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A Short Primer on the Administrative Law of Bank Regulation

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Financial Services

I. Introduction

Presidential elections, whatever their outcome, often serve as a natural inflection point in the regulatory cycle, marking a shift in regulatory priorities and agendas. This is particularly true in bank regulation, where higher-profile regulatory changes are often accompanied by lower-profile but equally important changes in supervisory approaches and practices. Bearing that in mind, it may be a useful time for banks and other financial institutions to refresh their knowledge of the key administrative law requirements that will govern the next regulatory cycle, including the various judicial remedies available to affected parties when regulators do not satisfy those requirements.

Although sometimes taken for granted, the Administrative Procedure Act ("APA") and complementary statutes and jurisprudence provide affected parties with a powerful set of tools to ensure that any regulatory or supervisory changes are consistent with law, enacted through legally mandated procedures, and applied in a fair and appropriate manner. This article briefly highlights and describes those key tools, and in particular the most significant requirements, remedies, and considerations, with a focus on three areas most likely to impact financial services: (i) agency rulemaking; (ii) other forms of policymaking, including agency guidance; and (iii) *ad hoc* supervision and examination.[1]

II. Agency Rulemaking

A federal agency's ability to make law through the enactment of rules is a significant administrative power, and federal agencies generally have substantial discretion in their rulemaking activities. Yet their rulemaking activities must still satisfy certain standards and procedures derived from the Constitution, statutes, case law, and executive orders. The most

[1] Because agency enforcement activities present similar but distinct issues and can involve different procedural considerations, we do not address them here.

important of these in practice is the APA.[2] Under the APA, rulemaking may be "formal" (*i.e.*, where rules "are required by statute to be made on the record after opportunity for an agency hearing," using trial-like procedures) or "informal," which may occur through other mechanisms such as notice-and-comment rulemaking, direct final rulemaking, and the issuance of interpretive rules, guidance documents, and other general policy statements.[3] Because formal rulemaking is rare in financial services regulation but informal rulemaking is common, we focus here on the latter.

At the center of the APA is a series of procedural and substantive standards that generally govern any agency action, which vary depending on the type of rule at issue. If an agency wishes to enact a so-called "legislative" or "substantive" rule—meaning a rule that has the force and effect of law—section 553 of the APA generally requires the federal agency to do so pursuant to a notice-and-comment rulemaking process.[4] In other cases in which an agency wishes to enact a rule that does not have the force and effect of law—such as "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice"[5]—the APA exempts such "non-legislative" rules from the notice-and-comment requirement, though other requirements continue to apply to varying degrees. In addition to these procedural standards, additional substantive standards described below apply to both types of rules.

Collectively, these procedural and substantive standards establish important protections against inappropriate agency action. These protections may be particularly relevant to financial regulation, as many of the legal standards applicable to banks have been established not by

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[2] Although the APA applies to only federal agencies, 5 U.S.C. § 551(1), States have enacted their own codes of administrative procedure (*e.g.*, the New York State Administrative Procedure Act), which may be relevant to certain challenges to actions by state regulators. We focus here only on standards governing federal agencies.

[3] 5 U.S.C. § 553(c). Although rules are generally promulgated through informal rulemaking, "when rules are required by statute to be made on the record after opportunity for an agency hearing," § 556 and § 557 of the APA apply, forcing the agency to complete trial-like procedures before rules can be promulgated.

[4] Determining whether a rule is "legislative" is a complex and fact-specific analysis, but the principal test is whether the rule "has legal effect" or "speak[s] with the force of law." *Nat. Res. Def. Council v. Wheeler*, 955 F.3d 68, 83 (D.C. Cir. 2020) (quotation marks omitted). Courts have taken a variety of approaches to making this determination; for example, the D.C. Circuit has identified four circumstances in which a rule will be deemed "legislative": "(1) whether in the absence of the rule there would not be an adequate legislative basis for enforcement action or other agency action to confer benefits or ensure the performance of duties, (2) whether the agency has published the rule in the Code of Federal Regulations, (3) whether the agency has explicitly invoked its general legislative authority, or (4) whether the rule effectively amends a prior legislative rule." *Am. Min. Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

