January 16, 2024

Ann E. Misback
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave. NW
Washington, DC 20551

James P. Sheesley
Assistant Executive Secretary
ATTN: Comments/Legal OES
(RIN 3064-AF29)
Federal Deposit Insurance Corp.
550 17th Street, NW
Washington, DC 20429

Chief Counsel's Office
ATTN: Comment Processing
Office of the Comptroller of the
Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 2019

RE: Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity; Docket No. R-1813, RIN 7100-AG64; Docket ID OCC-2023-0008; RIN 3064-AF29

I enclose "The Constitutionality of the Proposed Capital Adequacy Rule Under the Nondelegation Doctrine," a white paper I co-authored with R. Trent McCotter published by the Texas Public Policy Foundation in December 2023, as a comment opposing the above-captioned proposed rule.

In the white paper, we argue that the federal banking agencies' claimed statutory authority to issue a final version of the rule raises serious questions about whether the relevant statutes are consistent with the requirements of the U.S. Constitution. If finalized, the rule would likely be unconstitutional under the original understanding of the constitutional nondelegation doctrine. The rule would represent an exercise of the federal banking agencies' uncabined discretion to make fundamental policy judgments about bank capital that the Constitution requires Congress to make instead.

901 Congress Avenue, Austin, TX 78701 512-472-2700 FAX 512-472-2728 www.texaspolicy.com

The enclosed white paper discusses these points and others in greater detail. Given the constitutional concerns with the proposed rule, it should be abandoned and not issued as a final rule.

Sincerely,

Robert Henneke
Texas Public Policy Foundation

THE CONSTITUTIONALITY OF THE PROPOSED CAPITAL ADEQUACY RULE UNDER THE NONDELEGATION DOCTRINE

by Robert Henneke and Trent McCotter

December 2023

Texas Public Policy Foundation

December 2023

By Robert Henneke and Trent McCotter
Texas Public Policy Foundation

Table of Contents

Executive Summary 3

Background 4

The Historical Expansion of Regulators' Discretion Under the Capital-Adequacy Statutes. 4

The Capital Adequacy Rule's Aggressive Exercise of Delagated Power. 7

Nondelegation Analysis 8

Congress's Delegation of Authority for the Capital Adequacy Rule Would Likely Survive the Current "Intelligible Principle" Test 10

Congress's Delegation of Authority for the Capital Adequacy Rule Is Likely Unconstitutional Under the Original Understanding of Nondelegation. . .11

Conclusion 18

The Constitutionality of the Proposed Capital Adequacy Rule Under the Nondelegation Doctrine

Robert Henneke and Trent McCotter

Executive Summary

In July 2023, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC") issued a proposed regulation (the "Capital Adequacy Rule" or "Rule") overhauling the methods for large financial institutions to calculate their risk-based capital requirements. These federal banking agencies claim authority to issue the Capital Adequacy Rule—a rulemaking that is so impactful that experts estimate it will reduce the annual GDP of the United States by $67 billion each year—under various statutes broadly empowering them to require banks to maintain "adequate capital." This claimed authority raises serious questions about whether such a broad delegation of power from Congress is consistent with the U.S. Constitution. Although the Capital Adequacy Rule is likely constitutional under the existing nondelegation doctrine, a majority of the Justices on the Supreme Court have indicated a desire to revisit that doctrine and strengthen it consistent with its original understanding. Doing so would likely rein in sprawling delegations that leave important policymaking in the hands of administrative agencies. Under the doctrine as originally understood and correctly applied—and as envisioned by those Justices—there are strong arguments that the Capital Adequacy Rule is *not* constitutional.

The Capital Adequacy Rule runs over 1,000 pages and proposes two main changes to the current bank regulatory regime: *First*, it would extend capital standards that currently apply only to the very largest, global banking firms to *all* banking firms with assets greater than $100 billion, a more than fivefold increase in the number of regulated entities. *Second*, it would mandate a more stringent "standardized" approach to risk modeling that would require significantly higher capital levels. Together, these changes portend massive effects on banks and the economy—likely requiring 16% more capital on average, increasing the costs of lending, and reducing annual GDP by tens of billions of dollars each year. The agencies' sweeping assertion of regulatory authority in the Capital Adequacy Rule, and the underlying capital-adequacy regime it seeks to modify, raise profound questions about Congress's ability to delegate foundational macroeconomic policy decisions to unaccountable regulators rather than deciding such issues itself, as it traditionally did.

Under the existing nondelegation doctrine, Congress's grant of power to regulators to set "adequate" capital levels would likely survive constitutional scrutiny, largely because the modern test is toothless. But in recent years, a majority of the current Supreme Court has signaled significant interest in reviving the nondelegation doctrine to serve as an important constitutional check on broad grants of authority from Congress to executive branch agencies. Although those Justices have not settled on a new approach, Justice Gorsuch's dissenting opinion in *Gundy v. United States*, 139 S. Ct. 2116, 2131–48 (2019), sketched out a more robust version of the doctrine that would impose meaningful limits on Congress's ability to leave policymaking up to administrative agencies.

The Capital Adequacy Rule would likely be unconstitutional under the original understanding of the nondelegation doctrine articulated by Justice Gorsuch. There are strong arguments that delegating such broad and ill-defined power over core banking activities to executive agencies would violate the original understanding of nondelegation.

The Capital Adequacy Rule rests on broad statutory delegations of authority to require that banks "maintain adequate capital," to make those capital requirements "risk-based," and to set "more stringent" rules for banks with $100 billion or more in assets. *See* 12 U.S.C. §§ 3907(a)(1), 1831o(c), 5365(a). But as the regulators themselves have conceded, these

The Capital Adequacy Rule raises significant questions about whether and to what extent the Constitution allows Congress to delegate major policy questions, implicating tens of billions of dollars in annual GDP, to federal agencies.

vague delegations shift to the agencies the authority to make the fundamental "policy judgment" "as to the optimum trade-off between making more bank resources available for investment in productive activities and the costs that will be borne by the public fisc and the economy if banks fail." *Development of New Basel Capital Accords: Hearing Before the S. Comm. on Banking, Hous. & Urb. Affs.*, 109th Cong. (2005) (statement of Daniel K. Tarullo, former Federal Reserve oversight governor). In other words, the agencies, not Congress, have been left to make key judgment calls about "the maximum level of depository system risk that society is willing to tolerate." U.S. Dep't of the Treasury, Modernizing the Financial System: Recommendations for Safer, More Competitive Banks II-17 (1991). This shift is at odds with the text and structure of the Constitution, which requires Congress—not agencies—to make policy decisions, and limits agencies to finding facts and filling in less important details.

The nondelegation problem here is especially acute in part because of the distinctive "multi-layer" delegations Congress has provided. The relevant agencies are not only empowered to set whatever capital levels they deem to be "adequate," but Congress has also expressly authorized them to consider *any* factors they deem relevant when doing so. Congress has thereby multiplied the agencies' discretion by empowering them not only to determine what capital is "adequate," but also to decide what considerations go into that determination in the first place.

In sum, the Capital Adequacy Rule raises significant questions about whether and to what extent the Constitution allows Congress to delegate major policy questions, implicating tens of billions of dollars in annual GDP, to federal agencies. If the Supreme Court chooses to revitalize the nondelegation doctrine in the near future, the Capital Adequacy Rule would be vulnerable to a significant constitutional challenge in the courts.

Background

For most of the history of federal banking regulation, regulators applied capital requirements only to individual banks on a case-by-case basis. Minimum capital requirements that applied across categories of banks were fixed in statute by Congress. In response to financial instability beginning in the 1970s, however, Congress successively delegated to regulators the power to determine and fix capital requirements for *all* regulated banking institutions. The recently proposed Capital Adequacy Rule is the latest and most aggressive exercise of that delegated power. This newfound freedom for regulators to impose ever-increasing capital requirements raises serious questions about whether Congress itself has made the necessary policy judgments about how to balance risk against access to credit and capital markets on a macroeconomic scale, or instead has handed off those significant questions to politically unaccountable agencies.

I. THE HISTORICAL EXPANSION OF REGULATORS' DISCRETION UNDER THE CAPITAL-ADEQUACY STATUTES

A. Congress and the States Originally Fixed Capital Requirements by Statute.

Early capital requirements were fixed directly by Congress. The first capital requirements in federal banking regulation were enacted in the National Bank Act of 1864, which provided that no bank could obtain a national charter "with a less capital than one hundred thousand dollars" in general, with less than "two hundred thousand dollars" for banks in cities exceeding 50,000 persons, or with less than "fifty thousand dollars" in areas with less than 6,000 persons upon approval by the Secretary of the Treasury. Act of June 3, 1864, ch. 106, § 7, 13 Stat. 99, 101. The National Bank Act also required that nationally chartered banks maintain a "surplus fund" into which they paid 10 percent of net semiannual profits until the total fund amounted to 20 percent of the bank's capital stock. *Id.* § 33, 13 Stat. at 109. It also prohibited banks from "withdraw[ing] … any portion of its capital" to below the required levels. *Id.* § 38, 13 Stat. at 110.

