

Consumer Finance Monitor (Season 3, Episode 15): Dodd-Frank Act Section 1071 Rulemaking: A Close Look at the Settlement in the Lawsuit Against the CFPB

Speakers: Chris Willis and Nitin Shah

Chris Willis:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry.

Chris Willis:

I'm your host, Chris Willis. And I'm the Chair of Ballard Spahr's Consumer Financial Services Litigation Group. And I'll be moderating today's program. For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted the blog since 2011, so there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those of us in the industry. So to subscribe to our blog or to get on the list for our webinars, just visit us at ballardspahr.com. And if you like our podcast, let us know. Leave us a review on Apple Podcasts, Google Play, or wherever you get your podcasts.

Chris Willis:

Now today's episode of the podcast is very special and we're going to be talking about an issue that is of great importance to the financial services community. And that is the CFPB's potential rulemaking under Section 1071 of Dodd-Frank. Section 1071 required the CFPB to create a regulation that requires the collection and reporting of data relating to small business lending that's roughly similar to what is required under the Home Mortgage Disclosure Act, which of course is collected and used for fair lending monitoring and enforcement.

Chris Willis:

And I'm very fortunate today to be joined by Nitin Shah from Democracy Forward. He was actually the lawyer for the plaintiffs in the lawsuit that was filed against the CFPB, which resulted in a recent settlement that is set forth now what seems to be a definitive timeline for the CFPB's rulemaking. Nitin, thanks for joining us and welcome to the podcast.

Nitin Shah:

Hi, Chris. Thanks so much for having me. It's a pleasure to be here.

Chris Willis:

Well, I want to have the opportunity to get you to tell our listeners about the lawsuit and the settlement, but first, can you tell me a little bit about your organization, Democracy Forward and then who your client was in the lawsuit with the CFPB and what that organization is?

Nitin Shah:

Absolutely. Democracy Forward is a nonprofit organization founded in 2017. And what we are basically is a bunch of administrative law nerds who have come together because of a view that the Trump Administration in particular has engaged in a number of unlawful acts. And what we seek to do is to hold the administration accountable for that in court, whenever they've engaged in unlawful activity and where it's hurt real people.

Nitin Shah:

And that's certainly, we think the case with regard to the administration and the bureau's failure to implement Section 1071. And so as a result of that, we brought this lawsuit and we're very happy with the settlement that we've obtained on behalf of our clients. They are the California Reinvestment Coalition, the National Association for Latino Community Asset Builders, and also two individuals, small business owners. The two nonprofit organizations are nonprofits based in... The CRC is based in San Francisco. NALCAB is based in San Antonio, Texas.

Nitin Shah:

They're both dedicated to facilitating capital access for low and moderate income communities and especially communities of color. So what they do is they work directly with financial institutions, including CDFIs and community organizations, to try to ensure that these organizations have access to the resources they need to continue to try to eradicate discrimination and lending and to ensure equal capital access.

Nitin Shah:

Now, in order to do that, what they need is data. They need to be able to identify where there are areas of needs and opportunities for lending, both to minority-owned businesses, women-owned businesses and to small businesses. And that's exactly what Section 1071 exists to do. It exists to ensure that data exists, to facilitate the enforcement of fair lending laws and to identify areas where credit deserts exist, whether as a result of redlining and historical discriminatory practices or other market-based failures. And so without that data, it's much harder for them to be able to do their jobs and ensure that low and moderate income communities have access to capital.

Chris Willis:

And I think it's worth pointing out that even though the issues that you're concerned with here and that we're talking about here relate to business lending, the Equal Credit Opportunity Act applies to business lending just as much as it does to consumer lending. Most of our listeners are probably very interested in consumer finance, but the Equal Credit Opportunity Act unlike many other consumer protection laws does apply to small business lending.

Nitin Shah:

That's exactly right. It sure does. And there's historically been an enforcement gap and a real challenge in identifying exactly where these credit deserts exist. However, there has been some additional research that's been undertaken, especially by folks at the University of Utah School of Business, where they've found that there is a very substantial amount of lack of access to capital for small businesses throughout the country. And those problems are especially exacerbated where the entrepreneurs are operating in low and moderate income communities.

