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FINANCIAL REGULATORY AGENCIES

SECURITIES AND EXCHANGE COMMISSION AND RELATED AGENCIES

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The primary purposes of the laws and regulations governing capital markets and of capital market regulators are to deter and punish fraud and other material misstatements to investors; foster reasonable, scaled disclosure of information that is material to investors' financial outcomes and proxy voting decisions; and maintain fair, orderly, and efficient secondary capital markets.

The Securities Act of 1933[1] and the Securities Exchange Act of 1934[2] reflect nearly nine decades of rushed and haphazard amendments. The securities laws are now extremely complex and do not constitute a coherent, rational regulatory regime. For example, the current SEC has proposed a climate change reporting rule that would *quadruple* the costs of being a public company.[3] This would have a substantial adverse impact on existing companies. Over time, it would also substantially reduce the number of public companies and therefore the number of investing options available to ordinary Americans. The Securities and Exchange Commission (SEC) should be reducing impediments to capital formation, not radically increasing them.

The SEC and Congress should fundamentally reform the securities laws governing issuers, broker–dealers, exchanges, and other market participants. Among other things, they should establish a simplified and rationalized securities disclosure system with:

- Three basic categories of firm: private firms, an intermediate category of smaller firms,[4] and public firms;
- Reasonable, scaled disclosure requirements; and
- Specified secondary markets for the securities of these firms.[5]

The SEC needs to be reformed to achieve its important core functions more effectively, to improve transparency and due process, and to reduce unnecessary regulatory impediments to capital formation.[6] Under current law, the SEC Chairman has the authority to make almost all of the necessary changes.[7] Unfortunately, financial regulators, particularly the SEC and the Financial Industry Regulatory Authority (FINRA), are poorly managed and organized.

With regulatory authority delegated by the government, both the Public Company Accounting Oversight Board (PCAOB) and FINRA have proved to be ineffective, costly, opaque, and largely impervious to reform. To reduce costs and improve transparency, due process, congressional oversight, and responsiveness, PCAOB and FINRA should be abolished, and their regulatory functions should be merged into the SEC. Furthermore, Congress should establish an independent board or commission and charge it with producing a detailed report within 18 months that examines the degree to which the regulatory functions of the various other so-called self-regulatory organizations (SROs), which are no longer self-regulatory in any meaningful sense, should be moved to the SEC.[8]

Discrimination based on immutable characteristics has no place in financial regulation. Offices at financial regulators that promote racist policies (usually in the name of "diversity, equity, and inclusion") should be abolished, and regulations that require appointments on the basis of race, ethnicity, sex, or sexual orientation should be eliminated. Equal protection of the law, equal opportunity, and individual merit should govern regulatory decisions.[9]

Congress has given the SEC broad "general exemptive authority,"[10] but the SEC has used this authority only rarely. It should use this authority significantly more often to reduce the regulatory burden on issuers, particularly smaller entrepreneurs.

ENTREPRENEURIAL CAPITAL FORMATION

Financial regulators should remove regulatory impediments to entrepreneurial capital formation.[11] In the absence of the fundamental reform outlined above, the SEC should:

- Simplify and streamline Regulation A (the small issues exemption)[12] and Regulation CF (crowdfunding)[13] and preempt blue sky registration and qualification requirements for all primary and secondary Regulation A offerings.[14]

- Either democratize access to private offerings by broadening the definition of accredited investor for purposes of Regulation D or eliminate the accredited investor restriction altogether.[15]

- Allow traditional self-certification of accredited investor status for all Regulation D Rule 506 offerings.

- Exempt small micro-offerings from registration requirements.[16]

- Exempt small and intermittent finders from broker–dealer registration requirements and provide a simplified registration process for private placement brokers.[17]

- Exempt peer-to-peer lending from federal and state securities laws and reduce the regulatory burden on Regulation CF debt securities.

- Make the Title I Emerging Growth Company (EGC) exemptions permanent for all EGCs.

- Reduce the regulatory burden on small broker–dealers and exempt privately held, non-custodial broker–dealers from the requirements to use a PCAOB-registered firm for their audits.

Congress should:

- Amend the Internal Revenue Code to disregard crowdfunding and Regulation A shareholders for purposes of the 100-shareholder limit for Subchapter S corporations.[18]

BETTER CAPITAL MARKETS

To improve capital markets, the SEC should:

- Preempt blue sky registration, qualification, and continuing reporting requirements for securities traded on established securities markets (including a national securities exchange or an alternative trading system).[19]

- Terminate the Consolidated Audit Trail (CAT) program.[20]

- Abolish Rule 144 and other regulations that restrict securities resales and instead require a company that has sold securities to provide sufficient current information to the market to permit reasonable investment decisions and secondary sales.

