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President Trump's First 100 Days: Steps Toward Financial Services Reform

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The Dodd–Frank Act is every bit as far-reaching in its consequences for the U.S. economy as Obamacare is for the U.S. health care system. Dodd–Frank relies on the federal government to plan, protect, and prop up the financial system, an approach based on the mistaken belief that the 2008 crisis stemmed from too little regulation in financial markets. Just as in other industries, a mix of bureaucratic red tape, government mandates, and taxpayer backing of losses is not a formula for widespread prosperity.[1]

Given that dismantling Dodd–Frank will require legislation, it makes perfect sense that the President's team has met with House Financial Services Chairman Jeb Hensarling (R–TX),[2] whose committee passed the Financial CHOICE Act, a bill that replaces large parts of Dodd–Frank.[3] As his Administration continues to work with Congress, the President can take specific steps to fulfill his campaign promises to dismantle Dodd–Frank and unleash American economic growth. This *Issue Brief* offers several such steps that the President should take during his first 100 days in office.

Broad Policy Declarations

Working together, Congress and the Administration can implement major financial regulatory reforms that benefit all Americans. Congress and the Administration can also correct a glaring weakness of the Dodd–Frank Act: its failure to reverse the harmful federal backing of mortgages that contributed to the 2008 crisis. Legislators need a powerful signal that the President will support eliminating Dodd–Frank and restoring market discipline to reduce the risk of future financial crises and bailouts.

To provide this support, the President should immediately send a letter to the Speaker of the House of Representatives, the President of the Senate, and the respective Chairmen of the House Financial Services Committee and the Senate Committee on Banking, Housing, and Urban Affairs. The letter should outline the broad principles of the President's agenda, and also express that the Trump Administration strongly supports legislation that:

- **Dismantles** the failed Dodd–Frank Act and replaces it with new policies to encourage economic growth and job creation by restoring market discipline and reducing regulatory burdens;
- **Revokes** the charters of Fannie Mae and Freddie Mac, winding them down in an orderly manner; and
- **Ensures** that no private entities in the U.S. housing-finance system have either an explicit or implicit government guarantee.

Targeted Policy Actions to Aid Policy Implementation

The heads of federal departments and agencies customarily offer their resignation to incoming

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Presidents, but it appears that three key directors appointed by President Obama are intent on serving the remainder of their terms, all of which extend into 2018. A brief description of these three situations, and a course of action tailored to each director, is provided here.

- **Richard Cordray, CFPB Director.** Richard Cordray, the first Director of the Consumer Financial Protection Bureau (CFPB), can only be removed for cause, but his term runs to July 15, 2018. Although he is prohibited from engaging in partisan politics as the director of a federal agency, there are indications that Cordray (the former Ohio Attorney General) might run for governor of Ohio in 2018.[4] The deadline to file for candidacy in the election is February 2018, so Director Cordray should clearly state his intentions to remain detached from partisan politics. The President should ask Director Cordray for a clear statement of whether he intends to resign or serve the remainder of his term.[5]

- **Richard Berner, OFR Director.** The Office of Financial Research (OFR) has conducted controversial research in furtherance of the priorities of the Financial Stability Oversight Council (FSOC) under the Obama Administration, and the only check on the OFR's power to monitor financial market transactions is the director's own discretion. In contrast to the for cause provision for the CFPB Director, Dodd–Frank is silent regarding the procedure for removing the OFR Director from office. President Trump should seek the resignation of OFR Director Berner, whose term expires December 31, 2018. If necessary, the President should remove Director Berner from office.

- **Mel Watt, FHFA Director.** President Obama appointed Mel Watt, a former Democrat Congressman, to serve as Director of the Federal Housing Finance Agency (FHFA), the prudential supervisor of Fannie Mae and Freddie Mac. Director Watt, whose term expires on December 9, 2018, has taken major actions that are incompatible with a sound housing-finance system.[6] The President should pursue dismissal of Director Watt and appoint a new director as soon as possible, beginning the process by formally asking Director Watt to resign.[7]

Two Targeted Policy Actions to Dismantle Dodd–Frank

The legislative process to dismantle Dodd–Frank is likely to be lengthy and contentious. While working with Congress to achieve his goals, the President can, on his own, take the following steps to protect taxpayers, restore market discipline, and reduce regulatory burdens.