Congress monitored and updated these requirements over time. In the Gold Standard Act of 1900, Congress lowered the initial capital requirement to $25,000 for banks in towns of under 3,000 people. Act of March 14, 1900, ch. 41, § 10, 31 Stat. 45, 48. When Congress established the Federal Reserve system in 1913, it also incorporated the National Bank Act minimum capital requirements as criteria for membership. Act of Dec. 23, 1913, ch. 6, § 9, 38 Stat. 251, 259.

States also fixed early capital requirements by statute. In general, state statutes required banks to maintain the same or less capital than under a comparable national charter. *See* Eugene Nelson White, *The Regulation and Reform of the American Banking System, 1900–1929*, at 17–18 (1983) (citing National Monetary Comm., *Digest of State Banking Statutes* (Samuel A. Welldon comp.), S. Doc. No. 353, 61st Cong. (1910)). But some states also began enacting statutes requiring the maintenance of certain levels of "operating" capital, as well. Unlike the then-applicable federal requirements, which focused on the absolute amount of capital needed to start a bank, these state statutes focused on the minimum capital needed to hold increasing levels of deposits. For example, the California Bank Act of 1909 required that banks chartered in the state maintain capital equal to at least 10 percent of their deposits. California Bank Act of 1909, § 19, https://tinyurl.com/mrythk8v. In the 1920s and 1930s, thirteen other states, including New York and Texas, enacted similar statutes. *See* Roland I. Robinson, *The Capital-Deposit Ratio in Banking Supervision*, 49 J. Pol. Econ. 41, 47–49 (1941).

B. Despite Congressional Inaction, Regulators Began Considering Capital Adequacy as a Factor in Their General "Safety and Soundness" Case-by-Case Supervision.

While states increasingly adopted new operating capital requirements, Congress declined to do the same. In 1914, around the time that states began enacting ongoing capital requirements focused on the ratio of capital to deposits, U.S. Comptroller of the Currency John Skelton Williams proposed a similar federal requirement, recommending that national banks be prohibited by law from holding deposits of more than ten times their unimpaired capital and surplus. *Id.* at 42. Congress considered adopting a mandatory capital-deposit ratio in the Glass-Steagall Act, but ultimately declined to include the requirement. 77 Cong. Rec. 3704, 3730–31 (1933) (remarks of Sen. Carter Glass) (referring to capital ratios as a "controversial problem[]" "omit[ted] ... from the bill").

Regulators nonetheless began incorporating capital-deposit ratios into their bank supervision. In the 1930s, the Federal Reserve, the newly created FDIC, and the OCC each began considering banks' capital-deposit ratios as part of their supervisory functions. *See* Robinson, *supra*, at 44–47. Still, unlike state capital-ratio requirements, which

When compared to the federal banking agencies' modern focus on capital ratios, federal banking regulation prior to the 1970s "is a prehistory of capital-adequacy regulation."

made the maintenance of capital ratios a condition of state banking charters, federal regulators' evaluation of bank capital was just one factor in their overall supervision of banks. Bank capital was only one part of the "general 'safety and soundness' standard" that "regulators applied ... to all banks." Eric A. Posner, *How Do Bank Regulators Determine Capital-Adequacy Requirements?*, 82 U. Chi. L. Rev. 1853, 1865 (2015) (cleaned up). For example, regulators would sometimes condition the approval of applications to establish new branches or merge with other institutions on increases in bank capital. *See* Susan Burhouse et al., *Basel and the Evolution of Capital Regulation: Moving Forward, Looking Back*, FDIC (Jan. 14, 2003), https://www.fdic.gov/analysis/archived-research/fyi/011403fyi.pdf. These efforts were case-by-case applications of general capital-adequacy guidelines, however, rather than uniform capital requirements as provided under the earlier federal and state statutes.

For this reason, when compared to the federal banking agencies' modern focus on capital ratios, federal banking regulation prior to the 1970s "is a prehistory of capital-adequacy regulation." Posner, *supra*, at 1865. "[M]ost early attempts at quantifying the notion of capital adequacy were controversial and unsuccessful." Burhouse, *supra*. It was not until the early 1980s that the federal banking agencies, and then Congress, would take a different approach.

C. Starting in the 1980s, Congress Delegated to Regulators the Power to Fix Capital Requirements Across Classes of Banks and the Financial System As a Whole.

1. Congress Responds to Financial Instability by Delegating Extremely Broad Powers.

The high inflation and low economic growth of the 1970s led to "[a] number of banks fail[ing] ... and the capital-asset ratios of most banks declined." Posner, *supra*, at 1866. After a failure of the internationally active German Herstatt Bank in 1974, regulators began to reconsider capital requirements. In 1981, a "convergence of macroeconomic weakness ... bank failures and diminishing bank capital" led the Federal Reserve, FDIC, and OCC to attempt the creation of a broader capital-requirements regime by announcing coordinated regulations that attempted to reverse the decline of capital in the banking system. Burhouse, *supra*. But this groundbreaking regulatory initiative quickly ran into legal hurdles in court. After the OCC issued an order requiring a bank to raise its capital, the Fifth Circuit rejected the OCC's finding that the bank had failed to maintain adequate capital levels. *See First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674 (5th Cir. 1983). The court called into question the validity of "capital inadequacy" as a basis for the OCC's finding of "unsafe and unsound" practices, pointing to record statements by the Comptroller that "banks do not fail because of capital problems." *Id.* at 687.

After banking crises in Latin America "revealed that some US banks were dangerously exposed to risky foreign-sovereign debt," Posner, *supra*, at 1867, Congress passed the International Lending Supervision Act of 1983 ("ILSA"), 12 U.S.C. § 3901 et seq., which broadly directed banking regulators to "achieve and maintain adequate capital by establishing minimum levels of capital," *FDIC v. Bank of Coushatta*, 930 F.2d 1122, 1125–26 (5th Cir. 1991) ("Section 3907 [of title 12, U.S. Code,] was enacted to provide 'a stronger, unambiguous statutory directive to the regulators to strengthen banks' capital positions.'" (quoting H.R. Rep. No. 98-175, 98th Cong., 1st Sess. 45, *reprinted in* 1983 U.S.C.C.A.N. 1768, 1928)). Viewed against the Fifth Circuit's decision in *Bellaire*, ILSA "put on firmer footing the regulators' authority to issue capital-adequacy rules." Posner, *supra*, at 1867. Specifically, 12 U.S.C. § 3907 authorizes "[e]ach appropriate Federal banking agency [to] cause banking institutions to achieve and maintain *adequate capital* by establishing minimum levels of capital for such banking institutions and by using such other methods as the appropriate Federal banking agency deems appropriate." 12 U.S.C. § 3907(a)(1) (emphasis added). As one scholar has noted, after ILSA, "[w]hat constitutes 'adequate capital'" is thus "a question within the agencies' discretion." Michael P. Malloy, *Capital Adequacy and Regulatory Objectives*, 25 Suffolk Transnat'l L. Rev. 299, 302 (2002).

2. *After Another Wave of Bank Failures in the Late 1980s, Congress Extended Regulators' Delegated Power Over Insured Depository Institutions.*

After another wave of failures affecting banks, thrifts, and savings-and-loan institutions in the late 1980s, Congress reacted with the Federal Deposit Insurance Corporation Improvement Act ("FDIC Improvement Act") of 1991, Pub. L. No. 102-242, 105 Stat. 2236, which provided various requirements for the adequate capitalization of FDIC-insured depository institutions. *See* 12 U.S.C. § 1831o. *First*, the statute defines five "capital categories," requiring the federal banking agencies to "specify ... the levels at which an insured depository institution" is "well capitalized," "adequately capitalized," and so on down to "critically undercapitalized." *Id.* § 1831o(b)(1), (c)(2). *Second*, the statute requires that "the capital standards prescribed by each appropriate Federal banking agency" (i.e., those authorized by ILSA) "shall include—(i) a leverage limit; and (ii) a risk-based capital requirement," and further authorizes those agencies to "establish any additional relevant capital measures to carry out the purpose of this section." *Id.* § 1831o(c)(1)(A), (B); *see id.* § 1831o(c)(3) (setting "[l]everage limit range" relating to "critically undercapitalized" status and requiring "tangible equity in an amount ... not less than 2 percent of total assets"). *Third*, the statute imposes certain consequences for insured depository institutions that are inadequately capitalized, including restrictions on dividends and bonuses. *Id.* § 1831o(d)(1)(A); *see also id.* § 1831o(e)–(f), (h).

