

## D.C. Circuit Brings CFPB under Presidential Control

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On October 11, 2016, the United States Court of Appeals for the D.C. Circuit issued its long-awaited opinion in *PHH Corp. v. Consumer Financial Protection Bureau*, in which the Court held that the structure of the Consumer Financial Protection Bureau (“**CFPB**”) was unconstitutional under the Separation of Powers doctrine because its single Director was not subject to the supervision and control of the Executive Branch.<sup>1</sup> The Court’s remedy was to reinterpret the relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”) to recast the CFPB as an executive agency, providing the President the power to supervise, direct, and remove at will its Director. Despite finding that the structure under which CFPB had been operating since its creation in 2011 was unconstitutional, the Court explicitly declined to address – at least for now – the effect of its ruling on past CFPB rules and enforcement actions.<sup>2</sup>

On the merits, the Court ruled that the CFPB erred when it departed from longstanding statutory interpretations of Section 8 of the Real Estate Settlement Procedures Act (“**RESPA**”) and retroactively applied the new interpretation to PHH Corporation’s (“**PHH**”) alleged acceptance of kickbacks from mortgage insurers.

While it is unlikely that the constitutional ruling will affect the CFPB’s ability to carry out its regulatory and enforcement agenda, the Court’s strong rebuke of the CFPB on the merits may make it more difficult for the CFPB to re-interpret prior statutory determinations of other agencies.

### Background

#### The CFPB

The CFPB was created in 2011 by Dodd-Frank. In creating the CFPB, Congress departed from the model of traditional multi-member, independent agencies and instead organized the CFPB under a single Director who was to be removable only for cause during his or her five-year term. That single Director oversees the CFPB’s broad authority to enforce nineteen separate consumer protection laws that were previously overseen by seven different federal agencies. Commenting on the breadth of the CFPB’s enforcement authority and the concentration of that authority in a single Director, the Court concluded that “the Director of the CFPB is the single most powerful official in the entire U.S. Government, other than the President.”<sup>3</sup>

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## Captive Reinsurance

One of the laws under the CFPB's enforcement authority is Section 8 of RESPA, which governs referral fees in certain mortgage settlement services, including "captive" reinsurance arrangements. A captive reinsurance arrangement occurs when a mortgage lender refers its borrowers to a certain mortgage insurer. The insurer then purchases reinsurance from an affiliate of the mortgage lender.

Under Section 8(a) of RESPA it is unlawful for a person to give or accept "any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."<sup>4</sup> But RESPA Section 8(c) provides specifically for a safe harbor where the mortgage insurers paid a "bona fide salary or compensation or other payment for goods or facilities actually furnished."<sup>5</sup>

It is important to recognize that Section 8 of RESPA has been one of the most contested provisions of consumer credit law due to its sweeping language, the vague nature of its prohibition, and its draconian sanctions (which include criminal penalties). Throughout the 1980s and early 1990s, the industry contested the proper interpretation of Section 8 with regard to a variety of arrangements, including, but not limited to, captive reinsurance arrangements. Some of these disputes were resolved following the issuance of a letter in 1997 by the U.S. Department of Housing and Urban Development ("**HUD**") – the agency responsible for enforcing RESPA prior to the formation of the CFPB – which allowed captive reinsurance arrangements when the fair market value conditions are met. HUD reaffirmed its interpretation several times thereafter and its position regarding fair market value was widely cited in treatises and court cases. The industry relied on this HUD letter for 18 years until the CFPB abruptly rejected HUD's conclusion in 2015, re-interpreting Section 8 of RESPA to prohibit any payment for reinsurance that is part of a "tying arrangement."

## PHH and CFPB

PHH had engaged in captive reinsurance arrangements since 1995 and had relied on HUD's interpretation until the CFPB brought an administrative enforcement action claiming that PHH's captive reinsurance arrangements violated Section 8 of RESPA. The CFPB imposed a \$109 million fine on PHH for these alleged violations, including violations stemming from conduct that occurred prior to the CFPB's re-interpretation of Section 8 in 2015. In doing so, the CFPB also held that the three-year statute of limitations in RESPA did not apply to administrative determinations made by the CFPB. PHH appealed, disputing the CFPB's interpretation of RESPA, its retroactive application of its interpretation, and its disregard of the statute of limitations. PHH also asserted that the CFPB was unconstitutionally formed and, thus, lacked the authority to bring action against PHH.

## Independent Agencies With a Single Director Removable Only for Cause Ruled Unconstitutional

The Court first addressed the constitutional question raised by PHH: whether an independent agency can be headed by a single Director removable only for cause in light of the Separation of Powers doctrine, which requires that the executive power be exercised under the supervision and control of the President.

