Consumer Finance Monitor (Season 5, Episode 43): Fifth Circuit Rules that the Consumer Financial Protection Bureau is Unconstitutionally Funded: What Does The Decision Mean? A Deep Dive with Special Guest Isaac Boltansky, Managing Director and Director of Policy Research, BTIG

Speakers: Alan Kaplinsky, Rich Andreano, John Culhane, Michael Gordon, and Isaac Boltansky

Alan Kaplinsky:

Welcome to Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr law firm. I'm your host, Alan Kaplinsky, former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'll be moderating today's program. For those of you who want even more information about the topic we'll be discussing today or anything else pertaining to consumer finance. Don't forget about our blog, consumerfinancemonitor.com. We've posted the blog since 2011, and so there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspahr.com.

If you'd like our podcast, let us know. Leave us a review on Apple Podcasts, Google, or wherever you get your podcasts. Also, please let us know if you have other ideas for other topics that we should consider covering or speakers that we should consider as guests on our show. This podcast today is based on a webinar we did on just Tuesday of this week entitled, Fifth Circuit Rules that the Consumer Financial Protection Bureau is Unconstitutional Funded. What does the decision mean? Unanimous three judge panel of the U.S. Court of Appeals for the Fifth Circuit has ruled that the manner in which the CFPB is funded, violates the appropriations clause of the U.S. Constitution. The CFPB is funded through requests made by the CFPB director to the Federal Reserve Board, rather than through the congressional appropriations process, a case CFSA et al versus the CFPB involved a challenge by two trade groups to the CFPBs payday lending rule that got issued in 2017.

The panel also ruled that the trade groups were entitled to have the rule vacated because they were harmed by the bureau's use of its unconstitutional funding to promulgate the payday lending rule. The panel's rulings that the CFPBs funding mechanism is unconstitutional and that the appropriate remedy for the constitutional violation is to vacate the challenged rule, carry enormous potential implications. During today's webinar, our plan is to review the decision in detail, discuss its potential implications. Our discussion topics will include CFPBs options for next steps that it can take. The decision's implication for ongoing CFPB activity while review is still pending. We'll also discuss implications for final and pending rules and guidance of the bureau, pending investigations, pending and fully litigated enforcement actions and final consent orders and consent orders for which court approval is pending. And we'll talk about the impact on CFPBs supervisory and other activities.

So I am joined today by my colleagues John Culhane, Mike Gordon and Rich Andreano and our special guest Isaac Boltansky. So first of all, John Culhane. John's a partner in our consumer financial services group in Philadelphia, is known for his work advising on interstate, direct and indirect consumer and residential mortgage loan and leasing programs. John's practice focuses very much on the CFPB, compliance exams and defending clients who have been targeted by the CFPB. Second is Rich Andreano. Rich is the practice group leader of our mortgage banking group and co-chair of our fair lending team. He's based out of our Washington DC office. He assists clients with preparing for and handling CFPB mortgage related exams and with a variety of mortgage related regulatory issues. Mike Gordon is a partner in our consumer financial services group. He is a former senior official at the CFPB with two decades of experience in consumer financial services law.

In addition to being a former regulator, Mike has also been general counsel of FinTech lending platform. And finally, and certainly not least, our very good friend Isaac Boltansky. Isaac has been a guest on many of our programs and we're always delighted to have him join us. He is the managing director and director of policy research of BTIG. BTIG is a global financial services firm specializing in investment banking, institutional trading, research and related brokerage services. Isaac will be our last speaker today and make sure you stay for Isaac, because Isaac has got hopefully the answer for all these problems and that is he is going to discuss what might happen in congress and what the timing is for that, what the impact of the midterms is, et cetera. It's now my pleasure to turn the program over to John Culhane.

John Culhane:

Thanks, Alan. We've set forth at the beginning of the deck, the statutory and constitutional provisions that the fifth circuit panel is discussing. So obviously the main one from Dodd-Frank, section 1017(e) authorizing the transfer of funds from the Board of Governors. We have not included part of this section. I'm going to reference it briefly. Section 1017(e), lower case E in parens, authorized the bureau to obtain supplemental appropriate funds of 200 million from 2010 through 2014. And there've been some arguments that that may have some impact on the analysis here and it may be important for determining how institutions can proceed. So I'll reference it, you can look it up. It's not quoted in the slide here. I do want to note at the outset though that the CFPB pulls an awful lot of money from the Federal Reserve system. Almost 642 million for fiscal year 2022.

