resources to absorb the added regulatory cost. They believe that the risk weights in place prior to the financial crisis were poorly calibrated and “encouraged financial firms to crowd into these” risky assets, exacerbating the downturn.[29] Risk weighting may encourage regulators to set the weights so as “to provide a cheaper source of funding for governments and projects favored by politicians,” which can lead to a distortion in credit allocation.[30] Better, they argue, to eliminate the risk-weighted system for those banks that agree to hold more capital and satisfy a higher, simpler leverage ratio.

In addition to the issue of whether it is better to have either both a risk-weighted ratio and a leverage ratio or just a leverage ratio is the broader issue of the role of capital in bank regulation. Those who argue in favor of just having a higher leverage ratio also generally support eliminating other forms of prudential regulation, such as liquidity requirements, asset concentration guidelines, and counterparty limits. They argue that capital is essential to absorbing losses and, so long as sufficient capital is in place, banks should not be subject to excessive regulatory micromanagement.[31] Others, however, believe that the different components of prudential regulation each play an important role in ensuring the safety and soundness of financial institutions and are essential complements to bank capital.

Provision in the FCA

Under the FCA, a banking organization[32] that has received high ratings on recent examinations could choose to be subject to a higher, 10% leverage ratio.[33] In exchange for choosing to be subject to the 10% leverage ratio, banks would be exempt from risk-weighted capital ratios; liquidity requirements; certain merger, acquisition, and consolidation restrictions; limitations on

[28] House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, p. 6, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

[29] Ibid., p. 8.

[30] Ibid., p. 9.

[31] House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, p. 7, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

[32] A banking organization is defined in the FCA to include an insured depository institution, an insured credit union, a depository institution holding company, a company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act, and certain U.S. intermediate holding companies established by foreign banking organizations.

[33] Larger and more complex banks would have to comply with the supplemental leverage ratio (which includes off-balance sheet exposures) while credit unions and more traditional banks would have to comply with narrower definitions of the leverage ratio.

dividends; living will mandates; and other regulations. A bank would not have to follow this new regulatory approach but would have the option. Regulators would still have authority to conduct stress tests[34] on certain entities that opted for the new regulatory approach but would be limited in their ability to require them to alter their capital levels.

Some of the regulations from which a bank could receive relief are regulations that apply to all banks, such as the risk-weighted ratios. Other regulations from which a bank could receive relief under the FCA would only apply to larger banks (with an asset threshold of $50 billion to $700 billion, depending on the provision). For example, banks opting in to the new leverage ratio approach would be partially exempt from the Dodd-Frank Act's Section 165 enhanced prudential regulations (discussed in "Regulating Systemically Important Financial Institutions, Limiting Their Size, and Preventing "Bailouts"").

Securities and Derivatives Relief[35]

Background

Federal securities laws and attendant regulations are overseen and enforced by the Securities and Exchange Commission and apply to various entities involved in the securities markets as well as companies that issue securities. Statutorily, the regulations that the SEC oversees—whether specifically directed by Congress or regulatory rules adopted independently by the SEC per its authority under the securities laws—are supposed to facilitate the agency's broad missions, including to (1) ensure investor protection; and (2) facilitate capital formation—goals that at times may be in opposition to each other.

Derivatives markets are regulated by the CFTC and SEC depending on the type of derivatives being traded. The Dodd-Frank Act created a new regulatory regime for derivatives in response to vulnerabilities highlighted during the crisis.

Policy Issues

When securities regulation is lenient, then it may be easier for companies to raise capital from investors, but also may leave investors less protected from fraud or misinformation. When it is stringent investors may be better protected, but it may make it more difficult to raise capital. Some observers feel securities regulation has become too onerous and is unnecessarily stifling capital formation. Others feel the current regulatory environment strikes an appropriate balance between the two objectives.

Provisions in the FCA

Many of the securities-related provisions in the FCA provide regulatory relief with the aim of facilitating capital formation. Among the over three dozen securities-related provisions in the FCA are

- Provisions that relax restrictions on who is eligible to invest in certain types of securities, including venture capital investors. For example, under federal securities laws, entities who qualify as *accredited investors* are eligible to invest

[34] For information on current stress tests, see the Federal Reserve web page at http://www.federalreserve.gov/bankinforeg/stress-tests-capital-planning.htm.

[35] This section was authored by Gary Shorter and Rena Miller. See **Appendix** for contact information.

in private and limited corporate offerings (private placements) that are exempt from SEC registration requirements. The concept of the accredited investor is that some investors are sophisticated enough to understand the risks of investing in privately placed securities. Individuals are currently defined as accredited investors based on income or asset thresholds. The FCA would amend the definition of an accredited investor to also include licensed securities industry professionals (including registered brokers and investment advisers) and persons whom the SEC and FINRA determines to have certain educational or job experiences that qualify them as having sufficient professional subject expertise. The FCA provision is modeled after H.R. 2187, which previously passed the House.

- Provisions that relax regulatory requirements on licensed professionals in the securities industry, including private equity advisers, private funds, municipal advisors, investment fund researchers, and credit rating agencies. For example, under federal securities laws, SEC-registered investment advisers are *fiduciaries*, a designation that carries a legal obligation to act in their client's best interest. By contrast, brokers and dealers who receive commissions are generally not subject to the fiduciary standard, and are instead required to make investment recommendations that are *suitable* for the customer, a comparatively less demanding standard of client duty. The Dodd-Frank Act authorized, but did not require, the SEC to promulgate rules that establish a uniform standard of client responsibility for broker-dealers and investment advisers, which SEC officials currently describe as a work in progress. In 2016, the Department of Labor (DOL) finalized rules to amend the definition of *investment advice* to broaden the class of financial professionals subject to the fiduciary obligation under the Employee Retirement Income Security Act of 1974[36] which governs retirement and benefit plans. The rules go into effect April 10, 2017.[37] The FCA would repeal the DOL rule and require that prior to conducting the aforementioned rulemaking, the SEC must first report to Congress on whether (1) retail investors would be harmed by the rule; and (2) alternative approaches existed to reduce confusion or harm to retail investors. The provision is modeled after provisions in H.R. 1090, which previously passed the House.[38]
- Provisions that relax regulatory requirements for firms that issue capital or securities, including emerging growth companies, risk retention requirements for non-mortgage securitizers, firms subject to disclosures on conflict minerals, and companies raising funds via crowdfunding or from angel investors. For example, Section 404(a) of the Sarbanes-Oxley Act of 2002[39] requires public company annual reports to include commentary on the effectiveness of the company's internal controls (methodology aimed at ensuring the integrity of financial and accounting information) and requires a company's outside auditor to attest to that managerial assessment of the internal controls. Due to the proportionally higher

[36] P.L. 93-406,

[37] See CRS Legal Sidebar WSLG1562, *Labor Department Issues Final Rule on Fiduciaries and Investment Advice*, by Jennifer A. Staman and Jon O. Shimabukuro.

[38] See CRS Report R44207, *Department of Labor's 2015 Proposed Fiduciary Rule: Background and Issues*, by John J. Topoleski and Gary Shorter.

[39] P.L. 107-204.

cost on smaller public companies of complying with Section 404(b), the Dodd-Frank Act permanently exempted non-accelerated filers—generally public companies with less than $75 million in global public float—from compliance with Section 404(b). Many in the business community still criticize Section 404(b) for being problematically costly for firms with more than $75 million in public float, however.[40] In a study required by the Dodd-Frank Act, the SEC did not recommend expanding the current Section 404(b) exemption threshold.[41] The FCA would expand the number of firms with Section 404(b) exemptions from less than $75 million to less than $250 million in public float. The FCA would also extend the exemption to depository institutions with less than $1 billion in assets.

- Provisions related to derivatives markets. One example is the regulation of cross-border swaps. The topic of cross-border swaps broadly relates to the question of to what degree did the Dodd-Frank Act authorize the CFTC to regulate swaps that may extend beyond U.S. borders? Because the swaps market is international in nature, with considerable cross-border trading, this question is material. The Dodd-Frank Act stated that swaps reforms shall not apply to activities outside the United States unless the activities have "a direct and significant connection with activities in, or effect on, commerce of the United States." One issue that has arisen is the need for U.S. and foreign regulators to recognize one another's derivatives clearinghouses, trading exchanges, and data repositories for reporting trades as "equivalent," so that one trade spanning multiple jurisdictions need only be cleared, traded, and reported one time.

  The FCA requires the CFTC to issue a rule within one year that establishes criteria for finding foreign jurisdictions regulations comprehensive and comparable to the U.S. regime. If the CFTC has not done so after 18 months, the FCA would consider the eight largest foreign swaps jurisdictions (which would encompass most of the world of swaps trading, particularly if countries in the European Union were treated as one swaps jurisdiction) to be comparable and comprehensive—unless the CFTC found a foreign jurisdiction to be lacking. Effectively, for trades that involved a non-U.S. person, the bill appears to substitute as a default the swaps requirements of the eight largest foreign swaps markets for U.S. requirements.[42]

[40] Independent Community Bankers Association, "ICBA Backs Senate Bill Supporting Community Bank Access to Capital," *ICBA Press Release*, July 22, 2015, at http://www.icba.org/news/newsreleasedetail.cfm?ItemNumber=380679.

