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Constitutional Issues with SIFI Designation Process

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Table of Contents

I. Introduction

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA)[2] was the Congressional response to the financial crisis that emerged in 2008. The DFA reflects Congressional concern that distress at systemically significant nonbank financial companies could lead to a broad seizing up of financial markets, with a resulting deep recession. These nonbank financial companies are typically subject to functional regulation and supervision by such entities as the Securities and Exchange Commission or State insurance commissioners. But they are not necessarily subject to bank-like supervision as provided by the Board of Governors of the Federal Reserve System (Board), which holds itself out as the "umbrella" or "consolidated supervisor" of bank holding companies.[3] In addition, Congress was concerned that existing methods of dealing with failed nonbank financial companies, such as the Bankruptcy Code, were not sufficient to permit these companies from being resolved without causing further instability.

As the key remedial mechanism, Title I of the DFA establishes a new agency, the Financial Stability Oversight Council (FSOC or Council), which is vested with the power to designate particular nonbank financial companies as "systemically important financial institutions" (SIFIs) that may pose a threat to the financial security of the United States.

The consequences of such a designation are significant and substantial. The designated companies will be subject to indefinite, close regulatory supervision by the Board under "enhanced prudential standards." These prudential standards relate to such issues as minimum capital requirements, liquidity, concentration, public disclosure, short-term debt limits, and the sufficiency of the risk management policies of the company. The Board may require each supervised nonbank company to periodically provide a plan for a rapid and orderly resolution in the event of material financial distress or failure.

Under Title II of the legislation, the Treasury Secretary has the authority, upon the recommendation of the Federal Deposit Insurance Corporation (FDIC) and certain other agencies, to place a nonbank financial company designated as a SIFI into an FDIC receivership. A SIFI may also be placed into an FDIC receivership if the Treasury Secretary, on the recommendation of the FDIC (in consultation with the President), determines that the company is in default and presents a danger to the financial stability of the United States.

Critically, the DFA does not provide clear guidance as to which nonbank financial companies present the required risk to our financial system such that they should be designated as a SIFI. Instead, the DFA contains a checklist of ten undifferentiated and un-weighted factors the FSOC must consider, as well as an eleventh wildcard that allows it to consider "any other risk-related factors the Council deems appropriate." There are no thresholds or levels of risk that will trigger a designation that an institution is systemically important. Many of the factors listed relate to the riskiness of the institution's activities, such as the degree to which the company is leveraged. While a high amount of leverage may indicate significant risk, it is irrelevant as regarding the risk that the company presents to the *financial system*. The fact that a particular company is engaging in risky activities is simply not relevant to the question of whether the company is systemically significant. Another irrelevant factor included in the list is the

2 Pub. L. 111-203, 124 Stat. 1391 (2010).

3 Federal Reserve Bank Holding Company Supervision Manual explains the Fed's role as umbrella supervisor as follows: Consolidated supervision allows the Federal Reserve to *understand* the financial and managerial strength and risks within the consolidated organization as a whole, providing the ability to address significant management, operational, capital, or other deficiencies within the overall organization before they pose a threat to subsidiary banks. Federal Reserve Board, Bank Holding Company Supervision Manual §1050.0.4.4 (2009).

importance of the company in providing credit to low-income, minority and underserved communities. Providing such credit is no doubt socially important, but there is no apparent connection between providing that service and risk to the financial system of the United States.

As a result of the lack of clear standards in the DFA, the FSOC has had great difficulty in developing clear guidance for the community of potential SIFIs. Neither the final FSOC interpretative issuances nor its formal rulings designating particular companies as SIFIs provide meaningful information on the substantive criteria that will lead to a SIFI designation. Thus, other than through mere speculation based on the three nonbank companies designated to date,[4] it is not possible to determine who will be caught in the net.

Further compounding the current situation is the failure of the Federal Reserve Board to provide prudential standards for nonbank SIFIs. In March 2014, the Board issued its enhanced prudential standards for bank holding companies designated as SIFIs, but was not able at that time to issue the standards that will apply to nonbank SIFIS.[5] Thus, three SIFIs designated to date, American International Group, Inc., Prudential Financial and General Electric remain in regulatory limbo.

Uncertainty about the possibility of designation and the nature and extent of future Board enhanced regulation alone imposes a cost on business planning as companies attempt to devise strategies to avoid regulation in the dark; and such uncertainty can be used as regulatory blackmail. But the possibility of designation without an understanding of either the nature or weight given to the factors that may lead to a designation, or the nature and scope of enhanced Board supervised regulation, invites an intolerable degree of uncertainty and competitive disadvantage for potential SIFIs.

Equally concerning is that neither the statute nor the procedural rules thus far promulgated by the FSOC provide the due process protections demanded by such intrusive regulation. No provision is made for a timely notice that a company is a SIFI target. The Council's powerful independent investigative arm, the Office of Financial Research (OFR),[6] can engage in general and particular inquiries to gather information. The OFR may promulgate binding rules respecting the manner and types of data to be collected from companies that supersede any similar rules issued by member agencies. OFR may issue subpoenas for financial

4 American International Group, Inc. and GE Capital were designated SIFIs in July 2013, and Prudential Financial in September 2013. It has been suggested that the FSOC has withheld from the public decisional documents that reflect the basis and rationale of designation determinations. "In the case of Prudential, and perhaps other designation decisions, there is a separate, confidential decision that FSOC has declined to make available to the public. There is reason to believe that in these non-public versions of the decisions, the agency's reasoning and substantiation is no weightier than in the public version. And, of course, the public can draw no guidance from secret decisional documents that the agency refuses to make publically available. This practice by the FSOC is just one manifestation of the unusual opaqueness that characterizes Council proceedings." Statement of Eugene Scalia, Gibson, Dunn & Crutcher, Before the House Committee on Financial Services Regarding the Financial Stability Oversight Council's Designation of Systemically Important Nonbank Financial Companies, at note of text, May 20, 2014 (Scalia Testimony).