That amount has just been increasing dramatically each year. The opinion rep references a provision in the Federal Reserve Act dealing with the transfer of funds from the Federal Reserve Bank to the Federal Reserve to the Treasury. So we've included it here and obviously the appropriations clause. I'm not going to talk about the history of the litigation. We're going to skip forward a little bit. I think everybody has a sense of what happened here. The CFPB promulgated a payday lending rule. It was promptly sued and eventually we wound up with a case before a panel of the Fifth Circuit. The fifth Circuit panel gave the CFPB a somewhat puric victory on parts of the decision, agreeing with the district court and rejecting arguments that the rule was invalid because of the removal provision issue, administrative Procedure Act violations and an asserted unconstitutional delegation of legislative power to the CFPB.

But importantly, and the reason we're all here, the panel disagreed with the district court and agreed with the plaintiffs that the CFPBs funding mechanism is unconstitutional. You'll see this referenced as a violation of the appropriations clause and that is how the panel has framed its decision. But they've really emphasized the separation of powers principles inherent in the Constitution and enshrined in the appropriation clause. In fact, it's pretty clear that this opinion was written with a view towards review by the Supreme Court. There's an extensive review of the history of the appropriations clause, citations to the Federalist Papers, the text of the constitution, the provisions in the Constitution that start out addressing revenue issues. All of that by way of emphasizing the originalist nature of the opinion and the importance of the appropriations clause role in the separation of powers, by ensuring that congress has the exclusive power over the federal purse.

Another important aspect of this opinion is that, and again I think this is to tee up issues for Supreme Court Review. The very unique aspects of the CFPB and what the panel regularly refers to as it's self actualizing perpetual funding mechanism that even according to the panel, siphons funds from the treasury citing to the provision in 1017(e) that I alluded to earlier. To drill down on this a little bit more, there's a lot of discussion in the opinion about just how powerful the CFPB is. There's not a lot of discussion about other self-funded agencies. The CFPB argued that congress had passed on Frank that it was just like all of the other self-funded agencies that every other court that had considered the funding issue had ruled that it was constitutional, and the panel sort of gave that those arguments the back of its hand.

They didn't note that the DC circuit had emphasized the existence of these other agencies, the bank regulatory agencies in particular. But as we've noted here, it concluded that whatever the line is and it didn't articulate how that line should be established, but whatever that line is between a constitutionally funded agency and an unconstitutionally funded agency, the CFPB is on the wrong side of that line. And the factors that the bureau, that the panel pointed to in reaching this decision had to do with the way in which the CFPBs funding is insulated from congressional review. And there are two parts of that.

The CFPB receives funding from the Federal Reserve, which itself is funded outside of the appropriations process. And so you've got the CFPB being funded outside of the appropriations process by drawing funds from the Federal Reserve. The Federal Reserve itself being funded outside of the appropriation process, something that the panel refers to as not merely

seeding direct control over the bureau's budget, but also indirect control. Describing this as a double insulation from congressional purse strings that is unprecedented across the government. And all of this, again, is made much more acute by the very nature of the Bureau and its capacious portfolio of authority, making it in the words of the panel, the epitome of the unification of the purse funding and the sword enforcement in the executive.

There's also some reference to the fact that this is actually exacerbated by the new structure for the director in that the director now serves at the pleasure of the president and can be removed at any time. So this single director removable at the president's pleasure means that you've got a director who is going to be under the control of the president. And means that the executive now has again the purse funding and the sword noting that the CFPB is both legislature, prosecutor and court, creating substantive rules for a wide swath of industries as we've seen. And prosecuting violations and levying fines that in some cases have been just enormous. All of which is to say that this combination renders the CFPB unconstitutional. Now to be entitled to relief, the plaintiffs had to show harm resulting from the appropriations clause violation that comes from the decision of the Supreme Court in Collins versus Yellen, the case that held that the director of VHFA had to be remove removable for cause.

But although the panel says that this is not a per se rule, it nonetheless found this to be very straightforward because basically the bureau can't do anything without drawing on its funding. So it couldn't possibly have promulgated the rule without this unconstitutional funding source and the plaintiffs were harmed as a result. So where we end up, the panel reverses the district court's grant of summary judgment in favor of the plaintiff and vacates the rule. And let me turn it to Alan to talk about the options now for the CFPB going forward.

Alan Kaplinsky:

Okay. John, thank you very much for providing the history and the content of the opinion. So I'm going to in just a few minutes tell you about what I believe the strategic options of the CFPB are at this point. The CFPB, not surprisingly has stated that it's going to be business as usual. Nothing has changed according to the CFPB. Well I guess if you don't mind a sort of Damocles hanging over your head, I guess that might be true. But let me seriously tell you about what I believe their two options are. One is to file a petition for rehearing en banc. They could also file technically a petition for rehearing before the same panel. They have no shot at getting that if they file a petition for rehearing and it gets granted, the opinion that got issued will be vacated and it will be entitled to no precedential value at all.

