Articles + Publications | June 23, 2023

Why Pausing CFPB Small Biz Lending Rule May Be Prudent

Law360

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Locke Lord Chicago's **Rusty Perdew** and **Louis Manetti** co-authored an article for Law360 examining a suit against the Consumer Financial Protection Bureau to suspend its final rule expanding the data reporting requirements for small business loan applications.

"This lawsuit is currently the only one of its kind aimed at the final rule, and the impact could be substantial. At issue is whether small business lenders must begin the costly and burdensome process of preparing to comply with the final rule's onerous reporting requirements," Perdew and Manetti wrote.

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Rio Bank, the American Bankers Association and the Texas Bankers Association have **sued** the Consumer Financial Protection Bureau and have moved for preliminary injunctive relief to suspend the CFPB's recent final rule expanding the data reporting requirements for small business loan applications.

Both the lawsuit — Texas Bankers Association v. Consumer Financial Protection Bureau[1] in the U.S. District Court for the Southern District of Texas — and the request for an injunction assert that the CFPB's funding structure is unconstitutional, which is currently being argued before the U.S. Supreme Court.

This lawsuit is currently the only one of its kind aimed at the final rule, and the impact could be substantial. At issue is whether small business lenders must begin the costly and burdensome process of preparing to comply with the final rule's onerous reporting requirements.

Plaintiffs are hoping for an injunction to stay the final rule, perhaps nationwide, until the Supreme Court resolves the issue of the CFPB's funding structure.

Plaintiffs challenge the CFPB's expansion of data collection requirements for small business lending.

The lawsuit challenges the final rule issued by the CFPB March 30, requiring lenders to collect and report loan application data for small, minority-owned and women-owned businesses.[2]

The final rule amends Regulation B, the implementing regulation of the Equal Credit Opportunity Act, and expands the statutory data collection amendments of the ECOA authorized by Section 1071 of the Dodd-Frank Act.[3]

The final rule covers a "variety of entities that engage in small-business lending," so long as they originated 100 small business loans in each of the prior two calendar years.[4] Depending on the size of the lender, compliance with the final rule is required as early as October 2024.[5]

The final rule significantly increased the burden on small business lenders to collect and report data from loan applications. The lawsuit describes the sweep of the final rule:

The agency took the original three pages of legislation and the 13 reporting data points required by the [ECOA] and turned them into almost 900 pages of rulemaking … [with] over 80 reporting requirements that have been exponentially grown by the CFPB since the Act requiring this Rule was passed.[6]

The expanded data points that lenders must collect and report include: reasons for an application denial; pricing information; gross annual revenue; the number of non-owner workers; time in business; the number of owners; and the ethnicity, race and sex of the principal owners.[7]

The lawsuit challenges the CFPB's final rule on multiple grounds.

The plaintiffs allege that the final rule is invalid for four reasons.

First, they argue that the final rule is invalid because the CFPB's funding structure is unconstitutional, relying on Community Financial Services Association of America v. CFPB, the 2022 decision from the U.S. Court of Appeals for the Fifth Circuit[8] that held the structure violates constitutional separation of powers.[9]

The lawsuit argues that the:

unconstitutional nature of the CFPB's funding infects every aspect of the Rule at issue here as it would not have taken place — and certainly would not have grown into the crushing behemoth just released by the CFPB — if the agency had not been funded inappropriately and thereby lacked oversight.[10]

Second, the lawsuit asserts that the final rule is invalid because it exceeds Section 1071's statutory scope.[11] The plaintiffs argue that the CFPB acted beyond the scope of its authority when it expanded the 13 data points listed in Section 1071 of the Dodd-Frank Act to 81 items in the final rule.[12]

The plaintiffs also argue that the final rule will ultimately undermine the statutory purpose of expanding the availability of credit to small, minority-owned and women-owned businesses by "forc[ing] small and rural banks with limited staff and resources to put more resources into government reporting rather than lending in the community."[13]

Third, the lawsuit alleges that the final rule is arbitrary and capricious because it did not consider comments relevant to the statute's purpose.[14] They assert that comments alerted the CFPB to the burdensome costs on smaller banks,[15] and they estimate that it will cost each community bank $100,000 to comply with the final rule's requirements.[16]

Finally, the plaintiffs argue that the final rule is arbitrary and capricious because the CFPB did not engage in a

proper cost-benefit analysis.[17] They assert that the CFPB simply took the costs associated with collecting the 13 statutory data points in Section 1071, and substituted that figure for the costs associated with collecting the 81 data items reflected in the final rule.[18]

The plaintiffs seek preliminary injunctive relief to stay the final rule.