3. *After the 2008 Financial Crisis, Congress Delegated Capital Requirements for Holding Companies to Regulators in the Dodd-Frank Act.*

In 2010, in the wake of the 2008 financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which—among many other things—provides for "enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies." Dodd-Frank, Pub. L. No. 111-203, § 165, 124 Stat. 1376, 1423 (2010) (codified as amended at 12 U.S.C. § 5365). Two principal provisions are relevant here.

First, Dodd-Frank extended agency regulatory authority to enact prudential standards for systemically significant nonbank financial companies and large bank holding companies. Dodd-Frank—as later amended by the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act ("Economic Growth Act"), Pub. L. No. 115-174, § 401, 132 Stat. 1296, 1356–59 (2018)—requires the Federal Reserve, "[i]n order to prevent or mitigate risks to the financial stability of the United States ..., [to] establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than" $250 billion. 12 U.S.C. § 5365(a)(1). Those standards "shall include" "risk-based capital requirements and leverage limits," unless the Board finds that such requirements are not appropriate for a firm, plus "liquidity requirements," "overall risk management requirements," "resolution plan requirements," and "concentration limits." *Id.* § 5365(b)(1)(A). And they *may* include "a contingent capital requirement," "enhanced public disclosures," "short-term debt limits," and "such other prudential standards as the Board ... determines are appropriate." *Id.* § 5365(b)(1)(B).

Section 5365(b)(3) imposes "[c]onsiderations" the Board must take into account when prescribing these standards, including "differences among [the] nonbank financial companies" it supervises, like (1) "whether the company owns an insured depository institution," (2) "nonfinancial activities and affiliations of the company," (3) "any other risk- related factors that the Board" finds "appropriate," and (4) "the factors described in subsections (a) and (b) of section 5323 of this title"—which include firm-specific considerations. *Id.* § 5365(b)(3)(A). The Board must also avoid "sharp, discontinuous changes in the prudential standards," *id.* § 5365(b)(3)(B), consider "any recommendations of the [Financial Stability Oversight] Council," *id.* § 5365(b)(3)(C), and "adapt the required standards … in light of any predominant line of business" of a given company, *id.* § 5365(b)(3)(D); *see also id.* § 5635(i) (requiring periodic "stress tests" to determine adequate capital); *id.* § 5365(j)(1) (requiring, in certain circumstances, a 15:1 debt-to-equity ratio on banks with $250 billion or more in assets).

Under Dodd-Frank, the Board also *may*, by order or rule, extend "any prudential standard established under [§ 5365] to any bank holding company ... with total consolidated assets equal to or greater than" $100 billion. *Id.* § 5365(a)(2)(C). To do so, it must find such extension "appropriate" to prevent or mitigate risks to U.S. financial stability, or to "promote the safety and soundness" of the entity, *and* "take[] into consideration" certain enumerated factors, including most of those described above in § 5365(b)(3). *Id.* § 5365(a)(2)(C).

Second, in a separate provision, Dodd-Frank requires that the "appropriate Federal banking agencies shall establish" both "minimum leverage capital requirements" and "minimum risk-based capital requirements" for insured depository institutions, bank holding companies and systemically significant nonbank financial companies, and that these "minimum ... capital requirements ... shall not be less than the generally applicable ... capital requirements" for insured depository institutions under the FDIC Improvement Act, discussed above. 12 U.S.C. § 5371(b)(1)–(2).

Section 5371(b)(7) further requires the agencies to develop additional "capital requirements ... that address the risks that the activities of [various regulated entities] pose, not only to the institution engaging in the activity, but to other public and private stakeholders in the event of adverse performance, disruption, or failure of the institution or the activity." *Id.* § 5371(b)(7)(A). Those rules must "address, at a minimum, the risks arising from ... significant volumes of activity in derivatives, securitized products, ... concentrations in assets for which the values presented in financial reports are based on models rather than historical costs or prices deriving from deep and liquid 2-way markets," and "concentrations in market share for any activity that would substantially disrupt financial markets if the institution is forced to unexpectedly cease the activity." *Id.* § 5371(b)(7)(B).

Finally, Dodd-Frank amended 12 U.S.C. § 3907, as enacted by ILSA, to require the federal banking agencies to "seek to make the capital standards required under this section or other[s] ... countercyclical so that the amount of capital required ... increases in times of economic expansion and decreases in times of economic contraction." 12 U.S.C. § 3907(a)(1).

II. THE CAPITAL ADEQUACY RULE'S AGGRESSIVE EXERCISE OF DELEGATED POWER

In July 2023, the Federal Reserve, FDIC, and OCC proposed the Capital Adequacy Rule, which spans over 1,000 pages and proposes making two significant changes to the current bank regulatory regime. The Rule is controversial, to put it mildly. It sparked rare public dissents from within the agencies, with even agency heads criticizing its overly conservative approach to risk assessment and vitiation of the prior careful tailoring between banking firms. *See, e.g.*, *Statement by Travis Hill, Vice Chairman*, FDIC (July 27, 2023), https://tinyurl.com/4hjmt4ze; *Statement by Governor Michelle W. Bowman*, Bd. of Governors of the Fed. Reserve Sys. (July 27, 2023), https://tinyurl.com/ya2jfdak. Likewise, industry commentators have claimed that the Rule is "totally unjustified" and likely to have "serious negative consequences for the economy" while "undermin[ing]," not strengthening, "the overall stability of the financial system." *Basel Endgame: Background and Key Issues* ("BPI Fact

Sheet") at 1, Bank Pol'y Inst. (Sept. 5, 2023), https://tinyurl.com/578rkjy4.

Under the current regulations, financial institutions regulated by the Federal Reserve, FDIC, and OCC must meet several operational capital requirements. These requirements provide that financial institutions must maintain a "common equity tier 1 capital ratio of 4.5 percent," a "tier 1 capital ratio of 6 percent," a "total capital ratio of 8 percent," and a "leverage ratio of 4 percent." 12 C.F.R. § 217.10(a) (Federal Reserve); *id.* § 324.10 (FDIC); *id.* § 3.10 (OCC). Financial institutions calculate these ratios by measuring the relevant definition of capital against their "risk-weighted assets." *See* 12 C.F.R. § 217.10(a)–(b). Regulators instruct firms how to weight the riskiness of various assets, *see generally* 12 C.F.R. pt. 217, subpt. D, and have provided a "[s]tandardized [a]pproach" to calculating risk-weighted assets available to all firms. *See id.* §§ 217.30–217.63.

Consistent with Dodd-Frank's requirement to establish enhanced standards for larger firms, 12 U.S.C. § 5365(a)(1), the Federal Reserve has designated four "categories" of large bank holding companies and nonbank financial institutions. "Category I" includes "global systemically important bank holding companies," also known as "GSIBs." "Category II" includes firms with $700 billion or more in average total consolidated assets that are not GSIBs (plus certain smaller firms—for example, those with international exposure). "Category III" includes firms with between $250 and $700 billion in total consolidated assets. "Category IV" includes firms with between $100 and $250 billion in total consolidated assets. *See Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations*, 84 Fed. Reg. 59032 (Nov. 1, 2019). Depending on the firm category, different prudential standards and capital requirements apply:

- Firms in Categories I and II are allowed to use more complex internal models called "advanced approaches" to calculate risk in addition to the standardized approach available to all firms. *See* 12 C.F.R. §§ 217.100–217.173.

- Firms in Categories I, II, or III must meet an additional "supplementary leverage ratio" of 3% of total assets, and firms in Category I must meet an "enhanced supplementary leverage ratio" of another 2% of total assets. *Id.* §§ 217.10(a)(v), 217.11(c)(4). Firms in these categories may also be subject to a "countercyclical capital buffer," which is currently set at zero. *See id.* § 217.11(b)(2)(i).

- Firms in Categories I, II, III, and IV face a "stress capital buffer," which is at least 2.5%, but increases depending on how the firm performs under periodic "stress tests" performed by regulators. 12 C.F.R. §§ 217.11(2)(vi), 225.8(f).

- Firms in Category I face a "surcharge" capital requirement of between 0% and 5.5%, depending on various factors aimed at assessing a firm's systemic importance. 12 C.F.R §§ 217.11(d), 217.403(a)–(c), 217.404–405. Known as the "GSIB surcharge," this requirement is imposed in addition to the other operating capital requirements discussed above.

The Capital Adequacy Rule would make two principal changes to the current regulatory regime. *First*, it would extend capital standards that currently apply only to Category I firms to Category II, III, and IV firms as well. This would represent a more than fivefold increase in the number of firms subject to these Category I standards. *Second*, for measuring risk-weighted assets, the Rule would replace the internal models used by Category I and II firms with a more stringent, expanded, and standardized approach that will apply to *all* firms in Categories I through IV, with increased requirements that are likely to significantly raise capital requirements. *See* OCC, Federal Reserve & FDIC, *Interagency Overview of the Notice of Proposed Rulemaking for Amendments to the Regulatory Capital Rule*, at 2–3 (July 27, 2023), https://tinyurl.com/2ntwuhuf.