And indeed, technically speaking, while the opinion is out there right now, the Fifth Circuit has not issued its mandate, and until the mandate comes down it's not binding on anybody. But if for example, hypothetically the CFPB were to do nothing, just let the opinion stand, then the mandate would be issued in due course, and at that point it would become effective. CFPB as a 45 day deadline because it's a federal agency in order to seek rehearing en banc, if it were just a regular defendant, it would only have 14 days to do it. The deadline of 45 days can be extended upon motion. The petition itself will automatically stay the issuance of the mandate. The rehearing requires a majority of vote of the 16 active judges. There were 17 actual positions on the court. There was one vacancy that has not yet been filled.

There's been a nomination but it's not filled. So there are 16 active judges. 12 are appointed by republican presidents including five nominees of President Trump. In addition to the three republican appointed active judges on the panel who ruled for the plaintiffs, there are four other republican appointed active judges that have indicated already that they agree that the CFPBs funding mechanism is unconstitutional because they joined in the concurring opinion of a case that came down earlier this year called, CFPB versus all American Check Cashing company. A concurring opinion that didn't actually have to be issued. But at that point, Judge Jones of the court joined with four other judges, one of whom was also on the panel in the CFSA case and they concluded that the funding was unconstitutional.

So assuming that these seven active judges would vote against a rehearing en banc, a rehearing en banc could only be granted if nine of the remaining active judges, in other words, all of the remaining active judges unanimously voted in favor of rehearing. Only four of the nine remaining judges are democratic appointees. So even assuming all of them voted to grant rehearing, it would require all of the five remaining republican non appointees to vote in a block in favor of a rehearing. My view here is they have virtually no chance I think of getting a rehearing en banc, virtually none. But I do think they will probably seek a rehearing en banc. And the reason for that is it will end up delaying the case significantly. It could be several months of delay.

And if I'm Rohit Chopra and I'm trying to decide how do I increase the likelihood of the Supreme Court deciding in my favor, I'm going to try to create a conflict in the circuits, there is no conflict right now. The only opinion that is dealt with this subject at the court of appeals level is the CFSA opinion of the Fifth Circuit. Some people and pundits have said, "Well no, there's another case in the DC circuit called the PHH case." No. The PHH case dealt with the appointments clause and dealt with the seal of law issue it. There's a discussion in there of funding but the court never dealt with the funding issue at all. So there is no conflict and delay I think is a good thing for Rohit Chopra at this point. Let me turn now to filing petition for writ of certiorari.

The deadline for doing that is 90 days from the date rehearing is denied or if granted within 90 days of the date judgment in the rehearing is entered. They the opinion came down on October 19th. If it's denied 90 days from that point will be the deadline for filing a cert petition. That 90 day period however is pretty flexible. The Supreme Court will frequently upon motion extend that deadline for up to 60 days and those petitions to extend are routinely granted. If rehearing is not sought and that could happen. The deadline is 90 days from the date of the panel judgment to file a cert petition. And according to my calculation, that would be January 17th of 2023. The CFPB can request a stay of the mandate from this circuit while the petition for cert is pending. If it's not granted, it can go to the Supreme Court and seek a stay.

As a practical matter, I can't conceive either the Fifth Circuit or the Supreme Court not granting a stay, while it considers granting the petition for rehearing granting the cert petition. I do think the cert petition will be granted. And that's because of the enormity of this opinion. I can't imagine that they wouldn't grant CERT. So it's often very difficult to predict what the Supreme Court is going to do. But I'm going to go out on a limb and say today they will grant CERT. So now I'd like to turn the program over to Rich Andreano who's going to talk about the impact on regulations other than the payday lending reg.

Rich Andreano:

Thank you, Alan and good day everyone. Yes, talk about the regulations. Some of the focus will be on more the mortgage regulations was the heart really of Dodd-Frank, but the analysis really applies to all of their rules. Now generally, do we all have QIB rules with various aspects of the CFPB rules? Yes we do. But if the industry were given a vote that we keep all of them as is for now, knowing there could be some changes in the future or they all disappear. The chaos that result from them disappearing I think would cause a lot of people to vote thumbs up, let's keep them in place and work on some improvement to them. But not all the rules we think will be treated the same. Because there's really two, rather one major distinction. When the CFPB became active, Dodd-Frank transferred by virtue of transferring various statutes, also transferred the regs to the bureau.

Then the bureau used authority granted by Dodd-Frank to adopt new rules and amend some of the transferred rules. Now he here is this case focused on authority that the bureau was using to create the payday lending rule, which was a new rule, and it had to use its funding to do that because the funding was unconstitutional. It vacated the rule. That does not bode well for any rules that the bureau itself has adopted. It suggests that they too would be invalid. However, the transfer rule that existed at the time the bureau was stood up probably survived because that was done by operation of law and not by CFPB action. Now are we then concerned? Is this time to be concerned perhaps that we may end up in a chaotic area where all the newer rules are not effective? Yes, time to be concerned.