5 79 Fed. Reg. 17240 1743-44, 44-45 (Mar. 27, 2014). See also, Donna Borak, Why the Fed Won't Say How It Will Regulate Nonbank SIFIs, American Banker, Feb.20, 2014, accessible at http://www.americanbanker.com/issues/179_35/why-thefed-won't-say-how-it-will-regulate-nnbank-sifis.htm; Donna Borak, Fed feels Heat to Tailor Capital for Nonbank Firms, American Banker May 2, 2014, accessible at http://www.americanbanker.com/issues/179_85/fed-feels-heat-to-tailor-capital-rules-for-nonbank-firms.htm; Melanie Fein, Why Nonbank SIFI Designations Put the Cart Before the Horse, American Banker, May 8, 2014.

6 DFA, Sections 152-158.

information enforceable by courts. The Council may direct OFR to initiate a risk inquiry of a nonbank institution.

The first official Council notice a company receives that it is under consideration for designation as a SIFI is after these preliminary inquiries. Then it is given time, to be set by the Council, to submit materials to contest such consideration. If the Council thereafter issues a notice of proposed SIFI determination, a company has 30 days to request a written or oral hearing to challenge the determination. But that adjudicatory hearing is not a formal "on the record" proceeding, so the company is not accorded the usual administrative trial protections required under the Administrative Procedure Act (APA), and the opportunity for an oral hearing is within the Council's sole discretion. However, even this minimal right to a hearing may be unilaterally waived or modified by the Council. The determination becomes final on a two-thirds vote of the Council, which must include the affirmative vote of the FSOC chairperson (who is the Treasury Secretary). A supervisory determination may be appealed to a federal district court within 30 days. Court review of the Council's action is limited to whether the determination is "arbitrary or capricious." The determination may be subsequently rescinded by a similar super-majority Council vote that must be joined by the chairperson.

One legal commenter has recently concluded that the Council's determination that Prudential Financial is a SIFI[7] would have been found flawed by a reviewing court under the APA's arbitrary and capricious standard.[8] That standard requires an agency to demonstrate that its ruling was the product of reasoned decision-making: an "agency must examine relevant data and articulate a satisfactory explanation of its actions, including 'a rational connection between the facts found and the choice made'"[9] The commenter identified numerous decisional lapses, including: the Council's failure to discuss the DFA's ten statutory factors with the specificity, clarity, and concreteness necessary to apprise Prudential Financial, and any future parties targeted for special regulation, of the relative weight given to the various factors, and where the "line was crossed" with respect to any particular factor; its dismissal of the pertinence of decades of experienced state insurance regulatory authorities without evaluation on the ground that they do not possess "the same" authorities that the Board would have if given supervisory authority by a SIFI designation; and the failure of the Council to apply the statutory designation factors in a manner that recognizes the difference between the banking and insurance sectors.[10]

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7 FSOC, Basis for the Financial Stability Council's Final Determination Regarding Prudential Financial (September (9, 2013).

8 Scalia Testimony, supra note 4, pp.3-8.

9 Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Ins., Co., 463 U.S. 29 (1983).

10 It is interesting to note that in February 2014, months after the issuance of the Prudential Financial designation, a subcommittee of OFR's Financial Advisory Committee recommended the OFR undertake a detailed study of the insurance industry with respect to systemic risks and how these risks are handled by the current state regulatory framework. The proposed study would engage all major stakeholders of the "insurance ecosystem" and would be poised to guide any work being considered by the FSOC. OFR officials, however, downplayed any immediate action, calling it a recommendation to be considered. OFR's staff of some 200 analysts apparently have no one with primarily insurance sector expertise. See, Liz Fiesta, Treasury's OFR Contemplating New Study of Systemic Insurance Risk, Feb. 27, 2014, accessible at http://carriermanagement.com?news/2014/02/27/119133.htm.

Prudential Financial declined to initiate an APA court challenge for unstated reasons.[11] We believe that such a court action could have been successful. Further, we believe that the evidence of such a prolonged lack of specificity, clarity, and concreteness in FSOC's administrative development of the DFA is a symptom of a more fundamental and intractable problem: the lack of meaningful standards for SIFI designations in the DFA itself, a defect that cannot be resolved by the FSOC alone. A strong and persuasive argument may be made that the DFA's regulatory scheme for SIFIs is an unconstitutional delegation of unconstrained legislative authority to the Council and a failure to provide adequate due process protections for targeted nonbank companies. The following sections detail why we believe that the applicable case law authority supports our conclusions.

II. The DFA's Decisional Structure and Design

A. The Council: Composition

The Council[12] is composed of ten voting members: nine heads of departments, agencies, and independent regulatory agencies[13] and an independent member with insurance experience appointed by the President with advice and consent. There are also five nonvoting advisory members.[14] The chairperson is the Treasury Secretary. The voting members have one vote each. But with regard to certain specified actions requiring two-thirds majorities of members "then serving," the Treasury Secretary must be part of the supermajority. These actions include the determination that a United States or foreign nonbank company shall be supervised by the Federal Reserve Board; the determination that the financial activities of any company shall be supervised by the Federal Reserve Board under special, enhanced prudential operating standards to prevent it from evading Title I of the Act; the determination to end the SIFI designation; and determinations to waive or modify notice and opportunity for a hearing relating to SIFI designations.[15] A quorum consists of a majority of the members then serving.