These changes will likely have a significant impact on banks and the broader economy. Affected banks are estimated to require 16% more capital on average, which would have serious consequences beyond the financial firms themselves. Industry experts expect such a significant increase would limit these banks' ability to offer mortgages, car loans, small-business loans, and so on, and thereby "permanently reduce annual U.S. GDP by more than $67 billion each year." BPI Fact Sheet, *supra*, at 1.

Nondelegation Analysis

In the Capital Adequacy Rule, the Federal Reserve, OCC, and FDIC have asserted sweeping authority to dramatically alter the capital requirements for financial institutions. That puts unilateral decision-making about the nation's credit allocation and macroeconomic risk tolerance in the hands of those regulators, rather than Congress itself. Assuming that Congress in fact authorized this major policymaking discretion, this near-boundless delegation raises serious questions about whether Congress has unconstitutionally delegated its legislative power in violation of the nondelegation doctrine.

"Article I of the Constitution provides that 'all legislative Powers herein granted shall be vested in a Congress of the United States.'" *Gundy*, 139 S. Ct. at 2123 (plurality) (quoting U.S. Const. art. I, § 1). "Accompanying that assignment of power to Congress is a bar on its further delegation." *Id.* The prohibition on transferring legislative power elsewhere stems from three aspects of the Constitution: (1) the express assignment of legislative powers to Congress, (2) the lack of such powers assigned elsewhere, and (3) Article I's use of the mandatory "shall," indicating that these powers must *remain* with Congress. *See* Philip Hamburger, *Nondelegation Blues*, 91 Geo. Wash. L. Rev. 1083, 1163–66, 1201–14 (2023).

The Supreme Court has held that a federal statute violated the nondelegation doctrine only twice, both times in 1935. *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935). Although the statutory provisions in those cases contained significant directives and policies for the executive branch to follow, and *Schechter Poultry* included limitations like prohibitions on the executive branch adopting discriminatory or inequitable rules, *see* Nondelegation Analysis Part II.A, *infra*, the Court concluded that the relevant regimes as a whole still failed to impose any "policy of limitation" on the President's discretion. *Panama Refining*, 293 U.S. at 418.

Since then, however, the Court has significantly diluted the nondelegation doctrine, reasoning that Congress must have "the necessary resources of flexibility and practicality [that enable it] to perform its function[s]" by allowing it to "obtain the assistance of its coordinate Branches," including by "conferring substantial discretion on executive agencies to implement and enforce the laws." *Gundy*, 139 S. Ct. at 2123 (plurality) (cleaned up). The Court has essentially concluded that the modern world is too complicated for Congress to fulfill its constitutional role. *See, e.g.*, *Mistretta v. United States*, 488 U.S. 361, 372 (1989) ("[I]n our increasingly complex society, replete with ever changing and more technical problems, Congress simply cannot do its job absent an ability to delegate power under broad general directives.").

In recent years, however, some Justices and scholars have devoted significant attention to excessive power exercised by federal regulatory agencies. In various cases implicating a range of constitutional and administrative law doctrines, the Supreme Court has curtailed agency independence from the President.

Under current doctrine, a statute is constitutional if Congress "clearly delineates the general policy, the public agency which is to apply it, and the boundaries of this delegated authority." *Skinner v. Mid-Am. Pipeline Co.*, 490 U.S. 212, 219 (1989) (cleaned up). Although this test may appear to set some appreciable standard—especially that Congress must clearly delineate the boundaries of any delegated authority—the Court has simplified its analysis by requiring only that Congress "lay[] down by legislative act an intelligible principle to which the person or body authorized to exercise the delegated authority is directed to conform." *Gundy*, 139 S. Ct. at 2123 (plurality) (cleaned up).

There is some debate about the historical origins and strength of the "intelligible principle" language. *See id.* at 2138–39 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting) ("[M]aybe the most likely explanation of all lies in the story of the evolving 'intelligible principle' doctrine."). But in its current form, a statutory delegation will almost always survive, no matter how significant the power and no matter how vague the language of limitation. The Court has thus "time and again" upheld "very broad delegations," including amorphous and seemingly boundless directives to regulate in the "public interest," to set "fair and equitable" prices and "just and reasonable" rates, and to issue standards necessary "to protect the public health." *Id.* at 2313, 2129 (plurality) (cleaned up).

In recent years, however, some Justices and scholars have devoted significant attention to excessive power exercised by federal regulatory agencies. In various cases implicating a range of constitutional and administrative law doctrines, the Supreme Court has curtailed agency independence from the President. *See, e.g.*, *Seila L. LLC v. CFPB*, 140 S. Ct. 2183, 2192 (2020) (invalidating for-cause removal protections for sole agency head); *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 484 (2010) (invalidating dual-layer removal protections for inferior officers); *see also SEC v. Jarkesy*, 143 S. Ct. 2688 (2023) (mem.) (granting certiorari to consider constitutionality of SEC administrative adjudications). The Court has also cabined judicial deference to agency interpretations of federal law, *Kisor v. Wilkie*, 139 S. Ct. 2400, 2408 (2019), and is poised to go further this Term by possibly overturning *Chevron* deference, *see Loper Bright Enters. v. Raimondo*, 143 S. Ct. 2429 (2023) (mem.); *Relentless, Inc. v. Dep't of Com.*, No. 22-1219, 2023 WL 6780370 (U.S. Oct. 13, 2023) (mem.). The Court has also developed a robust "major questions doctrine," which limits the power of agencies to establish policies of great "economic and political significance" without "clear congressional authorization." *E.g.*, *West Virginia v. EPA*, 142 S. Ct. 2587, 2608–09 (2022) (rejecting that a merely "plausible" or "colorable" basis for such agency action is enough in these circumstances).

The Justices leading the charge against perceived agency overreach have also signaled a strong interest in addressing the modern nondelegation doctrine, which they view as "notoriously lax," Amy Coney Barrett, *Suspension and Delegation*, 99 Cornell L. Rev. 251, 318 (2014), and premised on "an understanding of the Constitution at war with its text and history," *Gundy*, 139 S. Ct. at 2131 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting); *see also id.* at 2130–31 (Alito, J., concurring in the judgment) (expressing "support" for "reconsider[ation]" of the Court's nondelegation jurisprudence); *Paul v. United States*, 140 S. Ct. 342, 342 (2019) (Kavanaugh, J., respecting the denial of certiorari) (endorsing further consideration of Justice Gorsuch's approach in the *Gundy* dissent). It is therefore increasingly likely that the Court will soon reconsider whether the existing "intelligible principle" test is compatible with the Constitution, properly understood, or whether a more demanding framework is needed to assess delegations to administrative agencies.

Given the potential for the Supreme Court to reinvigorate the nondelegation doctrine in the near future, this analysis proceeds down two paths when evaluating the constitutionality of the statutory delegations invoked by the federal regulatory agencies to propose the Capital Adequacy Rule. The first assumes the prevailing nondelegation standard continues to apply and concludes that the Capital Adequacy Rule would likely survive a nondelegation challenge under that standard. The second explores potential outcomes under a more robust nondelegation doctrine, concluding there are strong arguments that the delegation here is impermissible because it leaves fundamental policymaking to the agencies without meaningful limitations.

I. CONGRESS'S DELEGATION OF AUTHORITY FOR THE CAPITAL ADEQUACY RULE WOULD LIKELY SURVIVE THE CURRENT "INTELLIGIBLE PRINCIPLE" TEST

As noted above, under the Court's current nondelegation approach, Congress merely must "lay[] down by legislative act an intelligible principle to which the person or body authorized to exercise the delegated authority is directed to conform." *Gundy*, 139 S. Ct. at 2123 (plurality) (cleaned up). In its most formal framing, this test has three elements: Congress must "clearly delineate[]" (1) "the general policy," (2) "the public agency which is to apply it," and (3) "the boundaries of this delegated authority." *Skinner*, 490 U.S. at 219 (cleaned up).[1] No court has addressed whether the statutes delegating authority to federal banking agencies to set "adequate" capital requirements would survive this standard, but they likely would.

For the first two requirements of *Skinner*, Congress has specified general policies and the agencies which are to apply those policies. Section 3901(a), enacted by ILSA, states that "[i]t is the policy of the Congress to assure that the economic health and stability of the United States and the other nations of the world shall not be adversely affected or threatened in the future by imprudent lending practices or inadequate supervision," and that "[t]his shall be achieved by strengthening the bank regulatory framework to encourage prudent private decisionmaking and by enhancing international coordination among bank regulatory authorities." 12 U.S.C. § 3901(a).