Is it time to panic? No. Panic is never a good thing to do and we think at this point panic is now warranted. Now let's take a little closer look at what might actually happen, particularly in the mortgage area. Dodd-Frank main focus again was fixing the ills that had caused the mortgage crisis. Centerpiece, the ability to pay a qualified mortgage rule, the servicing rules, although I will say why it was counted as one rule. Revisions to that loan originator compensation rule that also included the loan originator qualification. The mandatory arbitration ban, the single premium credit financing ban, escrow impound accounts for higher priced mortgages, appraisals for higher risk, otherwise known as higher price mortgages. And that was a joint rule. The bureau and other agency. So only the bureau's version of that rule be at issue. The ECOA appraisal, credit appraisal and other valuation copy requirements and the Home Ownership Act, Equity Protection Act or HOPA high cost loan law, expansion specific counseling requirements for those loans and general counseling requirements.

Now if you count the servicing rule as one rule, those are seven major rules which the industry taking from the seven deadly sins like to refer to as the seven deadly rules. That's how they got that count. Now before the bureau stood up, actually, we said what about the appraisal independence requirements? That was actually adopted by the Fed because it was a very short

timeframe for those to become effective and it was adopted as an interim final rule that ultimately did transfer over to the bureau and get incorporated into the bureau's version of Reg Z. So that originally transferred interim final rule may still survive. Now we'd fast forward from there in the bureau engaged additional rule making including TILA-RESPA integrated disclosure rule or TRID rule, Home Mortgage Disclosure Act rule amendments. More recently amendments to the ability to repay and qualified mortgage rule, and a rule addressing LIBOR replacement.

Now all of those newer actions are all called into question cause the bureau had to use its funding to promulgate those rules. What about guidance? In addition to rules, your issues informal guidance. That also all would appear to be in jeopardy based on the ruling of the court. Now let's look at also what's on the docket coming up. We're waiting for the final Dodd-Frank section 1071, small business lending and data collection rule, particularly with the focus on minority and woman owned businesses. Court ordered March 2023 deadline for the bureau to issue that rule. We're waiting for a proposed automated valuation model rule, which also is a joint rule making with the bureau and other agents. Waiting for the proposed property assessed clean energy financing rule, which would impose ability to pay type concepts for that type of financing. Long wait to proposed consumer access to financial records rule and more recent action by the bureau proposed credit card late fee rule.

Also a potential for a second LIBOR replacement rule. In the original rule, the bureau delayed identifying any particular SOFR index as being comparable to the one year library. Wanted to see some developments. So presumably it would engage in rule making to in fact do that. Now what does this all mean? Well, the ability to pay qualified mortgage rules probably the most significant in the mortgage arena. Now people say, hey, FHA, VA, USDA, they each have their own qualified mortgage rules. Yes they do. And they are not affected by this. This is only affecting the CFPBs rule. Now the trouble if the rule goes away and we're left with the statute, and this is going to be the problem with a lot of rules is Dodd-Frank has a basic framework for ability to repay, it's fuzzier on the qualified mortgage concept. It has a framework, but that framework included a debt to income or residual in component.

The original ability to repay rule had a debt to income component. That was revised and replaced with an APR as compared to a market rate component. So we may end up with a statutory ability to pay requirements and no clear qualified mortgage. And the statute was also fuzzy on whether a qualified mortgage was entitled to a safe harbor or a presumption, using both terms and being as unclear as congress often is on things. Servicing rules. A lot of the servicing rules, while there are some statutory based requirements, a lot of them were based on the bureau's general authority. What the bureau essentially did was take all the consent orders that had been filed against servicers resulting from the mortgage crisis and took a lot of the concepts from those and put them in rule form. Successor interest provisions. The general servicing procedure requirements, early intervention requirements, continued to contact, single point of contact and loss mitigation procedures.

Those are all regulatory, not statutory. Those would all appear to go away. LO comp rule, little different. Fed using its HOPA authority adopted the initial LO comp rule. And then based on Dodd-Frank, the bureau revise that. So what might happen, we may revert to the original rule, which had a lot of issues. So this is where we will end up with a lot of these different rules. TRID rule, regulatory creation, it would go away. That creates problems. One Dodd-Frank added a lot of new disclosures that were not incorporated into the prior version of the TILA disclosures or the rest for good faith estimate in HUD one.

