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Texas Court Strikes Down CFPB Policy Expanding UDAAP Authority to Prohibit Discrimination in Noncredit Financial Products and Services

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On September 8, 2023, the US District Court for the Eastern District of Texas ruled that the Consumer Financial Protection Bureau (CFPB) exceeded its authority when it announced via an update to its exam manual a new policy to consider as "unfair" certain discriminatory acts and practices – including with respect to offering noncredit products and services. In its ruling, the court vacated the CFPB's exam manual update and enjoined the CFPB from enforcing the policy with respect to members of the plaintiff organizations that challenged the policy, which includes, among others, the US Chamber of Commerce and Consumer Bankers Association.

Challenged policy significantly expanded scope of CFPB's antidiscrimination efforts

In its March 16, 2022, update to the unfair, deceptive, and abusive acts and practices (UDAAP) chapter of the exam manual, the CFPB offered examples of practices that may be "unfair" because they are discriminatory. This included giving inferior terms to one customer demographic as compared to another, offering more products or services to one customer demographic as compared to another, and engaging in targeted advertising or marketing in a discriminatory manner. While the CFPB traditionally has had authority, pursuant to the Equal Credit Opportunity Act (ECOA), to prohibit discrimination in the offering of credit products, the update to the exam manual indicated the CFPB also would assess noncredit offerings for discrimination. This would have included an assessment of potential discrimination with respect to institutions' deployment of models, algorithms and decision-making processes, assessment of fees, and customer product usage, including with respect to noncredit products.

Court: CFPB's decision to examine institutions for 'unfair' discrimination – including for products and services falling outside ECOA's scope – exceeded its statutory authority

Relying on the major questions doctrine, the court considered whether Congress meant to confer upon the CFPB the power to examine institutions for unfair discrimination. The court determined that the CFPB's decision had significant economic and political implications and, as such, the bureau's action would need to be based upon a clear statement from Congress that the bureau should have such authority. The court found that the statutory definition of "unfairness" does not mention discrimination, is separate from other statutory provisions that do regulate discriminatory practices and has not historically been understood to encompass the power to prohibit discrimination. Thus, the court ruled that the CFPB's updates to the exam manual, which directed examiners to look at discriminatory practices as "unfair," exceeded the CFPB's statutory authority.

The court also followed the US Court of Appeals for the Fifth Circuit's decision in Community Financial Services Association of America v. Consumer Financial Protection Bureau, ruling that the exam manual was invalid because the CFPB is unconstitutionally funded. While the court could have ceased its analysis on these grounds, the court nevertheless considered the exam manual updates on the basis of the major questions doctrine in light of the US Supreme Court's pending review of the CFPB's funding mechanism, which provided a compelling reason to reach at least one alternative ground for providing relief to the plaintiffs in this case.

What's next?

The CFPB indicated on September 11, 2023, that it is reviewing its options for appeal, and noted on its website that the updated language in the UDAAP chapter is "no longer operative." In other instances where the CFPB is litigating over the scope of its authority – and even while a Supreme Court decision looms as to its very constitutionality – the bureau has not withdrawn from regulatory, supervisory or enforcement activity in other jurisdictions except where it must (for example, with respect to its small business lending rule, where the bureau has stayed compliance only for plaintiffs and members of plaintiff organizations, in the case successfully challenging implementation of that rule). This decision is different than some others, however, because the injunction prohibits the CFPB from enforcing the manual against the members of the plaintiff organizations, while vacating the "rule" – in this case, the exam manual – is a more universal remedy that means the bureau should not continue to rely on it. But what it portends for future litigation and enforcement activities where this same theory has been applied remains to be seen. One thing is certain: Financial institutions will need to think carefully about their exam management approach and confer with counsel early about requests that implicate the ruling.

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