[41] Securities and Exchange Commission (SEC), "Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 For Issuers with Public Float Between $75 and $250 Million," April 2011, at https://www.sec.gov/news/studies/2011/404bfloat-study.pdf.

[42] This provision is similar to one found in H.R. 2289, which passed the House on June 9, 2015. For more information, see CRS Report R44231, *Commodity Futures Trading Commission: Proposed Reauthorization in the 114th Congress*, by Rena S. Miller.

Executive Compensation[43]

Background

Generally, federal policy does not intervene to limit or regulate executive compensation levels. Instead, policy requires publicly-listed companies to disclose certain information about their executive compensation levels and practices.

Two examples of current disclosure requirements come from the Dodd-Frank Act. It requires public companies to conduct a nonbinding shareholder vote on executive compensation at least every three years; called “say-on-pay.” It also requires publicly traded companies to calculate and disclose the median annual total compensation of all employees excluding the Chief Executive Officer (CEO), the annual total compensation of the CEO, and the ratio between the two. Companies will be required to disclosure their CEO-worker pay ratios for their fiscal year beginning January 1, 2017.[44]

One exception to the general approach on executive compensation is a Dodd-Frank Act requirement that the Fed, OCC, FDIC, FHFA, NCUA, and SEC promulgate rules aimed at prohibiting incentive-based compensation (performance-based variable employee pay) that encourage “inappropriate risks” at financial institutions with greater than $1 billion in assets. [45] In 2016, the regulators jointly released proposed rules to implement the requirement.[46]

Policy Issues

Proponents of greater disclosure believe that requiring transparency about executive compensation will help prevent outsized pay arrangements that are not in the interest of investors or in line with social values. Critics argue that current disclosure requirements impose unnecessary costs that do not impart useful information that helps maximize shareholder return. For example, critics of the pay ratio have cited the compliance challenges and costs of building systems capable of generating the worker pay data needed to arrive at worker median pay data, particularly for large multinational or multi-segmented firms with decentralized payroll systems.[47]

A key question in this debate is whether high executive compensation levels reflect executives’ productivity or result from corporate governance shortcomings. Proponents can point to research that found that executive pay has become decoupled from corporate financial performance.[48] Its detractors counter that taken as a whole, the body of research on the issue has failed to convincingly make the case for such a decoupling.[49]

[43] This section was authored by Marc Labonte and Gary Shorter. See **Appendix** for contact information.

[44] SEC, “SEC Adopts Rule for Pay Ratio Disclosure,” August 5, 2015, at https://www.sec.gov/news/pressrelease/2015-160.html.

[45] See CRS Report R43262, *The “Pay Ratio Provision” in the Dodd-Frank Act: Legislation to Repeal It in the 113th Congress*, by Gary Shorter.

[46] See CRS Report R44554, *The Dodd-Frank Act: An Overview of the 2016 Incentive-Based Compensation Proposal*, by Raj Gnanarajah and Gary Shorter.

[47] Ibid.

[48] Lucian A. Bebchuk, Martijn Cremers, and Urs Peyeret, “CEO Pay Slice,” *Journal of Financial Economics*, October 2011, pp. 199-206, at http://www.law.harvard.edu/faculty/bebchuk/pdfs/Bebchuk-Cremers-Peyer_CEO-Pay-Slice_Sept2010.pdf.

[49] Stephen M. Bainbridge, “Dodd-Frank: Quack Federal Corporate Governance Round II,” *UCLA School of Law, Law-Econ Research Paper No. 10-12*, pp. 1-3, September 7, 2010, at http://ssrn.com/abstract=1673575.

Provisions in the FCA

The FCA would amend the Dodd-Frank Act's say-on-pay provision by eliminating mandatory periodic shareholder votes on executive pay and limiting such votes to when a company has made a *material change* to the previous year's executive compensation. The FCA would repeal the Dodd-Frank Act requirement that companies calculate and disclose the CEO-worker pay ratio.[50] The FCA would also repeal the Dodd-Frank Act's incentive compensation mandate.

Systemically Important ("Too Big To Fail") Financial Institutions

Although "too big to fail" (TBTF) has been a long-standing policy issue, it was highlighted by the near-collapse of several large financial firms in 2008, including Bear Stearns, Fannie Mae, Freddie Mac, Lehman Brothers, and AIG, which led to a worsening of the financial crisis. With the exception of Lehman Brothers (which failed), all of these firms received government assistance under emergency authority to avoid insolvency. Financial firms are said to be TBTF when policymakers judge that the firms' failure would cause unacceptable disruptions to the overall financial system. Financial firms can be perceived as TBTF because of their size or interconnectedness. In addition to fairness issues, economic theory suggests that market expectations that the government will not allow a firm to fail create moral hazard—if the creditors and counterparties of a TBTF firm believe that the government will protect them from losses, they have less incentive to monitor the firm's riskiness (referred to as *market discipline*). If this is the case, a firm that is perceived to be TBTF could have a funding advantage, which some call an implicit subsidy, compared with other banks.

Regulating Systemically Important Financial Institutions, Limiting Their Size, and Preventing "Bailouts"[51]

Background

The Dodd-Frank Act included a number of provisions to address TBTF, using several different policy approaches.[52] The Dodd-Frank Act's main approach was to create an enhanced regulatory regime mostly administered by the Federal Reserve to hold systemically important firms to stricter prudential standards than other financial firms. Prudential regulation is a concept from banking regulation that refers to monitoring an institution's financial safety and soundness; the concept was generally not applied federally to nonbank financial firms before the crisis, with limited exceptions. The enhanced regulatory regime can include capital standards, liquidity standards, counterparty limits, stress tests, risk-management standards, "living will" requirements, and early remediation requirements.

The Dodd-Frank Act applied enhanced prudential regulation to three sets of financial entities—banks; nonbank financial firms; and payment, clearing, and settlement systems (called *financial*

[50] This provision is similar to H.R. 414 as reported by the House Committee on Financial Services.

[51] This section was authored by Marc Labonte. See **Appendix** for contact information.

[52] For more information, see CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte.

market utilities, or FMUs).[53] Bank holding companies (BHCs) are automatically subject to enhanced regulation if they have $50 billion or more in assets. More than 30 BHCs, including most of the largest U.S. financial firms, meet this criterion. A BHC cannot "debank" to avoid enhanced regulation if it received funds under the Troubled Asset Relief Program (referred to as the "Hotel California" provision). A smaller subset of the largest U.S. BHCs faces, when fully phased in, additional capital, leverage, and liquidity requirements through U.S. regulations implementing Basel III, an international accord. Nonbank financial firms and FMUs are subject to enhanced regulation if they are designated as *systemically important financial institutions* (SIFIs) by the Financial Stability Oversight Council. To date, eight FMUs and four nonbank financial firms, three of which are insurance companies, have been designated. Subsequently, one firm (GE Capital) has had its designation removed by FSOC and one designation (MetLife) has been overturned in court.[54]

Table 2. Institutions Designated by FSOC as Systemically Important

SIFIs	FMUs
Current	*Current*
AIG	The Clearing House Payments Co.
Prudential Financial	CLS Bank International
Former	Chicago Mercantile Exchange
GE Capital[a]	The Depository Trust Company
MetLife[b]	Fixed Income Clearing Corporation
	ICE Clear Credit
	National Securities Clearing Corp.
	The Options Clearing Corp.

Source: FSOC, https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx.

Notes: See text for details.

a. On June 28, 2016, FSOC rescinded GE Capital's designation.

b. On March 30, 2016, the U.S. District Court for the District of Columbia struck down MetLife's designation.

The Dodd-Frank Act included other approaches to coping with the TBTF problem, including provisions to limit the size of financial firms and narrow the scope of emergency authority to limit future "bailouts". It gave the Federal Reserve the authority to restrict the size and activities of a financial firm that posed "a grave threat to financial stability" and prevented a nonbank financial firm from most mergers and acquisitions that would cause its liabilities to exceed 10% of total financial-sector liabilities. These powers could be used only in limited circumstances, however, and have not been exercised to date.

The Fed (under Section 13(3) of the Federal Reserve Act), FDIC, and Treasury (using the Exchange Stabilization Fund) used emergency authority to offer loans and guarantees to financial firms and markets during the financial crisis. Broadly speaking, the Dodd-Frank Act narrowed the

[53] The types of tools prescribed for enhanced regulation of FMUs differ from those listed above for banks and non-bank financial firms. For more information, see CRS Report R41529, *Supervision of U.S. Payment, Clearing, and Settlement Systems: Designation of Financial Market Utilities (FMUs)*, by Marc Labonte.

[54] Information on designated firms is available at https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx.

scope of these authorities in an attempt to rule out "bailouts" to failing firms, but preserved the availability of emergency liquidity to healthy but illiquid firms. It also extended access to the Fed's discount window to FMUs.

Policy Issues

The fact that many large firms have grown in dollar terms since the enactment of the Dodd-Frank Act has led some critics to question whether the TBTF problem has been solved. Debate continues about whether the best policy approach to address excessive risk taking from moral hazard is through enhanced prudential regulation or market discipline—the fear of losses curbing excessive risk-taking. Although these two approaches need not be at odds with one another in the abstract—and policymakers have tried to pursue both simultaneously—in practice they may be. Critics of enhanced prudential regulation fear that if the government explicitly designates specific firms as systemically important, investors will assume that the firms will not be allowed to fail, which will undermine market discipline. If enhanced regulation is not tough enough—critics point to regulatory failures during the crisis as evidence that it may not be—and market discipline is undermined, designated firms might take greater risks and the financial system could be less stable.

