Insight

Supreme Court Rules CFPB Structure Unconstitutional

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Executive Summary

- The 2010 Dodd-Frank Act created the new supervisory agency, the Consumer Financial Protection Bureau (CFPB), to regulate the consumer finance industry.
- Structured so that the single director could only be fired for cause and insulated from the traditional appropriations process, the CFPB has seen significant constitutional challenge from inception.
- That legal challenge has reached an end point with the Supreme Court's decision in *Seila Law vs. Consumer Financial Protection Bureau*, which held that the inability of the president to fire the CFPB director at will is unconstitutional, although the Supreme Court preserved the agency by severing the removal clause from the law creating the CFPB.

Context

In the wake of the financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, which, among a litany of other things, created the Consumer Financial Protection Bureau (CFPB). Tasked with regulating the consumer finance industry, the CFPB works to increase and improve transparency, accountability, and consumer protections.

Hoping to isolate the CFPB from political pressures, Congress designed it to be led by a single director. Under this system the director is given near unilateral powers and can be removed by the president only for cause, in cases of "inefficiency, neglect of duty or malfeasance in office." This structure is quite unlike that of other financial regulators such as the Securities and Exchange Commission (SEC) or Commodity Futures Trading Commission (CFTC), which have five-person bipartisan boards. Congress also determined that the CFPB be funded outside the traditional budgetary process.

These features were no accident or oversight, and represent the will of Congress in seeking to isolate the Bureau from political pressures. Nonetheless, the structure of the CFPB (as well as the Federal Housing Finance Agency, or FHFA) spurred a decade of legal challenge as to whether the CFPB structure violates the separation of powers doctrine. This question finally came before the Supreme Court in *Seila Law vs. Consumer Financial Protection Bureau*.

Seila Law

In 2017 the CFPB issued a civil investigative demand (essentially a subpoena) requesting information and documents from Seila Law LLC, a law firm based in California, in connection with a potential violation by the firm of federal consumer financial law. Seila Law refused to turn over the documents, and eventually challenged a petition brought by the CFPB on two grounds, one of which was that an agency headed by a single director who can only be fired for cause violates separation of powers principles and specifically the president's appointment and removal powers.

This viewpoint was upheld when *Seila Law* came before the Supreme Court, which voted 5-4 that the CFPB governance model is unconstitutional. Chief Justice John Roberts noted that "The structure of the CFPB violates the separation of powers," and that the director "must be removable by the President at will."

The Supreme Court chose, however, to sever the for-cause removal limitation from the statute, otherwise preserving the CFPB as is.

Implications

For the CFPB

The *Seila* decision will fundamentally expose the Bureau to enhanced political pressure, particularly from the president and the executive branch. These pressures will likely impact the work of the Bureau going forward. It is not just future agency rulemaking, however, that will likely be impacted. Controversial historic CFPB decisions made by directors with removal protections may become invalid or at least are likely to be litigated. Even the Supreme Court's decision to sever only part of the relevant statue may provide cause for concern regarding the legal underpinnings of the CFPB – or, even, at the most extreme view, constitute "re-writing" Dodd-Frank.

One example of a CFPB initiative thrown into some doubt by this decision is the recent proposal to modify the Qualified Mortgage (QM) rule that allows Fannie Mae and Freddie Mac, the government sponsored entities, to breach CFPB rules by providing mortgages to individuals with significant debt. The new standard is not expected to be finalized until 2021, which could potentially be under a new director.

Critics of the CFPB, however, will note that this decision, in addition to preserving the separation of powers doctrine and therefore being "correct," will likely have the advantage of significantly increasing transparency and accountability at the Bureau. The *Seila* decision will also be supported by critics of government – and in particular Dodd-Frank – regulatory overreach.

For CFPB Director, Kathy Kraninger

While there are no indications that President Trump is dissatisfied by Director Kraninger's tenure at the CFPB, the director has faced hostile questioning by congressional Democrats in the House and Senate, including relating to her approach to the constitutionality of the Bureau. Director Kraninger has served less than two years of her term. Were the next president to be a Democrat, come November that president would now be able to dismiss Director Kraninger at will.

For the FHFA

As noted in previous analysis on this topic, the structures of the CFPB and the FHFA are similar enough that the Supreme Court's decision has enormous weight. Like the CFPB, the FHFA director is appointed for five years and cannot be removed except for cause. This parallel would be significant enough even without the fact that the current FHFA director, Mark Calabria, has made significant strides toward reform of the housing finance giants Fannie Mae and Freddie Mac. These efforts could likewise be stalled, or even reversed, come November. The Supreme Court noted that the FHFA can be considered "a companion" to the CFPB but did not explicitly consider its status.

For Consumers

Many will see that consumer protection at a federal level has taken a blow, although the extent of that blow derives necessarily from the degree to which readers believe the CFPB is the only or the most effective safeguard of national consumer protection. As noted above, the work of future directors will necessarily be more informed by political winds, and these pressures will directly impact the work of the CFPB and the industries that it chooses to focus on. Politically sensitive issue areas include payday lenders, student loan providers, and credit reporting providers.

Next Steps

The legal case heard in *Seila* hinged on a 1935 law that permits “Congress to give for-cause removal protection to a multimember body of experts who were balanced along partisan lines.” Independent agencies with a degree of insulation from political interference are possible, and do exist, in the U.S. regulatory system, from the Federal Reserve to the SEC and more. What differentiates these bodies from the CFPB and the FHFA is their bipartisan commission structure (a proposal that existed in early drafts of the congressional statute, and is an issue that Congress has explicitly considered since). The benefits and detriments of restructuring the CFPB along these lines will likely feature in policy discussions over the next year – but it is extraordinarily unlikely that there will be desire in Congress to consider a proposal prior to (or even, likely, after) the upcoming election.

Conclusions

The intent of Congress in attempting to shield the Bureau from political influence was not in and of itself a concern – Congress just failed in its approach to the problem. Although the Supreme Court has undoubtedly reached the correct decision, their verdict will have wide-ranging ramifications for not just the CFPB, but also the FHFA and other independent agencies.