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Brian Gardner
Chief Washington Policy Strategist
bgardner@stifel.com

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Potomac Perspective

The U.S. Supreme Court has agreed to hear the appeal of a case about how the Consumer Financial Protection Bureau (CFPB) is funded. The headlines should be seen as a positive for the consumer finance sector but investors should not overreact.

The Supreme Court has agreed to hear the appeal of a lower court ruling that the Consumer Financial Protection Bureau's funding mechanism is unconstitutional. The CFPB is funded directly by the Federal Reserve (Fed) rather than Congress. The CFPB may request up to 12 percent of the Fed's budget, and the Fed cannot deny CFPB's request. The Fed is also not subject to congressional appropriations and is funded by open markets operations and other revenue sources. A lower court ruled that the double-insulation (i.e., funds not coming from Congress but instead coming from an agency that is also not subject to the appropriations process) is unconstitutional.

The headlines might move consumer finance stocks (positively), but investors should not overreact to the headlines for several reasons.

First, the Court apparently will not hear the case until next term (starts in October 2023,) so a decision is still around 12-15 months away.

Second, there might be some speculation that if the Court rules that the CFPB's funding structure is unconstitutional, prior CFPB decisions might be overturned as a consequence. Investors and industry participants should be skeptical about this view. The Court might be reluctant to create the chaos that would result from overturning a decade's worth of regulations and enforcement actions. Instead, it is more likely that the Court, if it upholds the lower court's decision that the CFPB is funded unconstitutionally, would hold that CFPB was acting with the color of authority and that its current decisions and regulations would remain intact but future funding methods would have to change.

Third, subjecting the CFPB to annual congressional appropriations could limit CFPB's authority and give Congress more leverage over the agency. However, **many CFPB actions are politically popular, and Congress might be reluctant to block or reverse CFPB rules very often. More likely, Congress could shrink the CFPB's budget which could, in turn, reduce its enforcement capabilities which is positive for the consumer financial sector.**

Finally, there are other remedies besides requiring direct appropriations from Congress. The Court could allow the CFPB to fund itself through user fees (similar to the Office of the Comptroller of the Currency for example), or the Court could allow the Fed to limit the CFPB's budget.

Bottom-line: The Supreme Court's announcement is positive for consumer financial stocks, but a Court decision might not be as impactful as some investors think.

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