Congress should:

- Prohibit the SEC from requiring issuer disclosure of social, ideological, political, or "human capital" information that is not material to investors' financial, economic, or pecuniary risks or returns. The proposed SEC climate change rule, which would quadruple the costs of being a public company, is particularly problematic.[21]

- Repeal the Dodd–Frank mandated disclosures relating to conflict minerals, mine safety, resource extraction, and CEO pay ratios.[22]

- Oppose efforts to redefine the purpose of business in the name of social justice; corporate social responsibility (CSR); stakeholder theory; environmental, social, and governance (ESG) criteria; socially responsible investing (SRI); sustainability; diversity; business ethics; or common-good capitalism.

- Prohibit securities regulators, including SROs, from promulgating rules or taking other actions that discriminate, either favorably or unfavorably, on the basis of the race, color, religion, sex, or national origin of such individual or group.

SEC ADMINISTRATION

To enable it to achieve its core mission more effectively, the SEC should:[23]

- Publish better data on securities offerings, securities markets, and securities law enforcement and publish an annual data book of time series data on these matters. Specifically, the SEC Division of Economic and Risk Analysis (DERA) needs to do a much better job of collecting and reporting fundamental data regarding offerings, regulatory costs, violations, enforcement, investors, state regulator taxes, fees and activities, and other matters.

- Ensure that SEC resources flow toward its core functions and away from ancillary and support functions or from missions that do not fall within the SEC's statutory charge.

- Ensure that any three SEC Commissioners are empowered to place an item on the agenda and to receive adequate staff support to do so even without the Chairman's support.

- Eliminate all administrative proceedings (APs) within the SEC except for stop orders related to defective registration statements. The SEC enforcement system does not need to have both district court cases and APs. Alternatively, respondents should be allowed to elect whether an adjudication occurs in the SEC's administrative law court or an ordinary Article III federal court.[24]

- End the practice of delegating the decision to initiate an enforcement case. The SEC Chairman—and possibly the U.S. Government Accountability Office (GAO)—should study whether other Commission delegation of authority to staff should be narrowed and whether sunsetting of such delegation of authority should be required.

Congress should:

- Require an Inspector General's (or possibly a GAO) report regarding SEC information technology spending and contracting. Spending appears to be much too high, and IT contracting is poorly managed.

- Statutorily limit the time for an investigation to two years with no extensions. Long investigations harm private parties and the quality of justice. With adequate management processes, the SEC should not need more than two years even for complicated matters.

The SEC Chairman should:

- Dramatically reduce the number of direct reports to the SEC Chairman.

- Merge SEC offices that are performing similar functions.

- Reduce the number of managers per employee.

CFTC ADMINISTRATION AND IMPROVED COMMODITIES AND DERIVATIVES MARKETS

Congress should:

- Modernize the definition of commodity (which is now largely a laundry list of agricultural commodities)[25] and clarify the treatment of digital assets.

- Clarify through an express amendment to the Commodity Exchange Act (CEA)[26] the circumstances that require a foreign swap trading platform to register with the Commodity Futures Trading Commission (CFTC) as a swap execution facility (SEF) under Sections 2(i)[27] and 5h[28] of the CEA. Currently, it is not clear whether having one or a small number of U.S. participants would require SEF registration under prior staff guidance, which has led foreign swap trading platforms to exclude all U.S. persons from their platforms or to go through the process of seeking an exemption from registration.

- Amend Section 2 of the CEA to authorize the CFTC Chairman to remove the agency's Executive Director without a Commission vote.

- To augment Commissioners' independence, establish funding amounts for the Commissioners' offices by statute with adjustments for inflation, with no requirement for a Commissioner to obtain budget or expense approvals from the Chairman or the agency's administrative staff.

The CFTC should:

- Allocate more resources to core agency functions rather than ancillary and support operations.

- Replace the existing position limits rule, which reduces liquidity and makes markets more volatile, with further delegation of authority to the exchanges to set position limits and position accountability levels where appropriate for the relevant market.

- Reduce overly prescriptive rules implementing the CFTC's core principles.

- Apply the definitions of "U.S. Person" and "Guarantee" in the CFTC's 2020 rule on cross-border application of swaps regulations (2020 Cross-Border Rule)[29] to the regulatory requirements that remain covered by the CFTC's 2013 guidance on the subject (2013 Guidance).[30] Currently, the definition of each of these foundational terms differs depending on whether the requirement in question is covered by the 2020 Cross-Border Rule or the 2013 Guidance.

- Remove the regulatory categories of "affiliate conduit" and "foreign consolidated subsidiary" from the 2013 Guidance and the CFTC's cross-border rule on margin for uncleared swaps,[31] respectively. These categories were replaced by the concept of a "Significant Risk Subsidiary" for purposes of the 2020 Cross-Border Rule because of widespread market confusion and compliance difficulties arising from their broad and vague scope.

