HUDSON COOK

Regulation of Consumer Financial Services Companies after the Election of 2017

- Is the CFPB gone, and can we all relax now?

November 30, 2016 | Richard P. Hackett

Judging by the direction of the stock market and the financial trade press, November 9, 2016, brought great relief to business in general and to financial services providers particularly. Conventional wisdom is that regulation will decrease, both in content and in fervor of enforcement. Some predict that the CFPB will be dismantled, others that its wings will be clipped and, at the least, that threatened new regulations will be delayed or derailed.

No one can accurately predict what priorities our new president will actually adopt from the menu of vast promises encompassed in the campaign. This article does not try. Rather, we examine some specific tools available to the Executive and Congress to change the direction of the CFPB and the specific procedural and legal contexts that apply to current threats against industry, keeping in mind the limitations of political reality in a divided Congress.

I. ***Will CFPB Issue Payday and Arbitration Rules? Others?***

A. *The Procedural Status*

Comment periods have recently closed on two important rules, each of which would have material adverse effect on some industry participants. The rule on payday, auto title and high cost installment loans would, by the CFPB's own estimation, render monoline payday lending economically unsustainable and severely constrain the auto title and installment lending businesses. The ban on class action waivers in pre-dispute arbitration agreements would significantly change the dynamic in private enforcement of consumer financial protection laws, re-enabling class action litigation. Affected industries are scurrying to make sure that neither sees the light of day as a final rule before Congress has a chance to consider restructuring the CFPB (below).

Conventional wisdom is that those rules will not be finalized before January 20, when President Trump is sworn in, and after that several measures may be taken to keep the rules "on ice" until the political process has played out.

First, there is the question whether CFPB staffers could physically handle the job of

finalizing these rules any time soon. The cycle time from close of comment period to final rule publication for recent CFPB rules has ranged from (a) nearly a year for a simple rule governing which auto finance companies are "larger participants" to be supervised by CFPB, to (b) almost two years for a more complex rule on prepaid cards. The complexity of the arbitration rule is somewhere between those two examples, suggesting a normal finalization in mid-2017. The payday rule is orders of magnitude more complex than prepaid cards, and it garnered over a million public comments. Ordinarily, it would be a substantial effort to process a million comments and respond to them adequately under the Administrative Procedures Act in less than two years. If the CFPB were to rush to judgment on the payday rule between October 7, 2016 (the close of the comment period) and January 20, 2017, the final rule would likely contain numerous procedural errors and be the poster child for "arbitrary and capricious" action, a basis for judicial overturn. If history is any guide, the arbitration rule faces similar difficulties becoming a "midnight regulation," but it is conceivable.

B. *The Executive Options: (1) You're Fired*

Second, is there anything the new President can do on January 20 to forestall further action on the rules? Here we must take up the effect of the recent decision in *PHH v Cordray.* In that case, the U.S. Court of Appeals for the DC Circuit held that the statutory structure of CFPB was a violation of the separation of powers concepts inherent in the U.S. Constitution, because it created a *completely* independent agency with vast rulemaking, adjudicatory and executive functions, free from control from anyone and free from the modulating influence of bi-partisan commission leadership that Congress has used for similar agencies. The simplest solution to cure that flaw, according to the court, was to excise the provision making the Director free from Presidential removal power, except for cause. The court "blue penciled" out that "for cause" requirement, but left the CFPB in place.

The PHH case is stayed under standard Circuit Court procedures until the time for a rehearing petition expires on November 26, 2016. Until then, neither party can enforce the decision, and the order to the lower court to proceed in conformity with the decision (the "mandate") has not issued. CFPB is also free to petition for a longer stay in order to petition for review in the Supreme Court. We do not yet know which path the CFPB will choose, but they have said they will use one. If the CFPB seeks Circuit Court review by the entire group of D.C. Circuit judges, call "en banc" review, the stay will continue, but the opinion in the case will remain law. If the Circuit Court approves en banc review, then the opinion is vacated (it goes away). If the CFPB petitions for review in the Supreme Court, the case will remain stayed, but the opinion will stay on the books.[1]

What does all this mean for President Trump, who is not a party to the litigation, but an interested bystander?

A President who had strong feelings about the CFPB and who was not afraid of being sued might say: the best law that exists on this issue says that I can fire the Director. It may later be changed, but I'll take my chances. Welcome to "The Apprentice." Since there is a Deputy Director who can act in the Director's absence, he would also be invited to the show.

The result would be a second case, *Cordray v. United States*, which likely would follow the same appeal path as *PHH v. Cordray*, might be consolidated with PHH, and (at the least) would allow the President and the Solicitor General to participate as *amicus curiae* in the appeal of the *PHH* case.

C. *Executive Options (2): Order CFPB to Comply with Executive Orders*

It may be unnecessarily messy and politically untoward to fire the Director and Deputy Director.

