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Consumer Financial Protection Bureau: Ripe for Reform

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Introduction

Chairman Barr, Ranking Member Foster, and Members of this Subcommittee, I appreciate the opportunity to speak to you today.

My name is Devin Watkins. I have been an attorney at the Competitive Enterprise Institute, or CEI, for the past five years. CEI has advocated, for nearly forty years, for more accountable government rather than bureaucratic control, so people can live freer, healthier, and more prosperous lives. That vision is needed today more than ever, especially for the Consumer Financial Protection Bureau (CFPB).

One of the matters I have worked on at CEI was the lawsuit in *State National Bank of Big Spring v. Mnuchin*, which CEI litigated up to the Supreme Court, challenging the CFPB's funding mechanism as unconstitutional. For a variety of reasons, the Supreme Court declined to review that case.

But I'm happy to report that last week on February 27, 2023, the Supreme Court agreed to consider the constitutionality of the CFPB's funding mechanism, which of course lies outside of congressional appropriations. I am hopeful that the Court will decide that the Constitution requires congressional appropriation for CFPB funding.

Today I would like to speak on various reforms to the CFPB that would improve its accountability to Congress, its protection of civil rights, and its mission generally. The most important reforms are those that the Constitution requires, and that is where I will begin.

I. Congress Should End CFPB's Funding Outside of Congressional Appropriations

The most critical CFPB reform is to ensure that its funding comes through Congressional appropriations instead of the Federal Reserve.

The Dodd-Frank Act bypassed congressional appropriations to avoid Congress's future oversight of the CFPB. This attempt to immunize funding from congressional decisions is a direct affront to democratic control and is prohibited by the Constitution. An important consequence of this change was the elimination of public accountability. Ultimately, any funding mechanism that appears designed to evade Congress's supervisory role is of questionable constitutionality.

America's founders knew executives would prefer unilateral control of public finances rather than making their case to Congress. They saw the consequences of such unchecked political authority when the King of England tried to bypass the legislature and control government funds. Eventually, it led to the Glorious Revolution, which gave Parliament power over the public purse.

The founders wanted to prevent the political chaos that England had faced from occurring here. That is why the Constitution requires that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."

This means that Congress is responsible for determining the budget for government agencies. But under the Dodd-Frank Act, the CFPB director can set his or her own budget. The Federal Reserve pays for that budget without the involvement of Congress.

Congress should remove the Federal Reserve's funding of the CFPB by use of its own budget. The budget is limited to funding issues, but removing the Federal Reserve's funding of the CFPB is just such an issue. Indeed, the chairman of this subcommittee has provided, through the Taking Account of Bureaucrats' Spending (TABS) Act, a non-budgetary implementation of this proposal.

Congress should eliminate the funding of the CFPB through the Federal Reserve, but it should also scrutinize the CFPB's actions to ensure that the money appropriated to the agency is put to good use. Indeed, it is the responsibility of Congress to examine the CFPB to ensure that it is operating correctly and then to condition such funding on changes that Congress feels are necessary.

Some members of Congress may disagree on whether the Constitution requires Congress to set the CFPB's budget. Nonetheless, everyone should still recognize the importance of passing conditional funding of the CFPB and other similar agencies due to the case of *Consumer Financial Protection Bureau v. Community Financial Services Association of America*.

In this case, the Supreme Court granted certiorari and will determine if the funding methods at issue improperly bypassed Congress's control over the CFPB's budget. The Fifth Circuit Court of Appeals ruled that the Federal Reserve's funding of the CFPB is unconstitutional, and therefore that Congress must allocate funds as mandated by the Constitution.

If the Supreme Court upholds the Fifth Circuit ruling, the CFPB's operations will end without congressional funding. There are many other agencies whose operations will likely be open to challenges, including the Federal Reserve, the Office of the Comptroller of the Currency (OCC),

the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Farm Credit Administration (FCA), the Office of Financial Research (OFR), and the Federal Housing Finance Agency (FHFA). These agencies operate partially or entirely outside of the regular congressional appropriations process.

