The CFPB Has Bigger Problems Than Being Unconstitutional

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The United States Court of Appeals for the District of Columbia Circuit issued its ruling this week in *PHH Corporation v. Consumer Financial Protection Bureau*[1] and determined the single-director structure of the CFPB circumvents constitutionally required checks and balances. While the constitutionality of the CFPB's leadership structure is dominating the headlines, the less publicized, but more impactful aspects of the decision, which reverses a $109 million fine levied by the CFPB against a mortgage lender, should garner equal attention in the financial services industry.

The CFPB issued the penalty against PHH, a New Jersey based home mortgage lender, for allegedly accepting kickbacks in violation of Section 8(a) of the Real Estate Settlement Procedures Act (RESPA). PHH appealed the agency's administrative order, asserting, among other defenses addressed below, that the CFPB's status as an independent agency led by an autonomous single director violates Article II of the Constitution. A three judge panel of the D.C. Circuit Court agreed. The author of the opinion, Judge Brett Kavanaugh reasoned:

> Because the CFPB is an independent agency headed by a single Director and not by a multi-member commission, the Director of the CFPB possesses more unilateral authority— that is, authority to take action on one's own, subject to no check—than any single commissioner or board member in any other independent agency in the U.S. Government. Indeed, as we will explain, the Director enjoys more unilateral authority than any other officer in any of the three branches of the U.S. Government, other than the President.

While the CFPB was originally proposed as a multi-member independent agency similar to the Federal Reserve, the final version of the legislation passed by Congress provides for a single director appointed for 5-year terms who can only be terminated for specific cause (inefficiency, neglect of duty or malfeasance in office). The Court found this structure, vesting power in a single individual with no oversight by the Executive Branch, creates the risk of arbitrary decision making and abuse of power, violating the constitutional system of separation of powers and checks and balances. Rather than shut down the CFPB, the Court concluded existing Supreme Court precedent required a narrower remedy of simply severing the Dodd-Frank Act's provision prohibiting the termination of the director:

> With the for-cause provisions severed, the President now will have the power to remove the Director at will, and to supervise and direct the Director. The CFPB therefore will continue to operate and to perform its many duties, but will do so as an executive agency akin to other executive agencies headed by a single person, such as the Department of Justice and the Department of Treasury.

What does this mean for the future of the CFPB? The decision will almost certainly be appealed by the CFPB, likely first to the entire D.C. Circuit and then to the Supreme Court. Proponents of the CFPB contend its independent single-director structure is intended to insulate the CFPB from political influence. Subjecting the CFPB to Executive Branch oversight and permitting the director to be fired at will by the President, they contend, will inhibit the CFPB's ability to implement and consistently enforce regulations free from political interference. Even traditional opponents of the CFPB's policies might agree. Financial institutions that require consistent enforcement of financial regulations in order to cost-effectively implement compliance procedures may not welcome the Court's move to subject the CFPB to oversight by a political branch of the government. Such concerns on both sides of the debate should lead to compromise legislation that creates a multi-member independent board similar to the Federal Reserve, but any such fix is likely a long way off.

While the CFPB's structure may have been unconstitutional, at least until the for-cause termination provision was severed, the Court's rulings, if upheld, on the due process and statute of limitations defenses raised by PHH deal a more significant setback to the CFPB's policies.

Section 8(a) of RESPA prohibits the payment of referral fees by mortgage insurers to mortgage lenders. The alleged violations by PHH involve reinsurance transactions between mortgage insurers and a reinsurance company affiliated with PHH. The CFPB asserts such arrangements are disguised referral fees. PHH contends "captive reinsurance" is permitted by certain exceptions under Section 8(c) of RESPA so long as the mortgage insurer pays no more than the reasonable market value for the reinsurance, an interpretation consistent with that of the Department of Housing and Urban Development, the agency responsible for enforcing Section 8 of RESPA prior to the creation of the CFPB in 2010. The Dodd-Frank Act transferred responsibility for enforcing Section 8 to the CFPB, and in 2014, the CFPB initiated an administrative action against PHH under a new interpretation of Section 8 that does not exempt captive reinsurance transactions, ultimately resulting in the $109 million fine.

According to the Court, the CFPB's departure from HUD's prior interpretation of Section 8 of RESPA and the retroactive application of its new interpretation violated PHH's due process rights. Addressing

[1] PHH Corp. v. Consumer Fin. Prot. Bureau, 2016 U.S. App. LEXIS 18332 (D.C. Cir. Oct. 11, 2016)

the limits upon retroactive application of the law imposed by the Due Process Clause, the Court held:

> Retroactivity—in particular, a new agency interpretation that is retroactively applied to proscribe past conduct—contravenes the bedrock due process principle that the people should have fair notice of what conduct is prohibited. As the Supreme Court has emphasized, "individuals should have an opportunity to know what the law is and to conform their conduct accordingly."

The ruling could significantly limit the potential liability of other lenders facing similar enforcement actions and should curtail future attempts by the CFPB to retroactively enforce new guidelines.

Finally, in what may be the most significant aspect of the ruling, the Court rejected the CFPB's contention that its enforcement actions are not subject to any statute of limitations. PHH claimed most of the transactions at issue occurred outside the three-year statute of limitations imposed by RESPA. In response, the CFPB argued that Section 5563 of the Dodd-Frank Act authorizes it to conduct hearings and adjudication proceedings to enforce consumer protection statutes such as RESPA and no statute of limitations is imposed by the Dodd-Frank Act on such administrative proceedings, as opposed to court proceedings. As the Court noted, the CFPB's argument would apply not just to RESPA, but to all 19 of the consumer protection laws that the CFPB enforces. The Court flatly rejected that argument, determining the Dodd-Frank Act incorporates the statute of limitations in the underlying statutes enforced by the CFPB in administrative proceedings:

> But Congress limited the enforcement power granted in Section 5563. The CFPB may enforce those federal laws "*unless* such Federal law specifically limits the Bureau from conducting a hearing or adjudication proceeding." Obviously, one such "limit" is a statute of *limitations*.

Ultimately, this narrow element of the decision may prove the most impactful on the CFPB's operations by significantly limiting the CFPB's current procedure of looking back numerous years, often beyond applicable statutes of limitations, when investigating and issuing penalties for violations of consumer protection laws.

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