Proponents of enhanced regulation question how credible a pledge to let firms fail can be. They point to the excessive risk taking leading up to 2008—when the government did not have a policy of aiding failing firms—and the subsequent decision to assist large firms to avoid a further deterioration in financial conditions as an example of the failure of market discipline. Also, the fact that many large failing firms did receive government assistance in 2008 may have already undermined the viability of the market discipline approach, by undermining the credibility of any subsequent pledge to allow firms to fail (regardless of current statutory limitations). Furthermore, systemic risk is a risk to the rest of society that investors do not internalize. From a policymaker's perspective, systemic risk may still be too high in the presence of perfect market discipline, because a TBTF firm's creditors have less to lose from its failure than the financial system as a whole. Another limit to market discipline is that creditors do not have access to the same confidential information as regulators.

The concept of prudential regulation of nonbank SIFIs raises additional policy questions:

- **Enhanced regulation.** Can the Federal Reserve effectively adapt banking prudential regulation and supervision to nonbanks, tailoring regulation to match their business models and the risks that they pose?
- **Designation process.** Given the lack of consensus on how to measure systemic importance, is FSOC's discretion appropriate or is the existing designation process too opaque and arbitrary?
- **Insurance and systemic risk.** Given that all currently designated SIFIs are insurers, is insurance a source of systemic risk and, if so, is it already adequately addressed by prudential regulation at the state level?
- **Size vs. activities.** Is the source of systemic risk for nonbanks caused mainly by firm size or by specific market practices by firms of all size? If the latter, then SIFI regulation is unlikely to contain systemic risk.

Provisions in the FCA

The FCA would repeal several provisions of the Dodd-Frank Act related to TBTF. Notably, it would repeal FSOC's ability to designate nonbank financial firms or FMUs as SIFIs and subject them to enhanced regulation and early remediation.[55] Firms and FMUs that are currently designated as SIFIs (see **Table 2**) would no longer be subject to enhanced regulation as detailed above.

The FCA would leave in place enhanced regulation from the Dodd-Frank Act and Basel III for large BHCs. However, banks that qualify for regulatory exemptions under the 10% leverage ratio would no longer be subject to these enhanced regulations, except for stress tests under a revised framework. The FCA also would repeal the "Hotel California" provision prohibiting a BHC from debanking.

In addition, the FCA would repeal Dodd-Frank Act provisions that gave the Federal Reserve the ability to restrict the size and activities of a financial firm that posed "a grave threat to financial stability" and the limit on a nonbank financial firm exceeding 10% of total financial sector liabilities (the provision would still apply to banks). The FCA would further narrow the Fed's emergency authority and would eliminate FMU access to the discount window, the FDIC's emergency authority to guarantee bank debt and systemic risk exception to least cost resolution, and the use of the Exchange Stabilization Fund for government guarantees.

Whether these changes would increase or decrease the riskiness of large financial firms and the financial system as a whole depends on whether the effect of potentially greater market discipline or reduced prudential regulation dominates. The effect on market discipline, in turn, will depend in part on what market participants believe will happen in the event of a failure, which is addressed in the next section.

Resolving a Failing TBTF Firm and Addressing Stability[56]

Background

The financial crisis raised issues about how to allow large financial firms to fail without triggering financial instability. During the week of September 15, 2008, the broker-dealer Lehman Brothers entered the bankruptcy process without receiving financial assistance from the federal government, but policymakers intervened with financial assistance to prevent the insurer AIG from entering the bankruptcy process. Subsequently, the financial system suffered a financial panic.[57] Some analysts believe that the rules for resolving failing non-bank financial firms contributed to financial instability during 2007-2008.[58]

In response to these concerns, Title II of the Dodd-Frank Act created a special resolution regime (called Orderly Liquidation Authority or OLA) for liquidating failing financial firms if federal policymakers determine that a firm's failure poses a threat to financial stability. OLA is statutorily structured as a fallback alternative to the normally applicable insolvency regimes, such as the U.S. Bankruptcy Code, and is to be triggered only under extraordinary circumstances.[59] OLA is an administrative, rather than judicial, resolution forum modeled on how the FDIC resolves

[55] The FCA also would repeal early remediation requirements for bank holding companies with more than $50 billion in assets.

[56] This section was authored by Edward Murphy. See **Appendix** for contact information.

[57] Henry Paulson, Jr., *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System* (Business Plus, 2010).

[58] Ben Bernanke, *Courage to Act* (W.W. Norton and Company, 2015).

[59] For more on OLA, see CRS Report R43801, *"Living Wills": The Legal Regime for Constructing Resolution Plans for Certain Financial Institutions*, by David H. Carpenter.

insured depository institutions.[60] Should the failing firm's estate lack sufficient liquid assets to prevent creditor reactions from contributing to financial instability, the FDIC is empowered to contribute resources to the failing firm's estate. Any such payments would be recouped by assessments on surviving firms in the financial industry. (Note that access to OLA is not limited to designated SIFIs and has not been used to date.)

The failure of most nonbank financial institutions generally is dealt with under the Bankruptcy Code.[61] The Bankruptcy Code consists of separate chapters designed for a variety of failing entities.[62] However, certain entities are not statutorily permitted to be resolved through the Bankruptcy Code. The policy justifications for these exceptions vary. For example, the FDIC is statutorily authorized to resolve failing insured depositories administratively in part because the FDIC, as deposit insurer, guarantees payment to depositors even if such obligations exceed the resources of the failing firm's estate, but also due to the threat of financial instability accompanied by widespread failures of depositories.[63] OLA allows another class of firms, financial firms with the exception of depository institutions, to be resolved administratively by the FDIC rather than judicially through the Bankruptcy Code.

Policy Issues

Advocates of the "Lehman Moment" explanation of the financial crisis highlight several specific characteristics of financial markets and the Bankruptcy Code at the time that may have magnified financial instability.[64] First, some argue that the Lehman Brothers bankruptcy announcement was a negative shock to confidence because investors had assumed that Lehman was "too big to fail." Second, and more specific to the bankruptcy process, some argue that the length of a likely judicial bankruptcy proceeding compared to an administrative agency resolution process contributed to financial uncertainty. Third, some argue that the treatment of some financial contracts, such as acceleration and netting of qualifying financial contracts (QFCs) is done selectively by counterparties to the detriment of the bankruptcy estate.[65] Fourth, some argue that the nature of financial intermediaries' continuous need to access credit (liquidity) makes a bankruptcy process impractical for large financial institutions.[66]

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[60] CRS Report R41350, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary*, coordinated by Baird Webel, The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary, coordinated by Baird Webel.

[61] 11 U.S.C. §109.

[62] Federal Reserve, *Study on the Resolution of Financial Companies Under the Bankruptcy Code*, Washington, DC, July 10, 2011.

[63] FDIC. *Resolutions Handbook*, pp. 24-25, rev. December 23, 2014, at https://www.fdic.gov/about/freedom/drr_handbook.pdf#nameddest=Ch1.

[64] Critics have disagreed with some of these assessments of the Lehman Moment and the bankruptcy code. For example, the 2008 run on money market mutual funds (MMFs) that held Lehman's debt could have occurred even if Lehman's failure was handled administratively and quickly.

[65] Some believe that issues related to the treatment of certain financial contracts can be handled through private contract. There have been amendments to many existing derivative contracts, in part under encouragement by federal regulators through the living wills process and through modifications of derivative contracts to comply with the International Swaps and Derivatives Association, Inc. (ISDA) Resolution Stay Protocol to implement a temporary stay from counterparties' ability to terminate, liquidate, and accelerate the contracts when one of the other participating financial institutions enters a resolution process. See International Swaps and Derivatives Assoc., Inc., *Major Banks Agree to Sign ISDA Resolution Stay Protocol*, press release, October 11, 2014, at http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol.

[66] For a more detailed discussion of these issues, see CRS Report R40530, *Insolvency of Systemically Significant*
(continued...)

Critics of OLA argue that it "institutionalized" bailouts and that the FDIC's plan for implementing OLA has promoted "expectations that the government will come to the rescue of large financial institutions and insulate their creditors and counterparties from losses."[67] The government, they argue, should not be given the authority to borrow money to carry out an orderly liquidation, especially given the potentially significant liquidity needs of a large financial institution in receivership.[68] Supporters of OLA, however, note that it is unlikely that markets will be able to provide sufficient private financing during the bankruptcy of a failing firm and, therefore, "it is not credible to suggest that a financial institution bankruptcy can work without standby government financing," as is provided by Title II.[69]

In addition, critics of OLA worry that the FDIC would not have the capability or expertise to resolve securities firms and other complex financial institutions that have very different operations and commitments than the small banks that the FDIC typically resolves.[70] The Chairman of the FDIC, however, has argued that in "the years since enactment of Dodd-Frank, the FDIC has made significant progress in developing the operational capabilities to carry out a resolution if needed."[71] He highlights the FDIC's "ability to plan and the availability of a large team of professionals experienced in financial institution resolution are additional advantages the FDIC can bring to bear" in the event OLA is used.[72]

OLA cannot be used to bail out failing firms in the sense that it can only be used to wind a firm down, but it could potentially be used to bail out a firm's creditors by making them whole. Although Title II instructs the FDIC to generally treat similarly situated creditors similarly, critics worry that the fact that, if necessary for financial stability, the FDIC has "authority to treat similarly situated creditors differently places far too much discretion in the hands of the government to pick winners and losers" during a resolution.[73] Uncertainty about how creditors would be treated in a failure could exacerbate a crisis and give an incentive for creditors to race to debtors and demand immediate repayment—to be the first creditor to get paid—thereby hastening insolvency or spreading the financial panic. While proponents argue that OLA can reduce financial instability by reducing uncertainty, this example demonstrates how in some ways OLA can increase uncertainty relative to the bankruptcy process. The FDIC, in addressing these concerns, has noted that it "expects that disparate treatment of creditors would occur only in very

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(...continued)

Financial Companies (SSFCs): Bankruptcy vs. Conservatorship/Receivership, by David H. Carpenter.