Nitin Shah:

And as we all know, of course, small businesses are engines of American economic growth. They provide a substantial amount of the employment in this country. And so it really provides an opportunity for financial institutions to really identify where they can be doing a better job of serving customers and expand their businesses. And it, of course, also helps the American economy continue to grow as well.

Chris Willis:

So there is a section in Dodd-Frank passed in 2010, Section 1071 that authorized the Consumer Financial Protection Bureau to create this data collection rule that would include presumably race, ethnicity, and other types of protected class information relating to small business lending. And the CFPB has not to date, at least done much in connection with that rulemaking. The Cordray Administration didn't do it. And it didn't seem like there was much progress going on under Kathy Kraninger's directorship. And so you brought a lawsuit on behalf of your clients related to this. Can you tell our listeners a little bit about the lawsuit? What was the claim being asserted and what relief was being sought in the lawsuit?

Nitin Shah:

Yeah. And just as background, this is we believe the last remaining provision of the Dodd-Frank Act from 2011 that imposes a mandatory duty on the bureau to engage in a rulemaking. We think this is the last mandatory rulemaking that the bureau has just dragged its feet on for going on nine years now. And so it's pretty remarkable in that respect. And you're right, a rule did not come out during the Cordray Administration as well. They did take some substantial steps towards doing so. They issued an RFI a few years ago, a request for information that resulted in thousands of comments being submitted and views of industry and other stakeholders being heard. They were making progress towards issuing a rule.

Nitin Shah:

And unfortunately, what appears to have been the case is that, that progress ground to a halt, once Director Cordray left and Acting Director Mulvaney took over. It appears that the team was simply reassigned to other matters. And they, as the bureau admitted in this lawsuit, effectively paused a rulemaking proceedings, which is ultimately the impetus for the lawsuit that we brought.

Nitin Shah:

The suit that we brought is under a statute. I mentioned that we're a bunch of administrative law nerds. So our bible is the Administrative Procedure Act, which is the statute through which most agency actions can be challenged. Normally under that statute, a prerequisite to filing suit is final agency action. In other words, you can't file your lawsuit until the agency's issued its final rule. One exception to that is Section 7061 of the APA, which permits you to file a lawsuit for agency action that's been unlawfully withheld or unreasonably delayed.

Nitin Shah:

And so if you file suit under that, you have to show that it's an agency action that the agency is actually required to take by law. It can't just be a discretionary action. And the relief you can obtain through filing a suit under that provision is a judicial order requiring the agency to do what it's required to do. In other words, the relief we sought here on behalf of our plaintiffs was an order from the judge saying, "CFPB, within this certain timeframe, you have to issue a final rule implementing Section 1071," and finally implement this long delayed requirement that Congress put in place in the Dodd-Frank Act.

Chris Willis:

And so now the litigation had been pending for some months, but most recently the news event that happened and that triggered this podcast is that your clients entered into a settlement agreement. And a consent order was entered into with the CFPB's consent by the judge in your case. Can you tell the audience, what were the provisions of the settlement and what does it require the CFPB to do in terms of the Section 1071 rulemaking?

Nitin Shah:

Yeah, I'd be happy to do that. The settlement in effect puts in place a framework and a process for obtaining court-ordered deadlines for each step of the rulemaking process. Now for a complex rule like this, where there are effects on small businesses, there are three main stages to that process. The first stage of that process is proceedings with the Small Business Administration pursuant to the Small Business Regulatory Enforcement Fairness Act, or SBREFA. That process will take a few months to complete. After that, there is issuance of the proposed rule and a comment period following issuance of the proposed rule and thereafter, of course, the bureau issues the final rule.