[5] *See* 5 U.S.C. § 553(b)(3)(A). The Attorney General's Manual on the Administrative Procedure Act (1947) supplies "working definitions" of "interpretative rules" ("rules or statements issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers") and "general statements of policy" ("statements issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power"). *Id.* at 30 n.3. "Rules of agency organization, procedure, or practice" (also known as "procedural rules") "do not themselves alter the rights or interests of parties, although [they] may alter the manner in which the parties present themselves or their viewpoints to the agency." *James v. Hurson Assocs. v. Glickman*, 229 F.3d 277, 280 (D.C. Cir. 2000) (quotation marks omitted).

statute, but rather through agency rulemaking of various types under statutes that are broad and general in nature.[6]

A. Procedural Standards - Notice and Comment & Publication

The most common form of legislative rulemaking is what is known as notice-and-comment rulemaking. Under the APA, a *legislative rule* must generally be issued through this notice and comment process, which requires that the responsible agency or agencies ensure that the public has a meaningful opportunity to comment on the proposed rule's content.[7] This is typically achieved by publication of a notice of proposed rulemaking in the *Federal Register*. The APA requires that this notice include "(1) a statement of the time, place, and nature of public rulemaking proceedings; (2) reference to the legal authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved."[8]

In addition to notice-and-comment requirements for legislative rules, the APA includes a separate publication requirement that is applicable to *all* types of rules, including non-legislative rules. Under the APA's publication requirement, which is part of the Freedom of Information Act ("FOIA"), agencies are required to publish "substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency," along with any amendments or revisions to, or repeals of, the same, in the Federal Register.[9] Agencies are also required to "make available for inspection in an electronic format" statements of policy and interpretations not published in the Federal Register, as well as administrative staff manuals and instructions to staff that affect a member of the public.[10]

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[6] *See, e.g.*, 12 U.S.C. §§ 1818(b), (e), (i) (granting federal banking agencies the authority to bring enforcement actions against insured depository institutions or institution-affiliated parties engaging in "unsafe or unsound" practices); 12 U.S.C. § 3907(b)(1) (granting agencies the authority to deem any failure to maintain minimum capital levels an unsafe or unsound practice).

[7] 5 U.S.C. § 553. The agency may omit the notice-and-comment requirement if it "for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. § 553(b)(B). The D.C. Circuit has stated that the "good cause" exception to section 553's notice and comment requirements is "narrowly construed and only reluctantly countenanced." *Mack Trucks, Inc. v. EPA*, 682 F.3d 87, 93 (D.C. Cir. 2012).

[8] 5 U.S.C. § 553(b)–(c).

[9] *Id.* § 552(a)(1)(D). This requirement also applies to all agency "rules of procedure, descriptions of forms available or the places at which forms may be obtained, and instructions as to the scope and contents of all papers, reports, or examinations." *Id.* § 552(a)(1)(C).

[10] 5 U.S.C. §§ 552(a)(1), (a)(2)(B), (a)(2)(C).

B. Substantive Standards - Judicial Review

In addition to these procedural standards, federal agency rulemaking may be challenged in court on a number of grounds. Indeed, there is a "strong presumption that Congress intends judicial review of administrative action,"[11] and the APA specifically provides that "final agency action for which there is no other adequate remedy in a court [is] subject to judicial review."[12]

Under sections 702 and 706 of the APA, a person adversely affected by agency action—including a final agency rule—can seek to have the courts set aside the action on a number of grounds that may be relevant to banks and other financial institutions. In particular, the APA provides that a court can "hold unlawful and set aside agency action, findings, and conclusions" for a range of reasons, including where that agency action, finding, or conclusion is:

- "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law";
- "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right"; and/or
- "without observance of procedure required by law."[13]

Given their importance, we briefly discuss these three standards below.

1. "Arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"

The Supreme Court has explained that under the commonly used "arbitrary and capricious" standard, a court must invalidate agency action that fails to "examine the relevant data and articulate a satisfactory explanation for [the] action including a rational connection between the facts found and the choice made."[14] Specifically, agency action would normally be arbitrary and capricious "if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[15]

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[11] *Smith v. Berryhill*, 139 S.Ct. 1765, 1776 (2019) (quoting *Bowen v. Mich. Acad. of Family Phys.*, 476 U.S. 667, 670 (1986)).