Any ambiguity regarding the constitutionality of the Federal Reserve's or other financial institution's actions could result in significant problems throughout the financial system. Congressional appropriation for these agencies is an easy fix that resolves any such problems.

None of us know whether or not the Supreme Court will uphold the ruling of the lower court. Therefore, Congress should pass conditional appropriations to guarantee the Federal Reserve and other financial agencies' proper functioning in case the Supreme Court supports the Fifth Circuit's decision.

Such appropriations would be conditional; they would only be triggered if the existing funding mechanisms were found unconstitutional. Congress should issue such appropriations with conditions, considering any reforms needed for these agencies, instead of writing a blank check.

II. Congress Should Require That No Money May Be Spent on Enforcement That Is Not Based on a Rulemaking

The most critical reform that Congress should require before it continues CFPB funding is to require the agency to ensure notice is given of what practices are illegal and to mandate a jury finding of wrongdoing before punishment.

Former CFPB Director Cordray started the practice of "regulation by enforcement," which contradicts the rule of law. Instead of providing clear rules for people to comply with, the agency required individuals to anticipate what the CFPB Director considers unfair or abusive.

This method is similar to setting the speed limit as "a reasonable speed" and then allowing officers to issue tickets based on their subjective judgment of a reasonable speed. This approach leads to arbitrary punishment and leaves no way for regulated parties to ensure their conduct remains lawful.

CFPB's treatment of PHH Corporation is an example of this. PHH Corporation followed the rules issued by the U.S. Department of Housing and Urban Development. CFPB disagreed with those rules, so it issued a new interpretation. But then it *retroactively* applied a new interpretation to punish PHH's past behavior. According to the D.C. Circuit, this "violated bedrock principles of due process."

No new types of violations of law should be announced through an adjudicative judgment or consent decree/order. The regulated community should only be informed of what is illegal by Congress or through the rulemaking process laid out by Congress. Every enforcement action should be able to point to a specific rule, promulgated through the rulemaking process, that clearly and convincingly applies to the conduct the defendant is accused of. Any other method of enforcement raises profound questions as to its conformity with the rule of law.

Former Acting CFPB Director Mick Mulvaney appreciated this. On April 10, 2018, he announced in testimony before this committee:

> In another change, the Bureau practice of "regulation by enforcement" has ceased. The Bureau will continue to enforce the law. That is our job, and we take it seriously. However, people will know what the rules are before the Bureau accuses them of breaking those rules.

Regrettably, Director Chopra has revived this indefensible practice. As former Senator Pat Toomey stated last year: "The CFPB recently changed its rules of adjudication to make it easier to engage in regulation by enforcement. This grossly unfair practice occurs when agencies fail to set clear rules of the road before bringing enforcement actions."

Congress can put an end to these unfair practices by requiring that enforcement cannot occur unless a previously promulgated rule clearly and convincingly prohibits the specific conduct the defendant is accused of. The rule must have already gone all the way through the notice-and-comment procedure when the conduct occurred that the CFPB is targeting. Congress should prohibit rule-free enforcement practices through substantive legislation and prohibit the funding of such enforcement. Clearly and convincingly is the legal standard that Congress should require the courts apply in civil cases to ensure that the rule prohibits the specific conduct that is alleged.

Any guidance issued by the CFPB should be limited to indicating the practices it considers lawful. This way, regulated parties can operate confidently in areas where the CFPB will not prosecute without going through a long rulemaking process. Notably, such limits would not allow CFPB to sneak in new regulatory requirements through guidance documents. Congress should state clearly that courts should give no weight to guidance documents that claim certain practices are illegal.

Congress must condition any funding it provides on prohibiting the use of funds for enforcement of practices that are not clearly and convincingly prohibited by a rule that has gone through the notice-and-comment process. After funding is limited, Congress should pass substantive legislation to ensure a long-term prohibition.