Another course might be to include CFPB in existing or future Executive Orders. His transition team has announced the President-elect's intention to issue an Executive Order freezing all new regulations temporarily. Could that apply to CFPB? The question brings us back to *PHH.* That case says that the President can fire the Director. Under conventional analysis, an agency whose head can be fired is an executive agency subject to executive control. But the Dodd-Frank Act explicitly says that CFPB is an "independent regulatory agency." There is a long history of that type of agency arguing with other Presidents that they cannot be subject to executive orders, and past presidents have conceded the argument rather than start a fight with Congress. Here, however, a court has said that the agency is not really independent - that it is so powerful that it cannot be, at least in the sense of being outside presidential control. At bottom, a President who can fire the Director can tell him to follow an order.[2]

Thus, we come to executive option 2. A President who was not afraid of litigation would explicitly include CPFB in the regulation-freeze order and also subject it to the order that requires new regulations to undergo cost-benefit analysis review by the Office of Information and Regulatory Affairs (part of OMB).[3] The latter would require new work that would occupy the CFPB Office of Research for some time and is missing from the current payday rule proposal.

How would all this work out? The CFPB might game out that it made sense to await a final decision in the *PHH* litigation under this scenario, because their issuance of a rule before the PHH case was decided would create an independent basis to find the rule illegal - namely violation of executive orders. And it may be two years or more before *PHH* is finally decided.

On the merits, *PHH* is a close case. The CFPB is correct in its claim that the Circuit Court dealt with the structure of independent agencies in a novel way. But the tension the court saw between the Constitution and the administrative estate is not new. In the 1920s, the Supreme Court ruled in *Myers* that Congress lacks the power to limit a President's power to remove a postmaster at will. The Congress cannot take over the executive. A decade later, in *Humphrey's Executor,* FDR sought to fire an FTC Commissioner, solely for policy reasons, where the FTC statute required the President to have specific cause to fire him. The Supreme Court said that Congress *does* have the power to create a "quasi-judicial" and "quasi-legislative" body of experts with a narrow focus who are insulated from political interference through (a) management in a bi-partisan panel of independent experts, and (b) protection during a term of years from

presidential removal of those experts. FDR lost. The court acknowledged that there is a lot of room between firing a postmaster and not being able to fire a single commissioner of a multi-member panel, saying that later cases would have to find the line between those extremes. *PHH* squarely raises the question where the line may be, because CFPB has all of the functions of FTC *and much more.* It has vast legislative, supervisory, enforcement, adjudicatory and other powers, and it lodges them all in a single person who does not have to ask Congress for money to operate.[4] That was the plan in Dodd-Frank: to insulate consumer protection efforts from the significant influence of industry money on both the president and congress, virtually forever. It may have worked too well.

In summary, the new Chief Executive might find the reasoning of the *PHH* decision persuasive enough to put his own marker down on the side of the D.C. Circuit, through either or both personnel decisions or executive orders.

D. *Congressional Options: Congressional Review Act.*[5]

A little-used federal law, dating back to Newt Gingrich's time on Congress, allows Congress and the President to veto a new federal regulation by "resolution of disapproval." It allows a resolution of disapproval (a veto) to pass the Senate without being subject to filibuster. Thus, the current political configuration of Congress could take up and pass a veto over the objections of the Democratic Senate minority. President Trump would likely sign it on January 20.

A Congressional veto can occur up to 60 legislative days (days in session) after the regulation is adopted. The only time the law was successfully used, in 2001, a Republican Congress handed a veto resolution blocking a new OSHA rule to a newly-inaugurated President George W. Bush. That timing would closely track what Congressional veto of a CFPB "midnight regulation" would look like today.

Most important, if a Congressional veto occurs, the agency involved is *prohibited by statute* from adopting a similar rule unless subsequently expressly authorized to do so in new legislation.

Thus, if CFPB should rush out either an arbitration rule or a payday rule before January 20 (or thereafter), it risks losing not only the rule, but also the authority to *ever* adopt a similar rule. A prudent CFPB Director might not take that risk, pending the outcome of the political process described below.

E. *Other Rules?*

CFPB has either begun to process or promised other rules covering third-party debt collection, first-party debt collection, bank overdraft protection programs, and supervision of installment and title lenders. Only the first in the foregoing list has started a SBREFA pre-rulemaking process and none are at the proposed rule stage. There are also other less significant rules in various stages. Given everything we have set out above, it seems unlikely that new formal proposals will be forthcoming until the political process described below shakes out.

II. ***Will CFPB Be Eliminated or Curtailed?***

A. *The Financial CHOICE Act.*

Last September, the House passed HR 5983, the Financial CHOICE Act. Its progenitor and long-time CPFB foe, Jeb Hensarling, has recently indicated in the press that he plans to revise and reintroduce it in January. Title III of the bill significantly curtails CFPB independence and power. A short summary of its provisions dealing with CFPB is attached in Appendix A. Congressman Hensarling claims that he has President-elect Trump's ear on the topic, and that seems likely, as Mr. Hensarling is reportedly on the short list for Secretary of Treasury. Dodd-Frank "repeal" was both a frequent talking point for candidate Trump and an issue where he can buy comity with traditional Republican leadership at little cost to standing with his voter base. Financial CHOICE very well may be part of the first 100 days of a Trump administration.