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11 One commenter fears that a court test of FSOC's exercise of its extraordinary discretionary authority is unlikely because "regulated firms, fearing retaliation, are very reluctant to challenge the legal authority of their regulators. Indeed, after Prudential Financial was designated a SIFI, the firm initially suggested that it would challenge the FSOC's decision, but after going through a pro forma administrative appeal process decided not to engage." Testimony of Peter J. Wallison before the House Committee on Financial Services on Examining the Dangers of the FSOC's Designation Process and Its Impact on The U.S. Financial System (May 20, 2014)(Wallison Testimony).

12 Established by DFA Section 111.

13 Secretary of the Treasury, the chairs of the Federal Reserve Board, Securities Exchange Commission, Federal Deposit Insurance Corporation, Commodity Futures Trading Commission, National Credit Union Administration, the directors of the Consumer [Financial] Protection Bureau, the Federal Housing Finance Agency, and the Comptroller of the Currency.

14 The directors of the Office of Financial Research and the Federal Insurance Office, a state insurance commissioner, a state banking supervisor, and a state securities commissioner.

15 See DFA Sections 113(a)(1),113(b))1), 113(c)(1), 113(d), and 113(f).

B. The Council: Purposes and Goals

Under DFA, the purposes and goals of the Council are threefold: "to identify the risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies, *or* nonbank financial enterprises, *or* that would arise outside the financial services marketplace; to promote market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties that the government shield them from losses in the event of failure; and to respond to emerging threats to the stability of the United States financial system."[16]

C. The Council: Powers and Authorities

The Council's principal administrative task is to identify which institutions are systemically important. Congress provided that commercial banking groups with more than $50 billion in assets are to be deemed SIFIs and subject to enhanced prudential standards imposed by the Federal Reserve.[17] The key designation issues therefore revolve around nonbank financial companies: who are they and how do you ascertain they are risky enough to require special regulatory supervision. DFA is not a model of clarity with respect to either issue.

Section 102 defines the universe of "nonbank financial companies" potentially subject to designation under Title I by referencing Section 4(k) of the Bank Holding Company Act[18] which leads one to other references and no definitive list. Commentators have already struggled with the question and concluded that nonbanks *could* encompass banking groups that are not bank holding companies; finance companies; investment banks and broker/dealers; life insurers; hedge funds; venture capital and private equity funds; mutual funds; money-market mutual funds; and financial market utilities.[19] Some clarification may come from the Federal Reserve Board, which is directed to promulgate regulations "setting forth the criteria for exempting certain types or classes of U.S. nonbank financial companies or foreign nonbank financial companies from supervision by the Board of Governors."[20]

Section 113 is equally unhelpful in understanding the bases on which the Council will rest its systemic significance determinations. That section provides a list of 10 undifferentiated factors or criteria that FSOC must consider in making such determinations as well as an eleventh wild card that allows it to consider "any other risk-related factors that the Council deems appropriate."[21] The statutory factors vary widely and there is no indication whatsoever of the link between many of them or what weight particular factors might carry in deciding the ultimate issue of the systemic risk posed by a nonbank company. As noted previously, there is no clear link between some of the factors and the systemic importance of a company (e.g., the role of a company in providing credit to minority and underserved communities). Other factors relate to the risk of a company's activities (e.g., use of leverage) which has no relation to the systemic importance of the company.[22]

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16 DFA, Section 112(a)(1)(emphasis supplied).

17 DFA, Section 165 (a).

18 12 U.S.C. 1843 (k).

19 See Douglas J. Elliot and Robert E. Litan, "Identifying and Regulating Systemically Important Financial Institutions: The Risks of Over and Under Identification and Regulation" (Brookings Institution, Jan. 16, 2011).

20 DFA, Section 170.

21 DFA, Section 113 (a)(2)(A-K).

D. <u>Council Actions to Implement the DFA's Goals</u>

In October 2010, the FSOC initiated a process purportedly designed to elaborate and explain these statutory factors by issuing an Advanced Notice of Proposed Rulemaking (ANPR) requesting public assistance in the development of specific criteria and an analytic framework by which it would identify and designate nonbank financial institutions that present financial stability threats. The ANPR posed fifteen questions focusing on how to apply the statutory factors in making designations.[23] Fifty public comments were submitted addressing the posed questions suggesting proposed frameworks for the application of the statutory criteria and particular metrics, weights and other considerations that should be utilized in the determination process.

On January 26, 2011, FSOC published a Notice of Proposed Rulemaking (NPR)[24] that essentially ignored the public comments on the ANPR, parroted the statutory factors without explanation or differentiation as to how the factors will be weighed against one another, and simply regrouped the ten statutory criteria into six categories, apparently for internal discussion purposes. The inadequacy of the proposed rule, both practically and legally, apparently became quickly understood by Council members. The Treasury Secretary publically remarked that any objective criteria adopted in advance of an economic crisis would be useless because every such "shock' has to be dealt with individually as it arises; and, in any event, any criteria adopted in advance would be "migrated around" by the markets and institutions affected.[25]

The Treasury Secretary's *ad hoc* approach was reflected not only in the January 2011 proposed rulemaking, but also in a reported Council consideration of what was called a "Noah's Ark" strategy to contain systemic failures by nonbank entities.[26] The strategy would have applied the systemic risk label to two or more of the largest members in each category of nonbank financial companies, such as insurers, hedge funds, or money market managers. The strategy appeared to be aimed at sending a warning signal to the other members of the categories. An alternative strategy noted in the article would have been to designate a larger number of firms in each category.

