Reining in the Regulators: Title VI of the Financial CHOICE Act

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Introduction

The drafters of the Financial CHOICE Act believe that the Dodd-Frank Act of 2010 mandated excessive regulation of the financial sector—especially banks—and also that U.S. financial regulators have not regulated wisely: both before and since Dodd-Frank. Although other parts of the CHOICE Act target specific provisions of Dodd-Frank (e.g., Title I provides an "off-ramp" from detailed Dodd-Frank regulation for well capitalized banks), Title VI addresses broader regulatory issues. In this chapter, we will address the following:

- Requiring cost-benefit analyses of all financial regulatory proposals;
- Requiring that Congress approve all major financial regulations;
- Eliminating the "Chevron deference" to regulatory agencies; and

- Requiring multi-person governing boards instead of single-heads of agencies.[188]

Background

There is little question that Dodd-Frank—enacted in the wake of the financial crisis of 2007-2009—constituted a major expansion of financial regulation. Its supporters believed that the expansion was needed to remedy the regulatory shortcomings that allowed the crisis to occur; its critics warned that (among other things) the expansion did not address all of the causes of the crisis, could increase the likelihood of a new crisis (because it enshrined large financial institutions as "too-big-to-fail"), would increase the costs of financial services firms, and would thus raise the prices of financial services to users.

In any event, Dodd-Frank instructed financial regulators to propose and finalize about 400 regulations ("rulemakings")[189] and created a major new financial agency—the Consumer Finance Protection Bureau (CFPB)—as well as a new multi-agency monitoring entity—the Financial Stability Oversight Council (FSOC)—and a new

[188] Recent news stories indicate that there may be a "2.0" version of the Financial CHOICE Act that would not replace single-headed agencies with multi-person boards. See, for example, Ian McKendry, Kate Berry, and John Heltman, "Cheat Sheet: Hensarling's Plans to Gut CFPB, Revamp Stress Tests," Credit Union Journal, February 9, 2017; available at: **https://www.cujournal.com/news/cheat-sheet-hensarlings-plans-to-gut-cfpb-revamp-stress-tests**. Because of the current uncertainty as to what the introduced Act will contain and because we believe that the issue of single-heads versus multi-person governing boards for financial regulatory agencies deserves some general discussion, we have retained this item in our discussion.

[189] The Davis Polk law firm puts the number at 390. See Davis Polk & Wardwell, "Dodd-Frank Progress Report," July 19, 2016.

financial research organization—the Office of Financial Research (OFR).[190] It is this expansion to which the CHOICE Act is a response.

Four Components of Title VI

We will address four components of the CHOICE Act's Title VI: cost-benefit analysis; Congressional approval; reduced deference; and agency boards. These are now discussed in turn.[191]

Requiring cost-benefit analyses of all financial regulatory proposals

Title VI specifies that a financial regulatory agency may not adopt a regulation if the agency determines that the "quantified" costs outweigh the "quantified" benefits. Further, the agency must identify all available alternatives and explain why the regulation meets the objectives of the regulation more effectively than do the alternatives. If an agency is challenged by an interested party and has not complied with these requirements, the regulation can be vacated by the courts.

Requiring that Congress approve all major financial regulations

Major regulations would take effect only if Congress passed a joint resolution of approval that is enacted into law within 70 days after the agency sends a report on the regulation to Congress. Major regulations are defined primarily as those that would have annual effects of $100 million or more, or significantly raise costs or prices, or have other adverse effects on the U.S. economy (as determined

[190] Dodd-Frank is also notable for what it did not do: It did little to simplify or streamline an already complex regulatory architecture, but overlaid these new regulations and organizations on top of the existing system.
[191] This summary draws heavily on Davis Polk & Wardwell, "Comparison of Legislation in the 115th Congress Affecting the Rulemaking Process," January 26, 2017; this document can be found at https://www.davispolk.com/publications/comparison-legislation-115th-congress-affecting-rulemaking-process/

by the Office of Information and Regulatory Affairs). In somewhat the same spirit, Congress could similarly render ineffective non-major rules by a joint resolution of disapproval.