Section 3907(a) then provides key operative language and establishes the agencies that are to carry it out: "Each appropriate Federal banking agency shall cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions and by using such other methods as the appropriate Federal banking agency deems appropriate." *Id.* § 3907(a). The term "Federal banking agency" is further defined to include the Federal Reserve, FDIC, and OCC. *See id.* §§ 3902(1), 1813(q).

1 As noted at the end of this section, however, jurists often simplify the analysis by noting that the Supreme Court has upheld exceedingly broad delegations and therefore any statute that is at least as specific as those broad delegations must necessarily satisfy the intelligible-principle test.

To satisfy the intelligible-principle test, that just leaves the requirement that Congress clearly delineate the "boundaries" of the delegated power. *Skinner*, 490 U.S. at 219 (cleaned up). As noted, the current standard is not demanding, and the relevant statutes likely provide a sufficient delineation. Section 3907 requires the banking agencies to "seek to make the capital standards required under this section … countercyclical." *Id.* § 3907(a)(1). Section 1831o directs the agencies to impose "a leverage limit" and a "risk-based capital requirement," and—perhaps most important to surviving a nondelegation challenge under current doctrine—then indicates that the leverage limit for undercapitalized status and its attendant penalties must be "not less than 2 percent of total assets." *Id.* § 1831o(c). The statute does not set a ceiling.

Section 5365 also imposes some restrictions *within* the granted authority. For example, it says that "to prevent or mitigate 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 financial institutions," the Federal Reserve must "establish prudential standards" for the largest firms that "are more stringent than the standards and requirements applicable to [firms] that do not present similar risks to the financial stability of the United States," requiring an "increase in stringency, based on the considerations identified in subsection (b)(3)." *Id.* § 5365(a)(1). In setting standards that are "more stringent" than those that apply to smaller firms, § 5365(a)(1)(A) requires consideration of "differences among" nonbank financial companies and large bank holding companies, including a list of specific factors. *See id.* § 5365(b) (incorporating considerations in 12 U.S.C. § 5323). Again, this does not set any kind of formula, rate, or cap on how high the Federal Reserve can set capital requirements, but it does tell the Federal Reserve what considerations must be made *between* organizations.

Together, these provisions likely provide the requisite intelligible principle to satisfy the current nondelegation doctrine as applied by courts. Jurists often simply note that the Supreme Court has upheld statutes that allow agencies to regulate in the "public interest"—and so anything more specific must necessarily survive a nondelegation challenge. *See, e.g., Mistretta*, 488 U.S. at 416 (Scalia, J., dissenting) ("What legislated standard, one must wonder, can possibly be too vague to survive judicial scrutiny, when we have repeatedly upheld, in various contexts, a 'public interest' standard?"). Under current doctrine, only the most unusual and open-ended or precatory statutes stand any chance of violating the nondelegation doctrine.

As discussed next, however, if the Court were to reinvigorate the nondelegation doctrine, as a majority of current Justices appear poised to do, there are strong arguments that the statutes granting amorphous and uncapped power to set capital requirements run afoul of Article I's prohibition on transfer of legislative powers from Congress to other entities, including the federal banking agencies.

II. CONGRESS'S DELEGATION OF AUTHORITY FOR THE CAPITAL ADEQUACY RULE IS LIKELY UNCONSTITUTIONAL UNDER THE ORIGINAL UNDERSTANDING OF NONDELEGATION

As noted above, a majority of Justices on the Supreme Court have expressed interest in revisiting the "notoriously lax" nondelegation doctrine. Justice Gorsuch's dissent in *Gundy*—with which four other Justices have expressed agreement or signaled is worth considering—proposed a strengthened, originalist framework for assessing nondelegation questions. That framework would require Congress to make "all the relevant policy decisions" itself, allowing agencies only to "find facts and fill up details." 139 S. Ct. at 2139 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). Under that reinvigorated standard, the Capital Adequacy Rule likely rests on an impermissible delegation. The vague power to set "adequate" capital requirements requires federal banking agencies to make key policy judgments—including the level of economic risk the nation should tolerate and how much capital is enough to mitigate that risk—that go far beyond "find[ing] facts" or "fill[ing] up the details." *Id.*

A. Overview of the Original Understanding of Nondelegation.

The original understanding of nondelegation prohibited Congress from transferring legislative powers to any other branch. A power is "legislative" when it provides the authority to set "generally applicable rules of conduct governing future actions by private persons." *Id.* at 2133 & nn.17–18 (collecting sources). Legislative power means making choices that are "heavily laden (or ought to be) with value judgments and policy assessments," in which case only Congress can make them. *Mistretta*, 488 U.S. at 414 (Scalia, J., dissenting). Stated another way, under the Constitution, certain "important subjects … must be entirely regulated by the legislature itself," *Wayman v. Southard*, 23 U.S. 1, 43 (1825), because "there are cases in which … the significance of the delegated decision is simply too great for the decision to be called anything other than 'legislative,'" *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 487 (2001) (Thomas, J., concurring).

The absolute bar on delegating this power was a fundamental principle underlying the separation of powers on which the Constitution was premised. John Locke called the legislative power "a positive voluntary grant" by the people to the legislature, and that grant was "only to make laws, and not to make legislators," meaning a legislature "can have no power to transfer their authority of making laws, and place it in other hands." John Locke, *Two Treatises of Government* bk. II, ch. XI, § 141 (1690). The Founders also looked to Montesquieu, who warned that "[w]hen the legislative and executive powers are united in the same person, or in the same body of magistrates, there can be no liberty," as those who "enact tyrannical laws" would "execute them in a tyrannical manner." 1 *The Complete Works of M. De Montesquieu* bk. 11, ch. VI, at 199 (Thomas Nugent trans., London, T. Evans & W. Davis 1777) (1748).

Consistent with these views, James Madison explained during the ratification debates that "[i]f nothing more were required, in exercising a legislative trust, than a general conveyance of authority—without laying down any precise rules by which the authority conveyed should be carried into effect—it would follow that the whole power of legislation might be transferred by the legislature from itself, and proclamations might become substitutes for law." 4 *The Debates in the Several State Conventions on the Adoption of the Federal Constitution* 560 (Jonathan Elliot ed., 2d ed. 1836).

In *Gundy*, Justice Gorsuch set out this same originalist view of the nondelegation doctrine, describing the Court's modern nondelegation doctrine as "at war with" the Constitution's "text and history." 139 S. Ct. at 2131 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). "If Congress could pass off its legislative power to the executive branch," then the "vesting clauses, and indeed the entire structure of the Constitution, would make no sense." *Id.* at 2134–35 (cleaned up).

Although Justice Alito did not join Justice Gorsuch's *Gundy* dissent, he signaled "support" for "reconsider[ing]" existing nondelegation doctrine in an appropriate case. *Id.* at 2131 (Alito, J., concurring). Later that year, Justice Kavanaugh separately expressed his support for considering Justice Gorsuch's view. *See Paul*, 140 S. Ct. at 342 (Kavanaugh, J., respecting the denial of certiorari). Although Justice Barrett has not opined on the nondelegation doctrine in judicial opinions, her academic writing referred to the current standard as "notoriously lax," which may signal an openness to strengthening the doctrine. *See* Barrett, *supra*, at 318. There are accordingly at least five votes (if not more) for revisiting—and presumably strengthening—the Court's toothless nondelegation doctrine, and Justice Gorsuch's *Gundy* opinion presents the most likely framework the Court would adopt.

Justice Gorsuch's opinion recognized of course that the Framers and the general public during the time of ratification did not expect Congress to issue laws with pinpoint precision. Drawing on a variety of sources, he identified three methods for identifying constitutionally acceptable delegations by Congress to other branches of the federal government:

1. Congress can "make[] the policy decisions" and then merely "authorize another branch to 'fill up the details.'" *Gundy*, 139 S. Ct. at 2136 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting).

2. Once Congress "prescribes [a] rule," it can "make the application of that rule depend on executive fact-finding." *Id.* at 2136–37.

3. Congress can delegate "non-legislative responsibilities," such as foreign-affairs powers. *Id.* at 2137. This is less a rule for identifying legislative delegations and more a recognition that multiple branches may have concurrent authority in certain areas. When Congress "delegates" such power to another branch that possesses such authority, there has been no delegation of legislative power at all. *See, e.g.*, *Wayman*, 23 U.S. at 43 (recognizing that courts under Article III, and Congress under Article I, share certain powers over operation of the federal judiciary).

In sum, "Congress may leave the executive the responsibility to find facts and fill up details," but must make "all the relevant policy decisions" itself. *Gundy*, 139 S. Ct. at 2139 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). Congress cannot "merely announce vague aspirations and then assign others the responsibility of adopting legislation to realize its goals." *Id.* at 2133.