Nitin Shah:

So with that sort of framework for how the rulemaking had to proceed in mind, what we've done here is reach an agreement with the bureau as to how we will reach an agreement for a court order deadline for each phase of that process. So at the outset, the first set of deadlines pertain to the SBREFA proceedings. The first step of the SBREFA proceeding is for the Bureau to publicly release an outline of its proposal for the Section 1071 rule pursuant to the settlement agreement. The

bureau has committed to doing so no later than September 15th, 2020. Thereafter, pursuant to the statute, the bureau has to convene a small business advocacy review panel to review that submission. So the bureau will convene that panel no later than October 15th, one month later. And then under the statute, the SBAR panel as it's called, has to complete its report within 60 days of convening. So we would expect that to be around the middle of December.

Nitin Shah:

Now, once the panel issues its report, the bureau will let us the plaintiffs know that that's happened and that will open the first of a couple of negotiating windows. We will meet and confer with the bureau to try to reach an agreement as to an appropriate deadline for issuance of the NPRM. To the extent we're unable to reach an agreement as to that deadline, we'll then go to the court and submit an accelerated series of briefs on our distinct proposals for when that deadline should be for the NPRM issuance and the court will essentially pick a date.

Nitin Shah:

And so the court will, in any case order a deadline, whether it's an agreed deadline or a deadline the court decides on as an order, that's enforceable, but like any other judicial order and the bureau will be required to issue its NPRM by then, unless it exercises some separate extension and modification provisions. And essentially the same process will play out for issuance of the final rule. After the comment period closes on NPRM, the proposed rule, we will have another meet and confer period, a negotiation window where we and the bureau will try to reach an agreement on the date for issuance of the final rule. In the event, again, we're unable to reach an agreement, we'll go to the court and have the court set a deadline for us instead.

Nitin Shah:

So what this does is it gives us a framework for our clients and the public to have assurance that this rulemaking is moving forward, that there will be court-ordered deadlines for compliance with the statutory mandate that's now long overdue. But at the same time, just like members of industry and other members of the public, we're not interested in a hastily put together rule. We want one that's thoughtful and considered and that adequately accounts for the various concerns that may go into this process. And so we think that by breaking it up into more digestible chunks, it'll sort of allow the bureau to have that thoughtful considered process while also ensuring that this rulemaking will happen.

Chris Willis:

So when I read the agreed order that you just described the provisions of, it really surprised me, and I'm not that familiar with administrative law. And I know it surprised a lot of industry participants that the CFPB would agree to giving a court and a meet and confer process with a private party, so much influence over, and in this instance, determinative influence over as it respects the court, the timing of a rulemaking. We normally think of administrative agencies as doing things on their own time and not being subject to outside pressure about when they do things or what they do. So can you give our audience some insight and give me some education about why would the bureau have agreed to something that seems so intrusive in terms of its rulemaking process?

Nitin Shah:

Yeah, that's a fair question. I understand why you'd have that reaction. I think the best way I can answer that question is by drawing on my own experience. Prior to joining this organization, I was a civil litigator in the Justice Department and therefore I was on the other side of the V in cases like this. And so drawing on that experience, I know that the thing you're really worried about as the litigator and as the agency at the outset of a suit like this is getting an order of the court at time zero, right now, saying, "Agency, you have to comply with this statutory requirement by X date." And who knows what that date might be. We'll say for purposes of discussion, this is just purely hypothetical, December 31st, 2021.

Nitin Shah:

And that can really set the agency's hair on fire because as you know, these rulemakings are very complicated. I've described the three main pieces of the framework for getting it done, but there are a whole lot of other intermediate decisions, other issues that can arise. You just don't really know all of the things that can come up between now and say the end of 2021 that could make it easy for you to comply with that deadline, or it could make it impossible. There's just no way to know. And part of the problem with litigating a case like this from the government side is if you don't know what could come up between now and then that would make it impossible for you to comply with that deadline, it's really hard for you to explain to a court why that deadline's not reasonable, right?

Nitin Shah:

I don't quote Donald Rumsfeld very often, but I always found his framework very helpful in this respect. He talks about, the known unknowns, the things you know, you don't know, and he talks about the unknown unknowns, the things you don't even know that you don't know. And the rulemaking process is rife with both types of unknown. And so that can make litigating cases like this very challenging. And it's especially challenging in a case like this, where there's no question, indeed it's undisputed that the agency was under a mandatory duty to issue this rule. And there's no dispute that it's taken eight or nine years with very little substantially to show for it.