Eliminating the "Chevron deference" to regulatory agencies

Under Chevron v. NRDC, 467 U.S. 837 (1984), the Supreme Court established the precedent that the courts should generally defer to the regulatory agency's interpretation of the statute under which the agency has promulgated a regulation. Title VI would override this judicial interpretation and require the courts to decide *de novo* the appropriate interpretation of the relevant statute.

Requiring multi-person governing boards instead of single-heads of agencies

Some financial regulatory agencies are headed by multi-person boards: specifically, the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), the Commodities and Futures Trading Corporation (CFTC), the National Credit Union Administration (NCUA), and the Federal Reserve. Other financial regulatory agencies are headed by a single individual: specifically, the CFPB, the Office of the Comptroller of the Currency (OCC), and the Federal Housing Finance Agency (FHFA).[192] For the latter three agencies, their single-headed structure would be replaced by a five-person board,[193] with a

[192] In addition, the Pension Benefit Guaranty Corporation (PBGC) is somewhat of a hybrid: It has a single Director but also a Board of Directors that is composed of the Secretaries of Labor, Treasury, and Commerce. Further, the U.S. Department of Labor (DOL)—an Executive Branch agency—has financial regulatory powers with respect to pension funds and retirement account arrangements.
[193] Also, the NCUA's three-person board would be replaced by a five-person board.

requirement that no more than three of the five could be from one of the two major political parties.[194]

An Assessment

Requiring cost-benefit analyses of all financial regulatory proposals

In principle, we endorse a cost-benefit test for any kind of regulation, including, of course, financial regulation. We should expect—or at least hope—that the benefits of a given regulation exceed its costs.[195] Indeed, there are already some specific areas of regulation, including some SEC regulations,[196] as well as some regulations by the FCC and the Environmental Protection Agency (EPA), for which cost-benefit analyses have been required and conducted.[197] Even for areas, such as environmental or safety regulations that involve saving lives (i.e., reductions in premature deaths), in which it would appear to be difficult to place a value on

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[194] This specification of a majority/minority political structure for the board membership is typical for most multi-person regulatory agencies: not only for financial regulatory agencies, such as the FDIC, the SEC, the CFTC, and the NCUA, but also for other federal regulatory agencies, such as the Federal Trade Commission (FTC), the Federal Communications Commission (FCC), the Federal Energy Regulatory Commission (FERC), and the National Labor Relations Board (NLRB).

[195] As a technical matter, where a regulation involves quantitative gradations—for example, a minimum capital requirement for banks that is expressed as the percentage ratio of net worth divided by total assets—the appropriate criterion for maximizing social welfare is (other things being equal) that the marginal benefit be equal to the marginal cost.

[196] See, for example, Bruce Kraus and Connor Raso, "Rational Boundaries for SEC Cost-Benefit Analysis," Yale Journal on Regulation, 30 (#2, 2013), pp. 289-342; and John C. Coates, IV, "Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications," Yale Law Journal, 124 (January-February 2015), pp. 882-1011.

[197] See, for example, the discussion in Coates, op. cit., as well as in Eric A. Posner and E. Glen Weyl, "Benefit-Cost Paradigms in Financial Regulation," Journal of Legal Studies, 43 (June 2013), pp. S1-S34; and Ryan Bubb, "Comment: The OIRA Model for Institutionalizing CBA of Financial Regulation, Law and Contemporary Problems, 78 (No. 3, 2015), pp. 47-53.

the benefits, the economics profession has developed methods—conceptually and empirically—for obtaining estimates (or at least bounds on estimates) that can help guide policy.

However, there are significant difficulties of measurement and valuation—of benefits and costs—in financial regulation. For example, higher capital requirements for large banks may well have the benefit of reducing the likelihood of a repeat of the crisis of 2007-2009. But can the reduced likelihood of another crisis be quantitatively linked to the size of the capital requirements? And what were the costs of that crisis—and thus the benefits of reducing the probability of a repeat of the crisis?

