

Is the Dragon Dead?

November 30, 2016 | [Thomas B. Hudson](#)

On October 11, consumer finance trade associations and publications sent up a joyous cry: A court had declared that the Consumer Financial Protection Bureau's structure violates the federal Constitution. Those in the auto finance business cheered - someone had slain the dragon. This was wonderful news for critics of the most out-of-control federal agency in memory, like me.

Then I read the court's opinion. It turns out that the dragon ain't dead. It has a pretty serious 'owie,' but it still has long claws and still breathes fire. Here's what happened.

The case involved a mortgage lending company, PHH Corporation. In January 2014, the CFPB challenged PHH's "captive reinsurance" arrangement. It seems that PHH referred its mortgage customers to mortgage insurers that, in turn, purchased reinsurance from a PHH affiliate. In an administrative action, the CFPB deemed the reinsurance payments to be improper kickbacks under the Real Estate Settlement Procedures Act and imposed a \$109 million penalty. Not surprisingly, PHH appealed the CFPB's action to the U.S. Court of Appeals for the District of Columbia Circuit. A three-judge panel heard the case.

PHH made three arguments to the appellate court. The argument that got the most attention was an attack on the constitutionality of the CFPB's structure, but PHH also advanced a due process challenge and additionally argued that the CFPB's assertion that it was not subject to statutes of limitations was wrong.

The appellate court agreed with PHH that the CFPB's structure is unconstitutional. In reaching this conclusion, the appellate court found that the director of the CFPB "enjoys more unilateral authority than any other officer in any of the three branches of the U.S. Government, other than the President." The appellate court ruled that the CFPB can continue to operate but "will do so as an executive agency akin to other executive agencies headed by a single person, such as the Department of Justice and the Department of the Treasury[.]" and that person will be removable by the president.

The appellate court also rejected the \$109 million penalty levied by the CFPB against PHH for violating RESPA. The court agreed with PHH that Section 8 of RESPA allows captive reinsurance arrangements, provided that the amount paid by the mortgage insurer for the reinsurance does not exceed the reasonable market value of the reinsurance.

The PHH reinsurance program had passed muster under the RESPA standards imposed by the Department of Housing and Urban Development, only to be declared illegal by the CFPB (which had, under the Dodd-Frank Act, taken over HUD's duties under RESPA). PHH cried foul, claiming that this governmental U-turn violated the Due Process Clause of the U.S. Constitution. The court agreed with PHH that the CFPB violated due process by retroactively applying a new interpretation of RESPA against PHH.

Lastly, the appellate court disagreed with the CFPB's contention that, under the Dodd-Frank Act, there is no statute of limitations for a CFPB administrative action to enforce any consumer protection law. Instead, the court found that there is a three-year statute of limitations applicable to a CFPB action to enforce Section 8 of RESPA.

So, after the dust settled, the results are that the CFPB director can be removed by the president, the CFPB can't change the rules in the middle of the game, and the CFPB cannot ignore statutes of limitations in its enforcement actions.

Remember, though, that this is a decision by a three-judge panel of the appellate court. The CFPB is likely to appeal.

If the opinion stands, though, the court's unconstitutionality determination may have some unexpected ripple effects.

Just a few days after the PHH decision, House Financial Services Committee Chairman Jeb Hensarling (R-TX) notified CFPB Director Richard Cordray by letter that the ruling means the Bureau must now follow executive orders requiring agencies to ensure the benefits of their proposed regulations outweigh the costs. Hensarling also asserted that the CFPB must now abide by executive orders requiring consultation with Indian tribal governments and state and local officials about its rulemaking activities. Abiding by these requirements would, at least, slow down the CFPB's steamroller.

In his letter to Director Cordray, Chairman Hensarling summarized several of the executive orders that now apply to the Bureau and requested "written assurance that the CFPB will comply in full" before it issues any future final rules. As of this writing, Director Cordray had not favored Chairman Hensarling with a reply.

So now we have a very annoyed dragon that should be, but probably isn't, chastened by a federal appellate court. My prediction is that the dragon's wounds are, unfortunately, nowhere near fatal.

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