Consumer Finance Monitor (Season 7, Episode 24): What Banking Leaders Need to Know About the U.S. Supreme Court Ruling That the CFPB's Funding Mechanism is Constitutional Part I

Speakers: Alan Kaplinsky, Rich Andreano, John Culhane, Joseph Schuster, and Kristen Larson

Alan Kaplinsky:

Welcome to the award-winning 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, the former practice group leader for 25 years, and now senior counsel at the Consumer Financial Services Group at Ballard Spahr. And I'm pleased to be moderating today's podcast show.

For those of you who want even more information, either about the topic that we're going to be discussing today or anything else in the consumer financial services world, don't forget to consult our blog Consumerfinancemonitor.com. We've hosted the blog since 2011 when the CFPB became operational, so there's a lot of relevant industry content there. We regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the mailing list for our webinars, please visit us at Ballardspahr.com. And if you like our podcast, please let us know about it. You can leave us a review on whatever platform you may use, be it Apple Podcasts, YouTube, Spotify, or any other podcast platform. And also, please let us know if you have any ideas for other topics that we should cover on our program or other speakers we should consider inviting as guests on our show.

Today is part one of a repurposed webinar that we did on May 30th entitled "Supreme Court CFPB Funding Mechanism is Constitutional: What Do Banking Leaders Need to Know?" This will be in two parts. We're doing part one today. And what we're going to be covering, at the beginning I'm going to talk about a new, perhaps, infirmaty, in the way that the CFPB is funded. Namely, that since September 2022 when the Federal Reserve System started losing money on a consolidated basis, under the Dodd Frank Act, the CFPB had no right to request and the Federal Reserve Board had no right to honor any requests for any additional funding. This topic has become the subject of an op-ed that appeared on May 20th in the Wall Street Journal, written by a very prominent law professor Hal Scott at Harvard Law School. And then it's been followed-up, very shortly in fact the day thereafter, by an article that Alex Pollock published on the website of the Federalist Society. When I'm done, then I will turn it over to John Culhane. We'll talk ab out cases that are still pending before the Supreme Court that could significantly impact the CFPB. Then we'll go to Joseph Schuster who will talk about some very specific legal challenges to CFPB final regulations and what the implications of the CFSA opinion are on that litigation. Then we'll go to Rich Andreano, who will talk specifically about another regulation. That adopted under 1071 of Dodd Frank, dealing with small business data collection. Then we'll go to Kristen Larson. Kristen will talk about the overdraft credit proposal and related issues. And then finally, Rich will wrap it up with proposed rules that will soon be issues by the CFPB.

Let me introduce our speakers. Rich Andreano, who is the chair of our mortgage banking group, John Culhane, no stranger I'm sure to any of you who frequently attend our webinars. And Kristen Larson, in our Minneapolis office and last, Joseph Schuster, who within the past couple of months rejoined our firm after spending several years at Goldman Sachs. So on May 16th, Justice Thomas issued a majority opinion by a seven to two vote, in which he concluded that the funding mechanism comported with the appropriation's clause of the Constitution, which states in relevant part in article one, section nine, clause seven, and this is what the case all turns on, just these few words, "No money shall be drawn from the treasury, but in consequence of appropriations made by law." And then the precise holding of Justice Thomas, very, very broad and all it's required is for Congress to describe a source of the funding and a purpose for the funding and nothing else, and that's really all you need to know.

I doubt very much whether Congress is going to repeat in the near future the funding mechanism that was used for the CFPB. I just don't see that in the cards, particularly under another problem that I'm going to describe to you in a minute. The other thing that I want to point out is the status of the payday lending rule because a lot of people have asked about that. People now recognize that that was the genesis of the original lawsuit. It was a lawsuit brought by CFSA and there were several arguments made in that lawsuit against the CFPB lawsuit that got filed in the Fifth Circuit and one argument was that the funding mechanism was unconstitutional. Then there was an argument that it violated the Administrative Procedure Act, and then an argument that was promulgated by a director unconstitutionally insulated from presidential removal, that is before the seal of law opinion. And then that the UDAP rulemaking authority violates the constitution's separation of powers by running a follow of the non delegation doctrine.