[67] House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, pp. 18-20, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

[68] House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, pp. 21-22, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

[69] Testimony of Adam Levitin at U.S. Congress, House Committee on Financial Services, *Making a Financial Choice: More Capital or More Government Control*, 114th Cong., 2nd sess., July 12, 2016.

[70] House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, p. 24, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

[71] Speech by Chairman Martin Gruenberg, FDIC, *A Progress Report on the Resolution of Systemically Important Financial Institutions*, May 12, 2015, at https://www.fdic.gov/news/news/speeches/spmay1215.html.

[72] Ibid.

[73] House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, p. 25, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

limited circumstances and has, by regulation, expressly limited its discretion to treat similarly situated creditors differently."[74] The FDIC has attempted to reduce uncertainty by stating its position on creditor seniority prior to a resolution occurring, but it is unclear how effective that will be at reducing uncertainty given the untested nature of the OLA process.

Proponents of OLA primarily point to two potential advantages that could contribute to financial stability: (1) OLA's administrative forum would allow the FDIC to move more quickly than generally is possible through a judicial bankruptcy proceeding, thus decreasing market uncertainty; and (2) OLA's statutory focus on maintaining financial stability, of which there is no statutory equivalent under the existing Bankruptcy Code; and (3) the ability of the FDIC to make guarantees to cover counterparty positions (which the Federal Reserve says it did not have legal authority to make in its decision not to rescue Lehman).

Critics say the first two advantages could be replicated in a judicial forum by establishing a new chapter of the Bankruptcy Code designed specifically for certain financial institutions. Critics say the third advantage, FDIC guarantees to counterparties, constitute bailouts of firm creditors and should be rejected.

Provisions in FCA

The FCA would repeal Title II of the Dodd-Frank Act and would add a dedicated chapter to the Bankruptcy Code to handle the failure of large complex financial firms, limited to firms with more than $50 billion in assets. As such, the resolution process would be handled through the courts rather than as an administrative action by the regulatory agencies. The FCA provisions are similar to provisions included in H.R. 2947 previously passed by the House and H.R. 4894 as reported by the Financial Services Committee.

Under the new chapter of the Bankruptcy Code, there would be several resolution options. The firm could be liquidated (Chapter 7), reorganized (Chapter 11), or recapitalized. However, the plan must be in the best interests of the creditors and must not be a likely threat to the financial stability of the United States.

Changes to Regulatory Authority

Conventional wisdom regarding regulators is that the structure and design of the organization matters for policy outcomes. Financial regulators conduct rulemaking, supervision, and enforcement to implement law and supervise financial institutions. These agencies have been given certain characteristics that enhance their day-to-day independence from the President or Congress, which may make policymaking more technical and less political or partisan, for better or worse.[75] Independence also may make regulators less accountable to elected officials and can reduce congressional influence. From a practical perspective, independence and accountability take various forms and each regulator has a unique group of characteristics that, along with tradition, determine its relative independence and accountability. The rest of this section discusses issues related to independence and accountability raised by the FCA.

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[74] FDIC, "Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy," 78 *Federal Register* 76618, December 18, 2013.

[75] For more information, see CRS Report R43391, *Independence of Federal Financial Regulators*, by Henry B. Hogue, Marc Labonte, and Baird Webel.

Agency Structure

Each financial regulator has unique structural attributes. How an agency is structured is believed to influence its policy outcomes. Two of the most fundamental structural elements are an agency's leadership structure and financing. Both elements would be modified for some financial regulators by the FCA.

Leadership Structure[76]

Background

Table 3 summarizes some of the key characteristics of leadership structure at the financial regulators. Because each agency was created at a different time and in a different policy context, each agency's leadership has different structural features.

The President nominates individuals for leadership positions at financial regulators with the advice and consent of the Senate. Currently, some financial regulatory agencies are led by a single leader and some are led by multimember boards or commissions. Multimember boards vary in size and in whether their membership has fixed, explicit ratios for party affiliations. In each case where there is a board structure, the board has a chairman, whose powers vis-à-vis other members vary by agency.

[76] This section was authored by Marc Labonte. See **Appendix** for contact information.

Table 3. Current Leadership Structure for Financial Regulators

Regulator	Type of Agency Head	Party Affiliations	Term of Office	Restrictions on Outside Employment
Commodity Futures Trading Commission	Five commissioners, one of whom is selected to be chairman.	Not more than three commissioners may be from the same political party.	Five-year staggered terms.	None.
Consumer Financial Protection Bureau	Director, deputy director, and four assistant directors.	No requirements related to party affiliations.	The director has a five-year term.	Director or deputies may not hold any position in any Federal Reserve bank, Federal Home Loan Bank, or business overseen by CFPB.
Federal Deposit Insurance Corporation	Five-person board composed of three presidential appointees (one of whom is chair and one of whom is vice chair), the Comptroller of the Currency, and the director of the CFPB.	No more than three members of the board may be from the same political party.	The appointed members have six-year terms. The chairman and vice chairman have five-year terms.	A board member may not hold an office or stock in any depository institution or holding company, Federal Reserve bank, or Federal Home Loan Bank. Two-year ban on post-service employment in a depository institution if a board member does not fulfill a full term.
Federal Housing Finance Agency	Director and three deputy directors.	No requirements related to party affiliations.	The director has a five-year term.	Director and deputies may not have a financial interest or employment in a regulated entity while at FHFA, or serve as an executive officer or director of any regulated entity three years prior to appointment.
Federal Reserve Board of Governors	Seven-member board. From the board, a chairman and two vice chairmen are chosen.	No requirements related to party affiliations.	Governors are appointed for 14-year, staggered terms; terms are nonrenewable unless appointed to a partial term. The chairman and vice chairmen are appointed for four-year, renewable terms.	Board members cannot have outside employment and cannot hold stock in banks. Two-year restriction on bank employment after leaving the Fed, unless the governor has served a full term.

Regulator	Type of Agency Head	Party Affiliations	Term of Office	Restrictions on Outside Employment
National Credit Union Administration	Three-member board with chairman.	No more than two members from the same party.	Six-year staggered terms; terms are nonrenewable unless appointed to a partial term.	Not more than one member of the Board may have recently been a credit union director or employee.
Office of the Comptroller of the Currency	Headed by the Comptroller, with up to four deputy comptrollers.	No requirements related to party affiliations.	The Comptroller has a five-year term.	None.
Securities and Exchange Commission	Five commissioners, one of whom is the chairman.	No more than three commissioners from the same political party, alternating appointments by party "as nearly as may be practicable." (15 U.S.C. §78d)	Staggered five-year terms.	Commissioners may not engage in other business or employment, nor participate in "transactions of a character subject to regulation by the Commission." (15 U.S.C. §78d)

Source: CRS. *U.S. Code* accessed through http://www.uscode.house.gov.

Notes: Where quotes are used, exact wording of statute is provided. Leadership of the Federal Reserve regional banks has different terms of office not shown in the table.

a. To the degree that a particular independent regulatory commission exercises quasi-judicial functions, it could be argued, based on a 1958 Supreme Court ruling, that its members would be protected from "at will" presidential removal, absent a specific provision to that effect. *Wiener v. United States*, 357 U.S. 349 (1958).

b. Although the SEC's enabling legislation is silent as to the removal of commissioners, reviewing courts have held that commissioners may not be summarily removed from office. See *SEC v. Blinder, Robinson & Co., Inc*., 855 F.2d 677, 681 (10th Cir. 1988). In Blinder, while the court noted that the chairman of the SEC served at pleasure of the President and therefore may be removed at will, it determined that commissioners may be removed only for inefficiency, neglect of duty, or malfeasance in office.

Policy Issues

Vesting power in a board arguably encourages a diversity of views to be represented that may lead to more durable policy decisions. In contrast, vesting power in one individual might arguably create stronger, more unified leadership and a single point of accountability, perhaps leading to faster and more numerous decisions. The collegial structure itself is thought to increase the independence of an agency from the President.[77] Where an agency is headed by a single individual, the appointee's views are more likely to reflect the views of the appointing President and his or her party; the leadership is unitary and no consensus is necessary.[78]

Some of the characteristics of leadership positions that enhance independence from Congress and the President include terms that exceed the length of a presidential term and are staggered and non-renewable; requirements that nominees have issue expertise; restrictions on outside employment during or after service; and removal of agency heads only "for cause."

