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Supreme Court Ruling Clarifies CFPB’s Status But Leaves Questions Remaining

**Overview:** The US Supreme Court recently ruled on the structure of the Consumer Financial Protection Bureau (the “Bureau” or “CFPB”), holding that the statutory limits on the President’s authority to remove the Bureau’s Director are unconstitutional but the agency itself is constitutionally valid. The ruling comes after nearly a decade of debate in Congress and in the financial services community regarding the appropriate structure of the CFPB and the relative autonomy of its Director.

**Background**

The Dodd-Frank Act created the CFPB as an independent agency and structured it to have a single Director who can only be removed from office for “inefficiency, neglect of duty, or malfeasance in office.” As a result, although the CFPB is an independent executive branch agency, once the President appoints the Bureau’s Director, the President may only remove the Director for cause. For years, Republicans in Congress have decried the CFPB Director’s autonomy, arguing that it, along with the fact that the Bureau receives its funding via a direct transfer from the Federal Reserve Board rather than via the annual congressional appropriations process, makes the Bureau unaccountable. Republicans supported numerous bills during the Obama Administration and early in the Trump Administration to either transform the Bureau into a multimember commission or to allow the President to remove the CFPB Director at will. However, none of these bills ultimately were enacted into law. At the same time, conservative legal leaders pursued litigation challenging the Bureau’s authority and autonomy under the Constitution.

In 2017, during the tenure of the Bureau’s first Director, Richard Cordray, the CFPB issued an investigative demand to Seila Law, a California-based law firm that provides debt-related legal services. An investigative demand from the Bureau operates essentially as an administrative subpoena. Seila Law resisted the investigative demand on the theory that, because the Bureau is led by a single Director who is only removable for cause, the CFPB’s structure violated the separation of powers principle enshrined in the U.S. Constitution. Both the District Court and the Ninth Circuit disagreed with Seila Law’s argument and ordered the law firm to comply with the investigative demand.
Seila Law v. CFPB

The US Constitution vests all executive power – that is, the power to ensure that “the Laws be faithfully executed” – in the President. Attendant with that authority is the power to delegate duties to lesser executive officers such as the heads of regulatory agencies like the Bureau. Because these lesser executive officers exercise the President’s powers on his or her behalf, the law has been well established for generations that the President has complete authority to supervise, direct, and if necessary, remove those who exercise the President’s executive power on his or her behalf. Seila Law essentially argued that, when Congress sought to limit the President’s authority to remove the Bureau’s Director, it violated the Constitution’s separation of powers clause by encroaching on the President’s ability to supervise the executive branch.

Voting along perceived partisan lines, the Supreme Court agreed. The Court had previously found only two limited exceptions to the President’s unrestricted removal power, neither of which apply to the Bureau. As a result, the Court ruled that the removal restrictions contained in the Dodd-Frank Act violated the Constitution. However, the Court went on to rule that the removal restrictions were severable from the rest of the Dodd-Frank Act, and that therefore, while the leadership structure is unconstitutional, the agency itself is constitutionally sound. As Chief Justice John Roberts wrote, “The agency may therefore continue to operate, but its Director, in light of our decision, must be removable by the President at will.”

Unanswered Questions

Although the Bureau’s current existential crisis is over, the Seila Law ruling has raised significant questions about its effects on the authority of the Director. For one thing, it is unclear – and the Supreme Court declined to address – whether prior agency actions are now invalidated due to the prior unconstitutionality of the agency’s structure. In the specific matter of Seila Law, this question was remanded to the lower courts. The Bureau had argued before the Supreme Court that because the investigative demand directed at Seila Law was later reauthorized by Director Cordray’s successor, Mick Mulvaney, who was not protected by the unconstitutional removal limitations, the demand was ratified by a director whose authority was not unconstitutional. In remanding this question to the lower courts, the Supreme Court specified that such questions must be decided on a case-by-case basis. As a result, we will have to wait for challenges to, or reauthorization of, various prior Bureau actions, including any currently ongoing investigations or lawsuits.

In an effort to stave off further challenges to prior Bureau actions, soon after the Supreme Court issued its ruling in Seila Law, Director Kraninger issued a ratification order that “includes the large majority of the Bureau’s existing regulations, as well as certain other actions.” The ratification order reaffirms a number of official actions from January 4, 2012, through June 30, 2020, including all of the agency’s rules with two exceptions: the 2017 Arbitration Agreements rule that prohibited mandatory arbitration clauses in consumer financial contracts, but which was overturned by Congress; and a part of the 2017 Payday, Vehicle Title, and Certain High-Cost Installment Loans rule that the Bureau had already rescinded with its recent final payday loan rule. The order also excluded previous Bureau actions that have no legal consequences for the public, and enforcement actions that have been finally resolved.

