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6 Things To Know About The Post-Chevron Finreg Impact

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Law360 (July 3, 2024, 10:49 PM EDT) -- The U.S. Supreme Court's decision to overturn the Chevron deference last week may make it tougher for financial regulators to defend a range of rules and regulations pursued by the Biden administration, although experts anticipate the ruling will have an uneven impact across the financial services industry.

In the cases Loper Bright v. Raimondo and Relentless v. Department of Commerce, the high court's conservative majority overturned a decades-old precedent instructing judges about when they could defer to federal agencies' interpretations of law in rulemaking. The justices said that precedent, established in 1984 in Chevron v. Natural Resources Defense Council, improperly prioritized the executive branch's legal interpretations over the judicial branch's.

Experts told Law360 that in light of the ruling, financial regulators may have a harder time defending aggressive rules and guidance and may lean more heavily on their supervisory and enforcement authorities. And while Congress has intentionally left rulemaking flexibility to agencies in certain areas, the high court's decision may boost challenges to the rulemaking agenda of agencies such as the U.S. Securities and Exchange Commission.

Here are six things to know about how the end of the Chevron deference impacts the financial regulatory space.

Pending and Future Regulatory Actions Could Be Dialed Back as Litigation Risk Rises

Biden administration financial regulators have pursued ambitious agendas aimed at, for instance, reining in junk fees, cracking down on cryptocurrency, addressing emerging climate risk and tightening big-bank rules, all efforts that have drawn repeated industry complaints.

Those complaints have animated a growing number of lawsuits challenging the output of agencies like the SEC and Consumer Financial Protection Bureau, and an election-year push to wrap up unfinished rules on banker pay, medical debt and debit card swipe fees, among others, could provoke further court fights yet.

Although this litigiousness on the part of the financial industry was already on the rise before last week, the demise of Chevron deference could embolden more such challenges by making it clear that the agency interpretations of law underpinning a rule won't be entitled to the benefit of the doubt in court.

"It really removes one of the hurdles that you would have to face in any case involving an interpretive decision by a regulatory agency," Scott Pearson, leader of the consumer financial services practice at Manatt Phelps & Phillips LLP, told Law360. "Chevron made it more challenging to prevail, but now that disincentive for trade groups or affected companies to bring challenges in the first place is gone."

With this barrier lowered, recent novel assertions of agency authority — like the CFPB's moves to apply certain credit card protections to buy-now, pay-later loans and establish a nonbank "repeat offender" registry — could be at greater risk of getting challenged and overturned, Pearson said.

It could also dampen how aggressive regulators are willing to be with agenda items still in development, including new, potentially stricter bank merger review guidelines and the Basel III endgame overhaul to bank capital requirements underway at the prudential banking agencies.

"I do think this will crystallize what has already been a changing mindset for the banking regulators," said Aaron Chastain, a Bradley Arant Boult Cummings LLP financial services litigation and regulatory partner. "They're going to be more cognizant that they will have challenges based on their statutory interpretations and will have to work [harder] to justify them once they're in front of a judge."

Financial industry boosters welcome the possibility of a post-Chevron chastening. In a statement last week, for example, Consumer Bankers Association CEO Lindsey Johnson cast Loper Bright as a deserved rebuke to regulators who she said often seem "to be chasing headlines and short-term political wins."

The prospect of regulators becoming more gun-shy may not just be wishful thinking on the part of industry lobbyists, either. In one anecdote shared with Law360, the release of the Loper Bright decision appears to have prompted a significant concession on the same day from a financial agency in enforcement negotiations related to a disputed statutory interpretation.

The chilling effect could be particularly strong at banking regulators like the Federal Reserve, which has traditionally tried to avoid contentious policymaking and is, as University of Michigan business law professor Jeremy Kress put it, "notoriously litigation averse."

"My biggest fear is that the banking agencies will paralyze themselves through inaction because of the threat of litigation," said Kress, who has advocated for tougher bank rules and advised the U.S. Department of Justice last year on bank merger policy. "I sense that the appetite among them to take legal risk is pretty weak."

"There's little doubt that the banking agencies are going to find themselves subject to more intense judicial oversight of their rulemaking, similar to what the SEC has already experienced," Kress added. "But what the SEC hasn't done, and banking agencies shouldn't do, is sit idly by for fear of being challenged in court."

Be Careful What You Wish For

Bold rules and guidance may be trickier to defend without Chevron deference, but that doesn't mean the federal financial agencies must pack up and go home. Columbia Law School professor Kathryn Judge pointed out that the agencies have multiple powerful tools to shape how the financial industry runs.

If the banking agencies are more hesitant to use rulemaking, for example, "they may rely more heavily on their supervisory authority to make sure that banks are taking the steps necessary to address the

risks that they're exposed to," said Judge, who specializes in financial markets and regulation.

Federal regulators have broad authority to look around inside a whole range of financial services firms and issue criticisms, recommendations and directives when they don't like what they see.

