Time to Reform the CFPB

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The Fifth Circuit's ruling that the way the agency is funded is unconstitutional opens the door to rewrite its remit and take politics out of its decisions
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Paraphrasing Leon Trotsky, payment systems, processors, fintechs, and financial-services firms may not be interested in the CFPB, but the CFPB is interested in them.

Former acting director Mick Mulvaney warned that the bureau was "all too powerful," with its single head simultaneously serving as "a one-man legislature empowered to write rules to bind parties in new ways; as an executive officer subject to limited control by the President; and as an appellate judge presiding over the Bureau's in-house court-like adjudications."

He added that it was "primed to ignore due process and abandon the rule of law in favor of bureaucratic fiat and administrative absolutism."

This was by design. The CFPB was established in 2011 with near-plenary authority, insulated from congressional and executive accountability, and informed by a distrust of industry, a paternalistic view of consumers, and supreme confidence in the ability of regulatory overlords to do good. Enforcement of 18 existing statutes by seven agencies was consolidated into the CFPB.

The bureau has been subject to multiple legal challenges. In Seila Law LLC v. Consumer Financial Protection Bureau, the Supreme Court ruled on June 29, 2020, that a single director who is removable only for cause is unconstitutional because it violates the separation of powers.

However, by severing the for-cause removal provision from the rest of Dodd-Frank, the court preserved the bureau. The decision remedied Mulvaney's concern the President couldn't control the Bureau's director.

Playing Chicken

The latest constitutional challenge is more consequential. The U.S. Court of Appeals for the Fifth Circuit, in Community Financial Services Association of America et al v. CFPB, ruled on Oct. 19 that the bureau's "Payday, Vehicle-Title, and Certain High-Cost Installment Loans" rule violated the constitution's appropriations clause. If it stands, the ruling will be a seismic check on CFPB absolutism.

The ruling is based on the idea that insulating the CFPB from congressional funding, and therefore accountability, violates the Constitution's structural separation of powers.

The Fifth Circuit said: "An expansive executive agency insulated (no, double-insulated) from Congress's purse strings, expressly exempt from budgetary review, and headed by a single Director removable at the President's pleasure is the epitome of the unification of the purse and the sword in the executive" – a reference to founder George Mason's warning "the purse and the sword ought never to get into the same hands."

The bureau will request a review by the full 17-member Fifth Circuit or immediately make a request for certiorari to the Supreme Court. In a recent en banc Fifth Circuit decision, CFPB v. All American Check Cashing Inc., in a concurrence filed by

Judge Edith Jones, five judges said the CFPB’s funding mechanism was unconstitutional. The bureau might, therefore, calculate an en banc Fifth Circuit review wouldn’t be its best shot.

Starved of funds, even the most energetic regulator can’t do much within, much less beyond, its statutory mandate. The CFPB self-appropriates from the Fed up to 12% of the Fed’s operating expenses, adjusted for inflation. As with any government bureaucracy, its spending and activity increase with available funding.

In 2022, the CFPB is drawing $692 million from the Fed, which is 94.3% of the bureau’s maximum, and up 15.7% year-over-year. In 2023 it plans to self-appropriate $731.7 million, which will be 98.2% of its maximum.

The Supreme Court should be sympathetic to the idea of separating the power of the purse from that of the sword. And if it is, any such ruling might also impact agencies like the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency, and the Securities and Exchange Commission. These longstanding agencies, while not double-insulated or enjoying the CFPB’s expansive power, aren’t funded by Congress.

For now, the ruling only binds the Fifth Circuit. But it invites more challenges. If the Supreme Court upholds the decision, all the CFPB’s actions since inception, and its current activities, will be vulnerable to challenge.

The remedy would be for Congress to modify Dodd-Frank to fund the Bureau by periodic congressional appropriations.

For this, Republicans might demand a price in the form, for example, of circumscribing the CFPB’s remit and establishing a bipartisan board à la the Federal Trade Commission and the

FDIC in lieu of a sole executive. Even with a razor-thin House margin, Republicans could play chicken over the CFPB's survival.

Constantly Expanding

After the president, the CFPB director is one of the most powerful individuals in government. Personnel matter. On his first day in office, President Biden demanded and received director Kathy Kraninger's resignation. Her replacement was Sen. Elizabeth Warren protégé Rohit Chopra, who was confirmed without a single Republican vote.