So the Fifth Circuit entered an order a while ago stating the compliance date until 286 days until after the appeal is resolved. We've heard nothing from the CFPB about the rule because the case has now gone back to the Fifth Circuit or will soon go back to the Fifth Circuit and counsel to CFSA has sent a letter to the Fifth Circuit reminding them that there is still three issues that they lost on in the Fifth Circuit before the court concluded that they would win on the constitutional issue. There were three other issues they lost and they were unable to file a petition for rehearing on bank at that time because they were the prevailing party. And the letter informed the Fifth Circuit that after the mandate gets issued, that makes sure that there's going to be sufficient time for them to file a petition for rehearing on bank. So this case is not over yet because there are these other issues that haven't yet... They were decided by the panel adversely to the industry, but it's not a done deal and it won't be until after the petition for rehearing gets filed and the Fifth Circuit decides whether to grant it and if they grant it then there will probably be new briefing, I would think, on the other issues.

Okay, this is a really fun part of the program I think because barely was the ink dry on Justice Thomas's opinion than two scholars of the Constitution, prominent people, very prominent people, one of them Professor Hal Scott, Professor Emeritus from Harvard, who is really an icon in the area of banking law and constitutional law and an expert on Federal Reserve Board funding. And he wrote an Op-Ed in the Wall Street Journal four days after the opinion came down on the 20th of May. And he concluded that any funding of the CFPB after approximately September 2022 is unlawful because the Dodd-Frank Act requires that any draws by the CFPB be made out of earnings of the Federal Reserve system. And since September 2022, the Federal Reserve system has been losing money hand over fist. It's in the billions and billions of dollars.

It's a misery brought upon itself by the FOMC that has continuously been jacking up interest rates who's continued to subscribe to the theory of higher for longer, they haven't covered it yet, and until they start cutting rates, this problem is going to continue and it's probably only going to get worse. The losses keep snowballing on each other and a clear meaning in a reading of the language of Dodd-Frank says the CFPB can be paid only out of earnings of the Federal Reserve system. So if the Federal Reserve system is losing money, unfortunately the CFPB can't continue to be funded. Now you may say, "Well, why in the world did Congress when they were considering the Dodd-Frank Act back in 2010, how come they wrote the thing this way? Why didn't they say they would be paid out of revenues of the Federal Reserve system?"

Well, they didn't do it that way and I think the reason is they never thought ever that there would be a situation where the Federal Reserve system would be losing money. They were making a lot of money at that time. It was a low interest rate environment that persisted for several years. Now, somebody maybe even architect of the CFPB, I'm referring to Senator Elizabeth Warren, somebody must have thought of this problem. There were a lot of smart people and by the way, ironically, Elizabeth Warren is a former colleague of Hal Scott who wrote the Op-Ed. Now it's not just Hal Scott, it's also another scholar I would call him, not a lawyer, Alex Pollock, wrote a blog and it's on the blog of the Federalist Society, admittedly a conservative organization, but his blog essentially said the same thing. How can the CFPB still be funded? Now what's really weird about this whole thing is we haven't heard any response from the CFPB consumer advocates.

Nobody has said boo yet, which means one or two things. Either they think that Hal Scott and Alex Pollock are crazy, which I don't think is the case, or they can't figure out an answer yet, and I don't blame them because I can't figure out an answer. The language in Dodd-Frank is, as you might say, pellucidly clear. So the question becomes, when is this going to get challenged? I think it's only a matter of time. I doubt if it can get challenged in connection with the CFSA case that's back in the Fifth Circuit, although maybe it could be. But I think any of the other regulations that the CFPB has been working on after September 2022, they're all fair game and their complaints can be amended, sometimes it will need approval of the court and I

don't know of any reason why in addition to making the non-constitutional and other arguments, they wouldn't make this argument, which is in part a statutory argument and a constitutional argument.

Okay, with that, I'd like to turn the program over to John. But John, before I do that, I know it doesn't fit in neatly within the topics that we're covering today, but the Supreme Court issued an opinion at 10:00 A.M. Eastern this morning that anybody who is employed by a national bank or does work for a national bank needs to be familiar with. It is a blockbuster opinion. It's going to cause a lot of agita in the banking industry. In short, what they concluded was the Second Circuit was wrong in essentially concluding that any state law that had any effect at all, any negative effect, any negative impact, that that would be preempted. And the court said, "No, no, they're Dodd-Frank. The standard is Barnett Bank and that means significant impairment," and they sent the case back to the Second Circuit to do an analysis of whether there's been significant impairment. So John, I know you're going to talk about other significant decisions, but I just felt we had to let our audience know about the Cantera, the Bank of America case.