On May 26, the plaintiffs moved for a preliminary injunction, asking the court to suspend both the compliance deadlines and the corresponding time frames for preparing to follow the final rule.[19]? The plaintiffs' sole basis for a preliminary injunction is the claim of unconstitutionality under Community Financial.[20]

They argue they will suffer ?irreparable harm if the final ?rule is not stayed because the plaintiffs and their members would be forced to spend millions of dollars preparing to comply with an invalid rule,[21] and further, that compliance will drive some community and mid-sized banks out of small business lending altogether.[22]

They also aver that an injunction serves the public interest because when an agency seeks to enforce an invalid rule, the equities lean heavily in favor of an injunction.[23]

The plaintiffs ask the court to leave the injunction in place ?until the Supreme Court ?issues a ruling in the Community Financial case.?[24] That case is currently being briefed in the Supreme Court and any argument will likely not take place until the fall term begins, with a ruling coming an unknown amount of time after the argument. Thus, the requested preliminary injunction could last into 2024.

The CFPB responded to the motion June 16. The CFPB argued the plaintiffs lack standing, and lack an irreparable injury, because the plaintiffs allegedly didn't show they were required to comply with the final rule at all or that compliance would require imminent action.[25] The plaintiffs will likely be able to overcome these issues.

The CFPB also disputed that the plaintiffs had shown a likelihood of success on the merits because, the CFPB argues, the Fifth Circuit erred in the Community Financial case.[26] Alternatively, the CFPB asked that any injunction be limited to the plaintiffs only and not be entered nationwide.[27]

The plaintiffs' reply is due June 23. No hearing has been scheduled.

If granted, a preliminary injunction could be nationwide. The U.S. Constitution vests the district court with the judicial power of the U.S., and that power is not limited to the district where the court sits but extends across the country.[28]

Thus, district courts may enter a nationwide injunction.[29] The scope of injunctive relief is dictated by the extent of the violation rather than the geographical extent of the plaintiff class.[30]

When a court determines that agency regulations are unlawful, according to the U.S. Court of Appeals for the D.C. Circuit's 1989 ruling in Harmon v. Thornburgh, "the ordinary result is that the rules are vacated — not that their application to the individual petitioners is proscribed."[31]

Given the novel issues presented, a preliminary injunction seems appropriate.

The Supreme Court has confronted constitutional challenges to the CFPB's structure, but the breadth of this case is unique.

In Seila Law LLC v. CFPB in 2020, the court held that the CFPB's leadership by a single independent director violated constitutional separation of powers.[32] But the court declined to hold any specific agency action invalid as a result, stating that the "only constitutional defect we have identified in the CFPB's structure is the Director's insulation from removal."[33]

And it confirmed in Collins v. Yellen in 2021 that when an agency officer was properly appointed, there is no reason to regard the agency's actions as void, even though there was a constitutional flaw in the officer's removal.[34]

In other words, the court determined that the constitutionally invalid aspect — the restrictions on the director's removal — was severable and did not affect the CFPB as a whole. It reasoned that the "CFPB's structure and duties remain fully operative without the offending tenure restriction."[35] The Supreme Court left it to the lower court to determine the impact of its ruling on the specific agency action that was challenged.[36]

The funding of the CFPB as an agency is certainly a deeper problem than removal procedures for its properly appointed leader. So, the court could determine, as the plaintiffs argue, that the CFPB's funding structure is fatally unconstitutional and thereby invalidates one or more agency actions.

