“An Arrow Has Found its Target”: Federal Appeals Court Deems CFPB Funding Method Unconstitutional, Invalidating Payday Lending Rule

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In a decision with potentially far-reaching implications for the CFPB, a three-judge panel of the U.S. Circuit Court of Appeals for the Fifth Circuit yesterday ruled that the Bureau’s funding structure is unconstitutional. The case involved a longstanding challenge to the Bureau’s 2017 Payday Lending Rule and marks another significant obstacle for the Bureau two years after the Supreme Court’s decision in *Seila Law* that its leadership structure violated separation of powers principles.

Here, the Fifth Circuit panel unanimously held that, although the Bureau did not exceed its statutory authority in promulgating the Rule, it “lacked the wherewithal to exercise that power via constitutionally appropriated funds.” The panel held that Congress’s decision to cede its power of the purse to the Bureau violates the Appropriations Clause of the Constitution and the clause’s underpinning, the constitutional separation of powers. As such, the court reasoned that while most of “Plaintiffs’ claims miss their mark, . . . one arrow has found its target” and the Payday Lending Rule could not stand given the Bureau’s unconstitutional funding mechanism “deprived [it] of the lawful money necessary to fulfill those responsibilities.”

The CFPB’s funding method was established in the 2010 Dodd-Frank Act. Rather than receiving funding through annual congressional appropriations, the Bureau receives funding directly from the Federal Reserve—eliminating the periodic assessments that accompany congressional appropriations analyses. The Federal Reserve, which itself exists outside the appropriations process, must grant the CFPB’s self-directed funding requests up to a certain cap. Although other federal financial regulators also receive funding from independent sources, the panel held that its structure “goes a significant step further than that enjoyed by other agencies”—pointing to the Bureau’s double-insulation from Congress’s purse strings coupled with its singular director and expansive enforcement authority.

In the near term, the Bureau will continue to be unable to enforce the Payday Lending Rule, but its immediate practical impact on other CFPB efforts is likely to be limited. The agency is likely to seek a stay and petition the full Fifth Circuit for an *en banc* review, but the decision could lead to an increase in litigation challenging other Bureau actions, whether rulemaking or enforcement, that are supported of course by the same funding mechanism found to be unconstitutional.

The Fifth Circuit’s holding differs from certain other courts that have heard the issue, so the split may ultimately find its way before the Supreme Court. Regardless of ultimate impact and outcome, Wednesday’s decision is another example of recent judicial scrutiny of regulatory authority, which has impacted regulatory and enforcement activities at a number of agencies including the CFPB, FTC, and EPA.