DIGITAL ASSETS

Both the SEC and the CFTC have been irresponsible actors in the digital asset area. They have had more than a decade to promulgate rules governing digital assets, yet the SEC has utterly failed to do so, and the CFTC has provided only minimal guidance. Instead, both agencies have chosen regulation by enforcement—and have done it poorly. They neither adequately protect investors nor provide responsible market participants with the regulatory environment that they need to thrive.

The SEC and CFTC should clarify the treatment of digital assets (coins or tokens). Specifically, they should:

- Promulgate a joint regulation providing that a holder of digital assets may not be deemed a party to an investment contract or an investor in a common enterprise unless, while the enterprise is a going concern, the holder is entitled to a share of the earnings or profits of the common enterprise or a defined flow of payments from the common enterprise in consideration of the investment or unless, upon liquidation, the holder has rights against the assets of the common enterprise. Otherwise, the digital asset shall be deemed a commodity to be regulated by the CFTC, not the SEC.

- Amend the definition of commodity to include digital assets that are not a security as so defined and amend the definition of security to make it clear that a certificate (digital, electronic, or otherwise) that represents ownership of commodities and is convertible into a physical commodity on demand is not a security but a commodity.

In the absence of regulatory action, Congress should enact legislation that achieves these goals.

IMPROVED REGULATION OF THE INDUSTRY AND SROS

Congress and the SEC need to conduct more robust oversight of self-regulatory organizations, and SROs need to be reformed; otherwise, as discussed above, SRO regulatory functions should be merged into the SEC. The SEC, FINRA itself, or Congress should:

- In the absence of merging FINRA into the SEC as recommended, require that:

    1. FINRA's Board of Governors meetings be open to the public unless the board votes to meet in executive session.

2. FINRA's Board of Governors' agenda be made available to the public in advance.

3. Board minutes describing actions taken be published without delay.

4. FINRA make available to the public in advance rulemakings that the FINRA board is expected to consider.

5. FINRA arbitration and disciplinary hearings should be open to the public and reported.

- Require FINRA arbitrators to make findings of fact based on the evidentiary record and demonstrate how those facts led to the award given (except with respect to very small claims). These written FINRA arbitration decisions should be subject to SEC review and limited judicial review.

- Require that all SRO fines, including those imposed by FINRA, should go either to a newly established investor reimbursement fund or to the Treasury. SROs should not have a financial interest in imposing fines.

- Require all SROs to conduct meaningful cost-benefit analysis as part of the rulemaking process with respect to major rules.

- Require all SROs to publish rules in proposed format and seek public comment before they are submitted to the SEC or the CFTC.

- Require each SRO to submit an annual report to Congress with detailed, specified information about its budget and fees; its enforcement activities (including sanctions and fines imposed by type of violation and type of firm or individual); its dispute resolution activities; and its rulemaking activities.

Congress should:

- Conduct annual oversight hearings on SROs.

- Either make FINRA, the Municipal Securities Rulemaking Board (MSRB), and the National Futures Association (NFA) "Designated Federal Entities" and establish an inspector general with respect to financial SROs, including FINRA, the MSRB, and the NFA or place FINRA, the MSRB, and the NFA within the ambit of an existing inspector general.

- Require the SEC and the CFTC to publish a detailed annual report on SRO supervision.

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CONSUMER FINANCIAL PROTECTION BUREAU

Robert Bowes

The Consumer Financial Protection Bureau (CFPB) was authorized in 2010 by the Dodd–Frank Act.[32] Since the Bureau's inception, its status as an "independent" agency with no congressional oversight has been questioned in multiple court cases, and the agency has been assailed by critics[33] as a shakedown mechanism to provide unaccountable funding to leftist nonprofits politically aligned with those who spearheaded its creation.

In 2015, for example, *Investor's Business Daily* accused the CFPB of "diverting potentially millions of dollars in settlement payments for alleged victims of lending bias to a slush fund for poverty groups tied to the Democratic Party" and planning "to create a so-called Civil Penalty Fund from its own shakedown operations targeting financial institutions" that would use "ramped-up (and trumped-up) anti-discrimination lawsuits and investigations" to "bankroll some 60 liberal nonprofits, many of whom are radical Acorn-style pressure groups."[34]

The CFPB has a fiscal year (FY) 2023 budget of $653.2 million[35] and 1,635 full-time equivalent (FTE) employees.[36] From FY 2012 through FY 2020, it imposed approximately $1.25 billion in civil money penalties;[37] in FY 2022, it imposed approximately $172.5 million in civil money penalties.[38] These penalties are imposed by the CFPB Civil Penalty Fund, described as "a victims relief fund, into which the CFPB deposits civil penalties it collects in judicial and administrative actions under Federal consumer financial laws."[39]

The CFPB is headed by a single Director who is appointed by the President to a five-year term.[40] Its organizational structure includes five divisions: Operations; Consumer Education and External Affairs; Legal; Supervision, Enforcement and Fair Lending; and Research, Monitoring and Regulations.[41] Each of these divisions reports to the Office of the Director, except for the Operations Division, which reports to the Deputy Director.