III. Congress Should Not Fund Agency Expenditures on Enforcement Actions to Impose Penalties or Monetary Fines Without Jury Trials in Article III Courts

The CFPB often issues monetary fees or fines over $20 through its administrative adjudication system. However, Congress should end this practice; instead, the CFPB should bring such enforcement actions through Article III courts with a jury.

The Seventh Amendment of the U.S. Constitution mandates that "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved." The phrase "In Suits at common law" allows equitable remedies like injunctions to be issued without a jury. Legal remedies, such as fines, fees, or any monetary damages above $20, must be determined by a jury.

The Seventh Amendment exists because the government can abuse monetary penalties, so the jury system acts as a backstop to prevent such abuse.

That Amendment has deep historical roots. In 1734 John Zenger criticized the governor, who retaliated against Zenger with a charge of seditious libel. Zenger's attorney reminded the jury that "Jurymen are to see with their own eyes, hear with their own ears, and to make use of their own consciences and understandings, in judging the lives, liberties, or estates of their fellow subjects." The jury found Zenger not guilty, a verdict that Gouverneur Morris described as the "germ of American Freedom, the morning star of liberty that subsequently revolutionized America."

Likewise, the British government enacted the Navigation Acts to force Americans to use British ships for all imports or exports at a high additional cost. Americans considered these laws unjust and refused to follow them. As a result, the British government fined those who violated these laws. Nevertheless, American juries refused to hold such individuals responsible for paying the fines.

In response, Parliament created the vice-admiralty courts to fine colonists without jury trials. The First Continental Congress thought this violated their rights and wrote an open letter to Great Britain, stating that "we claim all the benefits secured to the subject by the English Constitution, and particularly the inestimable right of trial by jury."

The Declaration of Independence cited one cause of American independence: the English government "depriving us in many cases, of the benefits of Trial by Jury." James Madison asserted, "Trial by jury in civil cases is as essential to secure the liberty of the people as any one of the pre-existent rights of nature." John Adams recognized that "Representative government and trial by jury are the heart and lungs of liberty." The 1776 Virginia Declaration of Rights and the Massachusetts Constitution required the civil jury trial to be "held sacred."

Nevertheless, the CFPB regularly fines individuals more than $20 without allowing them a jury determination of wrongdoing. Instead, the CFPB uses administrative law judges (ALJs) to determine if people have violated the law, which it appoints, oversees, and can fire at any time. How can any ALJ be impartial if the judge's livelihood depends on one of the parties before the judge not removing the judge from office? Even worse, when the ALJ determines the individual has not violated the law, the CFPB director can overrule the ALJ and act as prosecutor, judge, and jury. This structure does not meet minimum standards of fairness and due process of law.

In *Jarkesy v. Securities and Exchange Commission*, the Fifth Circuit Court of Appeals ruled that the SEC's enforcement of fraud against Jarkesy violated the Seventh Amendment because such enforcement requires a civil jury trial. The nature of the fraud actions that the SEC brought is similar in many ways to the prohibitions against fraud to consumers that the CFPB enforces.

Fraudulently inducing consumers to buy a product constitutes fraud, whether it pertains to securities enforced by the SEC or financial products enforced by the CFPB. In both cases, basic fairness requires a trial by jury to punish the offender and prevent abuse of government authority.

The Fifth Amendment right that "no person shall . . . be deprived of life, liberty, or property, without due process of law," was meant to ensure that before a person's property could be taken, any accusation of wrongdoing would be brought before an Article III judge.

There is a much stronger constitutional basis for an administrative adjudication system that issues orders or injunctions to prohibit an illegal act. Such agency actions can be appealed to judges directly and merely provide notice as to what the law requires. But the taking of someone's property—a government action that is expressly regulated by the Fifth Amendment—must go through the Article III courts. That is the only way the CFPB can avoid being a judge in its own case.