Although economists could surely develop estimates for both questions, the tradition of having economists provide quantitative estimates of costs and benefits in the context of proposed regulations is relatively recent.[198] And, indeed, there are diverse views among economists and lawyers as to the practicality and wisdom of requiring formal cost-benefit analyses for financial

[198] White—who was a regulator of the savings & loan industry in the late 1980s—can personally attest to the general absence of formal cost-benefit analyses among bank regulators through the late 1980s; and this absence appears to have persisted through the 1990s and into the 2000s. For example, one can peruse the pages of the Federal Register in connection with the proposed and final versions of financial regulations and find scant references to quantitative findings by the agency in support of its proposals and final rules or even by interested parties that have commented on the proposals. See also Prasad Krishnamurthy, "Rules, Standards, and Complexity in Capital Regulation," Journal of Legal Studies, 43 (June 2014), pp. S273-S296.

regulations.[199] By contrast, as early as the late 1970s (and possibly earlier), the EPA and other nonfinancial regulatory agencies were regularly trying to quantify outcomes and making estimates of costs and benefits.[200]

This early stage of the application of cost-benefit analysis to financial regulation makes us wary of the requirement that all financial regulations must be accompanied by formal cost-benefit analyses. Such a requirement could entail large commitments of agency resources—at a time when agency budgets are likely to be cut—and thus have the potential to delay substantially or flatly prevent the issuance of new regulations.[201]

To avoid regulatory torpor, then, any requirement for a cost-benefit analysis should be sufficiently flexible to account not only for the cost of regulation but also the cost and difficulties of the *analysis* itself. If a requirement for cost-benefit analysis included an arbitrary evidentiary threshold, then the requirement would block regulation that is likely to be beneficial based on *reasonably* available evidence at the time. Put simply, sometimes even scant

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[199] For a representative view of these differences of opinions, see the June 2014 (vol. 43) issue of the Journal of Legal Studies and the No. 3, 2015 (vol. 73) issue of Law and Contemporary Problems. It is worth noting that among the authors of these essays, there are skeptics of the social value of much of financial regulation who nevertheless are also skeptical of the practicality and value of requiring formal cost-benefit analyses of financial regulation. See, for example, John H. Cochrane, "Challenges for Cost-Benefit Analysis of Financial Regulation," Journal of Legal Studies, 43 (June 2014), pp. S63-S105. See also Thomas Philippon, "Efficiency and Benefit-Cost Analysis of the Financial System," Journal of Legal Studies, 43 (June 2014), pp. S107-S120; Jeffrey N. Gordon, "The Empty Call for Benefit-Cost Analysis in Financial Regulation," Journal of Legal Studies, 43 (June 2014), pp. S351-S378; and Coates, op. cit.

[200] See, for example, Lawrence J. White, Reforming Regulation: Processes and Problems. Englewood Cliffs, NJ: Prentice Hall, 1981. See also Bubb, op. cit.; and Posner and Weyl, op. cit.

[201] This effect would be exacerbated by the ability of affected parties to challenge in court the agencies' analyses as a means of challenging the regulations themselves.

evidence is sufficient to justify regulation. And as good as cost-benefit analysis is in principle, it is bad policy for the requirement of such analysis to bias the regulatory process against action.

Nevertheless, we believe that an appropriate requirement could encourage the development of cost-benefit analysis by regulators who could choose a relatively small set of financial regulations that do appear to be more amenable to cost-benefit analyses and, for these regulations, engage in relatively intensive investigation.[202] This process would help push the agencies more toward developing methodologies for quantifying costs and benefits and thus help develop an agency culture that regularly considers costs and benefits in the development of new regulations.[203] As part of this process, the parties that are affected by the regulation would be spurred to develop their own estimates of costs and benefits, and there would likely be a beneficial feedback from the agencies to the parties, and back to the agencies, in the development of methodologies and estimates.

Over time, as the new culture takes hold, there would be growth in the list of regulations that would benefit from, and thus require, a fully developed cost-benefit analysis.

Toward this end, Congress should require that the promulgating agency provide what we would call a Cost Effectiveness report in the event that the circumstances do not support a traditional quantifiable cost-benefit analysis. By cost effectiveness, we mean a process whereby the benefits of a regulation are identified, the

[202] We suggest the following as potential examples of financial regulation that would be particularly amenable to cost-benefit analyses: the CFPB's proposed "payday lending" regulation; the CFPB's possible restrictions on bank overdraft fees and arrangements; and the DOL's proposal for fiduciary obligations by financial advisers with respect to individuals' retirement accounts. We expect that there are many more examples of such regulations that could be suggested.
[203] A similar belief in encouraging a culture that regularly considers costs and benefits can be found in many of the essays in the two journal volumes that were mentioned in footnote 199.

costs of alternative means of achieving a given goal are developed and compared, and an explanation is provided for why a full quantitative analysis is not cost justified.