John Culhane:

Thanks, Alan. So I'm going to talk about some cases that are still pending before the Supreme Court that could significantly impact the CFPB. I'm really going to focus on four cases, Jarkesy versus the SEC, which deals with administrative hearings, the two cases that deal with Chevron deference, Loper Bright Enterprises versus Raimondo and Relentless Inc versus the Chamber of Commerce and then Corner Post, which deals with challenges to regulations under the Administrative Procedures Act and the running of the statute of limitations. So let me jump in here with a brief discussion of the Jarkesy case. This is really a significant case because three challenges have been made to the whole process by which agencies enter into administrative hearings and adjudication proceedings. The first is whether these provisions that allow agencies to initiate and adjudicate administrative enforcement proceedings violate the seventh amendment of the US Constitution, which is the right to a trial by jury.

The allegations in the Jarkesy case involve fraud and the Supreme Court has held that there's a right to a jury trial in suits at common law or in suits seeking common law like remedies, and fraud would be one where arguably the agency would be seeking common law like remedies. That may well be the case for actions by the CFPB where they're seeking relief under their UDAP authority, at least where they're pushing deception and arguing for a very severe deceptive practices. The second is really reviving an argument that has gone out of favor and that's the delegation doctrine and the argument here is that the SEC now under Dodd-Frank gets to choose between running its hearings through an agency adjudication or going to court, but there are no standards whatsoever for the SEC to follow in making that choice, nor are there any standards for the CFPB to follow.

It simply has the option to decide and obviously for those of you who have dealt with the CFPB, there's a significant difference between litigating in an agency hearing where you don't have quite the same rights that you have in federal court. And then finally, there are some technical arguments about whether administrative law judges are validly appointed or whether their appointments violate the constitution. This may not have as much impact on the CFPB because the way this is teed up in the case, the argument is made that there's a double insulation of administrative law judges. They can't be removed except for cause. The Merit Systems Protection Board has to find first that there's cause for removal and then it makes a recommendation to the SEC and the boards of the Merit System Protection Board and the commissioners of the SEC also can only be removed for cause.

Given the decision in SEILA law, I guess it remains to be seen whether that will be the case, whether that will be an issue for the CFPB. That case was argued back in November and obviously we're waiting for a decision. Two cases that I think we're all familiar with from prior discussions are the two cases challenging Chevron deference before the Supreme Court, Loper Bright Enterprises and Relentless Inc. I think we all recall that Chevron establishes a two-step framework for reviewing agency interpretations, which gives a lot of leeway to the agency. First, the court looks to see if the statute speaks to the question at issue. If it does, there's no ambiguity, the analysis stops there. And then if a statute is silent or ambiguous, the court looks to see whether the agency's interpretation is a permissible construction. It doesn't have to be the best interpretation, it just has to be one that can be tied to the words in the statute.

The agencies always argue that their interpretations are of statutory provisions that are unambiguous or even if the statute might be deemed to be ambiguous, that their interpretations are permissible and they win a significant amount of the time

when they get Chevron deference. Those two cases were argued in January, we expect the Supreme Court to overrule or substantially modify the Chevron deference. So at this point it may be that going forward the CFPB will be like any other litigant and it will only win if its arguments are persuasive, not because it's an administrative agency. Finally, there's a decision or case pending before the Supreme Court that deals with the timing of suits challenging regulations issued by agencies under the Administrative Procedures Act. This is another in the long series of cases involving interchange fees. What's unique about this case is that the plaintiff corner post didn't exist at the time that the Federal Reserve Board issued the regulations, so obviously it couldn't sue at that time.

And the question then is whether its ability to sue or to challenge those regulations should run from the time when the rule is issued or should run from the time when the rule first causes injury and not surprisingly, Corner Post is arguing that the statute of limitations, which is six years, should run from the time an injury is caused. Obviously if this is successful then it may give agencies additional time in which to challenge CFPB regulations. That's another case that's been fully briefed and argued back in February. I think as these come down, decisions come down, they'll have a significant impact on the CFPB, but there's a lot going on at the CFPB. So let me stop here and turn it over to Joseph to start our discussion of CFPB regulations. Joseph.