- **Review and suspend the FSOC's Systemic Designation Process.** Dodd–Frank authorizes the

1. For a title-by-title analysis of the Dodd–Frank Act, see Norbert J. Michel, ed., *The Case Against Dodd–Frank: How the "Consumer Protection" Law Endangers Americans* (Washington, DC: The Heritage Foundation, 2016), http://www.heritage.org/research/reports/2016/04/the-case-against-Dodd–Frank.
2. Joseph Lawler, "GOP Banking Chair: Dodd–Frank Dismantling Is First-year Priority for Trump," *The Washington Examiner*, January 5, 2017, http://www.washingtonexaminer.com/gop-banking-chair-Dodd–Frank-dismantling-is-first-year-priority-for-trump/article/2611012 (accessed January 26, 2017).
3. Norbert J. Michel, "Six Recommendations for the CHOICE Act 2.0," Heritage Foundation *Issue Brief* No. 4642, December 19, 2016, http://www.heritage.org/research/reports/2016/12/six-recommendations-for-the-choice-act-20?ac=1.
4. Henry Gomez, "For Ohio Democrats, the 2018 Gubernatorial Race Is in a Holding Pattern: Analysis," Cleveland.com, July 28, 2016, http://www.cleveland.com/open/index.ssf/2016/07/for_ohio_democrats_the_2018_gu.html (accessed January 27, 2017).
5. Because the CFPB director, under the Dodd–Frank Act, can only be removed for cause, White House legal counsel should be consulted before the Administration makes any contact with Director Cordray. The "for cause" issue is currently at the center of a recent ruling by the DC Circuit Court of Appeals which held that the CFPB's structure—a single director removable for cause—is unconstitutional. See Davis Polk & Wardell, LLP, "What's Next for PHH v. CFPB?" *Client Memorandum*, October 15, 2016, https://www.davispolk.com/sites/default/files/2016-10-17_whats_next_phh_v._cfpb.pdf (accessed January 31, 2017).
6. John L. Ligon, "Mortgage Principal Forgiveness Policy Is a Bad Idea," Heritage Foundation *Issue Brief* No. 4598, August 1, 2016, http://www.heritage.org/research/reports/2016/08/mortgage-principal-forgiveness-policy-is-a-bad-idea.
7. In order to preserve the ability to remove him for cause, White House legal counsel should be consulted before the Administration makes any contact with Director Watt.

FSOC to designate certain financial companies and activities for special regulation and supervision by the Federal Reserve.[8] The President should direct the Treasury Secretary to conduct a thorough review of these designation processes.[9] This review is especially necessary because the designation process itself could increase systemic risk.[10] Pending the outcome of this review, the Treasury Secretary should announce that he will not vote for any proposed supervision determination or systemic importance designation.

- **Review and suspend Orderly Liquidation Authority.** Title II of Dodd–Frank created an alternative to bankruptcy for certain failing financial companies known as Orderly Liquidation Authority (OLA). The OLA alternative gives enormous power to the federal government to liquidate companies with little to no oversight and creates additional incentives to bail out large financial institutions. Under OLA, the Federal Deposit Insurance Corporation (FDIC) acts as the receiver of the firm's parent holding company, and a firm can only be forced into OLA after the FDIC and the Fed certify that no viable private alternatives exist.[11] The President should direct the Treasury Secretary to review the risk OLA poses to the Treasury and, pending the outcome of this review, to withhold any determination under section 203(b) of the Dodd–Frank Act.

Targeted Policy Actions Aimed at Dodd–Frank Omission

For years, conservative policymakers have argued that Congress should move the U.S. toward a market-based housing-finance system. Harmful government housing-finance policies—as the U.S. has implemented for decades—only make housing less affordable for the typical American, increase risky debt, and destabilize housing and financial markets.[12] The President's actions through the Department of Housing and Urban Development (HUD) and the FHFA can help achieve meaningful legislative reform that achieves a robust and sustainable housing-finance system—one that prevents future taxpayer bailouts and ensures that creditworthy Americans have access to mortgages.[13] To reverse the damage done by harmful housing-finance policies, something that Dodd–Frank failed to do, the President should take the following specific actions:

- **Direct** the HUD Secretary to establish sound underwriting policies for mortgages insured by the FHA, including consideration of higher collateral requirements, a maximum seller concession, the use of a residual income test, a consumer disclosure regarding an affordable housing loan's historical propensity to default, and an increase in the capital ratio of the Mutual Mortgage Insurance Fund;

- **Require** the HUD Secretary to raise the insurance fees for FHA-insured loans, and to lower the loan limits for mortgages eligible for FHA insurance;

- **Require** the FHFA Director to raise the guarantee fees for loans securitized by Fannie and Freddie, and to the lower the loan limits for mortgages eligible for their purchase; and

- **Require** the FHFA director to suspend Fannie and Freddie contributions to the Housing Trust Fund while the companies remain in conservatorship.

