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The CFPB's Funding Structure Held Unconstitutional: The Practical Implications

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In another existential challenge to the Consumer Financial Protection Bureau (CFPB), the Fifth Circuit held in the *Community Financial* case that the CFPB's funding structure is unconstitutional. On this ground, it vacated the CFPB's Payday Lending Rule. The decision's rationale, however, is expected to have much further-reaching implications. Simply put, many believe that the Fifth Circuit's analysis invalidates practically all actions the CFPB has taken since its inception.

The CFPB's Unconstitutional Funding Structure

The CFPB is an executive agency with sweeping authority to issue regulations, conduct administrative hearings, wage civil litigation, and impose penalties on private citizens for a host of issues related to consumer finance. To exercise this authority, the CFPB requires funding, which it receives from a unique mechanism outside the congressional appropriations process. By statute, the CFPB director has the right to draw up to 12% of the Federal Reserve's annual budget without seeking approval from Congress.

The Fifth Circuit held that this funding structure violated the Constitution's Appropriations Clause, which requires that all expenditures of federal funds be approved by Congress. Specifically, the Fifth Circuit held that the CFPB's extensive mandate combined with the inability of Congress to subject the agency to oversight via the appropriations process improperly concentrated the power of both "purse and sword" in the Executive Branch.

The Remedy

As important, unlike the challenge to the CFPB's leadership structure in *Seila Law*, which led the Supreme Court to essentially rewrite the unconstitutional director-removal provision to salvage the CFPB's ability to operate, the *Community Financial* decision held that there was no similar way to fix the CFPB's unconstitutional funding. Fundamental to the *Community Financial* ruling was its interpretation of *Collins v. Yellen*, 141 S. Ct. 171

(2021), the Supreme Court's most recent take on the proper remedy when an agency's actions are tainted by an unconstitutional structure. Looking to *Collins*, the Fifth Circuit held that to obtain the holy grail of relief—vacatur of the agency action in its entirety—a party must show that: (1) a provision of the agency's enacting statute is unconstitutional; and (2) the unconstitutional provision inflicted harm.

The Fifth Circuit then found that making the showing *Collins* required was "straightforward" in the case before it because "the funding employed by the Bureau to promulgate the Payday Lending Rule was wholly drawn through the agency's unconstitutional funding scheme." From the court's perspective, this created "a linear nexus between the infirm provision (the Bureau's funding mechanism) and the challenged action (promulgation of the rule). In other words, without its unconstitutional funding, the Bureau lacked any other means to promulgate the rule."

The Implications

Problematically for the CFPB, the logic of this "linear nexus" between the CFPB's funding mechanism exists for practically all the agency's actions. Pursuant to the Dodd–Frank provisions that created the CFPB, all its operations have been funded out of the "Bureau Fund" into which quarterly draws from the Federal Reserve are deposited. That is the funding mechanism the Fifth Circuit rejected as unconstitutional. Indeed, while Dodd–Frank also created the agency's Civil Penalty Fund, the CFPB cannot by statute use those monies other than for limited purposes having to do with victim compensation and financial literacy.

There's lots of speculation about what will happen next. The CFPB has not indicated whether it will seek en banc review, try its luck with the Supreme Court, or perhaps seek a legislative fix. None of these routes is without substantial risk for the bureau. Seven of the 16 judges on the Fifth Circuit who would hear the case en banc have already authored or joined opinions concluding that the CFPB's funding structure is unconstitutional. The Supreme Court, which already invalidated the CFPB's leadership structure in *Seila Law*, now has an even more solid majority that appears poised to closely scrutinize federal agencies on these very issues. And voters have yet to decide the makeup of the 118th Congress.

Takeaway

Given this, covered persons under the CFPB's regulatory umbrella may consider striking while the iron is hot.

Parties subject to rules issued by the CFPB may consider challenging the CFPB's activity as the invalid product of the agency's constitutionally infirm funding structure. Any such challenge has the greatest likelihood of success in the Fifth Circuit, where *Community Financial* is binding and which stands as the only circuit court to have held the CFPB's funding structure unconstitutional. While the D.C. Circuit addressed the issue several years ago in *PHH Corp. v. CFPB*, numerous questions remain about the viability of its ruling. Not only was the majority's decision regarding the director-removal provision abrogated by the Supreme Court in *Seila Law*, many observers believe that its brief, cursory treatment of the appropriations issue cannot be relied upon.

Indeed, as the Fifth Circuit also noted, if anything, the subsequent *Seila Law* cure for the director-removal provision, which vests even more power in the Executive Branch, only exacerbated the separation of powers problem presented by the CFPB's self-funding mechanism. And while several district courts have also upheld the CFPB's funding structure, including the Districts of Rhode Island, Maryland, and Montana, the Middle District of Pennsylvania, Southern District of Indiana, and Central District of California, none dealt directly with the post–*Seila Law* issue or meaningfully grappled with the separation of powers arguments that carried the day in the Fifth Circuit.

Similarly, parties currently subject to CFPB investigation may consider whether to object on the grounds that the investigation is improperly funded. Some parties engaged in enforcement litigation with the CFPB, both within and even outside the Fifth Circuit, have already pressed for dismissals based on the Fifth Circuit's decision.

In short, parties should consider their options. While no one can yet say that the Fifth Circuit's decision in *Community Financial* will become law nationwide, it is clear that the decision has exposed a significant threat to the very existence of the CFPB.

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