Joseph Schuster:

Thank you, John. So I do want to mention what Alan said about Cantera is, just before I get into the late fee, is something that's really going to affect a lot of different entities in this space. Both Cantera states becoming more active in what they are permitting banks to do, state charter banks with potential [inaudible 00:20:13] and different things. So keeping an eye on that is important and so please do attend our June 6th webinar on that. And that does turn into the late fee because there are states that are starting to try to regulate what banks can charge for late fees. Now I want to give a little bit of background on the CFPBs credit card late fee rule. The CFPB issued a final rule to adjust the safe harbor under the Card Act to $8. Now smaller card issuers can charge 32 or $43 depending on whether it's the first time that a person has passed due or the second time that a person has passed due.

And the reason that the smaller issuers are permitted to do that is because the CFPB tried to avoid going through the REFA process. This is important because a lot of people, including the plaintiffs who filed the case that we're going to talk about, claim that the CFPB is trying to make good on the president's promise to cut late fees by 75% from $30 to $8. Now soon after the final rule came out, a case was filed in Texas and the case was then... It moved around a lot between different judges in the Federal District Court of Texas before ultimately ending up on desk of Judge Pittman and Judge Pittman will tell you about all this movement and he will tell you about how fast he responded to this case. The first thing that he did was he wanted to look at venue and there was a motion from the plaintiffs to file a preliminary injunction.

Judge Pittman first ruled on venue and attempted to transfer the case to the District Court of DC. The plaintiff's appeal and the Fifth Circuit said that Judge Pittman must first decide on the issue of the preliminary injunction before transferring the case to the district of DC. Judge Pittman did grant that injunction and he granted it based primarily on the CFSA ruling. Now there were a number of other claims in that case but Judge Pittman identified that those did not need to be addressed because of the CFSA case. However, he did say that some of those arguments are compelling. The injunction was granted. Eventually the court and the Fifth Circuit provided Judge Pittman the authority to continue with the case. Judge Pittman again transferred the case to the DC Court, or so we thought, that was on May 28th. Then yesterday, plaintiffs filed an emergency petition for writ of mandamus and administrative stay of transfer and the Fifth Circuit stayed the transfer until June 18th and requested that the CFPB respond to the petition by June 6th.

The CFPB is trying to move the case to DC and plans on trying to keep the case in Texas and the Fifth Circuit seems to be continually being involved in keeping that case in Texas. Now the preliminary injunction was based on CFSA, however there were a number of other items that were brought in that complaint as well and those are the pieces that either the Texas Court or the DC Court will need to be reviewing. The late fee case is different than the 1071 case that Rich is going to get into in a minute in that the preliminary injunction in the late fee case does not expire or become removed based on CFSA getting decided, Rich will get into the 1071 rule in a bit. However, the preliminary injunction on the late fee rule does stay in effect. It's likely that CFPB, in fact the CFB has indicated that they will ask for the preliminary injunction to be lifted.

However, I want to get into a couple of the other items that the court will look at as they look at whether or not to continue to have the injunction in place. Number one is the Card Act and the claim is that the CFPB did not follow the Card Act when they set this $8 fee. The Card Act requires that the CFPB look at whether there is a penalty fee and whether it's reasonably and proportionate, whether it compensates and it accounts for and deters future late payments. $8 does not compensate for a borrower going past due. It does not deter a person from going past due and somebody can pay basically the price of a latte to not make their credit card payments. The CFPB is required under the Card Act to consider the reduced access to credit and as this rule was moving towards becoming effective, a lot of different creditors were looking at what they needed to do to reduce line sizes, discontinue approvals of certain credit spectrums that they would otherwise approve because the late fee is an element of pricing and if somebody has a thin file or no file, not being able to price that credit appropriately was something that creditors were looking at and possibly closing down existing accounts.

