Next Stages In CFPB's Uncertain Future

By **Ori Lev** (October 26, 2022)

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In a consequential decision, a panel of the U.S. Court of Appeals for the Fifth Circuit has ruled that the Consumer Financial Protection Bureau is unconstitutionally funded and that its promulgation of a payday lending rule — and presumably all of its actions — are therefore invalid.[1]

In what can only be cruel irony for the agency, the court actually upheld the substantive validity of the payday lending rule against myriad challenges only to strike down the rule and neuter the agency because of how Congress structured it. So the CFPB may have won some battles, but it is losing the war.

The decision is likely to send shockwaves through the consumer financial services industry and send the CFPB scrambling to ask the U.S. Supreme Court to reverse the decision. In the meantime, the CFPB will likely be unable to exercise any of its authorities in the states covered by the Fifth Circuit and may face challenges to its actions elsewhere.

Below, we provide background, summarize the decision and discuss its likely implications.

Background

The CFPB's payday lending rule[2] had already had a long and litigated history before this decision. The rule was first issued under Director Richard Cordray in 2017.

As originally promulgated, the rule had two main prohibitions: a prohibition on making payday loans without assessing a borrower's ability to repay, or the underwriting provisions, and a prohibition on attempting to withdraw funds from a payday customer's account without customer consent after two consecutive failed withdrawal attempts, or the payment provisions.

Shortly after the rule was promulgated, two industry trade groups sued to challenge both aspects of the rule.

Then leadership of the CFPB changed. In 2020, Director Kathleen Kraninger repealed the underwriting provisions of the rule but left intact the payment provisions. In light of the Supreme Court's intervening decision in Seila Law v. CFPB[3] in 2020 — which held that the Dodd-Frank Wall Street Reform and Consumer Protection Act's restrictions on the president's authority to remove the CFPB director were unconstitutional, thus calling into doubt actions taken by Cordray before that decision was issued — Kraninger also ratified the payment provisions of the rule.

The original lawsuit challenging the entire rule was therefore refocused only on the payment provisions. The district court granted the CFPB summary judgment, rejecting the various legal challenges raised by the plaintiffs, but stayed the compliance date of the rule pending the resolution of the appeal. A separate lawsuit by consumer groups challenging the repeal of the underwriting provisions was dismissed on standing grounds.

The Battles Won

The appeal of the challenge to the payment provision has now been resolved.

In a pyrrhic victory for the CFPB, the Fifth Circuit panel methodically rejected most of the plaintiffs' claims. First, the court held that the rule was not outside the agency's statutory authority to identify and prohibit specific conduct as unfair. The CFPB also based the payment provisions of the rule on its authority to identify and prohibit abusive conduct, but the court did not address this issue in light of its holding that the rule was a proper exercise of the CFPB's unfairness rulemaking authority.

In so holding, the court upheld the CFPB's determination that the excessive withdrawal attempts covered by the rule cause substantial consumer injury not reasonably avoidable by consumers and not outweighed by countervailing benefits to consumers or competition — the definition of unfairness in the statute. The court's analysis of these issues will likely be helpful to the CFPB in other unfairness cases — both rulemaking and enforcement — if the agency survives to exercise that authority.

Second, the court rejected arguments that the rule was arbitrary and capricious, holding that the CFPB adequately considered and explained why it structured the rule as it did.

Having ruled for the CFPB on the bread-and-butter administrative law issues, the court went on to rule for the agency on a series of other constitutional issues.

First, it rejected the plaintiffs' argument that because Director Cordray was unconstitutionally insulated from removal by President Donald Trump at the time the rule was originally promulgated, the rule was invalid. Relying on the Supreme Court's 2021 decision in Collins v. Yellen,[4] the court held that the limitation on Director Cordray's removal did not invalidate the actions he took. Rather, the plaintiffs could succeed in that aspect of their challenge only if they could show that had Trump been able to remove Director Cordray from office, the rule would not have been promulgated — a showing the court found was not made.

Next, the court rejected the argument that by granting the CFPB the authority to promulgate rules defining and prohibiting certain conduct as unfair or abusive, Congress unconstitutionally delegated its lawmaking authority. Relying on precedent from the Supreme Court, the court held that the Dodd-Frank Act's definitions of unfairness and abusiveness provide an intelligible principle for the CFPB to follow such that its rulemaking authority was appropriate.

Losing the War

But none of those victories may ultimately matter in light of the court's holding with respect to the last of the plaintiffs' constitutional challenges — that the CFPB's funding outside the congressional appropriations process is unconstitutional.

The Constitution provides that "[n]o money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."[5] The purpose of the clause is to separate the "purse" — the power to dispense public funds — from the "sword" — the power to exercise executive authority. The opinion spends several pages explaining the history of and rationale for the appropriations clause.

As a general matter, the court explained, allowing an agency to self-fund itself appears to violate this constitutional provision and undermine the separation-of-powers rationale underlying the provision.