Throughout the legislative and regulatory process, Congress and the Executive Branch should encourage financial regulators to think in terms of, and to state publicly, the goals (the “output”) of specific regulations, ways of measuring that output, the cause-and-effect channels through which the regulation will achieve the goals, and the market failure theory on which the regulatory action is based. The aim should be the provision of a formal a quantitative analysis wherever possible.[204] All of this should be open to review by Congress, the Executive Branch, and the public.

Requiring that Congress approve all major financial regulations

Although the **report** of the House Committee on Financial Services states that the CHOICE Act would require a “joint resolution” of Congress to effectuate major regulation, the Act provides that such regulation will not become effective unless the joint resolution is "enacted into law", and the report observes that the CHOICE Act adopts the REINS Act, which, according to the CHOICE Act report, "requires Congress to pass, and the President to sign, a joint resolution of approval for all major regulations before they are effective." Or, put differently, one might say that, for important matters, the CHOICE Act is designed to prohibit regulation (as that term is commonly understood).

This proposed significant step back from the administrative state may well be desirable to the drafters of the CHOICE Act, but it is a reversal that we do not endorse. Having Congress and the President deliberate and pass on the details of regulatory minutia is simply a bad use of Congress’s time and resources—particularly in the technical, complex, and systemically sensitive area of financial

[204] See Cochrane, op. cit., p. S102, for similar ideas.

regulation. In this area, as with others in the general modern structure of governmental administration, Congress should focus on and pass legislation that involves broad policy goals and targets, and then leave the regulatory agencies to fill in the details with suitable specific implementation regulations.

If Congress believes that the regulators have misinterpreted Congressional intent, Congressional committee and subcommittee hearings are an immediate vehicle for encouraging the regulators to re-direct their actions. If hearings, along with other instruments of conveying public opinion, do not succeed in getting regulators to hew to the will of the elected officials, then Congress should consider fine-grained legislation to override and re-direct the regulators' actions. Such legislation should be exceptional, not routine.

There is also a "gaming" issue that may arise: To the extent that regulatory agencies can divide a large—and thereby "major"—regulation into smaller pieces that individually are below whatever threshold is chosen, the goal of this provision will be undermined.

Because we believe a process that requires Congressional joint resolutions and Presidential approval will not improve the quality of financial regulation, we recommend that such a process not be enacted.

Eliminating the "Chevron deference" to regulatory agencies

The Supreme Court's 1984 decision in Chevron v. NRDC, 467 U.S. 837 (1984), directed that lower courts defer to a regulatory agency's interpretations of statute in its promulgation of regulation so long as the relevant provision is ambiguous and the regulation is a reasonable policy choice for the agency to make. Such deference has the advantage of relying on agency expertise and economizing on scarce judicial resources. This process also offers the possibility of a coherent implementation strategy orchestrated by the relevant agency.

Concomitantly with the greater call on judicial resources, an end to Chevron deference would retard the regulatory process, given the greater prospect of success in challenges to promulgated regulation. Rather than throw all regulation into the imbroglio of litigation, where a particular regulation or set of regulations is problematic, it is better for Congress to enact new legislation that better constrains agency discretion. Consequently, we recommend against the elimination of the Chevron deference.

Requiring multi-person governing boards instead of single-heads of agencies

As we noted above, this provision may not be in the “2.0” version of the CHOICE Act. Nevertheless, as a general matter, it is worth discussing. In the “1.0” version of the CHOICE Act, this provision would apply to the CFPB, the OCC, and the FHFA.