[12] 5 U.S.C. § 704; *see also id.* § 702.

[13] See 5 U.S.C. § 706(2)(A), (C), (D). Agency action may also be challenged under the APA when it is "contrary to constitutional right, power, privilege, or immunity"; "unsupported by substantial evidence" in a formal rulemaking or other action reviewed on the record of an agency hearing provided by statute; or "unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court." *Id.* § 706(2)(B), (E), (F).

[14] *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quotation marks omitted).

[15] *Id.*

This substantive standard can be particularly relevant where agency rulemaking is highly technical or substantially rests on empirical data or quantitative analysis and conclusions, as is often the case in financial regulation (*e.g.*, capital or liquidity regulation). For example, courts have concluded that an agency decision that ignores substantial economic costs and achieves the opposite of its intended result is not reasoned.[16] Similarly, when an agency uses a computer model as part of an agency action, the agency must "explain the assumptions and methodology used in preparing the model and, if the methodology is challenged, must provide a complete analytic defense" of the model.[17]

2. "In excess of statutory jurisdiction, authority, or limitations, or short of statutory right"

The Supreme Court has also explained that "an administrative agency's power to regulate in the public interest must always be grounded in a valid grant of authority from Congress," and that it grants varying degrees of deference to agency interpretations when determining whether an agency has exceeded its statutory authority.[18] When considering under the *Chevron* doctrine how an agency has interpreted a statute the agency is charged with administering, a court will apply a two-step analysis to determine whether the agency has exceeded its statutory authority. First, if the statute is clear and unambiguous on its face, agency action that conflicts with this authority will be deemed invalid. Second, if the statute is "silent or ambiguous" on the relevant legal question, the court will determine whether the agency's interpretation "is based on a permissible construction of the statute."[19] If the agency's interpretation is reasonable, the court will not substitute its own interpretation of the statute, but will defer to the agency's interpretation.[20]

There are important exceptions to this rule, however. For example, *Chevron* deference is much less likely to apply where the agency does not promulgate its interpretation through notice-and-comment rulemaking.[21] In addition, the Supreme Court has suggested that *Chevron* deference does not apply where multiple agencies share interpretive authority over a statute.[22]

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[16] *See Nat'l Ass'n of Home Builders v. EPA*, 682 F.3d 1032, 1040 (D.C. Cir. 2012) ("[W]hen an agency decides to rely on a cost-benefit analysis as part of its rulemaking, a serious flaw undermining that analysis can render the rule unreasonable.")

[17] *U.S. Air Tour Ass'n v. FAA*, 298 F.3d 997, 1008 (D.C. Cir. 2002) (quotation marks omitted).

[18] *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 161 (2000); *United States v. Mead Corp.*, 533 U.S. 218, 226–27 (2001).

[19] *Chevron*, 467 U.S. at 843.

[20] *Id.* Agencies may also receive deference to their interpretations of their own ambiguous regulations, provided several additional prerequisites are met. *See Kisor v. Wilkie*, 139 S.Ct. 2400, 2414–18 (2019) (limiting *Auer v. Robbins*, 519 U.S. 452 (1997)).

[21] *See Mead*, 533 U.S. at 233; *see also id.* at 226–27 ("[A]dministrative implementation of a particular statutory provision qualifies for Chevron deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority."); *Christensen v. Harris County*, 529 U.S. 576 (2000).

[22] *See Bowen v. Am. Hosp. Ass'n*, 476 U.S. 610, 642 n.30 (1986) (declining to defer to an HHS regulation under the *Chevron* doctrine, even though Congress had expressly delegated rulemaking authority to the agency, because

This may be particularly relevant in the context of bank regulation, where several of the most significant statutory frameworks are administered by multiple agencies. For example, the D.C. Circuit has consistently refused to defer to the federal banking agencies in their interpretations of provisions of the Federal Deposit Insurance Act ("FDI Act") because multiple agencies bear overlapping responsibilities to enforce the statute.[23] The D.C. Circuit has also clarified that the multiple-agency doctrine precludes *Chevron* deference to agency interpretations of statutes, such as the FDI Act, that give more than one agency enforcement jurisdiction over the same party.[24]

3. "Without observance of procedure required by law"

