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A federal appeals court ruled that the funding mechanism for the Consumer Financial Protection Bureau (CFPB) is unconstitutional. If upheld, the decision could have implications for the consumer financial sector, especially nonbanks, as it would make congressional oversight of the CFPB easier.

A decision by a federal appeals court that the CFPB's funding structure is unconstitutional, if upheld, would give Congress direct tools in overseeing the agency. In turn, Congress could limit the CFPB's budget or limit its authority over certain sectors.

The ruling is so broad that it is tough to pinpoint sectors that would benefit the most. However, since banks are also subject to federal prudential regulators, nonbank financials are probably the biggest winners (if the ruling stands). Of course, some nonbank financial sectors are not exactly beloved on Capitol Hill (in either party). Debt collectors, payday lenders, credit reporting agencies, and student loan servicers lack broad popular appeal, but direct congressional oversight of the CFPB should benefit these sectors more than it will benefit the banks, simply because banks still have to answer to their primary regulators while there is no corresponding federal regulator for the nonbanks.

Banks could also benefit from the ruling but, for example, the chances of an impact from the ruling on bank overdraft fees is low, as the horse has already left the barn on that issue.

What's the Dispute About?

When Congress created the CFPB as part of the Dodd-Frank Act, Congress insulated the CFPB's budget from the appropriations process. The CFPB receives its funding from the Federal Reserve (which is also exempt from congressional appropriations). Every year, the CFPB requests funding from the Fed that is "determined by the (CFPB's) Director to be reasonably necessary to carry out" the agency's functions. The Fed has no say in the matter and must then transfer the requested amount as long as it does not exceed 12% of the Fed's "total operating expenses." The Fifth Circuit ruled that this double insulation from the appropriations process creates a constitutional problem since there is no direct oversight of the CFPB's budget.

What's Next?

The CFPB and the Biden administration will likely appeal the decision to the U.S. Supreme Court and argue that other agencies, including the Fed, are not subject to annual appropriations. While this is true, the appeals court emphasized the double insulation of the CFPB's funding from Congressional appropriations and given that the Supreme Court is increasingly skeptical of the powers of the administrative state, it seems likely that the Supreme Court would agree with the appeals court's ruling.

What Does This Mean?

If the courts ultimately subject the CFPB to annual appropriations, the direct impact is that Congress can limit the CFPB's budget, and it seems likely that a Republican Congress would do so. Furthermore, during the appropriations process, Congress might be able to include policy riders that would limit the CFPB's ability to regulate a consumer financial product or service. There is no guarantee that Congress will intervene, but it adds another tool to Congress's ability to oversee the CFPB, and that's significant.

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