To ensure that these unconstitutional practices stop, Congress should include a provision in any funding given to the CFPB that no money should be spent on the administrative adjudication process for issuing any monetary fine or other similar punishment (such as disgorgement to the government). Instead, such enforcement actions should go through the Article III courts with a jury determination of wrongdoing. After funding is limited, Congress should pass substantive legislation to ensure a long-term prohibition.

IV. Congress Should Limit CFPB's Authority to Practices That Are Not Common in the Industry By Providing Incentives for the Exercise of Legislative Authority on Large Issues

Congress—not the CFPB—should be responsible for mandating industry-wide changes to behavior, as these changes can have significant impacts on the economy that the CFPB is not well situated to understand.

I am not implying that all industry-wide practices are acceptable or that none require modification. However, such economy-wide concerns necessarily raise larger policy questions and therefore should ideally receive direct attention from Congress.

The CFPB's mission should generally be to find the industry players using atypical practices that harm consumers. Such entities may be stating the terms of what they are offering in an unusual way; they may just be lying to harm consumers.

If there is a new unfair practice, it will take time before it becomes common in the industry. This means the CFPB has an opportunity to intervene and prevent its spread quickly.

As to industry-wide practices that CFPB believes are harmful to considers, prior to issuing regulations the CFPB should be required to issue a report to Congress about why such industry-wide practices are harmful. Congress would then have an opportunity to decide whether that practice should remain lawful. If no legislation is passed into law concerning the practice in a given period (say, six months), only then would the agency have the power to issue a regulation on the industry-wide practice.

This would provide a strong incentive for Congress to pass a statute that addresses CFPB's concerns. The six-month rule would encourage Congress to occupy its rightful place as the decision-maker on large economic questions.

There is a potential incentive issue with a presidential veto, but one that can be fixed. Consider the reform described just above: if Congress decides to regulate some given practice, the President could veto that congressional decision and, assuming Congress can't override that veto, then the agency could issue a regulation contrary to the decision of Congress. This creates an incentive for the President to veto congressional legislation, because it increases his own authority to set policy.

To solve this problem, I would suggest conditioning the ability of the agency to issue the regulation on both the absence of pertinent federal legislation and the absence of a presidential veto against that legislation during the six-month period. This eliminates any incentive for the President to veto the congressional decision. The President can still veto any decision that Congress makes, but he wouldn't be empowering his own administration in doing so. Instead, the law would remain as it was before the CFPB issued its report to Congress.

With this change, CFPB can then focus its limited resources on the few bad apples unambiguously exploiting consumers, rather than transforming entire industries.

V. Congress Should Define the Mission of the CFPB By Specifying the Nature of "Deceptive, Unfair, and Abusive" Practices

The vagueness of the CFPB's authority and mission is a fundamental problem. It hinges on interpreting three pivotal terms: *deceptive*, *unfair*, and *abusive*. However, the definitions of these terms are largely unspecified, even though they constitute the basis of the CFPB's jurisdiction.

Congress should provide more precise instructions than simply instructing agencies to do good things and stop bad things. It should describe in detail what is being prohibited. Failure to do so will eventually lead the courts to invalidate the authority given to the executive branch under the non-delegation doctrine or substantially limit that authority.

The lack of clarity about what constitutes deceptive, unfair, and abusive practices has resulted in the gradual expansion of the CFPB's authority. In some cases, as described by the CFPB, these terms appear to encompass any practice that the CFPB disapproves of. This presents two significant issues: the CFPB is overstepping the boundaries of congressional intent, and fundamental constitutional concerns are at stake. It is imperative that Congress clarifies these territorial lines before the courts need to intervene.

I suggest providing greater clarity about the meaning of each of these words. Starting with *deceptive*, I would limit that to actions of fraud against the consumer. This occurs when a financial institution tells a consumer things that are not true or takes similar actions intending to mislead consumers or to inappropriately encourage purchases.