However, the court could determine that the funding structure, although unconstitutional, does not void the CFPB's actions, generally. In Seila Law, the court reasoned that the leadership removal defect was severable because there was "nothing in the text or history of the Dodd-Frank Act that demonstrates Congress would have preferred no CFPB to a CFPB supervised by the President."[37]

It concluded that although Congress constructed the CFPB to be maximally independent, it could not conclude that Congress would have preferred the CFPB to have not existed to being politically dependent.[38] Similarly, the court could conclude that the CFPB's funding structure, like its leadership structure, was set up to be independent but that any funding structure flaw is severable for similar reasons to those in Seila Law.

Given that the entire funding of the CFPB calls into question its power to act, and the outcome of Community Financial cannot be foreseen by a straightforward application of Seila Law, it would seem prudent for the court to stay the final rule's enforcement while this issue is sorted out.

Although similarly situated lenders that are subject to the final rule could file additional lawsuits challenging the final rule's application, Texas Bankers Association v. CFPB is currently the only challenge of its kind. In a related effort, Rep. Roger Williams, R-Tex., submitted a joint resolution May 31, disapproving the final rule.[39]

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[1] Texas Bankers Ass'n v. CFPB, 7:23 cv 00144 (S.D. Tex. May 14, 2023), Dkt. No. 12.

[2] 124 STAT. 2056 PUBLIC LAW 111–203—JULY 21, 2010.

[3] Id.

[4] CFPB Executive Summary of the Small Business Lending Rule, available at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_sbl_executive-summary.pdf (last accessed June 9, 2023) at 2.

[5] Consumer Financial Protection Bureau, 12 CFR Part 1002 § 1002.114.

[6] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 12 ¶ 5.

[7] Consumer Financial Protection Bureau, 12 CFR Part 1002 §1002.107; see also the CFPB's Data Points Chart for the Final Rule.

[8] Community Financial Services Association of America v. CFPB, 51 F.4th 616 (5th Cir. 2022). On February 27, 2023, the United States Supreme Court granted certiorari to review Community Financial as docket number 22-448, and that case is currently being ?briefed. Shortly thereafter, on March 23, 2023, the Second Circuit disagreed with Community Financial and created a circuit split on the ?issue. CFPB v. Law Offices of Crystal Moroney, PC, 63 F.4th 174 (2d Cir. 2023).

[9] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 12 ¶¶ 79-81.

[10] Id. ¶ 12.

[11] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 12 ¶¶ 84-91.

[12] Id. ¶ 86.

[13] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 12 ¶¶ 69, 103.

[14] Id. ¶¶ 92-99.

[15] Id. ¶ 95.

[16] Id. ¶ 12.

[17] Id. ¶¶ 100-10.

[18] Id. ¶ 104.

[19] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 13.

[20] Id. at 4 n.2.

[21] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 13-1 at 1.

[22] Id. at 11.

[23] Id. at 12.

[24] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 13 at 2.

[25] Texas Bankers Ass'n, 7:23 cv 00144, Dkt. No. 16 at 10-14.

[26] Id. at 22-23.

[27] Id. at 23-26.

[28] Texas v. U.S., 809 F.3d 134, 188 (5th Cir. 2015) (quoting U.S. Const. Art. III, § 1).

[29] Id.

[30] Califano v. Yamasaki, 442 U.S. 682, 702 (1979).

[31] Harmon v. Thornburgh, 878 F.2d 484, 495 n.21 (D.C. Cir. 1989).

[32] Seila Law LLC v. CFPB, 140 S. Ct. 2183, 2207 (2020).

[33] Id. at 2209.

[34] Collins v. Yellen, 141 S. Ct. 1761, 1787 (2021).

[35] Seila Law LLC, 140 S. Ct. at 2209.

[36] Id. at 2211.

[37] Id. at 2209.

[38] Id. at 2210.

[39] H.J. Res. 66, 118th Cong. (2023) (available at https://guides.library.cornell.edu/citing_us_gov_docs/BillsAndResolutions).

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