To be sure, "what qualifies as an important subject and what constitutes a detail may be debated," but "the Constitution's rule vesting federal legislative power in Congress is 'vital to the integrity and maintenance of the system of government ordained by the Constitution.'" *West Virginia*, 142 S. Ct. at 2617 (Gorsuch, J., concurring). Although framed as separate inquiries, the two questions are complementary. As Congress establishes more specifics for the executive branch to carry out, the easier it is to say Congress—and not the executive—is setting the policy to govern conduct. And as the executive has scope to set more and more of the outer boundaries of the requirements that private entities must follow, the easier it is to say that Congress has not made the requisite limiting determinations.

Under this originalist framework, it is insufficient that Congress has made *some* policy decisions. Every statute makes policy decisions in a generic sense, absent a delegation of truly absolute authority, unlimited even by subject matter (a power that even Congress itself lacks). Rather, Congress must impose a meaningful "policy of limitation" on the delegated authority *as a whole* and with respect to its constituent parts. *Panama Refining*, 293 U.S. at 418.

For example, in *Panama Refining*, the Supreme Court considered a nondelegation challenge to a law leaving it up to the President to decide whether and how to prohibit interstate transportation of certain petroleum products. *See id.* at 415 (explaining that the National Industrial Recovery Act of 1933 did "not state whether or in what circumstances or under what conditions the President is to prohibit the transportation of" petroleum). Elsewhere, the statute did feature a list of "policies," such as "eliminat[ing] unfair competitive practices," "promot[ing] the fullest possible utilization of the present productive capacity of industries," and "avoid[ing] undue restriction of production (except as may be temporarily required)." *Id.* at 417 (cleaned up). Regardless, the Court found the underlying statutory provision violated the nondelegation doctrine, because even though the law announced "policies" in the general sense, they were not sufficient "limitation[s]" on the President's discretion. *Id.* at 418. He was given a long list of desirable outcomes, and he was "free to select as he chooses from the many and various objects generally described." *Id.* at 431–32.

Perhaps even more telling is the statutory provision in *Schechter Poultry*, which constrained the President to issue poultry industry codes that "'impose no inequitable restrictions on admission'" and would not discriminate by "'promot[ing] monopolies or … eliminat[ing] or oppress[ing] small enterprises.'" 295 U.S. at 522–23. Despite these clear limitations on the President's power, the Court still found that the statute failed to impose sufficient limits on the executive branch.[2]

Similarly, in the Sex Offender Registration and Notification Act ("SORNA")—at issue in *Gundy*—Congress decided that the public should be protected from sex offenders and that an important tool to doing so was the creation of a "comprehensive national system for their registration." *Gundy*, 139 S. Ct. at 2121 (plurality) (cleaned up); *see* 34 U.S.C. § 20901 (identifying statute's "purpose"). Congress also set forth all manner of registration requirements for sex offenders convicted after the enactment of SORNA. But the statute left one important piece up to the Attorney General: "'the applicability of the requirements of this subchapter to sex offenders convicted *before* the enactment of'" SORNA, and the rules that will govern their registration. *Id.* at 2122 (emphasis added).

As the *Gundy* dissent explained, for those "pre-Act offenders," "SORNA leaves the Attorney General free to impose ... all of the statute's requirements, some of them, or none of them"—in other words, it gives the executive "unfettered discretion to decide which requirements to impose on which pre-Act offenders." *Id.* at 2143 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting); *see id.* ("[T]here isn't a single policy decision concerning pre-Act offenders on which Congress even tried to speak[.]"). This "blank check" for handling the half-million pre-Act offenders flouted the Constitution's separation of powers, even though Congress had certainly set policies in SORNA and even provided sufficient direction for all other types of offenders. *Id.* at 2144. What mattered was that *within the challenged scope of authority*—i.e., whether SORNA applied to pre-Act offenders—the executive was free to set policy.

The analysis below focuses on whether Congress's delegation to federal banking agencies to set "adequate" capital requirements qualifies as a lawful delegation of legislative authority under the original understanding of nondelegation, as explained in Justice Gorsuch's dissent in *Gundy*. The analysis focuses on his first two categories—the executive branch's authority to "fill up the details" and to engage in "fact-finding"—because the third category is likely inapplicable. *Id.* at 2136–37. Setting broad banking regulations

2 Likewise, in *Jarkesy v. SEC*, 34 F.4th 446, 459–63 (5th Cir. 2022), *cert. granted*, 143 S. Ct. 2688 (2023), the Fifth Circuit found a nondelegation violation where a statute gave the Securities and Exchange Commission ("SEC") unfettered discretion to decide whether to bring enforcement actions in district court or in administrative proceedings. Congress clearly made a policy choice: the SEC could bring enforcement actions and had only two options for where to bring them (e.g., the SEC could not bring a challenge in state court). But those policy choices still did not sufficiently limit the SEC within the realm of enforcement power authorized.

is not an inherently or historically "executive" function under Article II. *Id.* at 2136–37; *see* Heath Price Tarbert, *Are International Capital Adequacy Rules Adequate? The Basle Accord and Beyond*, 148 U. Pa. L. Rev. 1771, 1782 (2000) (noting that before 1988, "the U.S. Congress had the responsibility of devising and promulgating the nation's capital adequacy regulations"); *see also* Background Part I.A, *supra*.

B. Congress's Delegation of Authority to Set "Adequate" Capital Requirements Would Be Constitutionally Suspect Under a Reinvigorated Nondelegation Doctrine.

There is a strong argument that Congress gave the banking agencies too much leeway in making determinations that are "heavily laden (or ought to be) with value judgments and policy assessments" that only Congress can make. *Mistretta*, 488 U.S. at 414 (Scalia, J., dissenting). The relevant statutes are a classic example of Congress "merely announc[ing] vague aspirations and then assign[ing] others the responsibility of adopting legislation to realize its goals." *Gundy*, 139 S. Ct. at 2133 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting).

Starting with the subject matter: as widely recognized, there is incredible "subjectivity inherent in invested capital determinations" because they turn on "analysis of the magnitude and likelihood of the attendant risks." *Frontier State Bank Okla. City, Okla. v. FDIC*, 702 F.3d 588, 596–97 (10th Cir. 2012). "Reasonable minds will differ as to appropriate capital levels because they reasonably differ on their assessment of the attendant risks." *Id.* at 597. As former Federal Reserve Board oversight Governor for supervision and regulation Daniel K. Tarullo has stated: "Capital requirements reflect a judgment as to the optimum trade-off between making more bank resources available for investment in productive activities and the costs that will be borne by the public fisc and the economy if banks fail." *Development of New Basel Capital Accords*, *supra* (statement of Daniel K. Tarullo). "This trade-off is a policy judgment." *Id.* Higher capital requirements mean lower risks of bank failure but more expensive and more limited credit for businesses and individuals, and vice versa.

The Department of the Treasury has been clear that "[t]he question of the appropriate level for minimum capital ratios for insured depositories is essentially the question of what is the maximum level of depository system risk that society is willing to tolerate." U.S. Dep't of the Treasury, Modernizing the Financial System, *supra*, at II-17. Because calibrating capital requirements requires such societal judgments, "regulation" cannot "really determine what the right amount of capital is." Hal S. Scott, *Reducing Systemic Risk Through the Reform of Capital Regulation*, 13 J. Int'l Econ. L. 763, 773 (2010). There is no inherently correct formula or rate. Congress is thus the only appropriate body to weigh the risks and rewards of setting capital requirements at certain levels.

Determining capital requirements is therefore a prototypical legislative judgment. It sets "generally applicable rules of conduct governing future actions by private persons," *Gundy*, 139 S. Ct. at 2133 & nn.17–18 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting), affecting the entire country. It also requires weighing subjective considerations against each other. Such "basic policy decisions governing society are to be made by the Legislature." *Mistretta*, 488 U.S. at 415 (Scalia, J., dissenting). Or, put another way, this is hardly akin to authorizing an agency merely "to design tax stamps for margarine packages," *Gundy*, 139 S. Ct. at 2136 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting) (citing *In re Kollock*, 165 U.S. 526, 532 (1897)), or to "prescribe the forms of all accounts, records, and memoranda to be kept by the common carriers," *ICC v. Goodrich Transit Co.*, 224 U.S. 194, 210 (1912). Indeed, it is far afield even from early capital requirements in the National Bank Act of 1864, where *Congress* required nationally chartered banks to hold $100,000 in capital (and twice that in certain large cities)—while authorizing the Secretary of the Treasury to approve, on an individualized basis, $50,000 capital holdings for banks in certain smaller towns. *See* Act of June 3, 1864, ch. 106, § 7, 13 Stat. at 101.

Turning to the text of the relevant statutes, Congress failed to lay down with sufficient specificity its own policies and limitations to ensure that banking agencies merely carry out the rules set by Congress, rather than establishing their own rules and then demanding compliance. Section 3907 states that the banking agencies must require banking institutions to "achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions." 12 U.S.C. § 3907(a)(1). All the work is done by the word "adequate," but Congress did not define that term, nor is it pegged to any particular formula, rate, or cap. Indeed, what constitutes "adequate" capital is the very policy determination that Congress needed to make.