Like some other financial regulators, the CFPB is not funded through appropriations by Congress but through other means. In the CFPB's case, the agency is authorized to draw down funds equal to up to 12% of the Federal Reserve's total operating expenses each year and keep those funds it has drawn but hasn't used for future year expenses. The Federal Reserve itself is also not funded by congressional appropriations but by interest earned on securities it owns and assessments it levies on certain banks.

The court found that this double insulation from congressional appropriations — where the CFPB gets its unappropriated funds from another agency that itself is outside the appropriations process — was relevant to the appropriations clause analysis and distinguished the CFPB's funding structure from that of other nonappropriated regulators. In this regard, the court noted that Congress ceded not only direct control over the CFPB's budget by placing it outside the appropriations process but also indirect control by providing that the funds come from another unappropriated source. But the court did not explain why that matters or what indirect control Congress might have over the other unappropriated agencies that it cannot exercise with respect to the CFPB.

The court also focused on the fact that once the CFPB draws funds from the Federal Reserve, the CFPB maintains those funds in its own accounts, even if they are not used in a given year. That distinguishes the CFPB from the Federal Reserve, which must remit its surplus funds over a certain amount to the U.S. Department of the Treasury each year. All this, the court found, was constitutionally impermissible, especially given the CFPB's "capacious portfolio of authority."

Having held that the CFPB is unconstitutionally funded, the court next turned to the appropriate remedy. Finding that the payday lending rule was promulgated with the use of unconstitutionally nonappropriated funds — the only funds available to the CFPB — the court held that the plaintiffs were harmed by the constitutional defect and that the payday lending rule should be vacated.

Although the court did not address the broader implications for the CFPB's continued operation, the court's logic suggests that all the agency's actions — which are likewise funded by nonappropriated funds — are subject to challenge as invalid to the extent they inflict harm on some private party.

At least in the Fifth Circuit, therefore, the CFPB appears, for now, to lack authority to take any action.

What's Next?

Perhaps it is incorrect to say that the CFPB has lost the war, for the fight will likely continue. Although the court's opinion is only a panel opinion representing the views of three of the Fifth Circuit's 16 active judges, another four active Fifth Circuit judges have previously expressed the view that the CFPB's funding structure is unconstitutional.[6] While the CFPB could seek en banc review of this decision before the entire Fifth Circuit, its chances of success there are for that reason quite slim.

To avoid uncertainty and expedite a final decision on this issue, we believe it more likely that the agency will promptly seek Supreme Court review, with the goal of having the case heard and decided this term. It's anybody's guess what the Supreme Court will decide.

Should it agree with the Fifth Circuit that the agency's structure is unconstitutional,

Congress will be required to act to remedy the situation to enable the CFPB to continue to operate by changing the agency's funding structure. Such congressional action could also spark intense negotiations about the agency's single director — as opposed to commission — structure and perhaps its substantive authorities as well.

The CFPB has been a political football from the day it was created. Now the Supreme Court may toss that ball back into Congress' hands.

While this all plays out, companies subject to the CFPB's authority will have to consider how to deal with the agency. Those operating only in the Fifth Circuit appear to have a solid basis — at least in the short term — to resist any agency action, though companies should also consider their long-term relationship with the agency, which is likely to survive in some form.

For companies with operations outside the Fifth Circuit, the calculations are more complex. No binding precedent prohibits the CFPB's exercise of its authorities in the rest of the country — at least one other circuit has rejected the argument endorsed by the Fifth Circuit panel.[7] Such companies seeking to rely on the Fifth Circuit's reasoning to challenge the CFPB's authority will likely need to be willing to force the CFPB into litigation — either in the Fifth Circuit if the company also has operations there, or elsewhere with no guarantee of success in either the short or long term.

One final point. The court purports to distinguish the CFPB's funding mechanism from that of other nonappropriated financial regulators such as the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the National Credit Union Administration and the Federal Housing Finance Agency. It does so based on the double insulation theory discussed above as well as what the court describes as the uniquely broad scope of the CFPB's enforcement and regulatory authority. Whether those distinctions ultimately matter from an appropriations clause perspective remains to be seen. But if the Supreme Court agrees that the CFPB's funding is unconstitutional, the decision may raise the question as to whether these other agencies' funding structures withstand scrutiny.

Ori Lev is a partner at Mayer Brown LLP.

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[1] Consumer Financial Services Ass'n of America v. CFPB, No. 21-50826 (5th Cir. Oct. 19, 2022).

[2] 12 C.F.R. part 1041.

[3] 140 S. Ct. 2183 (2020).

[4] 141 S. Ct. 1761 (2021).

[5] U.S. Const. art. I, §9, cl. 7.

[6] See CFPB v. All Am. Check Cashing, Inc., 33 F. 4th 218, 221 (5th Cir. 2022) (en banc) (Jones, J. concurring).

[7] PHH Corp. v. CFPB, 881 F.3d 75, 95-96 (D.C. Cir. 2018) (en banc).