Agency actions may be subject to judicial review if the agency failed to follow the "procedure required by law."[25] These challenges typically require courts to consider whether an agency failed to provide adequate notice or failed to use the notice and comment procedures at all. For example, an agency action may be susceptible to challenge where the agency enacts a rule that it deems a policy statement exempt from the notice-and-comment requirement, but that rule functions as a legislative rule because the agency applies it with legally binding effect in practice.[26]

C. Special Considerations for Banking Agency Rulemaking

The APA's protections may be particularly important in the context of the federal banking agencies, as many of these agencies' rules are promulgated pursuant to a small number of general statutory provisions, key provisions of which may be subject to substantial interpretation and/or more detailed implementation through rulemaking. For example, the federal banking agencies' authority to constrain "unsafe or unsound practices" is a linchpin of the regulatory framework for banking organizations.[27] While these agencies have generally asserted an

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numerous agencies had been authorized to promulgate similar regulations, and thus "[t]here is . . . not the same basis for deference predicated on expertise as we found with respect to the Environmental Protection Agency's interpretation of the 1977 Clean Air Act Amendments in *Chevron*").

[23] *See, e.g.*, *DeNaples v. OCC*, 706 F.3d 481, 488 (D.C. Cir. 2013) (stating that the D.C. Circuit has "repeatedly pointed to the agencies' joint administrative authority under [the FDI Act] to justify refusing to defer to their interpretations," and collecting cases); *Grant Thornton, LLP v. OCC*, 514 F.3d 1328, 1331 (D.C. Cir. 2008) ("We review the OCC's interpretation of FIRREA and related statutory provisions *de novo* because multiple agencies besides the Comptroller administer the act, including the Board of Governors of the Federal Reserve [System], the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision in the Treasury Department."); *Proffitt v. FDIC*, 200 F.3d 855, 863 n.7 (D.C. Cir. 2000) (noting that *Chevron* does not apply to provisions administered by multiple agencies).

[24] *See, e.g.*, *Collins v. NTSB*, 351 F.3d 1246, 1252–53 (D.C. Cir. 2003); *Proffitt*, 200 F.3d at 863 n.7.

[25] 5 U.S.C. §§ 706(2)(D).

[26] *See Nat'l Min. Ass'n v. McCarthy*, 758 F.3d 243, 252–53 (D.C. Cir. 2014) (whether rule is legislative or general statement of policy depends in part on "whether the agency has applied the guidance as if it were binding on regulated parties").

[27] *See* 12 U.S.C. §§ 1818(b), (e), (i) (granting federal banking agencies the authority to bring enforcement actions against insured depository institutions or institution-affiliated parties engaging in "unsafe or unsound" practices).

expansive view of this authority, some courts have disagreed and construed it much more narrowly.[28] Similarly, regulatory capital standards—among the most significant requirements applicable to many financial institutions—have been established through complex and technically detailed regulations that are promulgated pursuant to statutes that grant the relevant agencies authority to set such requirements (if at all) in only the most general terms.[29]

III. Agency Guidance & Other Types of Policymaking

Although promulgating regulations is a major focus of federal agency activity, federal agencies may also issue guidance documents, policy statements, and interpretive rules that do not have the force and effect of law. As described above, and unlike legislative rules—which *do* have the force of law—these guidance documents and other forms of non-legislative rules need not be promulgated through the APA's notice-and-comment procedures.

This category of agency action is particularly relevant to banks, as the federal banking agencies frequently issue guidance documents and other non-legislative rules, including interagency statements, advisories, bulletins, policy statements, questions and answers, and frequently asked questions.[30] Recently, the federal banking agencies have taken steps to clarify the role of supervisory guidance in certain contexts, first through the issuance of a 2018 interagency statement of policy and more recently through issuance of a proposed rule that would codify, subject to certain changes, that statement as a regulation.[31]

Although these guidance documents and other non-legislative rules need not be issued through notice-and-comment rulemaking, a number of relevant standards and requirements nonetheless apply to federal agencies' activities in this area. First, and axiomatically, such a guidance document or other non-legislative rule must not be a legislative rule in reality; if it is, the agency's action may be susceptible to challenge on grounds that the agency acted without observance of procedure required by law (i.e., pursuant to notice and comment, as required under section 553 of the APA). Second, such a guidance document or other non-legislative rule remains subject to the other substantive standards established for judicial review under section

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[28] *See, e.g.*, *Kaplan v. OTS*, 104 F.3d 417, 421 (D.C. Cir. 1997) (holding, contrary to the position advanced by the OTS, that for the conduct to constitute an unsafe or unsound practice, the agency must show that there is some "undue risk to the institution" that is "reasonably foreseeable").