Those disclosures in that law still exists, but they were modified by Dodd-Frank. And even worse, a lot of lenders don't have the software to produce the old disclosures anymore. So that would be quite a mess. Debt collection rule, while people may quibble over it, it authorized a lot of use of electronic communication and such, also has safe harbors. All of that if these rules go away, would not be a good thing. Which is why we think as we get to the end and Isaac, there'll be some fixes. Now, I want to hand it off to Mike Gordon to address the in effect on an existing enforcement litigation and investigations. Mike.

Michael Gordon:

Thank you. Well, just as the CFPB can't constitutionally under this decision, expend funds for writing regulations. They can't use funds for other activities and that includes enforcement activity under the theory of this case. What does this mean for enforcement matters that are starting or that are well down the road? Essentially it's giving litigants and company targeted investigations, a card to play. But there are some tricky questions and strategic considerations and legal ones about when to play it and when a court will allow you to play it. But it's another card that you have and in some cases, it'll provide a great amount of leverage.

And I do expect, and we're already starting to see that it is not business as usual. Although the bureau may desire that, we're already starting to see a flurry of activity of those who are in active litigation with the bureau, making filings to make this argument in an attempt to get matters dismissed or slowed down at the very least. And I think that's going to continue. So it's very much not business as usual in the enforcement realm, although I do want to just emphasize that each company or individual that's being targeted by the agency is going to have to make its own sort of fact specific decision about when and how to use this card. And it could turn on a lot of factors that we don't have time to get into now. But I want to go through a few sort of the more common scenarios and hit some of the highlights. So I'll address litigation first.

And here as I mentioned, we're already starting to see a flurry of activity. The decision itself would be binding in district courts in Texas, Louisiana, and Mississippi. And if you're in one of those jurisdictions, you're likely considering, and you'd be wise to consider trying to raise this issue as soon as possible. And you may achieve dismissal or you may achieve delay pending resolution of the matter, but you're on much stronger ground than you are in other circuits where it hasn't been decided. But outside the fifth Circuit, we've already seen many litigants raise the issue, notwithstanding the fact that they're in other circuits. Just in the last four or five days, district court in Illinois saw the issue raised, district court in Utah in a ninth circuit case. There was a notice of supplemental authority filed and I believe there was another one filed very recently in a California district court. Basically all arguing that this is an issue that should stop or slow the litigation even if it hadn't been raised before, the argument hadn't been waived.

And the court needs to stop and consider whether the bureau can consider it to pursue the matter and whether it has the authority to do so given the funding structure. There's other types of litigation, I think of the example of the trade groups recent litigation against the bureau. Based on the bureau's promulgation of changes to the supervisory manual that announced the principle that discriminatory conduct can constitute an unfair practice. That's a case where it may be in the bureau's interests to seek delay of that issue, pending resolution and slow down that litigation in light of the uncertainty. But obviously in the vast majority of cases, it's going to be for a tool for those, were targeted by the bureau to slow or stop litigation. One other thing that I think is important to note, that is an important one of these in considerations that may affect your judgment or your strategy about how and when to play the card is the existence or likelihood that another agency state or federal could just pick up the baton.

So if you're in a litigation where it's a joint action as some are, an increasing number are. Between with the Bureau and a state AG, you still may feel like it's valuable to have the CFPB removed from the case and make a play for that outcome. But it may or may not change dramatically, your potential liability if depending on what the claims in the case are brought by each party. I would say there's similar concerns with other federal agencies and I would note that over the arc of the bureau's lifespan, there has been an increase in communication and coordination with other federal agency. It's not consistent across every agency and it's not a consistent trend. But overall I think that's true and particularly with states. And so even when a case may not have been brought jointly, a litigant or a target of investigation might want to be thinking about the likelihood that even if they're successful with the bureau, what does that mean?

Does that mean, is it likely given some other indications you may have that a state or another federal agency will pick up the case? May or may not affect your decision about how to act. But those other entities like states who have authority to pursue CFPB, claims under the Dodd-Frank Act and of course their own statutes, and same for other federal agencies, their authority has not been limited in any way. Even when there's overlap with the subject matter of a claim the bureau would've brought. As to ongoing investigations, I'll just quickly point out a couple things. If you've received a CID or if you receive a new CID, let's say, a civil investigative demand, there's a process that's laid out by bureau that a statute and the bureau's rules for moving to set that CID aside.

And the typical procedure is you've got a short time, about, I think it's 20 days to move to set aside a CID or modify it. That decision is ultimately made by the director at which time the fact that you've filed that could become public. And that's sort of the regime companies have lived under or targets of investigation have lived under. And then the bureau, if you can continue to after that point, refuse to cooperate, the bureau has the option of bringing an action in federal court. So what's changed now? Well companies for whom delay may be a valuable thing, could choose to avail themselves of that internal procedure making the constitutional argument that inevitably you would think that their director wouldn't accept. They could also just refuse to respond at all maybe to lodge their constitutional objection and wait for the bureau to sue.