So those were the Card Act challenges. Another challenge that claims had was the Administrative Procedures Act, which the claim is that the CFPB did not have reasons for decision making, failed to explain its reasons with sufficiency and failed to support its conclusions with substantial evidence. The data that they used was non-public data. It never became available for industry or others to comment on and the industry attempted to extend the comment period which was continually denied by the CFPB. The third piece here is TILA and TILA has that the effective date for certain changes to fees that are already disclosed must be October 1st but at least 60 days. Here the rule was issued March 5th with an effective date of May 14th, 2024. If a rule was issued March 5th, that would permit this rule to be effective October 1st, 2024, not May 14th, 2024. So where this case is now, it is still trying to figure out where the venue should be, whether it will remain in Texas or whether it will be moved to DC, and then we will see what happens with the preliminary injunction and the case will continue from there. With that, I will turn it over to Rich to talk about 1071.

Rich Andreano:

Thank you very much, Joe, and good day to everyone. The 1071 Rule is so named because it comes from Section 1071 of the Dodd-Frank Act and that amended the Equal Credit Opportunity Act to require institutions to collect and report on credit applications submitted by small businesses. So a lot easier to say 1071 rule than the small business data collection and reporting rule. And the Bureau was directed to adopt a rule. This is really a fair lending type law. The concern was with small businesses is that there was discrimination against minority owned and women owned small businesses, one, in getting credit in the first place and then in the terms of the credit that they received. So that was really what Congress was focusing on when it added this requirement. Now, Congress did specify various data elements that the CFPB was to put in the final rule but also authorized, and there's the language there, relatively broad authorization, for the Bureau to add additional data.

Similarly, Congress did this in Dodd-Frank when it amended the Home Mortgage Loan Disclosure Act. That is the statute that requires the collection and reporting of data on residential mortgage loans. Congress added numerous categories to be collected and reported and gave the Bureau authority to add additional categories and the Bureau more than doubled the number of categories, and we'll come back to HMDA briefly, why there's an important comparison here. Finally, and this was pursuant to a court order because the Bureau was actually sued to issue a rule because it took a long time getting around the proposing rule. March 2023, the final rule comes out. Significantly, the Bureau added in addition to minority owned and woman owned, it had LGBTQI+. It had not proposed that as a business ownership category but requested comments from stakeholders and based on the comments received supporting the addition of this category, it did add that.

So it's minority owned, women owned or LGBTQI+ owned plus numerous data categories regarding the applicants and the credit itself. Final rule took about two months to come out in the federal register, that then set the official effective date of August 29th, 2023. However, as we'll see, there were tiered implementation dates. If you want to know more about it, we list there some podcasts that we did addressing the details of the rule itself, but here we're only going to focus on things that are important to the challenges and what that is are the three tiered compliance states. What the Bureau decided to do was have it tiered based on the volume of small business lender engaged in by a lender. Now that often relates to the size of the lender in many cases but not always. A lot of small banks and frankly are significant sources of small business lending.

For those that 2,500 or more covered transactions in 2022, 2023, they were going to have an October 1st compliance date. That's 18 months. That's 18 months after the five rule was released on the Bureau's website. For a more moderate volume, 500 or more in 2022, 2023, April 1st, better but still only 24 months and we'll return to Home Mortgage Disclosure Act briefly.

For lower volume lenders, 100 or more in 2022. 2023, more reasonable date of January 1st, 2026. What about those that lend below that volume? Not covered by the rule. Now the Home Mortgage Disclosure Act really served as a template for the Bureau when it crafted the 1071 rule. It took a lot of concepts from Home Mortgage Disclosure Act. Now importantly, Dodd-Frank also amended that Home Mortgage Disclosure Act. In mid-October of 2015, the Bureau released the final rule making significant amendments to regulation C, the implementing regulation. It provided for an implementation date mainly of January 1st, 2018, so about 26 and a half months.

Importantly, the industry already had hundreds of systems in place, operations in place. Now they had to make significant changes, but they weren't starting at ground zero. With the 1071 rule, people were starting at ground zero and had initial implementation dates of 18 months, 24 months. So even without the core challenges that I note, had they not occurred, there would've been a challenge on the effect dates to begin with. But fortunately because of litigation, there is some leeway now in those implementation dates. Now here are the number of challenges. One, it was interesting both members of the Senate and House of Representatives objected vehemently to the rule and it was as if, and I think it's probably true, they had no idea that Congress probably had required the Bureau to adopt a rule. If you go back to Dodd-Frank in 2010, a lot of people who were in Congress today were not in Congress in 2010 and simply seemed to not realize that this rule was mandated by a statute.

