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Here Comes The Rule-Making Revolution

Law360, New York (March 9, 2017, 11:36 AM EST) --The business of agency rule-making — a significant source of the regulatory burden that financial institutions bear — is about to undergo a significant makeover given the convergence of parallel efforts by the executive and legislative branches of the government. This new rule-making culture should slow the trend that seems to default to lengthy, complicated regulations as a proxy for safe and sound operation. The 70-year old Administrative Procedure Act could surely use some modernization to better reflect the current business and economic environment.

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The election of President Donald Trump is one starting point. He has signed several executive orders requiring, among other things, that agencies establish formal processes to review regulations currently on the books, evaluate the effectiveness of Dodd-Frank regulations, and identify at least two existing regulations to be repealed for every new rule that is proposed. The stated goal of ensuring that the cost of any new regulation be offset by the elimination of two rules, subject to certain exceptions, sets a clear standard for regulatory agencies. A lawsuit filed on Feb. 9, 2017, to invalidate this two-for-one executive order will have to overcome a range of procedural defenses that are likely to be asserted and would not normally apply in a challenge filed against an agency that actually took a formal action to rescind or roll back an existing rule. But even if it does, the message that the executive order communicates to all agency heads — even independent regulatory agencies that are not directly subject to executive orders — is clear.

A second significant factor are the legislative efforts to reform the rule-making process. Congress and the president have already relied on the 1996 Congressional Review Act three times to repeal agency regulations, and the House has voted to repeal others. Under the CRA, a simple majority of Congress may disapprove an agency rule within 60 legislative days. Until now, the Congress has rarely exercised this oversight. This also sends a clear message to agencies that might otherwise have thought that they were on their own when it came to the promulgation of rules once an enabling statute had been enacted.

There are also other significant developments on the legislative horizon. The Regulatory Accountability Act passed by the House of Representatives on Jan. 11, 2017, would modernize provisions of the 1946 APA, as would certain provisions included in the soon-to-be-introduced Financial Choice Act by House Financial Services Committee Chairman Jeb Hensarling, R-Texas. Most significant would be the overturning of the Chevron doctrine created in 1984. Under that doctrine, the U.S. Supreme Court determined that when Congress had not directly addressed an issue, and the statute was ambiguous, an agency's reasonable interpretation of the statute should be entitled to judicial deference.

Agencies rely on the doctrine often, and parties challenging regulations bemoan the latitude that it provides agencies to fashion rules that may not be expressly enabled by a statute. The elimination of such agency deference would significantly strengthen the position of a party challenging an agency rule in court, and thus, likely have an impact on the nature and promulgation of rules in the future.

The RAA would also require that proposed rules include a reasoned determination that the benefits of the rule justify its costs. Among the financial services agencies, the U.S Securities and Exchange Commission, the U.S. Commodity Futures Trading Commission and the Consumer Financial Protection Bureau have had statutory cost-benefit analysis requirements, but Congress has not previously imposed such general requirements on independent agencies such as the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corp. and the Federal Reserve Board. This issue is one, however, that has been gathering steam over the last several years as challenges to agency actions argue that unless the agency understands the cost and the benefits of its action, it cannot defend the reasonability of the action and show that it is not arbitrary and capricious. The RAA would also create a category of rules called "high-impact rules" — any rule that imposes an annual cost of $1 billion or more on the economy. In those cases, the agency would be required to hold a public hearing to evaluate alternatives and costs. This will also make agency rule-making more complex and provide additional grounds to challenge agency rules.

Similarly, on March 2, the House of Representatives passed the Office of Information and Regulatory Affairs Insight, Reform, and Accountability Act, which would codify as law and expand the extensive rule-making principles and constraints contained in Executive Order 12866 issued by President Bill Clinton in 1993, by imposing the executive order's requirements on independent regulatory agencies, which have not been subject to the executive order.

While the goal of these changes is to reign in the blizzard of rule-making that has unnecessarily burdened American businesses, the promulgation of less rules by federal agencies may not automatically lead to the solution that people are hoping for. Those who have been around financial regulation through various business and political cycles know that federal agencies can sometimes revert to the path of least resistance to reach the same bottom line. For example, when it is difficult to promulgate or defend rules, agencies can use their broad discretion to act without rules through the influence of bank examinations, the adoption of safety and soundness directives, or the establishment of operating best practices through agency bulletins and other memoranda. These pronouncements may issue with no formal process or public commentary, leaving an aggrieved institution fighting a less defined and often harder target to challenge from a legal perspective.

Finally, two recent court decisions could have a significant impact on rule-making and regulatory decision-making. First, in upholding MetLife's challenge to its designation as a systemically important financial institution by the Financial Stability Oversight Council, the district court in Washington, D.C., criticized FSOC's failure to, among other things, consider the costs of its designation, as that standard was applied in 2015 by the Supreme Court in Michigan v. Environmental Protection Agency. Increasingly, courts are applying analyses that suggest that even where the statute does not explicitly require that the costs of an action be evaluated relative to it benefits, a failure to take account of costs and benefits may cause a rule to be invalid. The Metlife decision is on appeal and could be decided by the D.C. Circuit at any time.

Second, on Dec. 27, 2016, the U.S. Court of Appeals for the Tenth Circuit in Bandimere v. SEC found the administrative law judges used by the SEC to hear its administrative enforcement cases were not properly authorized under the U.S. Constitution. This ruling contrasts with a prior decision of the D.C.

Circuit, Landy v. FDIC, which upheld the appointment and authority of the FDIC's administrative law judges. But, an August 2016 decision of the D.C. Circuit in Lucia v. SEC in favor of the SEC is now pending en banc review, and the appeals court has specifically asked whether the Landy decision should be reversed. These issues ultimately may attract Supreme Court review.

There is little doubt of the direction that rule-making and administrative standards are now headed: less new rules, more old rules rescinded or amended, and costs to the economy carefully measured. Once promulgated, rules that deviate from the new template are likely to be easier to challenge. While these changes relate to the arcane business of rule-making and the validity of agency regulations and actions, those regulations and actions impact the opportunities and restrictions that businesses and individuals confront every day. So there is much at stake in this arcane business.

—By Thomas P. Vartanian, Dechert LLP

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DISCLOSURE: Dechert represents an amicus curiae in the MetLife case discussed here.

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