Banking and Finance

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Access to safe and reliable financial services is fundamental to Americans' prosperity. However, since the passage of the Sarbanes-Oxley Act in 2002, regulators have used their expanded authority to impose burdensome rules that interfere in Americans' financial decisions and hinder access to financial services for consumers and businesses.

Furthermore, the subsequent increased politicization of financial services as a public policy tool has eroded public confidence in financial institutions and their regulators and led to the growth of alternative forms of financial services and instruments—most notably cryptocurrency—which are now attracting politicians' and regulators' attention.

Instead of giving financial regulators even more authority, Congress should work to depoliticize financial services, reduce political interference in private capital formation, and tell regulators to keep their hands off cryptocurrency. The policies outlined below will help start that process.

SAFE Banking Act

The legal marijuana industry currently stands at $13.8 billion and is projected to grow at a compounded annual rate of 23.9 percent—reaching $66.3 billion by 2025. However, only 30 percent of marijuana-related businesses can use a bank or similar depository institution, leaving most such businesses to conduct transactions in cash.

Congress should:

- Allow banks and credit unions to serve legal marijuana businesses by passing the Secure and Fair Enforcement (SAFE) Banking Act (H.R. 1996, S. 910, 117th Congress) to provide safe-harbor protections for financial services firms serving legal marijuana businesses and provide the same protections to ancillary businesses.
- Phase out the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac and do not replace them.
- Until Fannie and Freddie are phased out, end the Third Amendment profit sweep that puts taxpayers at risk and violates shareholders' rights, ensure that Fannie and Freddie maintain adequate capital, and compensate private-sector shareholders for earnings seized under the Third Amendment "sweep" of the GSEs' profits.
- Prevent the Federal Reserve from issuing a central bank digital currency (CBDC) by passing a version of H.R. 6415 from the 117th Congress to prevent the Fed from issuing digital currency to individuals.

This situation raises public safety concerns because those businesses become prime targets for robbery. In fact, the Wharton School of Business Public Policy Initiative has found that one in every two marijuana dispensaries has been robbed.

Much of that crime is due to the incongruity between state and federal law over the legality of marijuana, which has forced many banks to forego offering any services to marijuana-related businesses for fear of federal penalties.

Although a majority of states have legalized marijuana to varying extents, the federal government still classifies marijuana as a Schedule I drug—the same as heroin. As a result, banks and credit unions can run afoul of criminal statutes, such as aiding, abetting, or acting as an accessory to crime, if they offer services to legal marijuana businesses. Given the often risk-averse nature of banks, many are hesitant to serve those businesses to avoid possible federal persecution. Legislation such as the SAFE Banking Act would remedy this public safety issue, respect states' sovereignty, and protect the ability of banks and private businesses to engage in free exchange with one another. It passed the House in the 116th and 117th Congress with strong bipartisan support.

Fannie Mae and Freddie Mac

The government-sponsored housing enterprises Fannie Mae and Freddie Mac are arguably the most systemically important financial entities, given their role in fomenting the financial crisis. However, they have been allowed, until recently, to operate with virtually no capital buffer. The government's conservatorship of Fannie and Freddie—which began in 2008 when it bailed out the GSEs in exchange for a 79.9 percent ownership stake in each of them—has increased the hazard they pose to taxpayers.

Fannie and Freddie should be phased out and not replaced. There should be no GSE for mortgages any more than there should be for other types of credit, such as car loans. This phaseout can be done through the method laid out in the Protecting American Taxpayers and Homeowners (PATH) Act (H.R. 2767, 113th Congress), which passed the House Financial Services Committee in 2013. Under the PATH Act, the GSEs sell off parts of their portfolios every year until they are completely liquidated. It can also be done by breaking up the GSEs and ending their line of credit with the U.S. Treasury.