Because the Supreme Court declined to decide whether ratification by the Bureau categorically cures constitutional defects springing from the CFPB’s previous leadership structure, it is not certain that Director Kraninger’s ratification order will end the debate on prior Bureau actions. However, at a minimum the order demonstrates the Bureau’s position on all its prior actions. And because the Court remanded the matter of the Seila Law investigative demand to the lower courts for consideration of the specific facts and legal questions, it strongly implied that the question of ratification by a constitutionally sound Director is an important one.
**Outlook:** It is important to note that the Supreme Court specifically limited its ruling to the single-director structure of the CFPB. Agencies led by multi-member commissions or boards, such as the SEC, the FCC, and the Federal Reserve Board, are unaffected by this decision. It is not clear yet whether this ruling is simply a correction of the tenure-protected single-director structure of a few agencies like the Bureau or is a first step by the Court’s conservative majority toward reducing the independence of independent agencies. More immediately, it renders the CFPB more susceptible to the political fluctuations of the White House, and potentially opens the door for Director Kraninger to make significant changes to the Bureau’s rules and actions. At the same time, the decision could have benefits to Democrats, who have long supported the Bureau’s autonomy, in the near future; if former Vice President Joe Biden is elected President in November, he could remove Director Kraninger at his discretion upon assuming the presidency, prior to the end of her five-year term.

**FDIC Issues RFI on Voluntary Certification Program to Promote New Technologies**

**Overview:** On July 20, 2020, the FDIC announced that “it is seeking the public’s input on the potential for a public/private standard-setting partnership and voluntary certification program to promote the efficient and effective adoption of innovative technologies at FDIC-supervised financial institutions.” The FDIC hopes that the voluntary certification program could help banks that choose to use the system by standardizing due diligence practices applicable to adoption of new technologies.

**Seeking Ways to Integrate New Models and Technologies**

In recent months the FDIC’s office of innovation, FDiTech, has been actively making efforts to modernize the banking industry and its regulation, including promoting partnerships between fintech companies and banks. In November, 2019, the agency published a notice and request for public comment regarding a proposal for “Information Collection for Innovation Pilot Programs.” The innovation pilot program would function as a framework for banks and fintech firms to propose and test new and useful technological approaches to banking products and services. This new notice and request for information (“RFI”) relates to a proposed certification program that directly relates to a bank’s ability to partake in innovation pilot programs.

The FDIC explicitly states in the RFI that it is “especially interested in information on models and technology services developed and provided by . . . fintechs.” Toward that end, the request asks for input on whether a program could be established that would set standards by which financial institutions could implement new models and technologies, and manage the associated risks, by voluntarily certifying certain aspects of the new models or technologies themselves. The self-certification would also involve conducting appropriate due diligence of third-party technology providers by certifying certain aspects of those third-party providers’ operations or condition.

The FDIC acknowledged that, as the financial services industry evolves, banks often use third-party models and technologies for functions that either are new or had been historically performed in-house. The costs associated with assessing such third-party models and technologies can be a substantial barrier, especially for community banks. In response to this challenge, the FDIC is considering the development of relevant standards that banks can use to assess third-party products and services. The proposed program would allow banks to certify that a particular model or technology conforms to such standards. The hope is that banks – especially community banks – would be better able to engage with fintech firms and other third-party service providers at lower costs.
The FDIC is also interested in hearing about alternatives it could pursue instead of a voluntary certification program, which would support financial institutions’ efforts to assess risk efficiently and effectively when contemplating or monitoring relationships with third-party providers. The agency was careful to state that it is not considering substantive revisions to existing rules or guidance.

**Standard-Setting and Certification Programs**

The RFI sets forth an overview of how standard-setting programs usually operate. Specifically, a standard-setting organization (“SSO”) is established to work with stakeholders (including government agencies) in developing the relevant standards for a particular industry or economic sector. “The standard is established on a voluntary, consensus-driven basis and provides guidelines for engaging in a particular process or for offering a particular service or product.” The FDIC notes that SSOs often partner with government entities, academia, and industry, and involve consumers in the process. The goal is be inclusive so as to balance regulatory and market needs.

The implication here is that an SSO could establish certain standards applicable to models and technologies, as well as the third-party providers of such models and technologies, such that financial institutions could rely on certifications that these models, technologies, and third-parties have met the established standards. This ability to self-certify, or rely on a third-party’s self-certification, relative to established standards would hopefully streamline the process of adopting new models and technologies while also reducing the costs associated with performing the necessary due diligence.

**Requested Comments**

The FDIC requests comments on all aspects of the RFI, but listed 26 specific questions. Of particular note, the FDIC is asking:

- What factors inhibit the adoption of technological innovations or on-boarding of third-party technology service providers?

- Are there specific challenges related to a financial institution’s relationships with third-party providers of models or technology that could be addressed through standard-setting and voluntary certifications, especially as relate to due diligence, ongoing monitoring, review and validation, or information sharing and data protection?

- Would a voluntary certification process meaningfully reduce the costs of due diligence and on-boarding?

- What supervisory changes in safety and soundness examinations would be necessary to encourage or facilitate the development of such a certification program?

- What other supervisory, regulatory, or outreach efforts could the FDIC undertake to support the financial services industry’s development and usage of a standardized approach to the assessment of models or the due diligence of third-party providers of technology and other services?

**Outlook:** The RFI presents a meaningful opportunity for regulated financial institutions, as well as fintechs, to influence the FDIC’s approach to adoption of new technologies and models, and further evinces the FDIC’s intentions to foster more innovation in the financial services industry. Comments must be received by September 22, 2020.
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