Some clients have asked, can we go force the issue if we receive a CID? And that's a complicated question. It would depend on a number of things. But one strategy that was suggested was that you just run to the fifth circuit and try to get a decision there where you're going to get a good outcome. But you may run into problems with that under the abstention doctrine. And it's not clear that that is a winning strategy. You also could try to raise the issue before you're sued by the bureau if you think that's a good strategy. It's not clear whether that would succeed even in your home court jurisdiction where you're located, but that's going to be something you'd have to consider carefully given the posture of the case and other considerations. And so all I'm saying is here is it involves a careful review before those kinds of affirmative actions. If for other reasons you think it's in your interest to force the issue sooner.

But I think we'll see parties try to start raising these objections and courts quickly around the country, we're going to have more and more decisions. Ultimately, I think as Alan alluded to, it might be in the bureau's interest to have a circuit split established where the bureau's arguments get vetted and more favorable decisions come out. And I do think it's hard to predict exactly how long that'll take, but there is going to be a flurry of motions filed and ruled on and appealed and that process has already begun. One final point I wanted to make about supervisory activity, which is in a different category but has the same constitutional problem.

And so in other words, if you are subject to an exam and findings from the bureau, you would have the same argument that the bureau's current activities are unconstitutional, because they're expending money in an unconstitutional funding scheme. Of course in the fifth circuit, again, you're even stronger in making that argument. But the supervisory context is different, confidential, implicates by definition, sort of a longer term relationship with the bureau. So the strategic considerations might be quite different in the supervisory context, but the logic of the opinion would be the same. And if the bureau can't spend money, they can't spend money doing an exam and writing up findings. I'll turn it back over to John to talk about consent orders.

John Culhane:

Thanks, Mike. So obviously as Mike said, probably a lot is going to turn on whether you're in the fifth circuit or can get to the fifth circuit or whether you're outside the fifth circuit. I think our expectation is that the CFPB may take something of a light touch in the fifth circuit and seek stays everywhere it can, but outside of the fifth circuit, it's probably going to be much more aggressive. And there are a lot of barriers to trying to reopen a consent order. One thing we don't know is whether ultimately this decision is going to be prospective or it's going to be retroactive. And we know from the Marathon pipeline case that there are sort of three factors that the Supreme Court looks at, whether it's an issue of first impression whose resolution wasn't clearly foreshadowed by earlier cases. I think that one, that certainly you would say yes, although certainly, there's room for argument. Whether retroactive operation will really further the operation of the holding in question.

Well presumably it would in that if the CFPB can't act without funds, then it can't act without funds. But that brings us to the third question, and that is whether retroactive application would produce substantial inequitable results in individual cases. And maybe that's a little more complicated. Rich has mentioned just how much chaos could exist from the impact on regulations and not just cases involving litigation with the bureau, but all sorts of cases regarding the enforcement of the regulations adopted by the Bureau, et cetera. So by no means a simple issue. Let's assume that there is retroactive application, opening consent orders is still not the easiest thing to do. Every stipulation both in judicial litigation and in administrative actions includes a waiver of jurisdiction and a waiver of any right to appeal. That's routinely recited in the findings, in litigation matters. And there's an extensive section on waivers in administrative consents.

So you've got to overturn that. I'm going to jump for a moment to federal rule of civil procedure 60, which is the rule that governs relief from a judgment or order. It's got a time limit on it. This is really going, bringing a motion to the court that approved the order. There's a one year time limit. Your motion actually has to be made within a reasonable period of time but not to exceed a year. And there are specific grounds for relief. The one year period may be a pretty significant bar here. Now it doesn't preclude the same court from entertaining an independent action, but then you may run into Race Judicata. Race Judicata applies to consent orders and litigation and arguably applies to consent orders and administrative actions as well. And what are we going to have? Well, in all of these situations there's going to be an agreement that there was jurisdiction, and an agreement that the judgment was final, but we're going to have the same parties seeking to re-litigate the same issues in effect and that's going to be a barrier.

Now we've seen some references, and I alluded to this at the outset when I mentioned the provision in subsection E of 1017, we've seen some mention of the fact that the CFPB did have the ability to access appropriated funds, suggesting that maybe it did receive some appropriated funds as it was stood up. And you might both have timing and tracing issues. This may be more theoretical than real because as it turns out, the CFPB never actually asked for any appropriations. Not when it was stood up in 2010, not in 2012 to 2011, 2012, 2013, 2014. Now whether its potential ability to have sought 200 million inappropriate funds somehow means that the first 200 million it got through the Federal Reserve should be magically treated as appropriated funds and activities it took on that basis somehow magically be considered valid. I think that's unlikely. I think that's pretty much of a stretch, but we may very well see that argument play out.