In October 2011, FSOC abandoned its January proposal and advanced a new interpretive and guidance proposal,[27] which was essentially adopted *en toto* and became effective on May 11, 2012.[28] The adopted proposal kept the initial proposal's grouping of the ten statutory factors into six categories for assessment purposes. It sets up a three stage, case-by-case process for identifying and evaluating nonbank financial entities for designation as a SIFI. Stage 1 identifies a potential SIFI for further evaluation in Stage 2. It establishes six quantitative factors or screens that FSOC staff will use to identify companies that may merit further in-depth review. The

22 The fact that a nonbank company engages in very risky activities should be a concern of its shareholders, but is not an indication that the failure of the company could lead to a systemic failure of the United States financial system.
23 75 Fed. Reg. 61653 (2010).
24 76 Fed. Reg. 4555 (2011).
25 "Report on Extraordinary Financial Assistance Provided to Citigroup, Inc." SIGTARP 11-002, 42-43, January 13, 2011 (SIGTARP Report). The context of the Treasury Secretary's remarks are more fully explained infra at note 67 and accompanying text.
26 Ian Katz and Rebecca Christie, "Bernanke May Resist 'Noah's Ark' Approach on Systemic Risk" (Bloomberg News, May 24 2011).
27 See 76 Fed. Reg. 64264 (Oct. 18, 2011).
28 77 Fed. Reg. 21637 (Apr. 11, 2012).

primary screen is the requirement that a company must have $50 billion or more of consolidated global assets as the quantitative threshold factor. A company must also meet at least one of five further quantitative factors, which measure credit default swaps outstanding for which the company is the reference entity, derivatives contracts into which the company has entered, total debt outstanding, leverage ratio, and short-term debt ratio. The $50 billion threshold is apparently derived from the DFA's direction to include all banks with such assets as potential SIFIs without explanation why these quantitative figures should also apply to nonbanks as well. There is no indication how the quantitative dollar and ratio numbers for the other five screens were arrived at. However, at the discretion of the FSOC, a nonbank can be identified as a SIFI *even if it does not meet the threshold amount*.

In stage 2, companies identified in stage 1 are analyzed based on quantitative and qualitative factors using public information available or obtained from primary regulators and the OFR, and information that may be voluntarily supplied by a company if it has been informally notified. A company is evaluated through a six category frame work: interconnectedness, substitutability, size, leverage, liquidity and maturity mismatch, and existing regulatory scrutiny. There is no specific information on the quantitative metrics to be applied. There is to be a review of unspecified "qualitative" factors. Stage 2 will also involve two qualitative assessments that may not be fully covered by the six categories of factors: the extent to which a nonbank financial firm is regulated and whether the resolution of the firm could pose a threat to financial stability.

Stage three will involve gathering further information directly from the potential designee company. The company will be formally notified of its consideration for the first time and will be requested to supply quantitative and qualitative information, which can include internal assessments, internal risk management procedures, funding details, counterparty exposure or position data, strategic plans, resolvability, and potential acquisitions or dispositions. OFR can obtain information withheld through its subpoena power. With the new information, the company will again undergo evaluation through the six category frame work. Assessments of resolvability and the nature of the current regulatory oversight will be undertaken. The company will not be advised as to the basis for its potential SIFI designation. There are no time limits on the three stage evaluation process. Once the Council believes it has all the information necessary to make a determination, it notifies the company through a Notice of Proposed Determination which triggers the formal designation hearing process.

E. Limitations on the Council's Authority

It is important to note that the relevant substantive implementation authority accorded the FSOC in Title I is to make a determination of systemic importance to the financial stability of the United States of a nonbank financial company, and to conduct a hearing to justify the proposed determination if the company so requests. The entire proceeding is an informal adjudication not covered by the formal hearing rules of the APA. A designated company is not afforded the full panoply of procedural rights available to a party in an "on the record" APA formal adjudication.[29] The time to prepare for a hearing after receipt of the Council's notice of intent to

29 In formal adjudications, the APA requires that notice is provided of the time, place and nature of the requested hearing; the authority of the agency to hold the hearing; and the matters of fact and law asserted. At the hearing, the agency has the burden of proof. A party is entitled to present its case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross examination as may be required for a full and true disclosure of the facts. The transcript of the hearing and exhibits, together with all papers and requests filed in the proceeding, constitute the exclusive record for the decision. Parties are allowed to submit proposed findings and conclusions and

make a determination is a short 30 days, and the "hearing" may be limited to written submissions. There is no explicit requirement that the notice contain an explanation of the basis of the proposed determination or an opportunity for discovery. Moreover, the right to a hearing may be waived or modified by the Council by a two-thirds vote with the chair concurring. The Council's final determination decision, which must be accompanied by a statement of the basis of the decision, is subject to judicial review if a challenge is filed no later than 30 days after being notified of the final order.

Congress did not delegate to the Council, either expressly or by implication, the authority to alter the rights, duties or obligations of covered companies by promulgating binding legislative rules through notice and comment proceedings. The only rulemaking authority granted to the Council in Title I was "to adopt such rules as may be necessary for the conduct of business of the Council. Such rules shall be agency organization, procedure and practice for the purposes of section 553 of the APA."[30] Such grants are universally understood as applying only to the internal conduct of agency business and not to issue regulations that are legally binding upon third parties.

The import of this is that the "final rule" issued by the FSOC in 2013 is not a substantive rule with legally binding effect. This is acknowledged by the Council. In explaining why it did not include a definition of the term "company" in the 2013 rule, FSOC stated "that adding this definition to the rule would not be consistent with the focus of the rule on issues of Council procedure and practice, but the Council's intended interpretation of this term has been included in the interpretive guidance."[31] The Council added that "[t]he interpretive guidance does not impose duties in, or alter the rights, interests of, any company, nor does it relieve the Council of making specific determinations in accordance with Dodd-Frank."[32] As will be discussed more fully below, as an interpretive rule or policy statement, the 2013 FSOC guidance would not be accorded substantial *Chevron* deference.[33] But even if it were deemed to have substantive effect, the Supreme Court has ruled that a subsequent agency rule cannot substitute for the absence of a legitimate intelligible standard in the original challenged legislation.[34]

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present exceptions to any initial or recommended decision. See 5 U.S.C. 554 (b)(c), 556(d)(e), and 557 (c).