Provisions in the FCA

The FCA would convert the financial regulators with single leaders (the OCC, FHFA, and CFPB to multimember commissions. The members of the commissions would be nominated by the President and confirmed by the Senate to staggered, five-year, nonrenewable terms. The President could choose no more than three members from the same political party. These features are similar to current leadership of the SEC and CFTC. Board members would be removable by the President for "inefficiency, neglect of duty, or malfeasance." Nominees would be required to have expertise and would be restricted from outside employment during but not after service. The FCA also would remove the heads of the OCC and the CFPB from the FDIC's board and would increase the membership of the National Credit Union Administration's board from three to five.

Appropriations[79]

Background

The annual appropriations processes and periodic reauthorization legislation provide Congress with opportunities to influence the size, scope, priorities, and activities of an agency. Currently, the two financial regulators whose funding is primarily determined through the appropriations process and who are subject to periodic reauthorizations are the CFTC and the SEC.[80] Other financial regulators have more autonomy to determine their own budgets and assess fees to cover expenditures, typically subject to some general language regarding proportionality of budget and mission, as shown in **Table 4**.

Most financial regulators generate income from various sources, particularly fees or assessments on entities that they oversee. The two financial regulators that do not largely raise their own

[77] For a discussion, see Rachel Barkow, "Insulating Agencies: Avoiding Capture Through Institutional Design," *Texas Law Review*, vol. 89, no. 1 (November 2010), p. 15.

[78] Such an appointee's term might exceed the appointing President's term, however, and the appointee's policy preferences might not match those of the incoming President.

[79] This section was authored by Marc Labonte. See **Appendix** for contact information.

[80] The SEC is funded through the Financial Services and General Government (FSGG) appropriations bill. The CFTC funding is split, appearing in the FSGG bill in the Senate and the Agriculture appropriations bill in the House. The FDIC (for its inspector general) and NCUA (for the Community Development Revolving Loan Fund Program) also receive minor funding through the FSGG bill.

revenues are the CFTC and the CFPB. As noted above, the CFTC's funding comes from Treasury's general revenues and CFPB funding is transferred from the Federal Reserve's revenues.

Table 4. Current Funding for Financial Regulatory Agencies

Regulator	Subject to Annual Appropriations?	Subject to Periodic Reauthorization?	Primary Revenue Source
Commodity Futures Trading Commission	Yes	Yes, latest authorization expired Sept. 30, 2013.	Treasury general fund per congressional appropriation.
Consumer Financial Protection Bureau	No	No	Transfer from Federal Reserve System limited to 12% of the Fed's operating expenses.
Federal Deposit Insurance Corporation	No	No	Deposit insurance premiums determined by FDIC to meet a reserve ratio set by FDIC (with a statutory minimum of 1.35% of insured deposits).
Federal Housing Finance Agency	No	No	Fees and assessments on regulated institutions. Amounts determined by FHFA.
Federal Reserve	No	No	Income on securities and loans held by the Fed. The Fed also charges fees to cover the costs of business services it offers.
National Credit Union Administration	No	No	Deposit insurance premiums determined by NCUA to meet a reserve ratio set by NCUA (with a statutory minimum of 1.2% of insured deposits).
Office of the Comptroller of the Currency	No	No	Fees on regulated institutions. Amounts determined by OCC.
Securities and Exchange Commission	Yes, except for $100 million reserve fund.	Yes, latest authorization expired September 30, 2015.	Fees and assessments on regulated entities. Amounts set to meet congressional appropriation.

Source: CRS analysis of federal statute.

Notes: Both the SEC and CFTC have continued to operate since their authorizations expired.

Policy Issues

The appropriations and authorization processes provide Congress regular opportunities to evaluate an agency's performance. During these processes, Congress also might influence the activities of these agencies by legislating provisions that reallocate resources or place limitations on the use of appropriated funds to better reflect congressional priorities. Through line-item funding, bill text, or accompanying committee report text, Congress can encourage, discourage, require, or forbid specific activities at the agency, including rulemaking. Alternatively, Congress can adjust an agency's overall funding level if Congress is supportive or unsupportive of the agency's mission or conduct. Thus, congressional control over an agency's funding reduces its independence from (and increases its accountability to) Congress.

Provisions in the FCA

The FCA would bring the rest of the financial regulators—the FDIC, FHFA, NCUA, OCC, Fed, and CFPB—as well as FSOC into the appropriations process. For the Fed, spending related to monetary policy would remain outside of the appropriation process.[81] The CFPB would no longer receive transfers from the Federal Reserve and thus would no longer have a dedicated source of revenues. Fees and assessments that agencies currently collect to fund themselves would appear as offsetting collections in the federal budget with certain exceptions, such as deposit insurance premiums.

Other Changes to Regulatory Structure[82]

In addition to the leadership and funding changes mentioned above, the FCA also would make many agency-specific structural modifications.[83]

FSOC. The FCA would change agency representation on FSOC. Currently, only an agency's director can vote and participate at FSOC, including for agencies with multimember heads. The FCA would require each agency's leadership to reach a consensus position using the agency's normal voting process on FSOC votes. In addition, the FCA would repeal FSOC's duties to mediate interagency disputes and make policy recommendations to member agency. It would repeal FSOC's ability to rescind CFPB rules in limited cases. The FCA would also subject FSOC to the Government Sunshine Act[84] and open its meetings to members of the congressional committees of jurisdiction.

SEC. The FCA would reauthorize the SEC through FY2021. The amount authorized for FY2017 would equal the amount in the FY2017 appropriation passed by the House (H.R. 5485) and would be $50 million less than its FY2016 appropriation. The FCA would also eliminate the SEC's Reserve Fund, which was created by the Dodd-Frank Act to allow the SEC to spend up to $100 million independently of the appropriations process.

OFR. The FCA would eliminate the OFR. Currently, the OFR serves as a permanent staff supporting FSOC in addition to the staffs of the individual agencies represented on the FSOC. The OFR has authority to gather data from and monitor financial markets and institutions. It issues an annual report and publishes occasional research papers on specific financial-stability topics. The OFR is funded by assessments on SIFIs. Although some may be concerned that the OFR creates another layer of regulatory reporting requirements, the OFR must first rely on existing regulatory sources for data prior to seeking information directly from industry. Arguably, if the FCA repealed FSOC's designation authority, it would eliminate one of the principal duties that OFR supports.

FIO. The FCA would effectively merge Treasury's Federal Insurance Office and the position of "independent insurance expert," who is a voting member of FSOC. In their place, the FCA would

[81] Currently, the 12 Federal Reserve banks include a breakout of expenses associated with "monetary and economic policy" in their budget reporting, but the Board of Governors does not. In 2015, the banks spent $632 million on monetary and economic policy and $3,243 million on other operations. Federal Reserve, *Annual Report for 2015*, May 2016, Table 8, at http://www.federalreserve.gov/publications/annual-report/2015-federal-reserve-system-budgets.htm#xfederalreservebanksbudgets-f2c5aba5.

[82] This section was authored by Sean Hoskins, Marc Labonte, Baird Webel, and Edward Murphy. See **Appendix** for contact information.

[83] Changes to rules promulgated by specific agencies are discussed in other parts of the report.

[84] 5 U.S.C. §552b.

create the Office of Independent Insurance Advocate, a new independent bureau within Treasury, with the head appointed by the President and confirmed by the Senate. The Independent Insurance Advocate would be a voting member of FSOC and the office would take over many, but not all, of the duties of the FIO.

CFPB. The CFPB has been one of the more controversial products of the Dodd-Frank Act and would be subject to more fundamental revision under the FCA than other regulators. Since the CFPB was established, some have argued that the agency has too much independence and not enough accountability. Critics point to structural issues, such as the presence of a director rather than a board and funding that is outside the traditional congressional appropriations process. Supporters of the CFPB highlight other aspects that they argue provide sufficient transparency and accountability, including the CFPB director's biannual testimony before Congress and the cap on the CFPB's non-appropriated funding. Other structural characteristics, supporters argue, are important for ensuring that the CFPB is somewhat insulated from political pressures and can focus on the technical aspect of policymaking.

The FCA includes numerous sections that would modify the CFPB and its operations.[85] Most notably, the FCA would replace the CFPB's director with a five-member commission (see "Leadership Structure") and subject the CFPB to the traditional appropriations process (see "Appropriations"). In addition, the FCA would rename the CFPB as the Consumer Financial Opportunity Commission (CFOC) and would alter the CFOC's mandate to require additional focus on "strengthening participation in markets by covered persons, without Government interference or subsidies, to increase competition and enhance consumer choice." The FCA includes numerous other modifications, including repealing the CFPB's authority to deem certain acts to be unlawful because they are "abusive" and raising the CFPB's supervisory threshold for depositories from $10 billion to $50 billion in assets.

Fed. The Federal Reserve is unique among financial regulators in that, in addition to its regulatory role, it is responsible for conducting monetary policy and operating parts of the payment system. To shield monetary policy from undue political influence, the Federal Reserve is more independent from Congress and the Administration than other financial regulators. Nevertheless, it is still subject to congressional oversight. The FCA contains 11 sections related to the Fed, including the following:[86]

- A provision that would remove statutory restrictions on Government Accountability Office (GAO) audits of monetary policy and would require an annual audit that is not subject to current statutory provisions, such as confidentiality requirements. Effectively, this provision would expand GAO's powers to allow it to evaluate the economic merits of Fed policy decisions.
- A provision that would require the Fed to formulate a mathematical rule (called the "Directive Policy Rule") that would instruct it how to set monetary policy so as to achieve its mandate of stable prices and maximum employment based on macroeconomic variables. The provision would also require the Fed to calculate a traditional Taylor Rule (called the "Reference Policy Rule" in the bill) and compare it to the Directive Policy rule.[87] If the Fed did not comply, it would

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[85] Many of the provisions in the FCA are modeled off of stand-alone bills that have seen committee or floor action, such as H.R. 1195, H.R. 957, and H.R. 1486.