What's the response going to be to any of these arguments? Well, obviously the response is going to be everything the CFPB previously did is unconstitutional and we should not be straining at procedural rules to protect the actions of an agency that's been unconstitutional for 11 years. To the extent we're looking at stipulations, consent agreements and they look sort of like contracts, we're going to make one of the arguments the CFPB likes to make that it represented that it was legal and constitutional and had the capacity to contract and in fact it didn't. Maybe if we have to deal with Race Judicata, we'll try to argue that the CFPB is now a different party, that it's now an unconstitutional entity rather than a constitutional entity. And that any judgment that existed shouldn't really be treated as a final judgment on the merits due to its unconstitutional funding structure.

And if we're going back to the same court where there's an order in place and we have a timely motion that we can file. We can certainly argue mistake or fraud or the inequities of leaving the order in place. And then there's this broad catchall for relief under federal Rule of Civil procedure 60. Any other reason justifying relief. This is certainly any other reason justifying relief, but none of this has obviously played out yet. We have to think it will in the future. And outside the fifth Circuit, it's going to be a very tough time. Could be a very tough time for the CFPB. Let me stop there and turn it over to Isaac to talk about where this seems like it's inevitably going to end up, which is back in congress. Isaac.

Isaac Boltansky:

Thank you, sir. Look, the simple story here is if this ruling stands, there's going to need to be a legislative solution. Congress will have to take affirmative action to address a foundational question for an agency that is served as example number one, when republicans paint a case of regulatory overreach in the consumer financial regulatory sphere, and honestly even beyond that. So look for our purposes today, I assume that the next congress, the one that's going to begin in January of next year will have to deal with this issue. And that at least one chamber of that congress will be controlled by republicans. I have relatively high confidence that republicans are going to net the five seats they need to control the House of Representatives at least. And so we're going to operate from there. Therefore, the question becomes, what will republicans want? And this is something that I've tried to hit home to my clients.

As a foundational point, we need to remind ourselves that there are republicans who will vote against literally anything that affirms the Bureau's very existence. With that being said, I still think that there is a pathway for a deal if a deal is needed. So what would that deal look like? From my seat, first and foremost, you're going to have to see a commission structure. As everyone on this call knows this has been an area of great debate since Dodd-Frank. And my sense is that shifting from a single directorship to a commission structure is going to be a deal breaker for the republicans who are going to be leading the negotiations around this. And in particular, I think about congressman McHenry who I think is going to have the gavel and the House Financial Services Committee. Beyond the shift to a commission structure, I think that we're going to have to look at roughly half a dozen issues that could be on the table for republicans, depending on number of factors.

The things I've heard thrown around thus far are things like narrowing the Bureau's UDAP authority, or even curtailing the bureau's larger participant rule making authority through statute. And as always, as we've learned time and time again with the bureau, they're going to be personal and parochial issues that republican lawmakers push as part of any potential agreement. We will see what form that takes, but I can tell you they're going to start with some of the recent consternation regarding the bureau's interpretive rules and its advisory opinions on Reg B and the FCRA. Those are the things that when you talk to some of these republican staffers, you hear mentioned as recent examples of overreach. In terms of the actual funding mechanism, it's difficult to envision republicans agreeing to any peripheral means of funding. So while we're going to hear some calls for the bureau to be funded by fees on supervised institutions or use their civil penalty fund, which I know we had some questions

come up about, I can say with a rather high degree of certainty, that neither of those mechanisms will be satisfactory to republicans.

They want the bureau to come hat in hand to congress each and every year if they control at least one chamber of congress, which is my base case. So let's talk about if I'm wrong. I spend an enormous amount, almost too much time thinking about if I'm wrong. And they're really two factors that come to mind. First is how much pressure are we going to see from a business community? As everyone on this call knows from their day job, uncertainty is bad for business. And if there are tangible market headwinds like safe harbors no longer being safe, for example, then we will suddenly see strange bedfellows with certain financial institutions joining democrats to call for a quick funding agreement. I'm honestly just listening to Rich's presentation before, I'm reminded of that old saying that when the universe wants to punish you, it gives you exactly what you ask for.

And so I do think that one of the components that we should be aware of is how much the business community and particularly certain segments of the business community like banks, I think, could be pounding the pavement up on Capitol Hill asking for a quick resolution. The second factor that I kick around in my mind is what are democrats going to accept? Look, I've sat in a room with progressives who've told me time and time and time again that shifting to a commission structure is a red line that they will never cross. So look, there are going to be some in the democratic caucus who would rather let the Bureau flounder for a period of time and attempt to fight a new battle in the court of public opinion instead of giving up the commission structure or other areas during negotiation. So that's something that I think we're going to have to keep in mind as well.

