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Practice Update

Impact of Supreme Court's Decision in *Seila Law, LLC v. CFPB*

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On June 29, 2020, the Supreme Court resolved the ongoing dispute regarding the structure of the Consumer Financial Protection Bureau (CFPB) in *Seila Law LLC v. Consumer Financial Protection Bureau*, 591 U.S. – (2020). In a 5-4 decision, the Court removed the restriction in the Dodd-Frank Act that allowed president's ability to replace the CFPB Director only "for cause" but otherwise left the CFPB intact.[1] While *Seila Law* resolves the current question regarding the constitutionality of the CFPB's structure, it raises new questions regarding the legality of its past actions, its future course, and the impact of those decisions on regulated entities and consumers.

Summary of the Court's Decision

In the wake of the 2008 financial crisis, Congress passed the Dodd-Frank Act in 2010, which established the CFPB.[2] Congress insulated the CFPB from the annual appropriations process and established the CFPB with a single Director the president could remove only "for cause."[3] Since the CFPB's inception, it has faced challenges to the constitutionality of this structure, which was intended to protect the CFPB from political pressures like those that Congress felt prevented regulators from acting to prevent the 2008 mortgage crisis.

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In *Seila Law*, the Supreme Court addressed the removal issue when it held the limitation on the president's ability to remove the Director is unconstitutional because it violates the separation of powers.[4] The dispute began in 2017 when the CFPB served California-based debt-assistance law firm Seila Law with a civil investigative demand (CID) (the CFPB's version of a subpoena). Seila Law refused to comply because it contended the CFPB was unconstitutional due to its single-director structure. During the subsequent litigation over the CID, CFPB Director Kathy Kraninger agreed with Seila Law and took the position that the CFPB's structure was unconstitutional due to the restrictions on the president's ability to fire the director. Seila Law and the CFPB disagreed however on the remedy. The CFPB and the Solicitor General sought the narrow resolution, ultimately adopted by the Court, striking only the "for cause" language from Dodd-Frank. Seila Law contended the clause was not severable and the Court should abolish the CFPB altogether. The Court appointed *amicus curiae* to defend the constitutionality of the CFPB.[5]

In his majority decision, Chief Justice Roberts (joined by Justices Alito and Kavanaugh) concluded the CFPB's structure "has no foothold in history or tradition."[6] The majority held that the President's executive power generally includes the power to supervise and therefore remove those who exercise authority on the President's behalf. The Court distinguished the CFPB's solitary director structure from multimember, bipartisan agencies, such as the Federal Trade Commission. Justices Thomas (joined by Justice Gorsuch) concurred with the Chief Justice regarding the removal power but disagreed on severability. Justice Thomas would have held the removal issue was not severable from the rest of Title X of the Dodd-Frank Act. The dissent by Justice Kagan (and joined by Justices Breyer, Ginsburg, and Sotomayor) agreed with the Chief Justice on severability but would have upheld the CFPB's structure given the Constitution's silence about removal power, the independent prerogative of the

Congress to establish agencies as it sees fit, and the lack of a meaningful distinction between the agencies for which "for cause" removal is appropriate—notably the Federal Reserve Board and Federal Trade Commission—and the CFPB.[7]

The CFPB's Response to *Seila Law* and Ratification of Prior Actions

The Supreme Court remanded to the Ninth Circuit the question of how and whether the CFPB could ratify the CID it sent to Seila Law. In other words, assuming the prior CID was invalid because the Director was unconstitutionally appointed, the lower courts will review whether the Director now ratify her prior action—the issuance of the CID.[8] In response to the Court's decision, Director Kraninger ratified most regulatory actions taken by the CFPB between January 4, 2012 through June 30, 2020.[9] The CFPB's ratifications include most rulemaking activity. Reports have begun to surface that the CFPB is ratifying active enforcement actions.[10] This is not the first time the CFPB's Director ratified prior actions in response to questions about the Director's authority. In 2013, the Senate confirmed then-Director Richard Cordray and he later ratified his prior actions that he had undertaken while acting under a recess appointment.[11]

Future Impact of *Seila Law* and the Future of the CFPB

Seila Law raises several questions about the future of the CFPB. First, there is the impact and scope of Director Kraninger's ratifications. While no one was successful in challenging the CFPB's 2013 ratifications, it is possible someone may seek to challenge Director Kraninger's 2020 ratifications.[12] Although the success of such a challenge is highly unlikely given the precedent, if a challenge were to succeed it could cast doubt over many of the CFPB's otherwise-settled rules. Second, there is still a question about ratification of enforcement and supervision matters that Director Kraninger has yet to and may never ratify. The CFPB has stated it will not ratify past enforcement actions because they have "no legal consequence for the public."[13] However, even though not ratified, the CFPB still likely expects covered entities to abide by guidance about illegal practices outlined in those older orders and related public materials. Separately, entities still subject to restrictions from prior consent decrees may try to invalidate them if the CFPB does not ratify those prior actions.