This supervisory authority is particularly robust concerning banks — the Fed and its peer agencies have wide latitude to maintain the safety and soundness of the banking system — and the resulting interactions are not only confidential but also typically not subject to judicial review, unlike rulemaking.

Supervision and examination can accordingly be pathways for regulators to implement their policy views. However, for years, Chevron deference had provided them an incentive to promulgate policy instead through the more public and deliberative mechanism of rulemaking, Judge said.

"In Loper Bright, the court took away that carrot," Judge said. "It took away this extra incentive that bank and other regulators had to use rulemaking, as opposed to the other tools available to them."

Enforcement is another one of those tools. By carefully selecting targets and negotiating settlements, agencies can bootstrap a body of quasi-precedent to communicate what they consider to be prohibited and deter it.

"Nothing in Loper Bright reduces the authority of regulators such as the CFPB to use enforcement as a critical mechanism for not only enforcing but making federal policy in situations where there is ambiguity with regard to what a statute requires of a firm," Judge said.

The irony, of course, is that industry critics have long railed against this kind of "regulation by enforcement," arguing the practice creates stifling uncertainty, causes compliance to be costlier and more complex and produces inconsistent, arbitrary results.

But by making clear, proactive rulemaking appear more of a gamble, the Supreme Court's decision may prompt hard-charging regulators to turn to these other, less transparent alternatives.

Some Financial Regulation Will Be More Durable Than Others

Don't get the wrong idea: Attorneys who spoke to Law360 were careful to emphasize that by ending Chevron deference, the Supreme Court has not handed financial industry litigants a foolproof wrecking ball for rules they don't like.

For one, Bradley Arant's Chastain said in some areas of financial law Congress gave the agencies significant discretion to determine how technical regulatory details should be filled in. Under Loper Bright, courts are still supposed to "respect" that discretion and can consider agencies' expertise when reviewing their legal interpretations.

Bank capital requirements are one of those areas where lawmakers built in a lot of rulemaking flexibility, Chastain said. As a result, if such requirements were to be challenged, courts would probably still "tend to be pretty deferential," he said.

"I doubt there's going to be a lot of appetite for a very searching judicial review of those sorts of rulemakings," Chastain said. "As much as the industry is worried about Basel III, I think it would be hard to look at it and say Loper Bright provides a rifle-shot argument as to why the rules would need to be

discarded or set aside. I think you would see a stronger challenge that's based on [other grounds]."

The agencies themselves will also adapt over time to the new post-Chevron environment by adjusting how they write, justify and defend their rulemaking to account for the heightened legal risk, Judge said.

"There's no reason to assume that courts are going to be friendlier towards the banks than their regulators," Judge said. "The longer-term effect isn't necessarily going to be a more business-friendly environment for banks."

Manatt's Pearson said Loper Bright could cut both ways, too. Although the end of Chevron deference could fuel new challenges to block the Biden administration's financial regulatory agenda, it could also make it harder for a future administration to change the rules again and deregulate down the road.

"When there's a Republican administration, this is going to impact its rulemaking by just as much as it will a Democratic administration," Pearson said. "Sometimes these things may seem at the moment to be clearly pro-industry or pro-consumer or however you want to characterize it, but I don't think that's the case."

Some SEC Rule Challengers May Get a Boost

Attorneys said the SEC will likely see a smaller effect from the high court's ruling than other federal agencies. But the decision could be an additional arrow in the quiver of those challenging some specific agency rules.

David Fredrickson, senior of counsel at Covington & Burling LLP, said Chevron deference hasn't figured prominently in the SEC's past defense of its rules. Instead, the legal questions the agency typically faces for its rules include whether they were enacted arbitrarily and capriciously, whether the agency has adequately explained the basis for the rules, and whether there was an infringement of First Amendment rights.

Still, Fredrickson, who has held various senior roles in the SEC's Division of Corporation Finance and Office of the General Counsel, said the Chevron ruling would probably crop up in future arguments.

"If I'm litigating against the SEC, and I previously had six arguments, of course, I will add the seventh that the SEC is not entitled to any Chevron deference, just for good measure," Fredrickson said. "Whether that seventh argument will change outcomes — I think probably not, but good lawyers bring all the arguments they can make."

Fredrickson said that while the Chevron deference is less relevant to the SEC's controversial **climate disclosure rule**, for instance, it's more applicable to matters involving the definition of statutory terms. As one example, he pointed to the agency's decision to bring proprietary trading firms and some hedge funds **under its authority** as securities dealers, since the agency is aiming to broaden the definition of a dealer.

Similarly, the agency's rule heightening disclosure requirements on proxy advisory firms may face fresh attacks using the Loper Bright decision. In April, the SEC appealed a ruling that it cannot define proxy voting advice as "solicitation."

Christine Schleppegrell, a regulatory and compliance partner at Morgan Lewis & Bockius LLP, said Loper

Bright will bolster arguments made by those challenging SEC rules on the grounds of weak authority.