Meanwhile, Senator Warren has put down her marker against the bill in very clear terms, both opposing its general overhaul of the Dodd-Frank Act and specifically against modifying CFPB in any way. She commands great influence in a minority who have the numbers to filibuster indefinitely. It is possible that the Hensarling bill will languish in the Senate for a long time. Senate leadership has indicated that it is not likely to repeal the rule that allows filibusters, at least as to legislation.

But delay in dealing with the concerns about CFPB and refusal to compromise carries a very real risk for the CFPB. First, it's possible an appeal will uphold the PHH decision by 2018. More important, Director Cordray's term expires in July 2018. At the very latest, in July 2018, if a commission structure is not in yet place, President Trump can nominate a single anti-CFPB Director, who will have five years to dismantle the work of the agency. What is more, since Cordray was confirmed under the "nuclear option" of overriding a filibuster, it seems very likely the same would happen for his replacement from the opposite party. In July 2018, if nothing changes, President Trump can destroy the CFPB.

In short, a victory by Senate Democrats in delaying the Financial Choice Act could be pyrrhic in the extreme - leading to much more permanent damage to the work of CPFB. Compromise might make sense. In contrast, should House leaders pursue a complete repeal of CFPB, then the outcome in the Senate likely would be stalemate.

Returning to our initial topic of the fate of CFPB rules, even if a payday or arbitration rule has been finally adopted by July 2018, it very likely will still be in a pre-implementation period and can be walked back by a new Trump-appointed Director. If a Commission structure is implemented before the rules are adopted, it would be customary for the Commissioners to conduct a complete review of pending rules, and if they have already been adopted (and not vetoed by Congress), the Republican majority on the Commission could begin the process of walking them back.

III. ***CAN WE ALL RELAX NOW?***

Assuming that we are correct that existential threats contained in proposed CFPB rules will go away, and assuming further that CFPB comes under long-term modulating influences such as a Commission leadership, this is not the time to put away compliance

management systems. There are 55 or so other state and federal regulators and AGs to worry about.

At the federal level, CFPB retrenchment will bring back the OCC, the FDIC, the FRB , the NCUA[6] and the FTC. For fair lending issues, DOJ will still be at work. When CFPB first came into existence, there was notable regulatory competition from the prudentials to demonstrate that they were also consumer protection cops. Operation Choke Point is an example. We should expect a similar reaction to downscaling of the CFPB - the other cops will step up patrols.

A more constrained CPFB will also rely more on examination authority and the supervisory process to make subtle changes in industry practice over time (and in secret). There is no legislative proposal to constrain the supervisory process or the power to expand supervision over nonbanks. Thus, over time, we may see a CFPB that operates more like a prudential regulator, using enforcement primarily as a result of supervisory findings and moving the needle though supervisory guidelines rather than rules or enforcement actions. Such an environment makes it even more important for supervised companies to be up to snuff on the technical and substantive side of compliance management systems.

Aggressive state regulators, especially investigatory agencies like the AGs and financial regulators we see in New York and California, will continue to pressure both innovators and traditional industries. In addition, consumer advocate groups will likely pursue state referendum efforts similar to the successful campaign that has resulted in a 36% per annum rate cap in South Dakota. Those same advocates will also likely refocus efforts on state legislatures in attempts to add restrictions to state consumer credit laws.

Finally, assuming a Commission is the final decisional authority on a long-delayed payday rule, the work done by the CFPB to date, and the passion of the consumer advocates, suggests that some federal intervention in to small dollar lending is inevitable, perhaps in the next decade.

No, we should not relax. Just heave a sigh of relief and get on with it.

Appendix A

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[1] As this article went to press, the CFPB chose to file a petition for rehearing *en banc* in the DC Circuit, perhaps recognizing the beneficial effect of vacating the existing opinion if the rehearing is granted.

[2] Typically, but not universally, independent regulatory agencies are headed by commissions, and the commissioners cannot be fired by the President.

[3] EO 12866.

[4] To be clear, the D.C. Circuit focused on the threat to freedom inherent in the CFPB, not the importance of a unitary executive function. The technical constitutional issue,

however, is the threat to the executive of such a structure, as an extreme hypothetical will illustrate. Assume a united Congress opposed to a President from a different party created the Independent Bureau of Immigration Policy and Enforcement, gave it a single director independent of the President who served for ten years, funding outside the budget, and the power to make and enforce immigration policy, including control of what is now ICE and the immigration courts. Such an effort to remake our system of government in a parliamentary model would be swiftly struck down because it usurped traditional core executive functions. CFPB now legislates under, judges under, and enforces 19 federal laws, including many formerly enforced by executive agencies. There is a real constitutional question here.

[5] 5 USC § 801 et seq.

[6] Under the Financial CHOICE Act, these prudential regulators become the exclusive supervisors and enforcers of the federal consumer financial laws for depository institutions with less than $50Bn in assets.

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