Single-headed agency leadership has advantages and disadvantages, as does leadership by a multi-person board that has a mandatory political majority/minority structure. With a single-headed agency, there is clearer direction (and a clearer location of responsibility) and the likelihood of speedier action on regulatory matters. With a multi-person board, there is more opportunity for the exchange of ideas and for the give-and-take that may be important for partisan issues, but at the expense of slower action and a more diffuse location of direction and responsibility. Also, the advantages of a board may be limited if the agency is a member of a multi-agency entity (such as the FSOC) or a multi-agency task force; in such a case, the chair of an agency board is the representative, and other members’ views may not be well represented.

Because there are pluses and minuses to both structures, it would seem to us unlikely that a single structure is better suited for all financial regulation in the United States. It appears that the OCC, as a single-headed agency, has had a long-standing (since 1863) record and reputation for successful operation, but so has the FDIC, which has been in existence since 1933 and which is headed by a five-person board.[205]

Whatever the merits of any particular leadership structure for an agency, it is surely the case that the transition from a single-headed agency to an agency that is led by a multi-person board will involve time and disruption—which will slow down regulatory processes. Again, although the drafters of the CHOICE Act may favor impediments to the administrative state as a general matter, we do not.

Further, it is our perception that the drafters of the CHOICE Act are primarily unhappy about the CFPB and its single-headed structure. If this is the case, a provision that was more tightly focused on the CFPB—and that allowed the OCC and the FHFA to remain with their current structures—would better achieve the drafters' goal of improving the structure of the CFPB.

Conclusion

Title VI of the Financial CHOICE Act, which broadly addresses financial regulatory processes and structures, is a reaction to what the drafters perceive as the excesses of the Dodd-Frank Act and the misguided actions of financial regulators both before and since the passage of Dodd-Frank. Although the drafters express a laudable desire to improve the quality of financial regulation (e.g., through cost-benefit analysis), it appears that they also want—implicitly, if

[205] Unlike most other multi-person boards, two of the five members of the FDIC's board are currently designated by statute to be the Comptroller of the Currency (i.e., the head of the OCC) and the Director of the CFPB.

not explicitly—generally to slow the processes of regulation and reduce the overall burden of regulation through the broad changes that are encompassed in Title VI.

On this last point, we are concerned that the creation of an institutional bias against regulation will systemically undervalue the benefits of regulation even while limiting its costs. In our view, the goals of better regulation would be better served by a narrower focus on the places where financial regulations are seen to be a special problem, rather than broadly throwing sand in the gears of the regulatory process.

More specifically, with respect to the four areas of Title VI addressed here:

- We favor broad use of cost-benefit analysis but worry that a requirement of such analysis will stand in the way of regulation that would likely be beneficial even if the case for such benefit rests on relatively sparse evidence. Thus, we oppose any arbitrary evidentiary threshold generally applicable to all financial regulation. We encourage searching cost-benefit analysis in specific areas that are most likely to be conducive to such analysis, for its own sake and so as to promote a culture of close analysis within the agencies. We also favor a requirement that the promulgating agency provide a Cost Effectiveness report in the event that the circumstances do not support a traditional quantifiable cost-benefit analysis; such report would explain the agency's process and reasons for the limited nature of its analysis.

- We recommend against the CHOICE Act's requirement that major financial regulations would take effect only if approved by a joint resolution of Congress and by the President. Such a requirement would, in essence, eliminate major regulation and replace it, if at all, through the slower, and more fraught, legislative process. The result would be an impediment not only to detrimental rules, but also to beneficial ones as well, and would not be a good use of Congress's scarce time and resources.

- We recommend that the Chevron deference be retained in judicial review of financial agency regulation. In our view, such deference is a sensible mechanism for economizing on scarce judicial resources and as a means of encouraging an integrated strategy of statutory application.

- Although we take no general position on the wisdom of structuring a financial regulatory agency as a single-headed organization or as an entity that is headed by a multi-person board, we note that the transition from a single-headed to a multi-person-headed organization is likely to be accompanied by organizational disarray, as is the case during any transition. To the extent that the drafters' unhappiness with a single-headed organization is focused on the CFPB, we urge that the board requirement be narrowly applied to the CFPB, so that the OCC and the FHFA be spared the costs of a transition.

It is surely true that the processes and structures of financial regulation can be improved. However, the provisions of Title VI should be restructured and more narrowly focused, so as to achieve those improvements more effectively.