8. Peter Wallison, "Title I and the Financial Stability Oversight Council," in Michel, ed., *The Case Against Dodd–Frank: How The "Consumer Protection" Law Endangers Americans*.
9. These designations refer to those authorized by Sections 113 and 804 of the Dodd–Frank Act.
10. Wallison, "Title I and the Financial Stability Oversight Council."
11. Norbert J. Michel, "House Highlights Dodd–Frank Deficiencies," Daily Signal, July 24, 2014, http://dailysignal.com/2014/07/24/house-highlights-Dodd–Frank-deficiencies/.
12. Norbert J. Michel and John L. Ligon, "Five Guiding Principles for Housing Finance Policy: A Free-Market Vision," Heritage Foundation *Issue Brief* No. 4259, August 11, 2014, http://www.heritage.org/research/reports/2014/08/five-guiding-principles-for-housing-finance-policy-a-free-market-vision.
13. See John L. Ligon, "A Pathway to Shutting Down the Federal Housing Finance Enterprises," Heritage Foundation *Backgrounder* No. 3171, December 21, 2016, http://www.heritage.org/research/reports/2016/12/a-pathway-to-shutting-down-the-federal-housing-finance-enterprises.

Other (Possible) Policy Actions

Thanks in large part to Dodd–Frank, financial regulators issued more than 16,000 pages of regulation between July 2010 and July 2016.[14] Two of the more contentious final rules are the Securities and Exchange Commission's Conflict Minerals Rule and the Department of Labor's Fiduciary Duty Rule.[15] These rules could possibly be addressed by executive order, but the Trump Administration should work closely with Congress before issuing an executive order in case Congress decides to repeal these regulations using the Congressional Review Act.[16]

Conclusion

Dodd–Frank's proponents promised that the law's increase of government control over the economy would encourage investment and entrepreneurship and foster robust economic growth. More than six years since it was enacted, Dodd–Frank has clearly failed to produce these outcomes and instead has spawned a host of problems. The only jobs that Dodd–Frank created were for a cottage industry of inside-the-Beltway lawyers, lobbyists, compliance specialists, and bureaucrats.

Dismantling the Dodd–Frank Act, reducing other regulatory burdens, and building a sustainable housing-finance system will help end bailouts, devolve power away from Washington, DC, hold Wall Street and government regulators accountable, and empower Americans to achieve financial independence by preserving consumer choice.

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14. Norbert J. Michel and Tamara Skinner, "The Popular Narrative About Financial Deregulation Is Wrong," Daily Signal, July 29, 2016, http://dailysignal.com/2016/07/29/the-popular-narrative-about-financial-deregulation-is-wrong/.
15. See Norbert J. Michel, "Feds Just Can't Allow People To Save And Invest," *Forbes*, November 2, 2015, http://www.forbes.com/sites/norbertmichel/2015/11/02/feds-just-cant-allow-people-to-save-and-invest/#4fda76d1ee27 (accessed January 31, 2017), and David R. Burton, "How Dodd–Frank Mandated Disclosures Harm, Rather than Protect, Investors," Heritage Foundation *Issue Brief* No. 4526, March 10, 2016, http://www.heritage.org/research/reports/2016/03/how-doddfrank-mandated-disclosures-harm-rather-than-protect-investors.
16. See Diane Katz, "A Regulatory Reform Agenda for the First 100 Days," Heritage Foundation *Issue Brief* No. 4652, February 1, 2017, http://www.heritage.org/research/reports/2017/02/a-regulatory-reform-agenda-for-the-first-100-days. The Administration should also consider using its authority under Section 1023 of the Dodd–Frank Act to delay the CFPB's small-dollar lending and arbitration rules, depending on if and when those rules are finalized.