30 DFA, Section 111 (e)(2).

31 77 Fed. Reg. at 21639.

32 77 Fed. Reg. at 21647.

33 Gonzales v. Oregon, 546 U.S. 243 (2006).

34 Whitman v. American Trucking Assn's, 531 U.S. 457, 475 (2001).

III. SIFI Determination Scheme Violates the Non-delegation Doctrine

Supreme Court rulings since at least 1825 have recognized that there are constitutional limits to Congress's ability to delegate lawmaking powers to the Executive and Judiciary. Known as the "non-delegation doctrine," these cases require Congress to state an "intelligible principle" to guide and limit agency actions that have a legally binding impact on the public. However, to date, there have only been two instances in which the Supreme Court has applied this doctrine to invalidate Congressional legislation: *Panama Oil Refining Co. v. Ryan*[35] and *A.L. A. Schechter Poultry Corp. v. United States*.[36] Both cases were decided in 1935. However, in the long periods before and after its rulings in those cases, the Supreme Court has been careful to maintain the existence of that doctrine, even while approving ever broadening delegations of lawmaking power as necessary in our modern administrative state.[37] Thus, while the doctrine has not been used by the Supreme Court to invalidate broad delegations of authority post-1935, the Court has been careful to maintain the validity of the doctrine.

In 1825, the Court decided *Wayman v. Southard*,[38] one of the earliest non-delegation challenges. Acknowledging the difficulty of judicial policing of the lines between legislative, executive and judicial powers, Chief Justice Marshall put forth his methodology for resolving delegation issues in one cryptic sentence: "The line has not been exactly drawn which separates those *important subjects,* which must be entirely regulated by the legislature itself, from those of *less interest,* in which a general provision may be made, and power given to those who are to act under such general provisions to fill up the details."[39]

In 1989, Justice Scalia evinced a similar theme in *Mistretta v. United States*: "[W]hile the doctrine of unconstitutional delegation is unquestionably a fundamental element of our constitutional system, it is not an element readily enforceable by the courts. Once it is conceded, as it must be, that no statute can be entirely precise, and that some judgments, even some judgments involving policy considerations, must be left to the officers executing the law, and to the judges applying it, the debate over constitutional delegation becomes a debate not over a point of principle *but over a question of degree."*[40]

In 1998, in *Clinton v. City of New York*,[41] the Supreme Court considered the constitutionality of legislation authorizing the President to cancel line item spending and tax provisions after the President had signed the omnibus spending and tax bills into law (the Line Item Veto case). The lower court had found the legislation unconstitutional on two alternative grounds: the President was being allowed to declare law without following the precepts of the Presentation Clause that requires passage of identical legislation by both Houses of Congress and the presentment to the President for his signature or veto; and the law violated the non-delegation doctrine by "impermissibly disrupt[ing] the balance of powers among the three branches of government." The Supreme Court pointedly explained that it chose not to rest its ruling on the non-delegation issue because the Presentment Clause presented a narrower constitutional ground

35 293 U.S. 388 (1935).
36 295 U.S. 495 (1935).
37 See, e.g., Mistretta v. United States, 488 U.S. 361, 372-74, 378-79 (1989).
38 23 U.S. (Wheat.) 1 (1825).
39 Wayman, 23 U.S. at 23 (emphasis supplied).
40 Mistretta, 486 U.S. at 415-16.
41 524 U.S. 417 (1998).

that was dispositive of the cases.[42] It concluded, however, with a warning that "If there is to be a new procedure in which the President will play a different role in determining the final text in what 'may become a law,' such change must come not by legislation but through amendment procedures as set forth in Article V of the Constitution."[43]

In a dissenting opinion, Justice Breyer argued that the legislation authorizing the line item veto was not an excessive delegation of lawmaking authority violative of the constitutional separation of powers, but instead was a congressional experiment that may help representational government work better.[44] In other words, the statute was permissible because it was simply two branches of government adjusting the way they work together. Justice Kennedy, however, felt compelled to respond to Justice Breyer's dissent. Kennedy's rebuttal emphasized that the case raised important structural separation of powers concerns respecting the Framers' fears that the "concentration of power in the hands of a single branch is a threat to liberty." He noted that in such structural cases the Court has articulated interpretations of constitutional directions that are rigid and which may not be altered and are not subject to the balancing approach suggested by Breyer.[45] "By increasing the power of the President beyond what the Framers envisioned the statute compromises the political liberty of our citizens, liberty which our separation of powers seeks to secure."[46] Justice Kennedy succinctly encapsulated his view of the non-delegation doctrine in his conclusion: "That a cession of power is voluntary does not make it innocuous. The Constitution is a compact that is enduring for more than our time, and one Congress cannot yield up its own powers, much less than those of other Congresses to follow….Abdication of responsibility is not part of the constitutional design."[47]