The Court relied on *Humphrey's Executor v. United States*<sup>6</sup> for the proposition that Congress can create independent agencies – i.e., agencies whose officials are not subject to Executive Branch control – without violating Article II of the Constitution. But the Court observed that the "CFPB marks

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a major departure from the settled historical practice requiring *multi-member bodies* at the helm of independent agencies,” noting that the Court could not identify a single, longstanding example of a constitutionally permissible single Director, independent agency.<sup>7</sup> At the heart of the Court’s concerns was the absence of checks-and-balances of agencies that are “unchecked by the President, the official who is accountable to the people and who is made responsible by Article II for the exercise of executive power.”<sup>8</sup> The Court concluded that multi-member, independent agencies reflect a better safeguard to individual liberties, and thus pass constitutional muster, because:

- no single Director wields much power;
- such agencies produce more “deliberative decision making” and a greater range of diverse viewpoints that ensures “decisions will be more fully ventilated”;<sup>9</sup> and
- such agencies are less likely to produce arbitrary decisions or be subject to regulatory capture.

Accordingly, the Court held that the structure of the CFPB was unconstitutional, and struck the removal-for-cause language from the relevant sections of Dodd-Frank to render the CFPB, in effect, a traditional executive agency.

## **Scrutiny of CFPB’s Statutory Interpretations and Retroactive Application**

On the merits of the case, the Court rejected the CFPB’s departure from the longstanding statutory interpretation of its predecessor, HUD. With respect to Section 8 of RESPA, the Court reaffirmed the original construction adopted by HUD, ruling that Section 8 permits a mortgage lender such as PHH to maintain captive reinsurance arrangements so long as the amounts paid by the third-party mortgage insurance companies to the captive mortgage reinsurance company do not exceed reasonable market value.

The Court also held that even if the CFPB’s new statutory interpretation had been a permissible reading of the statute, its retroactive application to PHH violated “bedrock principles of due process.”<sup>10</sup> The Court ruled that the CFPB violated PHH’s due process rights by retroactively applying its new interpretation, which departed from consistent, prior interpretations issued by HUD that covered referral arrangements for mortgage loan reinsurance. The CFPB’s abrupt re-interpretation was described as “upend[ing] the entire system of unpaid referrals that has been part of the market for real estate settlement services . . . [and] flout[ing] . . . decades of carefully and repeatedly considered official government interpretations.”<sup>11</sup>

Finally, the D.C. Circuit ruled that the CFPB was bound by RESPA’s three-year statute of limitations. The CFPB could not avoid the restriction by asserting that the statute of limitations was not incorporated by the Dodd-Frank Act when Congress moved responsibility from HUD to the CFPB, or by asserting that the statute of limitations applied solely to judicial, rather than administrative, proceedings.

## **Conclusion**

The CFPB started out as a highly autonomous government agency with broad powers under Dodd-Frank, signed by President Obama in the wake of the 2008 financial crisis. As a result of the D.C. Circuit’s ruling in *PHH*, however, the CFPB’s broad enforcement powers are likely to be somewhat

mented, specifically with respect to the agency's attempts to depart from longstanding statutory interpretations of its predecessor agencies recognized by the courts. The CFPB Director also faces new accountability to the President, but it remains to be seen whether these checks on the CFPB's authority will materially impact, going forward, the agency's regulatory and enforcement agenda.

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1 No. 15-1177 (D.C. Cir. Oct. 11, 2016), *available at*

[https://www.cadc.uscourts.gov/internet/opinions.nsf/AAC6BFFC4C42614C852580490053C38B/\\$file/15-1177-1640101.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/AAC6BFFC4C42614C852580490053C38B/$file/15-1177-1640101.pdf) [hereinafter *PHH*]. The

CFPB's formation has raised constitutional questions going back to its formation in 2011. See *The Consumer Financial Protection Bureau: The New,*

*Powerful Regulator of Financial Products and Services, Cadwalader Clients & Friends Memo* (Mar. 6, 2012), *available at* <http://www.cadwalader.com/re>

<sources/clients-friends-memos/the-consumer-financial-protection-bureau-the-new-powerful-regulator-of-financial-products-and-services>.

2 See *PHH*, *supra* note 1, at 69-70 n.19 (finding that the enforcement action against PHH had to be vacated on the merits, the Court saved for another day the "issues regarding the legality of past rules and of past or current enforcement actions" resulting from the Court's constitutional ruling).

3 *Id.* at 27.

4 12 U.S.C. § 2607(a).

5 *Id.* § 2607(c).

6 See *Humphrey's Executor v. United States*, 295 U.S. 602 (1935).

7 *PHH*, *supra* note 1, at 43 (emphasis added); see *id.* at 27-33 (finding that the example agencies cited by the CFPB – the Office of Special Counsel, the Social Security Administration, and the Federal Housing Finance Agency – were of too-recent vintage and also constitutionally suspect).

8 *Id.* at 43.

9 *Id.* at 45.

10 *Id.* at 12, 79.

11 *Id.* at 75-76.

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