The CFPB's definition of "deceptive" should not be based solely on a failure to inform the consumer. However, the CFPB currently considers any failure to provide information it deems necessary as "deceptive." This raises concerns about the potential for the CFPB to require businesses to disclose information beyond what is needed or relevant. Without clarification, any product that the CFPB dislikes could be targeted under the current definition as insufficiently informing consumers of what the CFPB doesn't like about that product.

Similarly, the CFPB claims that any mistaken statement or impression may not be cured by a correction that explains the truth to the consumer. Such corrections to mistakes shouldn't be considered "deceptive." Only if the erroneous statement was made deliberately as part of a deceitful scheme, such as bait-and-switch, should it be considered "deceptive."

Presently, the CFPB regards a statement as "deceptive" if a "significant minority" misunderstands it. A minority group's misinterpretation of financial institutions' statements should not have the power of a heckler's veto. The general understanding of a statement in context by a typical consumer should be the determining factor.

Unfairness is subjective, and opinions may vary. Congress has provided some guidelines, but they remain vague and open to interpretation.

An example is the current CFPB's push for a disparate impact analysis of unfairness. According to the CFPB, any action affecting groups differently, even if unintentional, would be an unfair act for which it could issue fines. This effectively means any action that financial institutions take—which always affects some groups differently—is a potential violation of the law as defined by the CFPB.

Suppose a financial institution establishes a new branch. This would inevitably affect nearby residents differently from those living farther away. These two groups are always going to be different in some respects. CFPB claims that the action is unfair and illegal; however, this definition is too broad.

The determining of unfairness should only focus on the costs to the consumer using the financial service. That determination should not factor in the costs to society; that is Congress's responsibility, not the CFPB's. Furthermore, only the financial costs borne by the specific consumer, not others, should be considered. Additionally, emotional or non-monetary claims of harm should not be considered.

An example of how "unfair" and "abusive" are being understood by the CFPB to mean "actions we don't like" is the "junk fees" initiative. This initiative targets fees financial institutions charge for certain services that the CFPB regards as objectionable. The CFPB labels these fees as "junk," despite their existence serving a purpose that may not be immediately apparent to the CFPB.

Any rival company could offer a service without these so-called "junk fees." If they are truly just junk, one would expect consumers to flock to such an alternative. But that doesn't happen because these fees are often designed to pay for services that provide value.

One illustration of this is Dodd-Frank's elimination of debit card interchange fees, which Congress labeled as "junk fees." However, when these fees were restricted, it caused the rewards programs provided to consumers on debit cards to end. Credit card companies used these fees to provide services that encouraged customers to use their credit cards. Retailers were willing to pay those fees to attract consumers. By restricting these fees, consumers were adversely impacted. The probable outcome of the CFPB's "junk fee" initiative moving forward is further consumer harm.

There is no problem with prohibiting acts like changing prices after the consumer purchases a product or transactions that occur without the consumer's knowledge or consent. But the mission of the CFPB needs to be clearly defined so that everyone, including the CFPB, knows what Congress wants to be prohibited.

Congress can intervene now and prevent the harm to consumers that CFPB is causing. The goal of the CFPB should be to uphold consumer choice.

Conclusion

The most critical reforms to the CFPB are, fundamentally, constitutional issues. This includes restoring the congressional appropriations process, preventing enforcement without rulemaking, and ensuring that fines can only be issued after a finding of wrongdoing by juries. After that, Congress should limit the CFPB's authority to unusual practices, and provide more detail as to the CFPB's mission.

The time to reform the CFPB is now. Delaying action at the CFPB will result in the exacerbation and perpetuation of these issues—which will harm both consumers and the industry. There is no single best solution as to how to reform the CFPB. However, by coming together now, we can improve the current situation and protect against future problems.

Thank you for the opportunity to testify today regarding this timely and important issue.