The Supreme Court's most recent decision discussing the non-delegation doctrine was in 2001 in the case *Whitman v. American Trucking Assn's*.[48] Here, the Court took pains in overruling the appellate court's suggestion that the failure of Congress to supply an intelligible principle could be remedied by a court directing the agency to supply the proper standard: "In a delegation challenge, the constitutional question is whether the statute has delegated legislative power to the agency….[Article I, sec. 1 of the Constitution] permits no delegation of those powers…and so we repeatedly have said that when Congress confers decision-making authority upon agencies *Congress* must 'lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform.'…We have never suggested that an agency can cure an unlawful delegation of legislative power by adopting in its discretion a limiting construction of the statute….The idea that an agency can cure an unconstitutionally standardless delegation of power by declining to exercise some of that power seems to us internally contradictory. The very choice of which portion to exercise-that is to say, the prescription of the standard that Congress had omitted-would *itself* be an exercise of the forbidden legislative authority. Whether the statute delegates legislative power is a question for the courts, and the agencies voluntary self-denial has no bearing on the answer."[49]

42 Id., at 447-48.
43 Id. at 449.
44 Id., at 496-97.
45 Id., at 449-50.
46 Id., at 452.
47 Id.
48 531 U.S. 457 (2001).
49 531 U.S. at 472. The Court disavowed any contrary understanding in past rulings in Fahee v. Malloney, 332 U.S. 245, 252-53 (1947) and Lichter v. United States, 334 U.S. 742, 783 (1948). It also effectively overruled several

Based on these more recent cases, it seems clear that the Court continues to view the non-delegation doctrine as an important constitutional principle. And if we are reading the recent cases correctly, the Court will draw the line between acceptable and not acceptable delegations of Congressional legislative authority (i.e., administrative rulemaking power) in the context of each particular statutory scheme that comes before it. If the delegations under the scheme are "important subjects" or have a considerable "degree" of public impact, Congress must make the central, fundamental decisions; but Congress can leave what may be called ancillary matters to the President, agency officials or the courts.

The standardless delegation scheme of DFA is near historic in its scope and potentially deleterious impact and is credibly comparable to the scheme found unconstitutional by a unanimous Supreme Court in the *Schechter Poultry* case in 1935. In the *Schechte*r case, the legislation in question was the National Industrial Recovery Act (NIRA), a law authorizing the President to regulate industries to stimulate economic recovery from the Great Depression. The law permitted trade and industrial associations to seek presidential approval of codes of fair competition, which were exempt from anti-trust laws and subject to civil and criminal enforcement by the government, in order to "promote the policy of the Title." The policy was to "eliminate unfair competitive practices, to promote the fullest possible utilization of the productive capacity of industries….and otherwise rehabilitate industry…."[50] The NIRA was implemented by the National Recovery Administration (NRA) which obtained Presidential approval for over 700 codes making over 3,000 business practices illegal.

In overturning the legislation as an unconstitutional delegation of legislative power to the President, the Court emphasized the failure to define the term "fair competition," and its failure also to supply standards for any trade, industry or activity or to prescribe the rules of conduct to be applied to particular states of fact determined by appropriate administrative procedure. The Court distinguished other statutes' regulatory processes, most notably the Federal Trade Commission, by reference to the procedural safeguards provided by those statutes. The Court commented, "What are 'unfair methods of competition' are thus to be determined in particular instances, upon evidence, in light of the particular competitive conditions and of what is found to be specific and substantial public interest. To make this possible, Congress set up a special procedure."[51] The Court concluded that "[i]nstead of prescribing rules of conduct, it authorizes the making of codes to prescribe them. For that legislative undertaking, section 3 sets up no standards, aside from the statement of the general aims of rehabilitation, correction and expansion….In view of the scope of that broad declaration and of the few restrictions that are imposed, the discretion of the President in approving or prescribing codes, and thus enacting laws for the government of trade or industry throughout the country, is virtually unfettered. We think that the code-making authority thus conferred is an unconstitutional delegation of authority."[52]

The policy statement and the guidance standards provided by the DFA are no less opaque, uninforming, and subject to *ad hoc*, unfair application. The ten statutory factors are undifferentiated in their relation and weight to one another and may be discarded at the

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D.C. Circuit precedents relied on by the lower court.

50 295 U.S. at 531.

51 Id. at 533.

52 Id. at 541-42.

discretion of the FSOC. The relationship of many of the factors to the systemic importance of a non-financial company is not readily apparent. The informal adjudicatory process that is to serve as the critical SIFI determination mechanism provides less due process protections than the Court has demanded for informal adjudications canceling welfare or social security benefits or for protection in garnishments proceedings.[53] In addition to the consequences of a defective, opaque determination process mentioned previously, such a process will create investor confusion and uncertainty in regard to nonbank financial service companies that might be subject to designation as a SIFI. Erroneous conclusions could create higher costs of capital and borrowing for them as well as other market distortions.

Also of relevance to a court reviewing the non-delegation issue will be the nature and relation of the Office of Financial Research to the Council and the SIFI determination process. OFR is established by Subtitle B of Title I as an entity within the Treasury Department. It is headed by a Director appointed by the President with the advice and consent of the Senate for a six year term and may hold over until a successor is appointed and confirmed. The Director has "the sole discretion in the manner in which [he or she] fulfills the responsibilities and duties and exercises the authorities in this subtitle."[54] Among the significant duties of OFR is the issuance of binding rules respecting the collection of data on behalf of the Council, and providing such data to the Council and its member agencies; issuance of rules standardizing the types and formats of data reported and collected; and issuance of rules assisting member agencies in determining the types and formats authorized by DFA to be collected by such member agencies.[55] Rules promulgated respecting standardization must be implemented by the member agencies within three years, after which time OFR may implement them and supersede existing agency rules (after consultation with the Secretary).[56] The Director must report to and testify before its jurisdictional committees annually with respect to OFR's work and assessment of market stability and potential threats; but no other executive branch officer or agency can require the Director to submit that testimony or testimony on any other matter to Congress for prior review.[57] The Director can issue subpoenas and seek enforcement of them in federal district court without consultation with the chairman or the Council.[58]

