Banks Are at the Mercy of Regulatory Absolutism

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The financial services industry has been battered by bad law, but worse by an administrative regime on steroids.

The economic malaise — highlighted by an April labor-force-participation rate hovering near its lowest level since 1978 — is due in no small measure to regulators' sustained assault on the financial services industry. As the law firm Davis Polk reported last year in a five-year review of the Dodd-Frank Act's implementation, the law had spawned 22,296 pages of regulatory rules (including proposed rules), the equivalent of 34 copies of "Moby Dick." No CEO can know if he or she is within the law. At their whim regulators can find any financial institution noncompliant.

The problem is that the regulatory agencies have abused their role to implement financial policy to actually make financial policy, usurping the role given to Congress in our tripartite constitutional system. In some cases, this is because Dodd-Frank allowed the regulators too much latitude to interpret the law or fill in specifics where the law was too broad. But in other cases, regulators are simply exceeding their authority, thereby making a mockery of our separation of powers.

And it's not just conservatives and pro-business voices who are worried. Concerns about the administrative state cut across the ideological divide. Jonathan Turley, a liberal George Washington University law professor, has expressed alarm over both "the domination of federal agencies that have become increasingly independent in their actions and policies" and the rise of "the royal prerogative." In his book "Is Administrative Law Unlawful?" Columbia law professor Philip Hamburger warns that "rather than merely a means of completing the work of Congress and the courts at the margins, administrative power has become central."

Administrative absolutism is gaining ground.

In February, the Federal Deposit Insurance Corp.'s acting inspector general reported that the FDIC had "abusively" threatened three banks to force them out of the refund-anticipation-loan business in 2011 and 2012. In December 2010, the Office of the Comptroller of the Currency forced a bank it supervised to exit RALs.

Until March, the Financial Stability Oversight Council enjoyed what seemed like unfettered authority to dub financial organizations "systemically important" and subject to the Federal Reserve's special prudential supervision. In a rare show of defiance, MetLife challenged its SIFI designation. Judge Rosemary Collyer of the U.S. District Court for D.C. sided with MetLife, ruling that FSOC didn't follow its own rules or consider costs. However, she didn't question FSOC's authority to designate the life insurer systemically important.

There are many other examples.

The banking industry may have praised a Federal Reserve proposal eliminating early termination rights in derivative deals, but the rule — which was based on an earlier protocol by the International Swaps and Derivatives Association — amounts to the Fed effectively making retroactive changes to contractual terms, which is unconscionable. The Financial Crimes Enforcement Network hasn't publicly disclosed its matrix for determining civil-money penalties, and doesn't even have to hold administrative law hearings, which means its exercises plenary power. Through Operation Choke Point and similar initiatives, regulators have used their unchecked power to make policy, curbing industries they dislike — subprime lenders, pawnbrokers, firearms dealers and tobacco retailers — by cutting off their access to payment processing and banking.

No agency is more absolutist than the Consumer Financial Protection Bureau. It writes its own budget drawing funds from the Fed. CFPB Director Richard Cordray runs an agency with powerful discretion to rule any consumer financial product is unfair, deceptive or abusive. The problem, however, isn't Cordray. If an ideological clone of House Financial Services Committee Chairman Jeb Hensarling were the bureau's director, its consolidated power would still be problematic.

Dodd-Frank expressly bars the CFPB from regulating auto dealers' finance programs. In its overreaching enforcement of fair auto lending, the bureau evaded that ban by targeting auto dealers' wholesale bank suppliers. The agency's process for bringing discrimination claims essentially guesses borrowers' race in situations where lenders demonstrated no intent to discriminate. The disparate-impact theory fabricates racial-bias charges.

Yet legislative efforts to rein in the CFPB thus far have failed.

In April, the House Financial Service Committee voted along party lines, 33 to 20, for a bill bringing the bureau into the congressional appropriations process. Democratic lawmakers voted lockstep against their institutional prerogative because their ideological allies control the administrative state's commanding heights. They should reconsider.

Bringing administrative agencies to heel shouldn't be partisan. Congress makes law. Agencies are supposed to be servants of the law. Moreover, Dodd-Frank was passed by Democrats. In the Senate only one Democrat, Russ Feingold of Wisconsin, voted against it. Banning the CFPB from regulating auto dealers' finance programs is law because of congressional Democrats. They should be incensed the bureau flagrantly flouted their will and that of the legislative branch.

Unfortunately, neither of the top presidential candidates appears willing to reverse this trend. Similar to President Obama, likely Democrat presidential nominee Hillary Clinton is a proponent of using administrative agencies to advance policies that can't clear Congress. While presumptive Republican presidential nominee Donald Trump has decried Dodd-Frank's economic impact, he evinces little interest in structural separation of and checks on power. Both Clinton and Trump believe in a presidential royal prerogative at odds with Madisonian checks and balances.

What's to be done?

The financial services industry must more vigorously defend itself against regulatory policymaking and outright lawlessness in the courts and the political arena. The courts must step up. And Congress needs to stiffen its spine and reassert its institutional prerogative.

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