In addition, this requirement—at most—sets only an ill-defined floor or minimum level of capital, but no ceiling. *See Adequate*, Merriam-Webster, https://www.merriam-webster.com/dictionary/adequate (last visited Dec. 8, 2023) (defining adequate as "sufficient for a specific need or requirement"); *see also Sufficient*, Merriam-Webster, https://www.merriam-webster.com/dictionary/sufficient (last visited Dec. 8, 2023) (defining sufficient as "enough to meet the needs of a situation or a proposed end"). And, again, that floor itself is ultimately a subjective policy decision.

The Capital Adequacy Rule, with its high capital requirements, demonstrates just how meaningful the floor versus ceiling distinction is when it comes to laying down the required "policy of limitation." *Panama Refining*, 293 U.S. at 418. Congress made no policy determination as to how high the federal banking agencies can set capital requirements. That leaves those agencies with a free hand to make their own value judgments, weighing whatever factors they deem appropriate (a factor addressed below) and then *raise* those requirements. Statutory references to a floor of 2% capital as a definition of "critically undercapitalized" in § 1831o(c)(3) similarly fail to impose the required upper limit on the banking agencies.[3]

Congress also made no policy determination as to how capital and bank assets should be risk weighted. Risk-based capital requirements both define and measure capital based on a bank's risk exposure. They require banks to hold a portion of their capital in safer assets against financially riskier assets. But determining the degrees to which bank assets face risks or are considered safe—what regulators refer to as "risk weights"—is fraught with implicit and explicit value judgments. "Such determinations have not been limited to 'productivity' in a narrow sense: that is, how much investments contribute to aggregate growth in economic output. They have also reflected considerations of the *social and political value* of different kinds of bank lending activity." Joel Michaels, *Capital Regulation as Climate Policy*, 59 Idaho L. Rev. 127, 154 (2023) (emphasis added). In other words, they reflect policy decisions even separate from financial stability.

Regulators have in the past, for example, "deviated from actuarial science to apply lower risk-weights to loans that banks are encouraged to make under the Community Reinvestment Act." *Id.* at 158–60. In their 2013 Basel III rulemaking, the Federal Reserve and OCC originally proposed a 150% risk weight to "high-volatility commercial real estate." *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule; Final Rule*, 78 Fed. Reg. 62,018, 62,089 (Oct. 11, 2013). Various industry and public-interest stakeholders opposed the proposed risk-weighting because it would, as the Community Development Bankers Association told the OCC in a comment, "create new systemic barriers to access to credit within distressed communities and among low income consumers." Cmty. Dev. Bankers Ass'n, CDBA Comment Letter, Basel III Standardized Approach 3–4, 15 (2012). In the final rule, the agencies exempted Community Reinvestment Act-eligible investments from the proposed risk weight. 78 Fed. Reg. at 62,165.

Because Congress omitted meaningful definitions in this realm, evolving concepts of "risk" could lead regulators in the future to incorporate social, political, reputational, or other considerations, as it has in the past. *See, e.g.*, Gregg Gelzinis, *Addressing Climate-Related Financial Risk Through Bank Capital Requirements*, Ctr. for Am. Progress (May 11, 2021), https://tinyurl.com/yvn3r5re (noting the possibility of "[i]ntegrat[ing] additional transition risks and physical risks into capital risk weights").

Combined, federal banking agencies' unconstrained power to both set capital requirements with no upper bound and determine how capital is risk-weighted would allow them to centrally plan bank lending through the back door. The lack of statutory guidance enables both the "appearance [and] reality of regulatory credit allocation among private sector borrowers" that regulators have in the past carefully disclaimed. *Capital; Risk-Based Capital Guidelines*, 54 Fed. Reg. 4186, 4192–93 (Jan. 27, 1989).

The agencies' authority under § 3907 is further unconstrained because the statute contains a type of "multi-layer" delegation, where Congress gave broad and vague authority to the agencies to set "adequate" capital levels, and then expressly allowed the agencies to "us[e] such other methods as [they] deem[] appropriate" when making

3 Thus, even setting aside that it did not apply the original nondelegation doctrine, the Supreme Court's decision in *Whitman* rejecting a challenge to the EPA's authority to set certain emissions levels is inapposite because the Court interpreted that statute as setting both a floor *and* a ceiling on the levels the EPA could impose. *See* 531 U.S. at 473. None of the statutes relevant to setting adequate capital levels imposes any kind of ceiling.

that determination. 12 U.S.C. § 3907(a)(1). This means the agencies not only get to decide what "adequate" means, but they also get to decide what factors to consider when making that determination.

The statute in *Schechter Poultry* featured a similarly problematic provision. That statute first granted a broad power to the President to adopt codes of conduct that governed private activity, then allowed the President to "add[] to … what is proposed, as 'in his discretion' he thinks necessary 'to effectuate the policy' declared by the act." 295 U.S. at 538–39. The Court repeatedly noted this unusual aspect in its analysis concluding that the statute failed to impose meaningful limits, even though the additional discretion still had to effectuate the statutory policy. And the Court has found similar multi-layered schemes to be unconstitutional in other contexts, even where one layer may have been allowed. *See Free Enter. Fund*, 561 U.S. at 495 ("The added layer … makes a difference.").

This multi-layer delegation may itself violate the original understanding of the nondelegation doctrine. The only limitation on federal banking agencies is their own self-restraint in considering—or not—whatever they "deem[] appropriate" when setting the adequacy requirements. 12 U.S.C. § 3907(a)(1). But the Supreme Court has held that "an agency's voluntary self-denial has no bearing upon" "[w]hether the statute delegates legislative power." *Whitman*, 531 U.S. at 473. In other words, when evaluating whether a statute violates the nondelegation doctrine, a court must look only at the statute, not any agency regulations or interpretations of that statute, nor can a court assume the agency will limit itself. If the agency has statutory authority to consider whatever it wants, courts must assume the agency will do so.

A subsequent subsection of § 3907 demonstrates the free hand that Congress gave to the federal banking agencies in a related context. Under § 3907(a)(2), the agencies can set capital levels for *specific* banks, and several circuit courts have held that those agency determinations are judicially unreviewable, absent a constitutional challenge. *See Frontier State Bank*, 702 F.3d at 596 (citing *Bank of Coushatta*, 930 F.2d at 1126). "Congress intended to insulate the 'independent discretion' of bank regulators from judicial review." *Id.* (cleaned up).[4] The subsection authorizing the agencies to set specific banks' capital levels (§ 3907(a)(2)) is not the same subsection the agencies invoke to set market-wide capital requirements (§ 3907(a)(1)), and there are good reasons to distinguish the two in terms of whether Congress intended to bar judicial review even of non-constitutional challenges. But the nonreviewability of § 3907(a)(2) decisions nonetheless demonstrates that the agencies do not face meaningful restrictions in the context of bank-specific capital-level determinations, either.

Nor can history and tradition save the capital-adequacy regime. Before 1988, "the U.S. Congress had the responsibility of devising and promulgating the nation's capital adequacy regulations." Tarbert, *supra*, at 1782. Thus, the relevant statutes cannot be seen as codifying some longstanding tradition or understanding. Congress in the 1980s broke from tradition by handing over to banking agencies the authority to set capital-adequacy requirements. *See* Background Part I.C, *supra*.

Comparing this regime to one discussed in the *Gundy* dissent is instructive. Justice Gorsuch said that the statute addressed in *J. W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394 (1928), would likely pass an originalist nondelegation test, although he was unwilling to say it definitely would do so, *see Gundy*, 139 S. Ct. at 2139 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). That statute authorized the executive to calculate and collect customs duties where Congress had laid out a formula for objectively calculating such revenues based on the difference in cost between foreign production and domestic production, and Congress then barred the executive from varying the duty by more than 50% from statutory figures. *See J. W. Hampton*, 276 U.S. at 401. Congress itself set the formula and imposed a cap, leaving the executive to perform fact-finding in specific circumstances, which to be sure would sometimes be rather "intricate." *Gundy*, 139 S. Ct. at 2139 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). But Justice Gorsuch concluded that Congress had arguably "made all the relevant policy decisions" in *J. W. Hampton*, leaving "the executive the responsibility to find facts and fill up details." *Id.*

If the statute in *J. W. Hampton* was a close call under an originalist nondelegation doctrine, the modern capital-adequacy regime clearly crosses the line. Unlike the customs statute in *J. W. Hampton*, here Congress provided no formula (quantified using numbers or descriptors of certain values) for how to determine capital adequacy—nor did it

4 A court could still consider a *constitutional* challenge to an adequacy requirement, which ensures a proper party could raise a nondelegation challenge. *See Bank of Coushatta*, 930 F.2d at 1130; *see also Webster v. Doe*, 486 U.S. 592, 603 (1988).

define how to risk-weight capital, nor did it impose any cap on how high the limit could be set.[5] And then Congress left the agencies to determine which factors they wanted to use in determining how much capital is "adequate." Runaway rates were impossible under *J. W. Hampton*. But they are fully authorized—and perhaps inevitable—under the capital-adequacy statutes.