The Council itself does not have independent information gathering or investigative powers and must rely on OFR. The Council is authorized to "collect information from Council member agencies, other federal or state financial bodies, and, if necessary, direct the OFR to collect information from bank holding companies and nonbank financial companies," and to *"provide direction* to and request data analyses from, the [OFR] to support the work of the Council."[59] OFR must maintain the confidentiality of any data, information, or reports submitted

53 See, e.g., Goldberg v. Kelley, 397 U.S. 254, 264 (1970); Matthews v, Eldridge, 424 U.S. 319, 339-49 (1978); Sniadach v. Family Finance Corp., 395 U.S. 337 (1969).
54 DFA, Section 152 (a)(1), (2), and (5).
55 DFA, Section 153 (a).
56 DFA, Section 153 (c) (2).
57 DFA, Section (d)(1)(2).
58 DFA, Section 153 (f)(1)-(3).
59 DFA, Section 112(a)(2)(A)(B). See also 112 (d1)(2)(Council may receive and request information from OFR and OFR is authorized to provide it) and 112 (d)(3)(A)(the Council, "acting through the OFR," may require the submission of periodic reports and other reports from any nonbank financial company for the purpose of assessing the potential threat U.S. financial stability).

under Title I and reports and any non-public data or information will not waive any applicable state or federal confidentiality privileges.[60]

Finally, and perhaps of great significance for constitutional issues, OFR is the sole source of funding for the Council. By Section 155, Congress established a "Financial Research Fund," which is the repository for funds received from the Federal Reserve Board that cover all of the expenses of OFR during its first two years of operation and thereafter for funds received from assessments on bank holding companies with consolidated total assets of $50 billion or more and on nonbank companies supervised by the Board of Governors. The funds are not to be construed to be appropriated monies, may not be subject to apportionment by OMB, and may be utilized for any purpose or function of OFR. One of those purposes is to fund the operation of the Council.

Effectively, then, the Council and OFR are free of significant congressional oversight that the power of the purse affords Congress. Since one of the significant purposes of the non-delegation doctrine is to protect against congressional abdication of its legislative responsibilities, further insulating the agencies to which it has delegated unconstrained regulatory authority from one its vital oversight tools compounds the constitutional violations effected by the DFA.

IV. Judicial Review of the SIFI Rule

As noted previously, the DFA did not give FSOC the express or implied authority to issue legally binding rules. The fact that it published a document in the Federal Register labeled a Notice of Proposed Rulemaking, had the Office of Management and Budget review it and declare it to be a significant regulatory action, and invited public comments on it does not alter its status as an interpretive rule or change the adjudicatory nature of the Council's authority.[61] On court review, it will be treated as the agency's construction of its enabling legislation. However, it will not receive the substantial deference normally accorded an agency's interpretation of an ambiguous statute under the *Chevron* doctrine. The Supreme Court has made it clear that such deference "is warranted only 'when it appears that Congress delegated to the agency generally to make rules carrying the force of law, and that the interpretation claiming deference was promulgated in the exercise of that authority.'"[62] At best, the interpretation will be "entitled to respect only to the extent that it has the power to persuade and will be subject to arbitrary and capricious review to determine if it was the product of reasoned decision making."[63]

The Supreme Court has found interpretive rules defective when they simply copy statutory language: "Simply put, the existence of a parroting regulation does not change the fact that the question here is not the meaning of the regulation but the meaning of the statute. An agency does not acquire special authority to interpret its own statute when, instead of using its expertise and experience to formulate a regulation, it has elected to paraphrase the statutory language."[64]

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60 Section 112(d)(5)(A)(B).

61 See, Gordon v. FCC, 182 F.3d 987, 999 (D.C. Cir. 1999); Tafas v. Dudas, 541 F. Supp. 2d 805, 812 (D.C.E.D. Va. 2008).

62 Gonzales v. Oregon, 546 U.S. 243, 255-56,258 (2006), quoting U. S. v. Mead Corp., 533 U.S. 218, 226-27 (2001).

63 Public Citizen v. Dept. of HHS, 332 F. 3d 654,661 (D.C. Cir. 2003).

64 Gonzales, 546 U.S.at 257.

Finally, a reviewing court, in engaging in an assessment of the constitutional issues raised by the DFA's delegation of lawmaking power to the FSOC, is likely to take into account the contemporaneous views of both the relevant regulatory agencies as well as recognized experts on the theory and practice of risk assessment and management. The following public statements and assessments of the chairman and members of the FSOC, the Office of Financial Research, and independent academics respecting the necessity, practicality, and current ability to bring concrete content to the DFA's SIFI determination factors will be a disquieting consideration for a reviewing court.

For example, on January 13, 2011, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) issued a report on the circumstances and effects of the decision by the Treasury Department, the Federal Reserve Board, and the FDIC to provide bailout assistance.[65] The SIGTARP highlighted two concerns relevant here. First, that the conclusion of the various government actors that an institution had to be saved was "strikingly ad hoc" and that these decisions were based on as much gut instinct and fear of the unknown as on objective criteria for such determinations. The second was that the absence of objective criteria for such determinations raises concerns about whether systemic risk determinations were being made fairly and with consistent criteria. The SIGTARP suggested that both concerns should be addressed, at least in part, by the development, in advance of the next crisis, of clear, objective criteria and a detailed roadmap as to how those criteria should be applied.