Now you can argue, did the Bureau go beyond its statutory authority, but they were mandated to adopt a rule. So House and Senate, both narrowly passed resolutions under the Congressional Review Act, an act that allows significant rules, they have to be submitted by the agency to Congress and it gives Congress the opportunity to reject the rules. They did so however, president Biden vetoed that as he said he would. He vetoed to the override legislation. The Senate attempted but fell well short of the two thirds majority necessary to override a presidential veto. So the focus then switched to the court actions that were going on. The first one had been filed in Federal District Court in Texas, which sits the Fifth Circuit. That's where a lot of challenges to the Bureau occur nowadays, and it was by a local bank and Texas Bankers Association. One, it said that the CFPB funding structure was unconstitutional plus their administrative procedure Act claims.

American Bankers then later joined as a plaintiff in a hope to get coverage of a positive decision for its members and the claims, again, one CFPB funding structure, unconstitutional and the statutory claims under the APA. Then a level lawsuit came along in Kentucky in August of 2023 and it was various state and national banks and associations making basically the same claims in the Texas case but also interestingly added a First Amendment claim. And then lastly, a more narrow lawsuit filed at the end of last year by a sales-based financing trade group on the basis that such financing doesn't constitute credit under eCOA and therefore it's improper to cover such financing under the rule. Now, initially in the summer of 2023, the Texas Court preliminary enjoined the Bureau from implementing the rule, but that initial ruling contrary to the wish of the plaintiffs was limited only to the plaintiffs and the members of the plaintiff trade associations.

But significantly, the court said if the Supreme Court which was going to be looking at the issue of CFPB constitutionality with regard to its funding, if it rules that that funding mechanism is constitutional, it directed the Bureau to delay the compliance dates for the period between the date of the injunction and the date of that Supreme Court decision should it occur. Now what happened was because the court limited the application of the injunction, various parties started coming in trying to intervene and get coverage of the injunction for themselves and their members. Finally, the court relented in October 2023 and extended the injunction and the extension of compliance dates on a nationwide basis. So that was welcome news. Kentucky District Court did make a nationwide ruling in joining the Bureau from implementing the rule, but it didn't delay. That made this ruling, while nationwide, less helpful than having the delay of compliance states. No ruling yet in the Florida case. As noted in May of this year, the Supreme Court ruled that the Bureau's funding was in fact constitutional.

So what happens now? The Bureau acted relatively quickly and issued some informal guidance, which we'll do more follow up with some formal guidance, extending the compliance dates by the exact 290 days between the original injunction date from the Texas Federal Court and the Supreme Court decision. So the dates are now July 18th, 2025 instead of October 1st, 2024, January 16th, 2026 instead of April 1st, 2025 and October 18th, 2026 instead of January 1st, 2026. Now implementing a rule mid-month, particularly this type of rule, doesn't make sense. So I expect you might get some requests from the industry to move the dates to the first of the following month. We'll see what happens. Now, importantly, there are claims in these cases that are based on other concepts than the CFPB funding structure. So now these cases will now have to turn to the statutory claims such as the Bureau moved beyond its authority in adding all these additional categories.

I think though here we have to remember, Congress did direct the Bureau to adopt a rule and it did give the Bureau pretty broad authorization to expand the data categories beyond those in the statute. I think those are significant hurdles by parties challenging this rule. Now my predictions here is pending other legislation, obviously with an election coming up there could be a change in administration that could lead to a change in legislation that affects what is in Dodd-Frank currently, putting that aside, let's say everything stays the same, some version of this rule will go into effect, I think particularly as to larger lenders. Where I think the Bureau probably has its most risk was its cost analysis and the impact on lenders as a whole, but particularly small lenders. That's where I think there's some risk where a court may send the Bureau back to the drawing board in that area, and there we're just going to have to wait and see on that.