Third, while the Supreme Court resolved questions about the constitutionality of the CFPB for the time being, there still is much unknown about the CFPB's future. Going forward, the CFPB's approach to consumer finance regulation is likely to be more unpredictable than before. While Director Kraninger's term runs until December 11, 2023, now that a president can remove her for any reason, the CFPB is much more exposed to political pressure. The CFPB will likely find itself in the same position as the financial regulators prior to the financial crisis, which could lead to erratic enforcement and supervisory actions. Even prior to *Seila Law*, the CFPB revised its approach to civil money penalties, sometimes requiring payment of only nominal amounts.[14]

The outcome of this year's presidential election will likely determine the leadership of the CFPB in 2021 and thus the future course of the agency. Even if President Trump prevails in the election, his newfound ability to direct the focus of the CFPB could result in the CFPB hewing more closely to political pressure. For example, industry will continue to exert pressure on the CFPB to continue to relax rules on small dollar lending and debt collection. No matter who prevails, industry participants should be prepared to react to changing regulatory approaches. Thus far, the CFPB has had three directors (and two acting directors) each with his or her own approach. While the future of Director Kraninger's regulatory regime is well known, a change in leadership could result in the

CFPB reversing course on key initiatives. This week Director Kraninger repealed most of the CFPB's 2017 small dollar loan rule (put in place by then-Director Cordray), reaching a different conclusion about the rule's impact on consumers and industry and repealing requirements that lenders establish a borrower's ability to repay the loan then did her predecessor.[15] However, if the CFPB's leadership changes next year, it is possible or even likely that new leadership would reverse Director Kraninger's decision on the small dollar lending rule as well as her decisions on mortgage regulation regarding the recent qualified mortgage proposal and HMDA.

In its most recent regulatory agenda (see here), the CFPB stated it expects to tackle several controversial issues in the coming months including debt collection, small business lending, and PACE loans. Over the longer term, the CFPB expects to address abusiveness (see our prior alert here), consumer access to financial records, the credit card provisions of Regulation Z, artificial intelligence, loan originator compensation, and interpretations of the E-SIGN Act. These are all complex topics affecting a wide variety of stakeholders, many of which are not obviously partisan issues. Given uncertainty about the CFPB's future, it is possible this agenda or the agency's approach to each rulemaking could change in 2021 no matter which party wins the presidency.

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[1] *See* 12 U.S.C. § 5491.

[2] Public Law 111–203.

[3] 12 U.S.C. § 5491(c).

[4] *Slip op.* at 11.

[5] *Id.* at 8.

[6] *Id.* at 21.

[7] *Id.* at 67.

[8] The Director ratified the CID in the course of the litigation once the Director acknowledged she could be removed by the President for any reason. *Id.* at 30-31.

[9] Press Release, CFPB, "Consumer Financial Protection Bureau Ratifies Prior Regulatory Actions" (Jul. 7, 2020).

[10] *Id.* at 6-7.

[11] 78 FR 53734 (Aug. 30, 2013).

[12] In at least one case, a defendant in an enforcement action is contesting the Director's ability to ratify the initial filing of the case. *See* Defs.' Mot. for Judgment on the Pleadings, *CFPB v. Navient Corp.*, No. 3:17-cv-00101-RDM dkt. 505 (July 10, 2020).

[13] July 7 Press Release at 7.

[14] *See, e.g.,* CFPB, Press Release, "Consumer Financial Protection Bureau Takes Action Against Student-Loan Debt-Relief Business and Its Owners for Taking Illegal Advance Fees" (July 7, 2020) (suspending $3.8 million judgment if owners of company pay $23,000 and a $1 civil money penalty), CFPB, Press Release, "Consumer Financial Protection Bureau Settles with Military Travel Lender and Servicer" (Nov. 25, 2019) (suspending $3.5 million judgment and requiring payment of $1 civil money penalty).

[15] Press Release, CFPB, Consumer Financial Protection Bureau Issues Final Rule on Small Dollar Lending (Jul. 7, 2020).