Even looking beyond § 3907 to other statutes that have more limited scope, Congress still failed to impose the sort of minimum requirements necessary to satisfy a reinvigorated nondelegation doctrine. For example, Congress identified some "[c]onsiderations" for the Federal Reserve when exercising its capital-requirement authority, but those apply only to the largest financial institutions. *See* 12 U.S.C. § 5365(b)(3). Even then, the statute hardly constrains the Federal Reserve's decision-making. It says things like the Federal Reserve must consider the "nonfinancial activities and affiliations of the company," whatever that means. *Id.* § 5365(b)(3)(A)(iii). Even worse, just like § 3907, § 5365 contains a multi-layer delegation where Congress expressly allowed the Federal Reserve to come up with its own list of "any ... risk-related factors that [it] determines appropriate" when setting enhanced prudential standards. *See id.* § 5365(b)(3)(A)(iv).

Similarly, Congress has vaguely required "more stringent" standards for firms with $250 billion or more in total assets. 12 U.S.C. § 5365(a)(1). But saying that already-vague standards should be "more stringent" for certain firms still says nothing about what those original standards should be, nor what the "more stringent" version should be. And even for those large firms subject to "more stringent" rules, the Federal Reserve has essentially "unfettered discretion to decide which requirements to impose" and how to impose them. *Gundy*, 139 S. Ct. at 2143 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). At most, this limitation is analogous to the requirement in *Schechter Poultry* that any codes adopted by the President not discriminate against certain forms of enterprises. 295 U.S. at 522–23. That quasi-limitation on how the executive could treat entities *within* the scope of its power said little-to-nothing about how broad that scope of power was in the first place. In short, such a provision didn't save the statute in *Schechter Poultry*, and it likely would not do so here, either.

To be sure, the capital-adequacy statutes are not a perfect fit for the regimes in *Schechter Poultry* and *Panama Refining*. In *Schechter Poultry*, for example, the President was empowered to enact entire "codes of fair competition" for slaughterhouses and other industries, against the backdrop of a lengthy "Declaration of Policy" providing more than a dozen sometimes-competing goals, many of which stated in grandiose language and having nationwide effect. 295 U.S. at 535–36 (cleaned up). And this, the Court explained, delegated "unfettered discretion to make whatever [the President] thinks may be needed or advisable for the rehabilitation and expansion of trade or industry." *Id.* at 537–38. Here, on the other hand, Congress has arguably delegated in a narrower manner. It has not simply tasked the federal banking agencies with setting a "code of financial stability," it has specifically *required* risk-based capital rules as a specific means to that end and left the agency to determine what levels of capital are up to the task of ensuring such stability. But the agencies' power to determine just how much capital is "adequate" nonetheless remains unbounded, and it allows the agencies to incorporate even social and political considerations into that determination. The ultimate viability of a nondelegation challenge to the capital-adequacy regime will thus likely turn on just how strongly the Court reinvigorates the doctrine, if at all.

Finally, the banking agencies may argue that their rulemaking authority to set adequate capital requirements is justified as "executive fact-finding." *Gundy*, 139 S. Ct. at 2136–37 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). The fact-finding must be pursuant to a "rule" that Congress itself has set down with sufficient particularity, such that "application" of the rule then turns simply "on executive fact-finding." *Id.* Congress appears to have engaged in this sort of allowable delegation when it required insured depository institutions to maintain at least 2% capital levels, or else face penalties. 12 U.S.C. § 1831o(c)(3). Congress itself laid down a specific rule (institutions must maintain a particular figure of capital levels), and then made application of that rule dependent on executive fact-finding (the banking agencies determine whether a particular institution has fallen below 2%).

But the separate authority to issue rules imposing "adequate" capital levels above 2% likely would not fall within that same allowable form of delegation. As explained above, Congress has provided no meaningful limits, formulas, or

5 In this sense, the National Bank Act of 1864 provides a useful comparator. There, *Congress* set certain capital requirements for nationally chartered banks and then allowed the Secretary of the Treasury to *reduce* those requirements upon finding certain facts. This 19th-century arrangement thus looks much more like the statute the Court approved in *J.W. Hampton* than today's capital-adequacy regime.

restrictions. In other words, the "rule" of how high to set capital requirements is made by the agencies themselves, not by Congress.

* * *

Despite all of the broad statements of purpose and various considerations, Congress has decided *only* the following: (1) there should be capital requirements that are "adequate" to maintain the stability of U.S. and global financial systems, and guard against the risks posed to those systems by large bank failures; (2) those requirements should, in some sense, be "risk-based," have a "leverage" component, and, for insured depository institutions, must not fall below 2% of total assets; and (3) those requirements should be "more stringent" for larger firms with certain characteristics. But Congress has *not* decided the fundamental policy questions of what level of risk should be tolerated, what qualifies as capital, to what degree bank assets are risky, and—most importantly—how much capital is "adequate" to mitigate against that level of risk, as framed in any kind of limiting, objective, or defined language. There is no formula, no cap, no ratio, no historical doctrine incorporated by reference—nothing to *limit* the banking agencies' power to set the upper boundary of capital-reserve requirements. Federal banking agencies not only have authority to make the heavily policy-laden determination of what suffices as "adequate" capital requirements, but they are expressly authorized to consider whatever factors they deem appropriate when making that determination, without statutory definitions, formulas, or limits to serve as upper-bound constraints.

Conclusion

Although the statutory regime authorizing the Capital Adequacy Rule likely survives under the current nondelegation doctrine, it would be constitutionally suspect under an original understanding of nondelegation, as Congress has handed significant policymaking power to federal banking regulators without meaningful limitations.

Of course, the likely success of such a challenge turns on just how much the Court is willing to reinvigorate the nondelegation doctrine, which is unknowable at this time. But at least five Justices have signaled an interest in revisiting the issue, and the Court has not shied away from accepting cases challenging once-entrenched doctrines of administrative law and agency power. *See, e.g.*, *Relentless*, 2023 WL 6780370, at *1 (mem.) (granting certiorari to consider overruling *Chevron* deference); *Loper*, 143 S. Ct. at 2429 (mem.) (same); *Jarkesy*, 143 S. Ct. at 2688 (mem.) (granting certiorari to consider constitutionality of SEC administrative adjudications); *see also West Virginia*, 142 S. Ct. at 2607–09 (announcing robust major-questions doctrine); *Kisor*, 139 S. Ct. at 2418–23 (2019) (limiting deference to agency interpretations of their own rules under *Auer*). Indeed, there were at least four votes to grant review in *Gundy* itself, even though the underlying nondelegation challenge had been rejected by all twelve regional circuit courts.

ABOUT THE AUTHORS

The Honorable Robert Henneke is the executive director and general counsel at the Texas Public Policy Foundation.

Before joining the Foundation, Robert served as the twice-elected Kerr County Attorney where he brought conservative values to county government. Robert began his legal career serving as an Assistant Attorney General in the General Litigation division under the leadership of Texas Attorney General Greg Abbott. Robert has appeared on national news shows, such as Fox News, Fox Business, MSNBC, and others. His commentaries have been published in *USA Today*, the *Wall Street Journal*, *The Washington Post*, *Fox News*, *Forbes*, *The Washington Examiner*, *The Hill*, and other national publications.

He is a member of the State Bar of Texas and is admitted to practice before the Supreme Court of the United States, the Court of Appeals for the District of Columbia Circuit, the Fifth Circuit Court of Appeals, the Sixth Circuit Court of Appeals, the Seventh Circuit Court of Appeals, the Ninth Circuit Court of Appeals, and the Federal District Courts in the Eastern, Western, Northern and Southern Districts of Texas, and the Eastern District of Michigan.

Robert received his law degree from the University of Texas School of Law. He earned his undergraduate degree in English Literature from Georgetown University. Robert graduated from Tivy High School in Kerrville, Texas. He lives in Austin with his wife Lesley and their two sons and is an Eagle Scout. Robert was a 2019 Texas Lawyer Attorney of the Year Finalist.

Trent McCotter is a partner with Boyden Gray PLLC. He previously served as Deputy Associate Attorney General of the United States and as an Assistant U.S. Attorney in the Eastern District of Virginia. He has authored and submitted over 50 briefs at the Supreme Court and has personally argued more than fifteen federal appeals, including several en banc cases. His practice focuses on administrative and constitutional law. He is also the Director of the Separation of Powers Clinic at the Scalia Law School at George Mason University.

Texas Public Policy Foundation

901 Congress Avenue | Austin, Texas 78701 | (512) 472-2700 | www.TexasPolicy.com