But that's my thought there. Switch gears now a little bit, not a rule, although we thought it was a rulemaking, but the Bureau didn't treat it as a rulemaking, the revisions to the Bureau's UDAP or Unfair Deceptive and Abusive Acts and Practices manual. It, in March of 2022, revealed without much fanfare, just put it out, revisions to the exam manual that expressly provides that the unfair prong of UDAP covers discrimination in consumer financial products and services beyond areas covered by existing specific fair lending laws. Now let's look at this. In the generic concept of course, discrimination is unfair and we're not debating that at all. But the issue here is not as generic, it's does a specific statutory authority, UDAP, which sits in Dodd-Frank, separate from concepts of discrimination, did Congress intend to grant broad powers to the Bureau and then previously the FTC through the unfair prong of UDAP?

Now interestingly, we found out through this litigation that apparently the Bureau believes UDAP has always encompassed discrimination, that it didn't need to revise the exam manual to impose this concept and that in fact, it was free to impose this concept at any time. So that was a bit of a surprise to the industry. As you would expect, there was a challenge. First US Chamber, American Bankers and others submitted a white paper explaining to the Bureau why they were incorrect. The Bureau was unmoved, so a lawsuit then was filed and of course, as you would imagine, in a Texas Federal District Court. And in September of 2023, the District Court vacated the rule plus enjoined the Bureau against enforcing this theory against the plaintiffs and their members. The second part was aimed at the fact the Bureau said we could enforce this theory without regard to the exam manual. So Bureau then removed the revisions to the exam manual but appealed up to the Fifth Circuit and that was put on hold pending the decision of the Supreme Court in the CFSA versus CFPB case. So that's what happened there.

Now, what the Texas Court did, and the Bureau acknowledges, the Texas Court sitting in the First Circuit had no choice but to follow that the CFPB action was invalid because its funding was unconstitutional. But the District Court knew the Supreme Court was going to address that issue and might reverse the Fifth Circuit. So it looked at one of the Administrative Procedure Act claims, which was that this change was beyond the authority of the Bureau under its UDAP power coming from Dodd-Frank. The court agreed that yes, this was beyond the CFPB statutory authority, so it also based its ruling on that as well and that's an important decision in the Fifth Circuit. We'll have to look at that in the case. We do have a podcast if you want to know more on the concept of does unfair cover discrimination, Professor Jeff Sovereign joined Allen and myself for a robust discussion of the issue and I recommend that to you if you're interested in the topic. My predictions here is the Fifth Circuit to be saying it mildly is not kind to the CFPB. I see the Fifth Circuit likely upholding the District Court decision. At that point, if the Supreme Court gets this, we know what the Supreme Court will do. It will similarly affirm the District Court's decision here. Now with that, let's switch gears and look at some pending or other regulations that might face challenges now.

Kristen Larson:

Thanks Rich. First we're going to talk about the ORAF credit proposal. I'm sure most of you have heard of this. Essentially the CFPB is trying to close what they're calling the loophole in Reg Z, which is a current exception for overdraft credit. And anything above your breakeven costs are going to be treated as finance charges, which is going to require separate credit accounts and have the accounts to be deemed consumer credit where you have to comply with Reg Z visions, reg ease, compulsory use, and other laws like eCOA, Military Lending Act and Member's Service Relief Act. And so what's interesting about this, these rules are pending and this came out in January and traditionally, overdrafts have been regulated under Reg DD, Regulation E, Truth and Savings, Electronic Fund Transfers Act.

And here instead of amending those regulations, they're trying to amend the fee you can charge on a transaction account going in the back door through Reg Z. So we do expect to see challenges to this. Obviously they can't use the funding of the CFPB,

they might have that other angle that Alan discussed earlier and we'll also likely see some APA challenges as well. The next proposed rule that we want to talk about is the NSF fee rule. And so this was a weird duck when it came out because it was a rule that they're trying to ban fees that are rarely charged. And so they're trying to ban fees where a consumer is withdrawing, debiting or paying or transferring funds from their account and there's an instantaneous decline or near instantaneous decline due to insufficient funds. And generally these fees aren't charged and this isn't the NSF fee rule that we maybe expected to see.

