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A legal update from Dechert's Financial Institutions Group

U.S. Consumer Financial Protection Bureau Rulemaking: A New Frontier for Cost-Benefit Analysis

The Consumer Financial Protection Bureau (CFPB) recently announced that it plans to propose a series of rules regarding mortgage servicing during the summer of 2012 with the intention of finalizing them by January 2013. This announcement spotlights the special issues that the CFPB will face when it seeks to issue rules. It also points out the importance of public participation in the CFPB rulemaking process, as well as the potential for challenges to CFPB rules.

The Practical Takeaways of Cost-Benefit Requirements

As described more fully below, to the extent cost-benefit requirements apply:

- They provide a significant basis for commenters to impact a rulemaking process;
- They may subject the agency's empirical analysis to scrutiny; and
- They may provide a basis to invalidate a proposed rule.

CFPB Rulemaking Rules of the Road

The CFPB, unlike the federal banking agencies (the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the Prudential Regulators)), is subject to a statutory cost-benefit analysis requirement. A series of recent successful challenges to rulemakings by the Securities and Exchange Commission (SEC) have been based on findings that the SEC did not satisfy its statutory cost-benefit analysis requirements. These cases have highlighted the challenges that agencies face when their rulemakings are required to satisfy rigorous cost-benefit analysis principles.

The CFPB is also required to consult with federal regulators throughout its rulemaking process. If a federal regulator provides a written objection to all or part of a CFPB proposed rule, the CFPB is required to describe the objection and the basis for the CFPB's decision in regard to the objection. Furthermore, an agency that is a voting member of the Financial Stability Oversight Council (FSOC) and that has been unable to resolve certain concerns about the impact of a CFPB final rule may petition the FSOC to set aside the CFPB's rule. The approval of two-thirds of all voting FSOC members is required to achieve that result.

Cost-Benefit Analysis Requirements

The Dodd-Frank Act (DFA) mandates that the CFPB, in issuing a rule, consider "the potential benefits and costs to consumers and covered

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persons,[1] including the potential reduction of access by consumers to consumer financial products or services resulting from such rule." The DFA also requires the CFPB to consider the impact of a proposed rule on covered persons and the impact on consumers in rural areas.[2]

These statutory requirements should cause the CFPB to conduct and publish a detailed examination of the costs and benefits of its proposed regulatory approach, which may include an empirical analysis, and an explanation of why it did not take alternative regulatory approaches. Commenters should carefully review cost-benefit analyses and comment on any deficiencies therein to establish a record on the point for a possible judicial challenge.

Unlike the CFPB, the Prudential Regulators are not generally subject to statutory cost-benefit analysis requirements. In July 2011, however, the Obama Administration requested these agencies to comply with Executive Orders that call on federal departments to include cost-benefit analysis in the rulemaking proceedings. Unlike statutory requirements, Executive Orders raise different issues with regard to the creation of a third-party right of action that may be enforceable in court. It is notable that in October 2011 the Prudential Regulators included an extensive cost-benefit discussion in their proposed rule to implement the Volcker Rule.[3]

In contrast, the SEC has had a series of rulemakings successfully challenged based on alleged failures to comply with statutory cost-benefit analysis requirements. Most recently, in July 2011, the U.S. Court of Appeals for the District of Columbia Circuit (D.C. Circuit), in *Business Roundtable v. S.E.C.,* invalidated the SEC's proxy access rule, finding that the SEC had acted arbitrarily and capriciously by failing to adequately assess the economic effects of the rule.[4] (Dechert participated in this case by filing an *amicus curiae* brief.) In two prior decisions, the D.C. Circuit in 2005 and 2010 invalidated SEC rules due to inadequate cost-benefit analysis.[5]

The Commodity Futures Trading Commission (CFTC) is also subject to statutory cost-benefit analysis requirements in connection with its rulemaking activities. Two separate challenges to CFTC rules based on cost-benefit analysis claims were filed in December 2011 and April 2012.

Conclusion

There is increasing recognition that rulemaking activity involves a series of choices that can significantly affect the enforceability of rules and their impact on the parties to which they directly apply, as well as on the broader public and economy. A recent issue of *The Economist* magazine focused on the challenges posed by the numerous new regulatory initiatives set in motion by the DFA and the beneficial role that cost-benefit analysis could play in DFA-related rulemakings.[6] The Administration and Congress are showing increas-

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1 A covered person is any party that engages in offering or providing a consumer financial product or service and an affiliate of such party that acts as a service provider to it.

2 The CFPB is specifically required to include in its initial regulatory flexibility analysis for a rule a description of any projected increase in the cost of credit for small entities, and any significant alternatives to the proposed rules which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities. The CFPB has indicated that small entities are considered to be banks and other depository institutions with $175 million or less in assets and other financial businesses whose average annual receipts do not exceed $7 million.

In accordance with the Small Business Enforcement Fairness Act of 1996 as amended by the DFA, the CFPB on April 9, 2012, announced a Small Business Review Panel for Mortgage Servicing Rulemaking. In that regard, the CFPB issued an outline of proposals under consideration and alternatives considered. The outline states that the CFPB recognizes that a one-size-fits-all approach may not be optimal in regard to mortgage servicing requirements and requests input on the extent to which it may be appropriate to consider adjusting servicing standards for small servicers. The outline contains a discussion of the benefits and costs to small servicers of the various components of the anticipated rulemakings.

3 76 Fed. Reg. 68846, 68924-68936 (Nov. 7, 2011).

4 647 F.3d 1144 (D.C. Cir. 2011).

5 *Chamber of Commerce of the U.S. v. S.E.C.*, 412 F.3d 133 (D.C. Cir. 2005); *American Equity Investment Life Insurance Co., v. S.E.C.*, 613 F.3d 166 (D.C. Cir 2010).

6 "Over-Regulated America," *The Economist* (Feb. 18, 2012).

ing interest in encouraging federal regulators to incorporate rigorous cost-benefit analysis in their rulemaking proceedings.[7]

The CFPB's rulemaking activities will have a significant impact on consumers and financial services firms. As there is increasing recognition that additional regulation has the potential to result in higher costs to consumers and reduced availability of financial products and services, it seems likely that the cost-benefit analysis requirements for CFPB rulemakings will be a focus of close attention by regulators, financial services firms and consumer groups. Moreover, we also expect that the issue of whether the agency has conducted an adequate analysis of regulatory costs and benefits can be important even in cases where an agency may not be subject to an express statutory cost-benefit provision.

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[7] Executive Order 13563, Improving Regulation and Regulatory Review, 76 Fed. Reg. 3821 (Jan. 21, 2011); GAO Report to Congressional Addressees, "Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination" (Nov. 2011).

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