Client Alert

November 2017

The Demise of the Guidance Masquerade

October 2017 may mark the moment when the pendulum finally reached the outer limit of regulation in financial services. Most will assume that this is a reference to the use of the Congressional Review Act (the "CRA") to invalidate the CFPB's rulemaking concerning arbitration as the exclusive forum for consumer actions and the prohibition on class action lawsuits. The invalidation of such rules is one punch of the two-punch combination that occurred. The other is equally significant.

For years now, banking agencies have been promulgating regulation masquerading as guidance. Such guidance has not generally been vetted through the rulemaking process. Accordingly, guidance has not been subject to comment, been measured against the same cost- benefit analysis required of regulation and has escaped the potential for invalidation under the CRA. A recent determination by the U.S. Government Accountability Office (the "GAO") is likely to have a chilling effect on the issuance of new "guidance" in the future (and also potentially subjects existing guidance to new Congressional review). Instead, it is likely that new efforts to issue guidance will now need to go through more exacting standards for adoption. Thus, every Federal Reserve Board Supervision Regulation Letter, FDIC Financial Institution Letter, OCC Banking Circular and even issuances such as examination manuals, as well as every rule, policy statement and guidance document, no matter how labeled, issued by any agency, may now be held to a higher standard.

The foreshock for these events started on March 22, 2013, when the three federal banking agencies jointly issued "Interagency Guidance on Leveraged Lending." This guidance addressed regulatory limits on leverage relative to cash flow, how such loans would be underwritten and standards for evaluation, among other prudential requirements. Senator Pat Toomey asked the GAO to evaluate the interagency guidance as to whether it should be subject to the CRA.

Congress enacted the CRA in 1996. The CRA requires all government agencies, including independent regulatory agencies, to report to Congress on new rules before they become effective. In addition to a summary of the proposal, the CRA requires a cost-benefit analysis of the rule and certain procedural steps in the process. Under the CRA, a rule is "the whole or part of an agency statement of general or particular applicability in future effect designed to implement, interpret, or prescribe law or policy for describing the organization, procedure or practice requirements of an agency." The CRA excludes certain types of rules, such as those related to management of the agency itself.

The federal banking agencies advise that the GAO should defer to them as to whether the interagency guidance constituted a rule under the CRA. The GAO cited *Chamber of Commerce v. OSHA* for the proposition that "an agency's own label…is not dispositive." The federal banking agencies then indicated that the interagency guidance simply described how they will apply their enforcement powers. They said that the interagency guidance does not set any standards and does not affect the rights of third parties.

The GAO stated that it agreed with the bank regulatory agencies that the interagency guidance was a statement of policy. The GAO, however, determined that statements of policy are covered by the CRA. Congress, in adopting the CRA, stated that "[t]he committees intend [CRA] to be interpreted broadly with regard to the type and scope of rules that are subject to congressional review." Documents intended to be covered by the CRA were to include "statements of general policy, interpretations of general applicability,

any administrative staff manuals and instructions to staff that affect the member of the public," according to Representative Hyde, who was the sponsor of the legislation. Thus, the GAO's determination with regard to the interagency guidance reaffirms Congress's intent that regulations masquerading as rules or policy statements should still be subject to the exacting requirements of the CRA. Thus, the October 19, 2017 GAO letter was actually the first punch.

Only four days later came the second punch. On Tuesday, October 23, 2017, Congress, acting under the authority provided by the CRA with the Vice President casting the deciding vote, invalidated the CFPB's arbitration rulemaking. Thus, a Congress finally willing to wield the power provided by the CRA in the financial sector now has the opportunity to consider a much broader range of potential regulatory action no matter how the federal banking agencies labeled such issuances. Moreover, the GAO's action calls into question any enforcement action taken based on guidance.

This will not be a panacea. As the CFPB has demonstrated, regulators have other avenues to change policy. The CFPB has certainly been willing to communicate its views to the industry by taking enforcement action. For those institutions that are willing to contest agency action, however, the GAO letter will be of assistance in warding off unmerited action.

The GAO decision starts the CRA clock ticking on the leveraged lending guidance. Thus, there will be 60 days to see if Congress follows up on its action on the arbitration rule. If so, the October 2017 one-two punch truly may result in the arc of the pendulum heading back toward the middle.

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