[86] These provisions originally appeared in H.R. 3189, which passed the House on November 19, 2015. For more information, see CRS Report R44273, *Federal Reserve: Legislation in the 114th Congress*, by Marc Labonte.

[87] For more information on the Taylor Rule, see CRS In Focus IF10207, *Monetary Policy and the Taylor Rule*, by Marc (continued...)

trigger a GAO audit and testimony by the Fed chair before the committees of jurisdiction.

- A provision that would change the voting membership of the Federal Open Market Committee, which sets monetary policy. The provision would dilute the voting power of the Fed governors and the New York Fed president by expanding the votes of the other regional bank presidents from four to six.

CFTC. The FCA also includes a number of provisions found in the CFTC reauthorization bill (H.R. 2289), which previously passed the House. These provisions address issues including the authority of the commission over the agency staff, internal risk controls, limits on subpoenas, a requirement for a notice and comment process for agency guidance, and changes to judicial review of agency rules.

Rulemaking

Federal rulemaking is one of the basic tools that federal agencies use to implement public policy. In enacting legislation, Congress often grants agencies rulemaking authority, under which they are required or permitted to set standards and prescribe the details of certain federal policies and programs. Some rules an agency issues are promulgated under the agency's inherent authority, while others are in response to the specific requirements of legislation. When they issue those regulations, agencies are generally required to follow a certain set of procedures established by Congress. The most long-standing and broadly applicable federal rulemaking requirements are in the Administrative Procedure Act (APA) of 1946,[88] which applies to all executive agencies, including independent regulatory agencies. The APA contains rulemaking requirements and procedures for agency adjudications,[89] and it provides for judicial review of rulemaking and agency actions.

Three proposals in the FCA—requiring cost-benefit analysis (CBA), modifying the Congressional Review Act,[90] and overturning the judicial Chevron Doctrine—would modify regulator discretion and accountability in the rulemaking process.

Cost-Benefit Analysis[91]

Background

In the rulemaking process, cost-benefit analysis is the systematic examination of estimated total costs incurred and benefits accrued if a proposed rule were to be implemented. Many regulatory agencies are required—by statute or executive order—to perform some analysis of the potential effects of the rule prior to finalizing it, but not necessarily a quantified CBA. The scope of consideration and the level of detail required of the analysis can vary between different

(...continued)

Labonte.

[88] 5 U.S.C. §551 et seq.

[89] The Administrative Procedure Act (APA) of 1946's requirements for issuing rules generally include (with some exceptions) publication of a notice of proposed rulemaking, a comment period, publication of a final rule, and a minimum 30-day period from the rule's publication to its effective date.

[90] P.L. 104-121.

[91] This section was authored by David Perkins. See **Appendix** for contact information.

departments and agencies, and financial regulators generally are not required to quantify and evaluate total economic costs and benefits.[92]

Financial regulators generally face requirements that involve a relatively narrow analysis of a specific effect of a regulation—such as the effect on small businesses or the burden of recordkeeping and reporting necessary to comply with a new regulation—or that leave the parameters of a CBA to the discretion of the issuing agency. Also, because financial regulators are generally classified as *independent regulatory agencies*, they are exempted from Executive Order (EO) 12866. EO 12866 establishes analytical principles for federal CBA and a review process—performed by the Office of Information and Regulatory Affairs within the Office of Management and Budget—to ensure rulemaking adheres to those principles.[93]

Policy Issues

CBA requirements help to ensure that regulators are held accountable during the development, issuance, and implementation of rules, by requiring regulators to demonstrate that their decisions are based on an informed estimation of likely consequences. However, whether financial regulators should be statutorily required to perform certain types of CBAs that are subject to judicial, presidential, or congressional review would change the balance between their independence and accountability.[94]

One side of the debate asserts that financial regulators should not be subject to rigid legal structure when performing CBA—especially in regard to quantification of costs and benefits. One argument for this position is that attempts to quantify the effects of financial regulation are imprecise and unreliable, because they entail making causal assumptions that are contestable and uncertain and often face issues concerning data availability and accuracy.[95] The reason for this imprecise analysis is that financial regulation aims to induce behavioral, microeconomic, and macroeconomic responses, and its effects can be harder to quantify than other types of regulation, which generally require firms to take actions with more measurable effects.[96] Others warn that increasing rulemaking requirements could lead to "ossification" of the rulemaking process, meaning agencies find it difficult to regulate because the rulemaking process becomes difficult, costly, and time consuming.[97]

Others assert that financial regulators should be subject to stricter CBA requirements than is currently the case. They argue that the CBA—even in the case of financial regulation, when it might yield a wide range of estimates of cost and benefits or when technical experts might disagree over the accuracy—is necessary because it disciplines agencies in regard to what rules

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[92] For more information on cost-benefit analysis (CBA) and the rulemaking process, see CRS Report R41974, *Cost-Benefit and Other Analysis Requirements in the Rulemaking Process*, coordinated by Maeve P. Carey.

[93] For more information on CBA and independent regulatory agencies, see CRS Report R42821, *Independent Regulatory Agencies, Cost-Benefit Analysis, and Presidential Review of Regulations*, by Maeve P. Carey and Michelle D. Christensen. The independent regulatory agencies are listed in statute at 44 U.S.C. §3502(5).

[94] Cass R. Sunstein, "Financial Regulation and Cost-Benefit Analysis," *The Yale Law Journal Forum*, January 22, 2015, pp. 263-266.

[95]John C. Coates IV, "Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications," *The Yale Law Journal*, vol. 124, no. 4, pp. 882-887.

[96] John Cochrane, "Challenges for Cost-Benefit Analysis of Financial Regulation," *Journal of Legal Studies*, vol. 43 (June 2014), pp. S63-S69.

[97] See, for example, Thomas O. McGarity, "Some Thoughts on 'Deossifying' the Rulemaking Process," *Duke Law Journal*, vol. 41, no. 6 (June 1992), at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1447337, August 2009.

they implement and allows for an assessment of whether a regulation is desirable.[98] Some also argue that the challenges of performing CBA for financial regulations are not greater than for other industries, arguing that the necessary data are available and estimations of benefits and costs—while challenging—are possible.[99]

Provisions in the FCA

The FCA would require the financial regulators listed in **Table 1** to perform CBA as part of the rulemaking process and lists 12 specified areas of analysis. The 12 areas relate to verifying the necessity, efficacy, benefits and costs of the rule, and include

- a quantitative and qualitative assessment of all anticipated direct and indirect costs and benefits of the regulation;
- an identification of available alternatives and an explanation of why the proposed rule is most effective;
- an assessment of how the burden imposed by the regulation will be distributed among market participants;
- an assessment of the degree to which the key assumptions underlying the analyses are subject to uncertainty; and
- an explanation of predicted changes in market structure and behavior of market participants.

Other provisions would restrict the implementation of rules depending on the findings of the CBA and the agencies' adherence to the requirements of the bill. For example, agencies would be prohibited from issuing a final rule if the expected quantified costs were greater than expected quantified benefits, unless Congress granted a waiver by joint resolution. Also, the bill would entitle parties adversely affected by regulation to bring action to the U.S. Court of Appeals for the District of Columbia Circuit for judicial review. The court may vacate a rule if it finds the agency did not comply with certain requirements.

Finally, the bill would require each financial regulator to conduct certain additional CBA after the rule is issued and implemented, a type of analysis often referred to as retrospective analysis. Within five years of implementation of a rule, the agencies would be required to issue a report that examines the rule's realized economic effects, costs, and benefits.

Congressional Review of Federal Financial Agency Rulemaking[100]

Background

The Congressional Review Act (CRA) is an oversight tool that Congress can use to invalidate a final rule issued by a federal agency.[101] The CRA requires agencies to report to Congress on their

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[98] Cass R. Sunstein, "Financial Regulation and Cost-Benefit Analysis," *The Yale Law Journal Forum*, January 22, 2015, pp. 263-266.

[99] Eric A. Posner and E. Glen Weyl, "Benefit-Cost Paradigms in Financial Regulation," *University of Chicago Coase-Sandor Institute for Law and Economics Working Paper*, no. 660 (March 2014), pp. 1-3, 9-12.

[100] This section was authored by Christopher Davis. See **Appendix** for contact information.

[101] The Congressional Review Act was enacted on March 29, 1996 as part of the Small Business Regulatory Enforcement Fairness Act (SBREFA), Title II of P.L. 104-121, 110 stat. 868. The act is codified at 5 U.S.C. §§801-808. For more information on the act, see CRS Report R43992, *The Congressional Review Act: Frequently Asked* (continued...)

rulemaking activities and provides Congress with a special set of expedited parliamentary procedures, which Congress can use to consider legislation striking down agency rules it opposes. These "fast track" parliamentary procedures, which are available primarily in the Senate, limit debate and amendment on a joint resolution disapproving a rule and ensure that a simple majority can reach a final up-or-down vote on the measure.