Silver-tongued Chopra is smart, hugely ambitious, political, and distrustful of, and hostile to, the financial-services and payments industries. Chopra's CFPB is highly politicized. Deploying 1,650 full-time employees, it's constantly expanding the scope and prescriptiveness of its regulation and de facto law-making.

In October 2021, it ordered Amazon, Apple, Facebook, Google, PayPal, and Block (Square) to provide information about their payments practices. Meanwhile, a spate of headlines over fraud in peer-to-peer payment systems like PayPal, Venmo, Cash App, and Zelle have attracted the CFPB's interest.

Chopra is keen to impose bigger financial penalties. The CFPB reportedly is pressing Wells Fargo to settle a slew of investigations for more than $1 billion. Fines collected compensate consumers harmed, but also fund politically aligned "consumer education and financial literacy" groups.

Dodd-Frank requires that financial institutions give consumers access to their data, but doesn't specify how. In October, at the Money 20/20 trade show in Las Vegas, Chopra said the CFPB will issue a new rule requiring financial institutions to provide consumers' data upon their request.

He hopes this will reduce consumers' switching costs, spurring greater competition between financial institutions. It would be best, however, if the rule leaves the means to industry.

Chopra derides the U.S. payment system as behind that of other countries, intimating more direction from regulators is needed. The stark reality is otherwise. From retail, P2P, interbank and electronic bill presentment and payment systems and processors to e-wallets, the U.S. payments ecosystem is the most competitive and innovative in the world.

While the CFPB is charged with enforcing Federal consumer financial law to ensure markets for consumer financial products are competitive, the Department of Justice and the FTC are America's principal antitrust regulators. Nevertheless, the director is near obsessed with, and hostile to, industry oligopolies.

Fear of Super Apps

At Money 20/20, Chopra inveighed against: credit-reporting "conglomerates" Equifax, Experian, and TransUnion; "the card networks" Mastercard and Visa; and core processors Finastra, FIS, Fiserv, and Jack Henry.

He bizarrely contended it's critical that no one "owns" critical infrastructure. To the contrary, it's vital that someone own, and have an interest in maintaining and enhancing, essential payments infrastructure. Unowned shared assets are subject to overuse and underinvestment—the tragedy of the commons.

Chopra told community banks and credit unions that he's concerned "core services providers that small players rely on have too much power in the system." He worries "tech companies, gatekeepers, and middlemen" have too much control and make things harder for smaller players and new entrants.

The truth is payment networks, credit bureaus, core processors, and digital wallets have significant network effects and scale economies. Consumers, merchants, and banks, consequently, often are better served by a handful of fierce large competitors rather than by hundreds of smaller players.

In this way, the market dynamically determines the optimal number of competitors better than the savviest central planner.

Chopra charged merger review is “unmoored from the rule of law and the text of longstanding statutes.” Who knew he was a textualist! The director also worried about China’s super-app model and the possibility in the U.S. that an oligopoly of tech giants will reap rents as consumers’ primary dashboards for financial services and payments.

Traditional U.S. antitrust policy holds that there has to be market power and consumer harm for there to be a problem. It doesn’t preemptively intervene based on speculation because a competition problem may develop.

While Chopra professes to want to lower entry barriers and enable greater competition, a hyperactive, prescriptive CFPB does the opposite. It creates a regulatory moat for incumbents. Large players can better cope with regulatory burdens than small players and new entrants.

Un-Madisonian

Chopra would also like to control prices. He’s on a crusade against late, over-limit, and not-sufficient-funds fees, deriding them as “junk fees.”

But penalty fees serve a purpose. They encourage consumers to behave more responsibly, are consensual, and generate revenue. Further restricting penalty fees will discourage financial institutions from serving underserved and risky consumers, or shift the costs of services to responsible consumers.

Cryptocurrency Exchange FTX’s bankruptcy—with at least $1 billion in customer funds and perhaps as much as $2 billion going missing—and FTX’s sharing of consumer funds with trading firm Almeda, which shares its owner with that of FTX, fortify the CFPB’s interest in regulating cryptocurrencies. Congress needs to spell out which agencies should regulate crypto.

An absolutist CFPB is at odds with Madisonian tripartite separation of powers. It suppresses competition and innovation in financial services and payments, and harms consumers. If the Supreme Court upholds the Fifth Circuit’s ruling that the CFPB must be funded by and accountable to the legislature, this would be a real opportunity to reform the agency and make it an apolitical nightwatchman.

—*Eric Grover*