[29] *See, e.g.,* International Lending Supervision Act of 1983, Pub. L. 98-181 § 908, 97 Stat. 1153, 1280 (codified at 12 U.S.C. § 3907); Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. 102-242 § 131, 105 Stat. 2236, 2253 (codified at 12 U.S.C. § 1831*o*); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 § 616, 124 Stat. 1376, 1615 (codified at 12 U.S.C. §§ 1467a(g)(1), 1844(b)). For example, the International Lending Supervision Act's provisions directing the federal banking agencies to establish minimum capital requirements for insured depository institutions span only two sentences, while the regulations promulgated to implement that provision for national banks cover 215 pages in the present Code of Federal Regulations (*compare* 12 USC § 3907(a)(1), (2), *with* 12 CFR part 3).

[30] OCC, Fed. Reserve Sys., FDIC, Nat'l Credit Union Admin., Bureau of Consumer Fin. Protection, Notice of Proposed Rulemaking, Role of Supervisory Guidance at p.9, *available at* https://www.fdic.gov/news/board/2020/2020-10-20-notice-sum-d-fr.pdf.

[31] *See id.*

706 of the APA.[32] Thus, for example, such an agency action may be set aside by a court if it is found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" or "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[33] Third, as noted above, these guidance documents and other non-legislative rules remain subject to the APA's publication requirement. This requires that rules, statements of policy, and interpretations must be made available by the agency for inspection in a public format and, where of general applicability, published in the Federal Register. Should an agency fail to comply with the APA's publication requirement, the agency's action may again be susceptible to challenge under section 706 on grounds that the agency acted without observance of procedure required by law.[34]

IV. Supervision & Examination

A third key area of agency action of relevance to banks is the supervisory and examination activities of the federal financial regulatory agencies. Because the scope of these agencies' supervisory and examination authorities is highly complex—and because these agencies' supervisory and examination activities occur outside the public view, shielded by these agencies' confidential supervisory information regimes—we do not address them in detail here. We do note, however, that as with rulemaking and the issuance of guidance documents and other non-legislative rules, agency supervision and examination activities may be subject to judicial review under section 706(2) of the APA, which generally authorizes judicial review of "agency action, findings, and conclusions." Thus, these supervisory activities—for example, the issuance of an examination report with a matter requiring attention ("MRA")—may be susceptible to challenge under section 706 and set aside by a reviewing court, as, for example, "arbitrary and capricious," "in excess of statutory jurisdiction," or "without observance of procedure required by law."[35] Notably, to bring an action under the APA, a banking institution would need to challenge "final agency action" and may need to exhaust the agency's own appeals process—inquiries that will depend on the particular agency action and relevant statutory and regulatory scheme.[36]

V. Conclusion

Federal administrative law and federal financial services law are both complex and highly technical bodies of law, and the above discussion is by no means intended to present a

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[32] An agency interpretation lacking the "force of law" is not entitled to *Chevron* deference but may receive "weight . . . depend[ing] on the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Mead*, 533 U.S. at 228 (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)).

[33] 5 U.S.C. § 706(2)(A), (C).

[34] Additionally, public disclosure of the action may be sought under the Freedom of Information Act, 5 U.S.C. § 552.

[35] 5 U.S.C. § 706(2)(A), (C), (D).

[36] *See Darby v. Cisneros*, 509 U.S. 137, 154 (1993) (exhaustion of administrative remedies required before seeking judicial review "*only* when expressly required by statute or when an agency rule requires appeal before review and the administrative action is made inoperative pending that review").

comprehensive analysis of the laws governing federal agencies' activities in this area. Rather, it is intended to provide a general and summary overview of key issues and requirements that may warrant further analysis by parties affected by regulatory action. It demonstrates that the rulemaking and other activities of the federal agencies are subject to a range of significant standards and requirements to ensure that those activities are consistent with law, enacted through legally mandated procedures, and applied in a fair and appropriate manner.

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