Members of Congress have specified time periods in which to submit and act on a joint resolution of disapproval invalidating the rule. If both houses agree to such a joint resolution, it is sent to the President for his signature or veto. If a CRA joint resolution of disapproval is enacted, either by being signed by the President or by being enacted over his veto, the agency final rule in question "shall not take effect (or continue)."[102] The act also provides that if a joint resolution of disapproval is enacted, a new rule may not be issued in "substantially the same form" as the disapproved rule unless the rule is specifically authorized by a subsequent law. The CRA prohibits judicial review of any "determination, finding, action, or omission under" the act.[103]

Congress has considered several CRA joint resolutions of disapproval since 1996. The CRA mechanism has successfully overturned one agency final rule: a 2000 Occupational Safety and Health Administration (OSHA) rule related to workplace ergonomics standards. In addition to the OSHA disapproval resolution enacted, five disapproval resolutions were vetoed; all five vetoes took place in the current 114th Congress.

Policy Issues

The CRA was enacted in 1996 in response to concerns expressed by Members of both parties about Congress's ability to control what many viewed as a rapidly growing body of administrative rules. Simply put, many Members felt that as Congress delegated more power to agencies to implement law, the traditional oversight tools Congress possessed were not adequate. The CRA mechanism was structured to permit federal agencies to continue to promulgate regulations but provide Congress with more information about that rulemaking process and give Congress an expedited way to overturn rules it opposed. Two decades after the enactment of the CRA, congressional concern about administrative rules is arguably as high as ever, but there is a growing bipartisan consensus that the CRA has not been effective as an oversight tool. As one House committee report noted of the expedited disapproval mechanism, "Despite its conceptual promise, the CRA has produced few results."[104]

Perhaps the most widely cited reason why the CRA has overturned only one agency rule in 20 years is the de facto supermajority vote required to enact a CRA resolution of disapproval. Although all of the congressional votes related to a CRA disapproval resolution are simple majority votes, the way the mechanism is structured all but assures that a veto override—requiring that a two-thirds super majority of both houses of Congress—will be necessary to enact the disapproval resolution. This is because a President is most likely to veto a joint resolution that attempts to strike down a final rule proposed by his or her own Administration or by a like-minded independent agency.

(...continued)

Questions, by Maeve P. Carey, Alissa M. Dolan, and Christopher M. Davis.

102 5 U.S.C. §801(b)(1).

103 5 U.S.C. §805.

104 U.S. Congress, House Committee on the Judiciary, *Regulations from the Executive in Need of Scrutiny Act of 2015*, report to accompany H.R. 427, 114th Cong., 1st sess., H.Rept. 114-214, Part 1 (Washington: GPO, 2015), p. 8.

As a result, observers have argued that the structure of the CRA disapproval process tilts the playing field away from Congress and toward the President in a way that renders the CRA largely unworkable as an oversight mechanism; unless Congress can muster the supermajorities necessary to override a presidential veto—something that has been historically rare—an agency rule will go forward.[105]

This concern has led in recent Congresses to the introduction of several proposals that would restructure the CRA disapproval mechanism from a resolution of *disapproval* to a resolution of *approval*. Under proposals of this type, instead of rules automatically going into force unless Congress could enact a measure stopping them, some or all rules would become effective only upon the enactment of a law approving them.

Chief among proposals of this type is the Regulations from the Executive in Need of Scrutiny Act (REINS Act; H.R. 427). The REINS Act would keep the CRA process the same for nonmajor agency rules but would require Congress to vote to approve all so-called major rules before they could become effective. H.R. 427 passed the House on July 28, 2015.

Supporters of these proposals argue that amending the CRA mechanism in this way would properly "flip" the balance of power in rulemaking to favor Congress—the lawmaking branch—by requiring affirmative congressional action for a rule to become effective. Opponents of such an approach have expressed concern that it could make it difficult or impossible for agencies to issue needed rules and might significantly increase congressional workload. In the case of financial regulators, the approach would reduce their independence from—and increase their accountability to—Congress.

Provisions in the FCA

The FCA would amend the CRA in a manner virtually identical to that proposed in H.R. 427, the REINS Act described above. Unlike those measures, however, the FCA would apply this revised CRA approval mechanism only to rules promulgated by a "federal financial agency," a term it defines as the financial regulators listed in **Table 1**.

The FCA would require the agency to meet a number of reporting requirements to Congress when issuing a rule. The FCA would require a joint resolution of approval for major financial agency rules to be enacted under "fast track" consideration before such rules could take effect.[106] (As noted above, currently, major rules automatically take effect unless a joint resolution disapproving them is enacted. The bill defines "major rule" using the same definition as is currently contained in the CRA.) The FCA would provide that if a joint resolution of approval is not enacted by the end of 70 session days or legislative days after the financial agency proposing the rule submits its report on the rule to Congress, the major rule is not approved and will not take effect.

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[105] Since 1789, 37 of 44 Presidents have exercised their veto authority a total of 2,572 times. Congress has overridden these vetoes on 110 occasions (4.3%). For more information, see CRS Report RS22188, *Regular Vetoes and Pocket Vetoes: In Brief*, by Meghan M. Stuessy.

[106] The CRA establishes a unique category of final rule which it defines as a "major rule." 5 U.S.C. §804(2) defines a major rule as, "any rule that the Administrator of the Office of Information and Regulatory Affairs [OIRA] of the Office of Management and Budget [OMB] finds has resulted in or is likely to result in—(A) an annual effect on the economy of $100,000,000 or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets. The term does not include any rule promulgated under the Telecommunications Act of 1996 and the amendments made by that Act."

The FCA would, however, permit a major financial rule to take effect for one 90-calendar-day period without congressional approval if the President determined that the rule was necessary because of an imminent threat to health or safety or other emergency, for the enforcement of criminal laws, for national security, or to implement an international trade agreement.

Unlike the current CRA, the FCA would allow a court to review whether a financial agency has completed the necessary requirements for a final rule to take effect.[107]

Judicial Review[108]

Background

The FCA contains a provision that would change how agency interpretations of the law would be reviewed. Before discussing the benefits or drawbacks of such an approach, it is important to discuss the current legal framework in which courts review agency interpretations of the law. An administrative agency may generally only exercise that authority that is provided to it by Congress.[109] Often, however, congressional delegations of authority are imprecise and, as a result, agencies must construe ambiguous terms and make interpretive decisions to implement Congress's delegation.[110] The Supreme Court, in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[111] envisioned a limited role for courts in reviewing agency interpretations of law. *Chevron* has been a cornerstone of administrative law since being handed down more than three decades ago, having been cited and followed thousands of times by federal courts.[112] The *Chevron* test requires courts to enforce the clearly expressed intent of Congress. In the absence of such clarity, generally *Chevron* instructs reviewing courts to defer to an agency's construction of an ambiguous statute if the agency's interpretation is reasonable.[113] Thus, under *Chevron*, it is generally left to federal agencies, and not the courts, to resolve ambiguities necessary to interpret and implement authority provided to the agency by Congress.

Policy Issues

The *Chevron* Court explained that when Congress delegates to the administrative agency the authority to interpret the statute, a judge must not substitute his or her own interpretation of the

[107] The FCA also would provide that any rule promulgated by a federal financial agency that relates to a regulatory program for a commercial, recreational, or subsistence activity related to hunting, fishing, or camping, or any rule other than a major rule for which a financial agency for good cause finds that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest, will take effect at such time as the agency determines.

[108] This section was authored by David Carpenter. See **Appendix** for contact information.

[109] Louisiana Public Service Commission v. FCC, 476 U.S. 355, 374 (1986) ("[A]n agency literally has no power to act ... unless and until Congress confers power upon it.").

[110] This report discusses agency interpretations of ambiguous statutes; for a report regarding court treatment of agency interpretations of ambiguous regulations, see CRS Report R43153, *Seminole Rock Deference: Court Treatment of Agency Interpretation of Ambiguous Regulations*, by Daniel T. Shedd, Mr. Shedd has left CRS; questions about CRS Report R43153, *Seminole Rock Deference: Court Treatment of Agency Interpretation of Ambiguous Regulations*, by Daniel T. Shedd may be directed to Jared P. Cole, 7-6350.

[111] 467 U.S. 837 (1984).

[112] Stephen G. Breyer et al., ADMINISTRATIVE LAW AND REGULATORY POLICY 247 (2006) ("In a remarkably short period, *Chevron* ... may have become the most frequently cited case of all time. As of December 2005, *Chevron* had been cited in federal courts nearly 8,000 times—far more than three far better known and much older cases, Brown v. Board of Education [1,829 cites], Roe v. Wade [1,801 cites], and Marbury v. Madison [1,559 cites]").