In conclusion, and this is just how I think about the overall situation, as we continue to wait for more clarity from the courts, if this decision stands and congress is put on the clock for action, then the CFPBs future is going to be left to a congress that is highly likely to have at least one chamber controlled by republicans who largely believe that the bureau's varied creation was a mistake. And so to fund the bureau, republicans are going to demand anywhere from I think one to 10 pounds of flesh sticking with some of the metaphors we've used so far, depending upon the political climate and market reactions.

Those are the two factors that can change on my opinions. What does that mean practically? Look, if the bureau is forced into the congressional appropriations process, our expectation is that we would see a dramatic reduction in its top line budget and legislative riders that when you put both together, are going to limit the scale of its potential actions and the scopes of it, its ambition. So all of it leads to a far less ambitious and active agency if they are put on the congressional appropriations process. I'll stop there as I know there are other questions and hand it back to Alan Kaplinsky. Thank you.

Alan Kaplinsky:

Yeah. Thanks, Isaac. Let me ask you a question, and that is one pertaining to timing. Obviously the lame duck congress isn't going to deal with this issue, but do you really think that with the new congress convening next year and this case still percolating somewhere between the fifth circuit court of appeals and the Supreme Court, that congress will get down to business and try to craft a piece of legislation? Or is it likely for them to wait until it's gotten much worse?

Isaac Boltansky:

Congress does two things well, Alan. Nothing and overreact. And so the way that I think about this is congress is not going to actually take any action until its hand is forced by the courts. But it's hard enough to try to figure out what's going to happen here in a couple weeks with the upcoming midterm elections. And so it felt best to try to frame the analysis about what congress will do just based on the next two years where we should have little bit of insight into who's going to control each chamber. Beyond that, it gets harder to figure out, but I can tell you as long as there is republicans with a high ground in these negotiations, it's pretty clear to me that commission structure is likely and ultimately we're going to see riders that change the scale and scope of the Bureau's ambitions.

Alan Kaplinsky:

Yes. Yeah. And one other thing I think needs to be pointed out, and that is, its conceivable that congress will wait until there is a final decision of the Supreme Court. And if that final decision comes down, then the crisis begins unless the Supreme Court

stays its mandate and gives congress some reasonable period of time to solve the problem. That's ultimately how I think this is going to come out. There are, I guess you could say there is precedent for the Supreme Court in other unrelated cases coming down with an opinion, but recognizing the chaos that it's going to cause.

It will stay its hand. It'll basically say to congress, all right, I'm giving you 60 days to cure the problem. If you don't do it within that time, then the problem is yours. We're coming down with our opinion. And I mean, of course I may be wrong, but that's my fear. And then at that point it's really going to be all hands on deck. And as you pointed out, very hard to figure out who's going to be lobbying for what it's going to be. I think a free for all, frankly. You agree?

Isaac Boltansky:

Look, I think all of that's fair. And I would say that the one caveat to it, and the one thing that when I've tried to talk to staffers about it, the point that's made to me time and time again is, they'll act when they're forced to act. It does look as though we'll have to wait for the Supreme Court and possibly time after that. But the one caveat is, and this is something that I defer it to you and your team on, if we see the thinking behind this decision start to expand to other agencies. And at that point you could see congress attempt to become more proactive if suddenly things like the Federal Reserve and the OCC and the FHFA are in question. But as you know, that's such a long timeline and congress tends to only look at what's exactly in front of its face, and even then you have to hit it a few times before they act.

Alan Kaplinsky:

Yeah. Well, the one thing we totally avoided dealing with are the other agencies. That would be a separate webinar or podcast in and of itself. And we also didn't opine on whose right and whose wrong here, because it's not completely clear. However, given the composition of this U.S. Supreme Court, six republicans, three democrats, the republicans, all very conservative, I would say sort of like-minded with the judges on the fifth circuit who decided the case, if I were a betting man and I'm not, I would guess that the Supreme Court will find a way to affirm. Regardless of whether they might in their heart of hearts think the decision is wrong. That just about does it for our podcast show today.

I first want to thank our very special guest, Isaac Boltansky, and I also want to thank my colleagues at Ballard Spahr in the consumer Financial Services group, John Culhane, Rich Andreano and Mike Gordon. To make sure you don't miss our future episodes, subscribe to our show on your favorite podcast platform, Apple Podcast, Google, Spotify, or wherever you listen. Don't forget to check out our blog, consumerfinancemonitor.com for daily insights of the consumer finance industry. And if you have any questions or suggestions for our show, please email podcast@ballardspahr.com. And please stay tuned each Thursday for a new episode of our show. Thank you very much for listening today and have a good day.