Nitin Shah:

So that would create a substantial amount of litigation risk on the part of an agency in a case like this one. And so given that and given all the regulatory uncertainty you would be facing, if you actually got a judicial order setting by fiat, a deadline for issuance of the final rule, there can be an appetite for a creative solution and a creative solution is what I think we've come up with here. And I do commend to my counterparts at the bureau for being willing and able to kind of think through this and come up with this idea.

Nitin Shah:

And the idea is that instead of setting that deadline all the way out, it breaks it down into what I said were more digestible chunks. It says right now, if you're on the bureau's side, you can say, well, look, between now and issuing the SBREFA outline, there's enough certainty there that we can get that done by September subject to an ability to obtain an extension or modification if need be. So we can commit to that. And by the time we have the report of the small business panel, we'll have enough certainty that we'll be able to go to the negotiating table with you and figure out when the next step will occur. And the same for after the comment period closes, we'll know how many hundreds or thousands of comments, whatever it may be, we'll have a good sense of what those comments say and we'll know how much we have our work cut out for us, for actually getting the final rule done.

Nitin Shah:

So breaking it down into these three parts makes it easier for the bureau to be able to figure out when it can achieve the next step of the process. And frankly, it'll make it easier for the bureau, if in the event, we aren't able to agree to a deadline, to be able to say to the court concretely, "Here's why we need to set the deadline for what we're proposing to set it for." So I think, putting on my old government hat, I think those are some of the factors that go into consideration and why this was an agreement that was appealing for the bureau. From our side, for the plaintiff, since our main consideration and concern was having the assurance that this rulemaking will go forward on a concrete timeline and a court-enforceable timeline, that certainly made this an appealing agreement for us.

Chris Willis:

Now, as you talked about the various periods of time under the agreed order with the CFPB and particularly those relating to the publication of the notice of proposed rulemaking, and then the final rule being published, you mentioned a meet and confer process and an opportunity to come to agreement and if not, to have the court resolve it. I thought I remembered a reference to six month periods in connection with those deadlines. Am I remembering that right? And what is the role of those in those aspects of the rulemaking timeline?

Nitin Shah:

Yeah, absolutely. And this goes back to what I said earlier that we are not trying to impose upon the bureau a timeline that would deny it the opportunity to meaningfully consider input from the public, from stakeholders or to engage in whatever thinking it thinks needs to happen in order to put together the strongest possible rule. And so as a show of good faith and as a sort of understanding that we actually share a goal in a good rule coming out, we agreed to essentially goalpost on each negotiation window.

Nitin Shah:

So what we agreed to do here is that where we are proposing a deadline for the next step of the process, both for issuance of the proposed rule and for issuance of the final rule, we agreed not to go to the court and ask for issuance of a proposed rule within six months of the last triggering event. So within six months of the issuance of the SBAR report. In other words, if the SBAR report comes out on December 15th, the earliest deadline we would propose would be May 15th. And similarly, if, for example, the proposed rule were to come out and if the comment period were to close on August 15th, the soonest we would ask for the final rule to issue would be February 15th of the following year.

Nitin Shah:

And so in doing that, we provided the bureau, I think with some assurance that we weren't going to propose something that they would consider unreasonable, or that would set their hair on fire, or make it impossible for them to do the due diligence, they would consider necessary to engage in a thoughtful rulemaking process and that may have been helpful to get this settlement to land.

Chris Willis:

So is it true that the basic expectation, if everything goes relatively smoothly and according to expectations that we're likely to see a SBREFA outline this fall in September, a proposed rule sometime in 2021, and a final rule in 2022?

Nitin Shah:

Yeah. So I think that's a reasonable expectation based upon the goalposts that we've put in place in the agreement. Obviously, there's some flexibility built into it, and we may have to go to the court in case the bureau thinks it needs a whole lot of extra time. In addition, the bureau has to submit status reports every 90 days to update the court and the plaintiffs on its progress in achieving the requirements of the agreement. And in the event we agree to something and some extenuating circumstance comes up and the bureau decides it can't meet a goal or a deadline, then there's a provision for them to be able to seek relief of the court and get an extension. But I think the framework you've suggested is probably accurate.