Any plan must also uphold the rule of law by granting shareholders fair compensation for the value of their shares. Under the Third Amendment, implemented by the Obama administration in 2012, the government confiscated any profit the GSEs made—even after they had paid the government back. That left the GSEs with no capital reserves, which made them vulnerable to even the slightest hiccup in the economy.

The Third Amendment "sweep" was an unjust taking from Fannie's and Freddie's private shareholders and is currently being challenged in several lawsuits as unconstitutional. It was halted temporarily by the Treasury Department and the GSEs' regulator, the Federal Housing Finance Agency (FHFA), in 2019 to allow the GSEs to build capital and then effectively ended permanently in January 2021 when the Third Amendment was replaced by new amendments agreed to by the FHFA and the Treasury Department. However, the threat of it being brought back looms as long as Fannie and Freddie remain in conservatorship because federal officials will always be tempted to use the GSEs as an ATM for new spending.

Both shareholders and taxpayers suffered from the Third Amendment's raid of all the GSEs' profits for the U.S. Treasury. Shareholders saw their assets taken without government compensation, and the taking of that capital left the GSEs less financially stable and more prone to a potential bailout. The Housing Finance Restructuring Act of 2016 (H.R. 4913, 114th Congress) would have required any profits made by the GSEs to be used for rebuilding capital levels to help prevent future taxpayer bailouts.

In November 2020, the FHFA director finalized a regulatory capital framework to (a) require Fannie and Freddie to have specified levels of capital and (b) prevent government takeovers of that capital that would bring the GSEs below the prescribed level. Congress should codify that rule into law.

In addition, the GSEs' shareholders have never been compensated, although the Supreme Court left a narrow pathway open for them to recover damages in the 2021 case *Collins v. Mnuchin*. As a result, shareholder litigation is ongoing. As long as this arbitrary confiscation is allowed to stand or be brought back, a large amount of private capital will be scared off from the mortgage market, leaving government-backed mortgages as the only alternative for prospective home buyers.

Central Bank Digital Currency

In an effort to coopt the cryptocurrency revolution, governments across the world are implementing or contemplating a CBDC. President Biden's March 2022 Executive Order, "Ensuring Responsible Development of Digital Assets," calls for the "highest urgency on research and development efforts into the potential design and deployment options of a United States CBDC." Yet it pays scant attention to numerous downsides of government-run cryptocurrency, such as massive risks to privacy and financial stability.

If the Federal Reserve, rather than the private sector, were to issue its own cryptocurrency, the U.S. government would have direct access to the digital ledger that records financial transactions for individuals using that currency. Know Your Customer rules governing banking will empower the federal government to track and identify nearly every CBDC transaction. Even with safeguards, the information on individual purchase and investment decisions that the Fed would store would be vulnerable to hacking and abuse. Recent hacking incidents at the Internal Revenue Service and the Office of Personnel Management and selective illegal leaks of tax returns demonstrate the abuses that could occur if the government were to directly hold more data on millions of consumer financial transactions.

Furthermore, a CBDC could threaten the availability of business and consumer credit by causing a reduction of deposits at private banks as individuals transfer their savings directly to the Fed. Shrinking deposits at private banks would leave them with much less money with which to fund loans. The Fed would become a direct, politically pressured, unfairly advantaged competitor to private banks that could crowd out private-sector innovation in development of new cryptocurrencies and the emerging financial technology known as FinTech.

CBDCs are a solution in search of a problem because private-sector cryptocurrency products such as stablecoins are already advancing financial inclusion. For this reason, Congress should not introduce unneeded risk with direct government involvement.

Experts: John Berlau, Iain Murray

For Further Reading

John Berlau and Joshua Rutzick, "The 20-Year Experiment Holding America Back," *Wall Street Journal*, July 20, 2022, https://www.wsj.com/articles/the-20-year-experiment-holding-the-u-s-back-sarbanes-oxley-corporate-reform-bush-entrepreneurs-investors-fraud-business-11659044813.

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