Passage of Title X of Dodd–Frank was a bid to placate concern over a series of regulatory failures identified in the wake of the 2008 financial crisis. The law imported a new superstructure of federal regulation over consumer finance and mortgage lending and servicing industries traditionally regulated by state banking regulators. Consumer protection responsibilities previously handled by the Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, Federal Reserve, National Credit Union Administration, and Federal Trade Commission were transferred to and consolidated in the CFPB, which issues rules, orders, and guidance to implement federal consumer financial law.

The CFPB collects fines from the private sector that are put into the Civil Penalty Fund.[42] The fund serves two ostensible purposes: to compensate the victims whom the CFPB perceives to be harmed and to underwrite "consumer education" and "financial literacy" programs.[43] How the Civil Penalty Fund is spent is at the discretion of the CFPB Director. The CFPB has been unclear as to how it decides what "consumer education" or "financial literacy programs" to fund.[44] As noted, critics have charged that money from the Civil Penalty Fund has ended up in the pockets of leftist activist organizations.

In *Seila Law LLC v. Consumer Financial Protection Bureau*,[45] the Supreme Court of the United States held that the CFPB's leadership by a single individual removable only for inefficiency, neglect, or malfeasance violated constitutional separation of powers requirements because "[t]he Constitution requires that such officials remain dependent on the President, who in turn is accountable to the people."[46] The CFPB Director is thus subject to removal by the President.

The CFPB is not subject to congressional oversight, and its funding is not determined by elected lawmakers in Congress as part of the typical congressional appropriations process. It receives its funding from the Federal Reserve, which is itself funded outside the appropriations process through bank assessments. CFPB funding represents 12 percent of the total operating expenses of the Federal Reserve and is disbursed by the unelected Board of Governors of the Federal Reserve System.[47] This is not the case with respect to any other federal agency.

On October 19, 2022, in *Community Financial Services Association of America v. Consumer Financial Protection Bureau*, the U.S. Court of Appeals for the Fifth Circuit held that the CFPB's "perpetual insulation from Congress's appropriations power, including the express exemption from congressional review of its funding, renders the Bureau 'no longer dependent and, as a result, no longer accountable' to Congress and, ultimately, to the people"[48] and that "[b]y abandoning its 'most complete and effectual' check on 'the overgrown prerogatives of the other branches of the government'—indeed, by enabling them in the Bureau's case—Congress ran afoul of the separation of powers embodied in the Appropriations Clause."[49] The Court further remarked that the CFPB's "capacious portfolio of authority acts 'as a mini legislature, prosecutor, and court, responsible for creating substantive rules for a wide swath of industries, prosecuting violations, and levying knee-buckling penalties against private citizens.'"[50]

On February 27, 2023, the Supreme Court granted the petition for a *writ of certiorari*.[51] The Court should issue its final decision by 2024.

The CFPB is a highly politicized, damaging, and utterly unaccountable federal agency.[52] It is unconstitutional. Congress should abolish the CFPB and reverse Dodd–Frank Section 1061, thus returning the consumer protection function of the CFPB to banking regulators[53] and the Federal Trade Commission. Provided the Supreme Court affirms the Fifth Circuit holding in *Community Financial Services Association of America*, the next conservative President should order the immediate dissolution of the agency—pull down its prior rules, regulations and guidance, return its staff to their prior agencies and its building to the General Services Administration.

Until this can be accomplished, however, Congress should:

- **Ensure that any civil penalty funds not used to recompense wronged consumers go to the Department of the Treasury.** The funds should not be retained by the Bureau to be dispensed at the pleasure of the Director—potentially to political actors. Moreover, the CFPB should not have a financial incentive to impose penalties.

- **Repeal Dodd–Frank Section 1071.** This section, which relates to small-business data collection, imposes requirements on financial institutions' lending to small firms, raises costs, and limits small businesses' access to capital.[54]

- **Require that no CFPB funds are spent on enforcement actions that are not based on a rulemaking that complies with the Administrative Procedure Act.**[55]

- **Require that respondents in administrative actions be allowed to elect whether an adjudication occurs in an administrative law court or an ordinary Article III federal court.**[56]

- **Specify the nature of "deceptive, unfair, and abusive" practices to define the scope of the CFPB mission more precisely.**

ENDNOTES

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