We expected to see it related to multiple re-presentments, but the real interesting thing here is they're doing it under the UDAP and they're using the abusive prong and what they've done is they're trying to really expand what is abusive and they're taking away any sort of accountability of the consumer to know and understand what the status is of their account, what their balance is, to use any of the easy tools that we have, whether it's the cell phones, calling in, whatever you can do to check your balance, but they're just saying, "Well, consumers just generally lack their awareness and are unaware of the other risks and costs and regardless of what they do, this is unfair. You can't correct it with the disclosure, you can't correct it with anything else." But I think it's interesting the way it might get challenged, is that they're trying to sneak it into a fee proposal that no one really cares about because no one charges these fees. But as we've been saying all along, this is something that we want people to pay attention to because of the impact it can have. And with that, I'm going to turn it back over to Rich.

Rich Andreano:

Thank you very much, Kristen. Now address proposed rules that we're waiting for. The Bureau's actually behind its schedule on releasing the final rules and that's two non-bank public registries and the reason why non-bank is Dodd-Frank does grant the Bureau authority to create registries, but it's limited to non-banks. Now here's the Dodd-Frank provision. It's three sentences, that's all it is yet somehow the Bureau thought when you take this and added it to its general rulemaking authority, it has the authority to adopt these very large encompassing public registration requirements. This is my view of what this means and the Supreme Court, as John mentioned earlier, is likely going to overrule or significantly modify Chevron. It's going to play a big role along with the major questions doctrine in what happens with these final rules. I read this to say all Congress probably was thinking of is it's hard to regulate someone if you don't know they exist.

So what they were going to do I think was the Bureau could adopt a registry saying if you offer a consumer a financial service or product, you have to let me know you exist and provide some basic information. What products and services do you offer? Where do you offer them? What's the extent of the offering? Just so they could then decide who was out there and make their decisions for doing investigations or supervision to the extent you fell within their supervisory authority. I don't think Congress had in mind what the Bureau did propose. And let's take a quick look at what they did propose and it's two... We did do webinars on these registries and podcasts on these registries so podcasts are up on our website, so you can take a look at that if you'd like more information. Just going to do a real high overview of what they are.

And one is first in December of 2022, a registry of certain agency and court orders. As you see the Bureau states, other agencies enter into consent orders or, you go to court and there's a court order addressing violations of consumer financial services laws and imposing obligations on the party to that. That's basically what they're looking to cover and that you would have to put into this registry, all of the orders that you were subject to. Then for those who are supervised, which includes mortgage lenders, brokers servicers, parties making private lenders, those are among the people subject to Bureau supervision. You'd have to annually attest that this was still accurate and this was viewed as nothing more than a name and shame approach to really put it. While there's information usually publicly issued in the first place, the thought was let's shine the light more on them and name and shame.

Did commerce think of this when it put those three sentences requiring registration in Dodd-Frank, I highly doubt that. The other registry, we know the Bureau doesn't like arbitration provisions. It tried banning them and that got overturned under the Congressional Review Act, and other provisions that limit venue limit the ability of the consumer to write negative reviews about someone. So what did they do? Rather than trying to ban them, which they know it had limitations, it would propose that if you have a form contract that has various provisions limiting the rights of consumers, you have to, when there's public registry, the contracts you have and what those provisions specifically are, and then of course you then would have to update that as applicable. Again, if you want more information on there, there's links to our podcast on this. Now we thought we would've seen the final rules by now.

Why? Because in the fall rulemaking agenda, the Bureau targeted March 2024 for the final rule. We don't have them yet. My guess is they will not be deterred by the many negative comments and that they will move forward, they will adopt final rules. Those final rules will then be challenged. You can bet your bottom dollar it'll be in the federal District Court in Texas. And I think both rules will be struck down or severely limited because I just don't think this is what Congress intended. And I think if you apply, if Chevron's limited, add that plus the major question's doctrine, I think the Bureau is going to face strong headwinds in moving forward. With that, now let's take a look at some rulemaking in the fair credit reporting area.

Alan Kaplinsky:

I want to thank all of our colleagues for doing a terrific job today. Now, next week we will do part two of this repurposed webinar. So you'll want to make sure you download and listen to next week's episode. To make sure that you don't miss any of our future episodes, subscribe to our show on your favorite podcast platform, whatever that might be, Apple, YouTube, Spotify, wherever you listen. And don't forget to check out our blog, consumerfinancemonitor.com for daily insights on the consumer finance industry. And if you have any questions or suggestions for our show, please email us at podcast@ballardspahr.com. Stay tuned each Thursday for a new episode of our show. Thank you all for listening, and have a good day.