In light of the passage of the DFA and the then recently concluded ANPR by the FSOC soliciting public comment on possible SIFI determination criteria, the SIGTARP sought the views of Treasury Secretary (and Council chairperson) Timothy Geithner on the development of such criteria. Geithner responded that he believed creating effective, purely objective criteria for evaluating systemic risk is not possible: "What size and mix do you classify as systemic?...It depends too much on the state of the world at the time. You won't be able to make judgment about what's systemic and what's not until you know the nature of the shock the economy is undergoing." Geithner suggested that whatever objective criteria were developed in advance, markets and institutions would adjust and "migrate around them."[66] Geithner's views were reflected in the FSOC's initial final NPR, published shortly after the issuance of the SIGTARP Report, which, as discussed above, provided no substantive elaboration of the DFA's opaque risk determination factors.[67]

The issuance on January 5, 2012, of the first Working Paper by the Office of Financial Research[68] detailed the total absence of currently reliable quantitative measures of systemic risk, effectively confirming former Secretary Geithner's skeptical view. The authors' exhaustive survey of the existing economic literature "suggests that more than one risk measure will be needed to capture the complex and adaptive nature of the financial system. Because systemic risk is not yet fully understood, measurement is obviously challenging, with many competing—and sometimes contradictory—definitions of threats to financial stability. Moreover, a single consensus measure may neither be possible nor desirable, as such a 'Maginot' strategy invites a blindside surprise from some unforeseen or newly emerging crisis mechanism. Instead, a robust

65 See SIGTARP Report, supra at note 17.

66 SIGTARP Report at 42-43.

67 The subsequent discussion by FSOC members of a so-called "Noah's Ark" approach to identifying SIFI's, discussed above at note 22 and accompanying text, underline the sense that ad hoc determinations are deemed most feasible.

68 "A Survey of Systemic Risk Analytics' by Dimitrios Bisias, Mark Flood, Andrew W. Lo, and Stavros Valavanis, accessible at www.treasury.gov/initiatives/wsr/Pages/default.aspx (Systemic Risk Survey).

framework for monitoring and managing financial stability must incorporate both a diversity of perspectives and a continuing process for re-evaluating the evolving structure of the financial system and adapting systemic risk to these changes."[69] The authors appear skeptical that any risk measurement scheme devised will be sustainably reliable. "The system to be measured is highly complex, and so far, no systemic risk measure has been tested 'out of sample', i.e., outside the recent crisis. Indeed, some of the conceptual frameworks that we review are still in their infancy and have yet to be applied. Moreover, even if an exhaustive overview of the systemic risk literature were possible, it would likely be out of date as soon as it was written… [T]he boundaries of the discipline are fuzzy in many places and expanding everywhere. An organizational scheme that is adequate today is sure to become obsolete tomorrow. Not only will new approaches emerge over time, but innovative ideas will reveal blind spots and inadequacies in the current scheme, hence our taxonomies must evolve over time."[70]

A recent professional economic commentary from the Brookings Institute continues the view that a reliable predictive model for measuring the level of systemic risk is currently unavailable but posits that careful subjective judgments are necessary and possible:

> Dodd-Frank defines systemic risk in terms of a situation in which "material financial distress at the [financial institution], or the nature, scope, size, scale, concentration, or mix of the activities of the [financial institution], could pose a threat to the financial stability of the United States."
>
> There is substantially more disagreement about how to *measure* the level of systemic risk in the aggregate. Breaking this down to the contribution from individual institutions is yet trickier still. As a further important complication, systemic risk arguably varies over time. An entity could be systemically significant under some circumstances and not others.
>
> The FSOC's evaluation process to decide which institutions to designate as SIFIs relies heavily on subjective judgments of the relative importance and inter-relationships of the relevant qualitative and quantitative factors. This is not a criticism. Objective, quantitative criteria will require both a detailed analytical model of how the financial system works that is well beyond the current state of research and considerably more and better quality data than currently exists. Many academics and official researchers are working to create those prerequisites, but it will be years before they can hope to succeed, if they ever fully do.[71]

The author, while essentially conceding that the DFA's standardless prescriptions make the FSOC's designation process a guesswork exercise, suggests that the way to make regulation fair and successful is for the Federal Reserve Board to be discrete in the imposition of its prudential standards by "carefully balancing the costs and benefits when designing regulation and supervision;" "deferring to primary regulators as appropriate while maintaining the ability to perform [its] mission;" "do not impose excessively bank-like regulatory approaches;" "avoid the

69 Id. 1-2.
70 Id. at 4, 6.
71 Douglas J. Elliot, Regulating Systemically Important Financial Institutions That Are Not Banks (Brookings Institute, May 9, 2014).

dangers of a business ‘monoculture’;” “support useful innovation;” and “try to minimize the inevitable uncertainty about future regulation.” At the very least the suggestions underline the constitutional deficiencies of delegations of authority. This also reflects a naïve understanding of the political power complexities already at play as a result of DFA’s unworkable statutory scheme. In the end, as the *Whitman* Court declared, it is Congress’s duty to provide the proper regulatory directions.

The OFR survey is very useful in understanding the complexity and necessity of the task set forth by the DFA but confirms serious doubts whether the guidance given by Congress has provided sufficient direction for its immediate constitutional implementation. The Brookings study confirms the current unavailability of objective criteria and the need for congressional clarification and guidance.

V. Conclusion

The DFA fails to provide the “intelligible principle” constitutionally required to establish a scheme of financial risk management that imposes such a high degree of discretionary governmental control and potential harm to the regulated community, and lacks the necessary guidance and legal restraints on governmental actions. Supreme Court precedent makes it clear that it would be an abdication of congressional responsibility to allow the FSOC itself to fill the gaps in the definition of the scope of the power and responsibility that it has delegated to it. We therefore conclude that the SIFI designation procedures in the Dodd-Frank Act are constitutionally suspect, and that there is a good possibility that the Supreme Court would find them invalid based on the non-delegation doctrine.