

After Fifth Circuit ruling get ready for more challenges to CFPB authority, is Reg F next?

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The U.S. Court of Appeals for the Fifth Circuit on Oct. 19 held that the federal Consumer Financial Protection Bureau's Payday Lending Rule was invalid because it was promulgated using an unconstitutional funding scheme.

The upshot of the decision in *Community Financial Association of America v. CFPB*¹ is that while the CFPB itself validly organized, the three-judge panel found that the unique method of funding the CFPB's activities violated the U.S. Constitution's Appropriations Clause. And so, any activity that used these ill-gotten funds "deprived the Bureau of the lawful money necessary to fulfill those responsibilities." Because there was no other way for the CFPB to have made the Payday Lending Rule other than by using the unconstitutional funding, the rule is invalid.

CFPB funding held unconstitutional, but circuits are split

From its very conception the CFPB has been criticized for its unique structure. After all, it was designed to be insulated from political pressure yet have enormous power over the nation's consumer financial services environment, consolidated in the hands of one person, its director.

The three-judge panel found that the unique method of funding the CFPB's activities violated the U.S. Constitution's Appropriations Clause.

Another interesting feature is how the CFPB is funded. The Constitution's Appropriations Clause grants Congress exclusive control over "the federal purse" and this control is a necessary apparatus to the checks and balances between the three branches of the federal government. The Appropriations Clause is there to check "the executive [branch] . . . from unilaterally spending funds," and allowing Congress to retain control of the purse strings. The CFPB's funding scheme takes these purse strings away from Congress and so it is constitutionally defective, according to the opinion.

Six other district courts as well as the D.C. Circuit Court of Appeals have examined the issue and concluded the funding scheme is sound, the Court noted. But the Fifth Circuit disagreed.

Unlike most other federal agencies, the CFPB does not ask Congress for funding. Instead, it obtains its funds by making a request to the Federal Reserve, and that request may not exceed 12% of the Federal Reserve's "total operating expenses."

The Federal Reserve itself does not obtain funding from Congress, rather its expenses are paid, according to the opinion, by assessments made on banking institutions. The Federal Reserve will tell you² that its expenses are primarily paid from "interest on government securities that it has acquired through open market operations." After paying its expenses, the Federal Reserve turns the rest of its earnings over to the U.S. Treasury, so it too is insulated from the Appropriations Clause. However, the opinion points out that because Federal Reserve must remit its excess funds to Treasury, it remains "tethered" to Treasury. And since Treasury obtains its appropriations from Congress, "checks and balances" are at work.

No easy fix may be available to preserve CFPB activity undertaken during the period of unconstitutional funding.

Because the CFPB draws its funds from the Federal Reserve's insulated funds, the Fifth Circuit concluded it is not "tethered" to Treasury. The result, the opinion reasons, is that the CFPB is "double insulated" from Congressional control of its funding and removed from "checks and balances," making it unique among all federal agencies.

To be sure, this funding scheme was intentional, is contained in section 1017 of the Dodd-Frank Act which created the Bureau in 2010, and is exactly what was explained to Congress³ in hearings in 2011: "Congress provided the CFPB with a source of funding outside the appropriations process . . ."

A significant challenge to the CFPB, Reg. F and enforcement activities

The ruling poses a difficult challenge for the CFPB. Unlike the U.S. Supreme Court's decision in *Seila Law*,⁴ no easy fix may be available to preserve CFPB activity undertaken during the period of unconstitutional funding, at least in the Fifth Circuit. The decision's reasoning suggests it

is not at all possible to “sever” the funding scheme as a possible fix that would preserve the Bureau’s prior activities.

Decisions in similar cases, the Court wrote, look to whether the unconstitutional provision caused compensable harm. Although the Bureau had the requisite power to create the Payday Lending Rule, it required “funding that would enable the exercise of that power.” And since the funding was derived by an unconstitutional scheme, “without its unconstitutional funding, the Bureau lacked any other means to promulgate the rule. Plaintiffs were thus harmed by the Bureau’s improper use of unappropriated funds to engage in the rulemaking at issue.”

The likely outcome is that the issue ends up before the Supreme Court even if it is not brought through this decision.

A slew of new rules and amendments to rules pre-dating the Bureau have been promulgated under the invalidated funding scheme, including Regulation F, a first-of-its-kind federal rule covering consumer debt collection. Other CFPB rulemaking activities cover nearly all other aspects of consumer finance, from mortgage lending to credit reporting. They are all subject to the same challenge before courts sitting in the Fifth Circuit.

The CFPB also plays an enforcement role and has pending lawsuits and investigations across the nation. Likewise, in addition to rulemaking and enforcement, the Bureau performs examinations of certain covered entities. These too are called into question, at least in the Fifth Circuit, which covers Louisiana, Mississippi, and Texas.

Put another way, you can insert any of these activities into the Fifth Circuit’s decision and come out with the same result.

A period of uncertainty

The decision creates significant confusion and risk for the Bureau, covered entities and consumers. Those subject to

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CFPB enforcement actions in the Fifth Circuit are likely preparing motions to dismiss the cases brought against them. And those in the Fifth Circuit in the process of responding to a CFPB investigation are likely to petition a court in the coming days to enjoin the Bureau investigations.

As for rules, all we can say for sure is the Payday Lending Rule is void in the Fifth Circuit. No other rule was addressed, but there will be more challenges to other rules, and these are likely to be brought in the Fifth Circuit.

The path to SCOTUS

The Bureau could ask for the decision to be reviewed either by reconsideration or *en banc* by all Fifth Circuit judges. And of course, it could petition the U.S. Supreme Court to take the case — which it should do if it has any concern for avoiding the confusion and uncertainty resulting from this decision. Then again, the Bureau might do nothing. Even then, another litigant who loses on the same issue in another Circuit will likely petition the Supreme Court. Do not expect Congress to fix this in the near term, so the likely outcome is that the issue ends up before the Supreme Court even if it is not brought through this decision.

As for those outside the Fifth Circuit, remember that the D.C. Circuit Court of Appeals found four years ago that “[t]he way the CFPB is funded fits within the tradition of independent financial regulators.” That decision was rendered *en banc*. But three judges filed lengthy dissents, one of which was authored by now Supreme Court Associate Justice Kavanaugh who expressed significant concerns over the single director structure of the Bureau but did not speak to its funding.

Notes

¹ <https://bit.ly/3N3HxQh>

² <https://bit.ly/3TUeBfH>

³ <https://bit.ly/3TDG2Ld>

⁴ <https://bit.ly/3TD5gJp>