"It strengthens the challenges to rules that were already going to be challenged for other statutory reasons, but I don't think that the Chevron ruling necessarily is going to focus industry efforts that weren't already underway to challenge some of these things," she said.

Schleppegrell, who has held leadership roles in the SEC's Division of Investment Management, also said throwing out Chevron deference may limit the agency's options to appeal the Fifth Circuit's June decision to **vacate regulations** that would have required private fund advisers to provide detailed disclosures to investors.

"With this decision in Chevron coming out at the end of the same month that the private fund rules were vacated by the Fifth Circuit, it does suggest that the SEC appealing the vacatur of the private fund rules to the Supreme Court would not be particularly productive," she said.

But agencies likely saw the high court's decision coming and may have started preparing years ago by arguing they have clear statutory authority from Congress and, therefore, no need to rely on the Chevron deference. In those instances, the high court's ruling may have less of an effect, she said.

Early Tests of Loper Bright's Effect Are Already Taking Shape

Since last week, the Loper Bright decision has been invoked in multiple pending lawsuits that pit financial regulators against the financial regulated. These cases will provide some of the first opportunities to see how lower courts respond and, by extension, what the fallout might be.

The CFPB, for example, flagged the decision Tuesday for the Seventh Circuit, where the agency has appealed its loss in a redlining case that it brought against a Chicago-area mortgage lender, CFPB v. Townstone Financial.

The appeal centers on whether a key federal fair lending law's ban on discriminating against any credit "applicant" can be extended by regulation to include "prospective applicants." An Illinois federal judge ruled that "applicant" can't be construed this broadly and threw out the CFPB's case. However, the agency argued Tuesday that this wider interpretation is consistent with Loper Bright.

"For starters, that conclusion has never depended on deference; the bureau's interpretation is correct," the agency said.

Indeed, the CFPB's strategy at the circuit court since last year has been to "argue in favor of its reading of the word 'applicant' based on fundamental principles of statutory interpretation, and not based on Chevron deference," Bradley Arant's Chastain said.

Whether or not the CFPB chose this strategy specifically "anticipating the outcome in Loper Bright," he added, it underscores the point that agencies have already been thinking about how to make arguments capable of persuading skeptical judges without relying on deference.

Townstone, for its part, has said the CFPB is still wrong. Loper Bright did not "usher deference out the front door while surreptitiously escorting it back in through the rear, as CFPB seems to think," the company told the Seventh Circuit on Wednesday.

Earlier this week, a D.C. federal judge also cited Loper Bright in spontaneously throwing out an adverse recommendation against Bank of America in a Federal Deposit Insurance Corp. lawsuit accusing the bank of underpaying deposit insurance premiums a decade ago.

A magistrate judge's decision recommended granting summary judgment to the FDIC on the question of Bank of America's liability and holding a trial to determine whether the bank owes more than $1.1 billion or just around half that amount. U.S. District Judge Loren AliKhan vacated that decision on Monday.

Central to the case are FDIC rules laying out how banks were supposed to calculate their premiums. Bank of America and FDIC have disagreed over the proper interpretation and validity of those rules, but Judge AliKhan said Loper Bright had "changed the legal landscape" so much that it would make more sense to reset and hold a new briefing.

More Work in Congress

In an environment where administrative agency interpretations are easier to attack through litigation, Congress may face an added burden of delving into details previously delegated to agencies. That could complicate the legislative process for emerging areas like digital assets.

Andrew Hinkes, co-chair of K&L Gates LLP's digital assets industry group, said lawmakers may be more likely to include "more granular, specific technical detail" in future legislation to clearly and precisely codify an agency's delegated authority. That could require more agency input during the drafting process.

"Congress already relies on administrative agencies to provide technical assistance when drafting bills; there could be a marked increase in agency participation in bill drafting to attempt to avoid broad or vague delegations to agencies," Hinkes said.

In this session, Congress made considerable progress towards passing laws that would set rules of the road for the digital asset industry, with a market structure bill passing out of the House and continued dialogue around a bill that would set standards for reserve-backed stable-value tokens. But Jaret Seiberg, managing director of TD Cowen's Washington research group, said in a note following Loper Bright that the result is a "headwind that will require more lobbying and industry pressure" to get crypto bills through the chambers.

According to Seiberg, the loss of Chevron degrades a key path to compromise, "which is to keep the language ambiguous in order to leave the final decision to the regulator."

"This offers political benefits as lawmakers can later criticize the regulator for not following the intent of Congress, even if Congress failed to clearly articulate what should happen," Seiberg said.

Seiberg said it's likely that both Democrats and Republicans will want to hash out specificities related to investor protections, consequences for violations and the point at which a digital asset shifts from being a security to a commodity — a key part of the current market structure proposal — rather than leave the finer points to agencies.

But the drafting process could also reach a level of technical detail not normally seen in legislation, Seiberg said. That could include how anti-money laundering standards apply to assets that travel

through anonymizing software or standards around retail users' use of novel financial products.

"No longer will either side be comfortable deferring to the regulator, as the courts are now likely to second guess those decisions," he said.

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