

Practice Update

Fifth Circuit Affirms CFPB's Rulemaking Authority Despite Holding the Agency Unconstitutional

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On October 19, the United States Court of Appeals for the Fifth Circuit issued a significant decision in *Community Financial Services Association vs. CFPB* (“*CFSA*”). *CFSA* found the CFPB’s funding structure unconstitutional and vacated the agency’s Payday Lending Rule.[1] The court’s decision in *CFSA* on the constitutional question is a blow to the agency’s autonomy and raises questions about the validity of past and future agency actions. There is more to the opinion than the constitutional headline. Assuming questions around the agency’s funding structure can be resolved, the *CFSA* decision may ultimately be a validation of the CFPB’s expansive rulemaking authority.

I. CFPB Funding Structure Violates The Constitution’s Appropriations Clause

Congress does not appropriate funds to the CFPB.

The Dodd-Frank Act made the CFPB an independent bureau within the Federal Reserve System.[2] The Federal Reserve is an independent agency supported by assessments on member banks, rather than Congressional appropriations.[3] The Board of Governors of the Federal Reserve is obligated to approve yearly funding requests from the CFPB’s Director, as long as each is 12% or less of the Federal Reserve’s budget.[4] The CFPB is also entitled to

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keep any funds it requests, but does not ultimately use.[5] By contrast, the Federal Reserve's surplus funds, if any, flow to a general Treasury fund.[6]

CFSA found this funding structure violates the Appropriations Clause of the Constitution. In the court's view, the Appropriations Clause does not just *permit* Congressional authority over fiscal matters, it *requires* Congress to use this authority to "preserve individual liberty from the encroachments of executive power." [7] The CFPB's funding comes from the Federal Reserve System, which itself is not appropriated by Congress. *CFSA* deemed this funding structure as "double insulated" from Congressional appropriations. Double insulation renders the CFPB unaccountable to Congress, or ultimately to the people, violating the separation of powers embodied in the Appropriations Clause.[8]

CFSA found the CFPB's structure went "a significant step further" than the other federal financial regulators are not appropriated by Congress, such as the Board, FDIC, OCC, NCUA, and FHFA.[9] (The court did not elaborate on the specific differences between the CFPB's funding and those agencies). The problems of the funding structure were exacerbated by the breadth of the CFPB's rulemaking and enforcement authorities and its single director structure. The *CFSA* court vacated the Payday Lending Rule because the CFPB would not have been able to issue the rule without its unconstitutional funding.

II. Payday Lending Rule Is Valid Use Of the CFPB's Rulemaking Authority

The CFPB's Payday Lending Rule was finalized in 2017. The rule's so-called "Payments Provisions" limit a lender's ability to obtain loan repayments via preauthorized account access after two consecutive withdrawal attempts have failed for insufficient funds.[10] The CFPB adopted the rule by relying on its Dodd-Frank Act authority to prohibit "unfair" or "abusive" acts and practices.[11] The *CFSA* plaintiffs

argued the CFPB did not establish the successive withdrawal attempts prohibited by the rule were unfair or abusive. The court disagreed and held that the CFPB had set forth in the rule a reasonable basis to conclude the practices are unfair for several reasons.[12]

First, the court agreed with the CFPB's finding that successive withdrawal attempts caused substantial injury to consumers (a necessary element of an "unfairness" finding). The CFPB's rulemaking record demonstrated that successive withdrawal attempts cause substantial injury through repeated fees from the lender, NSF fees, overdraft fees, and return fees.[13] Second, the court agreed with the CFPB and found consumers could not reasonably avoid the injury from successive withdrawal attempts, another element of unfairness.[14] The court quoted extensively from the findings of the 2017 Payday Lending Rule and noted that its explanations were "fully fleshed out" in the rulemaking record and "supported by a variety of data and industry-related studies." [15]

CFSA also rejected plaintiffs' argument that the Payments Provisions were arbitrary and capricious. [16] The court cited extensively to the CFPB's rulemaking record to show it had properly considered the relevant factors and supported its decision with reasoned analysis and record evidence.[17]

III. Potential Impact of *CFSA* Decision

The potential impact of *CFSA*'s constitutional holding is enormous for the CFPB, the companies it regulates, and consumers. If the decision is upheld, every regulation the agency has issued since its creation in 2011 could be vacated including key regulations such as TILA-RESPA Integrated Disclosures, Home Mortgage Disclosure Act, Loan Originator Compensation, the Prepaid Accounts Rule, the Remittance Rule, and the Debt Collection Rule. Likewise, consent orders and monetary

judgments arising out of enforcement cases could be invalidated. The opinion weakens current and future CFPB enforcement cases because any company sued by the agency for failing to comply with a regulation could argue the regulation it allegedly violated is invalid based on *CFSA*. It will take months or years for the full impact of *CFSA*'s constitutional holding to play out in the courts, but it will no doubt inspire many new lawsuits and motions.

In the long run *CFSA*'s holding could be seen as a victory for the CFPB's rulemaking authority, particularly its authority to prohibit unfair or abusive practices through rulemaking. Courts often strike down agency rulemakings as beyond their statutory authority. Some have asserted the CFPB's Dodd-Frank Act authority to prohibit unfair or abusive practices is particularly broad and undefined. It would have been less controversial for the *CFSA* court to invalidate the Payday Lending Rule on the basis of the CFPB exceeding its rulemaking authority. Instead, the court chose the much more difficult path of finding the entire agency's structure unconstitutional. Assuming the constitutional problems can be resolved by Congress or the courts, *CFSA*'s reasoning is arguably a validation of the rule's reasoning and of the agency's broad authority to prohibit unfair or deceptive practices. In the long run, the agency's rulemaking authority appears to be on solid ground.

Citations

[1] *Community Financial Services Association of America Ltd. v. Consumer Financial Protection Bureau*, No. 21-50826 (5th Cir. Oct. 19, 2022)

[hereinafter Opinion].

[2] 12 U.S.C. § 5491.

[3] Opinion, *supra* note 1, at 4.

[4] 12 U.S.C. § 5497(a)(1)–(2).

[5] *Id.* § 5497(c)(1).

[6] Opinion, *supra* note 1, at 25 (citing *CFPB v. All*

Am. Check Cashing, Inc., 33 F.4th 218, 220 & n.2 (5th Cir. 2022)).

[7] *Id.* at 27.

[8] *Id.* at 31–32.

[9] *Id.* at 35.

[10] *Id.* at 5; 12 C.F.R. § 1041.8.

[11] Opinion, *supra* note 1, at 4; 12 C.F.R. § 1041.4 (2018); Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041). In July 2020, the agency rescinded a portion of the Payday Rule related to underwriting. The remaining provisions of the rule have not yet taken effect because they were stayed pending the *CFSA* decision.

[12] Opinion, *supra* note 1, at 12.

[13] *Id.* at 9.

[14] *Id.* at 10–12.

[15] *Id.* at 12.

[16] *Id.* at 15.

[17] *Id.* at 12–15.

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