Chris Willis:

So let's just switch gears slightly a little bit here, because we've talked thus far about the timeline for the rulemaking, which of course is what the lawsuit and the settlement were directed towards. But it's obviously of great importance, both to community groups and to industry players what the proposed and final rule may actually look like, what the requirements may be. And so, even though it wasn't a subject of the lawsuit, and I don't understand it to be a subject of the settlement, do you have any insights or previews from your knowledge of the rulemaking as to what some of the substantive issues may be that will come up and that the bureau will have to consider in framing the Section 1071 rule?

Nitin Shah:

Yeah. So the bureau held a symposium last November in which they invited various stakeholders to come and share their views on issues that may arise during the course of the rulemaking. And so industry was represented there as were other community groups, though not the plaintiffs in this case, as well as some think tank type folks. And I think one thing of note that emerged from the symposium I thought was that there's actually a consensus among industry that it's time for this

rulemaking to happen, that the regulatory uncertainty, that abounds as a consequence of this sort of hanging over everyone's head, but the status of it being uncertain was actually not helpful for anyone.

Nitin Shah:

That said, there are certainly going to be some issues that have been previewed that are likely to arise and that the bureau is going to do some thinking about during the rulemaking process. Now the Section 1071 speaks in fairly mandatory terms, and it defines concretely in very broad terms who a financial institution is. In fact, here, I can read you the definition because it's quite capacious. It means any partnership, company, corporation, association, trust estate, cooperative organization, or any other entity that engages in any financial activity. So it's a very broad definition.

Nitin Shah:

The statute also contains definitions of small business and minority and woman-owned business as well. I do think that based upon the symposium, there will probably be further discussion about whether the bureau should exercise its authority to create exceptions or exemptions for certain categories of financial institutions, for example, smaller financial institutions. And in addition to that, I think there will be discussion of how to define small business, whether to track an SBA definition or whether a different definition is more appropriate for the particular objectives of the statute and as well for defining women and minority-owned business, whether you have to be a small business and a woman-owned business or a minority-owned business, or whether those are three separate freestanding categories.

Nitin Shah:

Those are all issues that I think have been flagged. I think another one that folks are going to talk about a little bit is exactly what data the bureau should be publishing. Obviously there are privacy considerations that go into that. It's important to our clients, that the data be thorough, comprehensive, and granular enough that it allows our clients to do the important work that they need to do in order to identify communities that have been subject to discrimination, or whether credit deserts operating.

Nitin Shah:

At the same time, our other clients include two entrepreneurs, Deborah Field, owner of a publishing company in Portland, Oregon, and ReShonda Young who owns a gourmet popcorn franchise in Waterloo, Iowa. And they certainly don't want their loan applications being made public. So they certainly understand that there are privacy interests that may counterbalance some of the broader interests in ensuring that there's useful data, that it actually achieves statutory objectives.

Nitin Shah:

So to sum it up, I think, although the statute speaks in broad and fairly clear and mandatory terms, that's not to say that there won't be a substantial push from a certain stakeholders to try to narrow statutory terms and create broader exemptions. And so I think those are things that the bureau will be grappling with.

Chris Willis:

Well, Nitin, thank you so much for being on today's podcast. We really appreciate it. And your comments have been so helpful and so insightful on a subject that I think is of tremendous importance to the financial services industry because of the central role that these data collection rules have played in the past to fair lending enforcement and monitoring. We only have to look at HMDA as an example, and look at the outpouring of fair lending enforcement and monitoring both by government agencies and by consumer advocacy groups, following the creation of HMDA reporting to see the potential impact that Section 1071 rule may have in the small business area along the same lines. And so I think you'll probably agree with me that you've now set the ball rolling on what will be ultimately a very important rulemaking both for the consumer advocacy side, as well as the industry. So thank you for being on today's program.

Nitin Shah:

Absolutely, Chris, my pleasure. Thanks very much for having me.

Chris Willis:

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