[113] *Chevron*, 467 U.S. at 842-43.

statute in question when the agency has provided a permissible construction of the statute.[114] In reaching its decision, the Supreme Court established a two-part test, commonly referred to as the *Chevron* two-step, to be applied when a court is reviewing an agency's statutory interpretation. The Court announced:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.[115]

In *Chevron*, the Supreme Court elucidated several reasons for favoring a restrained judicial role when reviewing an agency interpretation of an ambiguous statute. First, the Court noted that when Congress enacts an ambiguous statute, it has, in effect, delegated to the agency the authority to clarify the ambiguity.[116] In other words, Congress made a conscious choice in selecting a specific agency to implement the statutory delegation, and the courts, the Supreme Court reasoned, should respect Congress's decision by granting the agency the ability to interpret the statute Congress has charged it with administering. Moreover, the Court noted that interpreting a statutory ambiguity is akin to making a policy decision on how to implement a statutory program. In the Court's view, agencies and legislators are best suited to balance applicable considerations and to resolve debates regarding competing, acceptable interpretations of an ambiguous delegation.[117]

Second, according to the Court, agencies have technical expertise in the field in which they are acting and are, therefore, in a better position to make appropriate policy decisions as part of a large and complex regulatory scheme. Courts, on the other hand, generally lack such expertise. In *Chevron*, the Court specifically acknowledged that "judges are not experts in the field" and thus "may not substitute [their] own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency."[118]

Finally, the *Chevron* Court noted that administrative agencies are politically accountable—though not directly—through the democratic process.[119] Although courts are called to reconcile political preferences in certain circumstances, they should not do so when the power to implement the statute has been delegated to an administrative agency. In the Court's view, an Administration has the authority to implement its policy judgments through the permissible interpretation of a statute.[120] If the agency's, and by extension the Administration's, permissible construction of a

[114] *Id.* at 843-44.

[115] *Id.* at 842-43.

[116] *Id.* at 843-44 (noting that when Congress leaves "a gap" in a statute, "there is an express delegation of authority to the agency to elucidate" that provision.).

[117] *Id.* at 864 ("Such policy arguments are more properly addressed to legislators or administrators, not to judges.").

[118] *Id.* at 844, 865.

[119] *Id*. at 865-66.

[120] *Id*. ("While agencies are not directly accountable to the people, the Chief Executive is, and it is entirely appropriate for this political branch of the Government to make such policy choices—resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the (continued...)

statute is undesirable, the electorate may have its voice heard through the democratic process. By contrast, when a federal court interprets a statute, the electorate cannot voice similar concerns to the unelected court.

Some have argued, however, that judicial deference under *Chevron* has allowed administrative agencies to exercise too much "power to expand the scope of their own authority ... to decide what and who they can regulate, and how to regulate," risking abrupt deviations from long-standing statutory interpretations.[121] Thus, the argument has been made that a recalibration of judicial review of administrative rulemakings is necessary to ensure that laws are interpreted as intended by Congress and to effectively hold agencies accountable in how they implement federal law. By contrast, such a recalibration of the judicial review over agency decisions arguably could result in courts engaging more directly in policymaking decisions. It also might increase the number of legal challenges to agency rulemakings, which could delay the time it takes for new regulations to take legal effect, as well as increase the costs of promulgating regulations.[122]

Provisions in the FCA

The FCA would upend *Chevron's* policy of judicial deference to administrative rulemakings as it applies to certain federal financial regulators. The provision would apply to regulations issued by the financial regulators listed in **Table 1**.[123] In lieu of deferring to the covered agencies' reasonable interpretations of silent or ambiguous statutes in accordance with *Chevron*, the FCA would require courts to apply a *de novo* review of administrative actions—that is, review wherein a court reviews an administrative agency's decision without any deference.[124] This would require courts to independently interpret a covered agency's statutory authority, rather than deferring to that agency's reasonable interpretations of the law. (It should be noted that, while the focus of this section is on regulations, FCA would require *de novo* review on not just administrative rulemakings but also the broader set of "final agency actions,"[125] which are subject to varying degrees of judicial deference.[126]) Although the bill would not prohibit courts from taking into account the relevant agency's reasoning and technical expertise of the subject matter, courts

(...continued)

administration of the statute in light of everyday realities.").

[121] House Committee on Financial Services, *The Financial Choice Act Detailed Summary*, p. 78, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

[122] See, generally, *H.R. 4768, The Separation of Powers Restoration Act of 2016: Hearing Before the Subcomm. on Reg. Reform, Commercial and Antitrust Law of the H. Comm. on the Judiciary*, 114th Cong. (2016) (written testimony of John D. Walke).

[123] But see FCA §467, which, in the context of a challenge to a CFTC rule issued pursuant to authority under the Commodity Exchange Act (7 U.S.C. §§1, et seq.), would require reviewing courts to "affirm and enforce the rule unless the Commission's action in promulgating the rule is found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; contrary to constitutional right, power, privilege, or immunity; in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; or without observance of procedure required by law." It is unclear how Section 467 would be read in conjunction with Section 641.

[124] Black's Law Dictionary, 94 (7th ed. 1999).

[125] 5 U.S.C. §704.

[126] For a discussion of the varying judicial standards of review that typically apply to different types of final agency actions, see the "Threshold Limitations on What Interpretations Qualify for *Chevron* Deference" section of CRS Report R43203, *Chevron Deference: Court Treatment of Agency Interpretations of Ambiguous Statutes*, by Daniel T. Shedd and Todd Garvey and the "Standards of Review" section of CRS Report R44356, *The Good Cause Exception to Notice and Comment Rulemaking: Judicial Review of Agency Action*, by Jared P. Cole.

would have much greater latitude to set aside, overrule, and modify agency interpretations if the FCA were enacted into law.[127]

Enforcement Powers[128]

Background

Another major administrative tool held by the federal financial agencies is their power to enforce laws within their jurisdictions. The strength and effectiveness of an administrative agency's enforcement power can be impacted by, among other things, the scope of the agency's statutory authority (e.g., the types of entities that fall within its enforcement jurisdiction; the type of enforcement powers, such as civil penalties, criminal penalties, restitution, and disgorgement, in the agency's arsenal; maximum and minimum penalties available for certain violations) and the enforcement-related resources (e.g., financial, personnel) at its disposal.

Policy Issues

The way in which federal financial regulators exercise their enforcement powers requires a balance between protecting consumers and investors from unlawful conduct, on the one hand, and ensuring that law-abiding financial institutions are not pushed out of certain markets and the costs of their products and services for consumers and investors are not unduly increased, on the other.[129]

Provisions in the FCA

The FCA would make a number of changes that would directly or indirectly affect the enforcement authorities of the federal financial regulators. For example, the FCA would increase the maximum civil penalties that could be assessed for violations of certain laws, such as the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.[130] The bill also would constrain certain SEC and CFTC enforcement powers by, for example, repealing the SEC's current statutory authority to, under certain circumstances, permanently or temporarily prohibit individuals from serving as an officer or director of a securities issuer.[131] Additionally, the FCA's proposals to modify the way in which various federal financial regulators are funded (see the "Appropriations" section, above) could indirectly impact the enforcement resources at the disposal of those regulators.

[127] Similar legislation (H.R. 4768) passed the House on July 12, 2016. The scope of that bill was not limited to the financial regulators, however.

[128] This section was authored by David Carpenter. See **Appendix** for contact information.

[129] For a general discussion of these issues, see the "Arguments for Consolidating Federal Consumer Financial Regulatory Powers" section of CRS Report R42572, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, by David H. Carpenter.

[130] 12 U.S.C. §1833.

[131] The SEC's current authority is found at 15 U.S.C. §77h-1(f).

Appendix. Authors of this Report and Areas of Expertise

Table A-1. CRS Contact Information

Author	Title	Telephone	Email	Expertise
David H. Carpenter	Legislative Attorney	7-9118	dcarpenter@crs.loc.gov	Banking and Consumer Financial Law
Christopher M. Davis	Analyst on Congress and the Legislative Process	7-0656	cmdavis@crs.loc.gov	Congressional review of agency rulemaking. House and Senate parliamentary procedure.
Sean Hoskins	Specialist in Financial Economics	7-8958	shoskins@crs.loc.gov	Banking, Consumer protection, and Leverage ratio
Marc Labonte	Specialist in Macroeconomic Policy	7-0640	mlabonte@crs.loc.gov	Systemically Important firms, Regulatory structure and funding
Edward V. Murphy	Specialist in Financial Economics	7-6201	tmurphy@crs.loc.gov	Banking, Securities, FSOC issues
David W. Perkins	Analyst in Macroeconomic Policy	7-6626	dperkins@crs.loc.gov	Macroeconomics, Cost-Benefit Analysis
Gary Shorter	Specialist in Financial Economics	7-7772	gshorter@crs.loc.gov	Securities regulation
Baird Webel	Specialist in Financial Economics	7-0652	bwebel@crs.loc.gov	Insurance regulation

Author Contact Information

Sean M. Hoskins, Coordinator
Specialist in Financial Economics
shoskins@crs.loc.gov, 7-8958

David H. Carpenter
Legislative Attorney
dcarpenter@crs.loc.gov, 7-9118

Christopher M. Davis
Analyst on Congress and the Legislative Process
cmdavis@crs.loc.gov, 7-0656

Marc Labonte
Specialist in Macroeconomic Policy
mlabonte@crs.loc.gov, 7-0640

Rena S. Miller
Specialist in Financial Economics
rsmiller@crs.loc.gov, 7-0826

Edward V. Murphy
Specialist in Financial Economics
tmurphy@crs.loc.gov, 7-6201

David W. Perkins
Analyst in Macroeconomic Policy
dperkins@crs.loc.gov, 7-6626

Gary Shorter
Specialist in Financial Economics
gshorter@crs.loc.gov, 7-7772

Baird Webel
Acting Section Research Manager
bwebel@crs.loc.gov, 7-0652

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