

UNDERSTANDING THE CFPB’S FUNDING PROBLEM

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The Dodd Frank Act of 2010 requires that the CFPB’s funding be sourced from the “combined earnings” of the Federal Reserve System.¹ However, the Fed has had no such earnings since September 2022 and thus cannot legally fund the CFPB until it returns to profitability. Nonetheless, the Fed has provided the CFPB with \$1.9 billion of funds during this time. In a hearing before the Senate Banking Committee on February 11, Fed Chair Powell dismissed the suggestion that continued funding of the CFPB conflicted with the statute, claiming that “it’s very clear on the law and the legislative history that we are still required to make those payments.”² The Chair did not, however, provide the rationale for this claim, which I believe is ill-founded.

In Part I, I explain why the Fed’s continued funding of the CFPB violates the statute creating the CFPB and rebut several potential counterarguments. This lack of funding justifies the immediate closure of the CFPB. In Part II, I explain how Congress can adopt legislation through reconciliation that permanently deals with the CFPB going forward.

I. THE FED’S LOSSES DEPRIVE THE CFPB OF LEGAL FUNDING

i. The Fed has had no combined earnings since 2022 but continues to fund the CFPB

The Federal Reserve Act requires that each of the twelve individual reserve banks remit to the Treasury all of their earnings (i.e. net income) in excess of required dividends and a small surplus. Specifically, the Federal Reserve Act requires that the “portion of net earnings of each Federal reserve bank which remains after dividend claims . . . have been fully met shall be deposited in the surplus fund of the bank” and that surplus funds that exceed \$6.7 billion are to be “transferred to the Board of Governors of the Federal Reserve System for transfer to the Secretary of the Treasury.”³ In 2022, the reserve banks (collectively, the “Fed”) remitted a combined \$73 billion to the Treasury relating to income accrued in the first three quarters of the year.⁴ In September 2022, the Fed began to lose money as its interest payments on deposits and its operating costs

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¹ DODD FRANK § 1017(a)(1); (12 USC § 5497(a)(1)).

² SENATE BANKING, HOUSING, & URBAN AFFAIRS COMMITTEE, *Hearing on Semiannual Monetary Policy Report* (Feb. 11, 2025).

³ FEDERAL RESERVE ACT § 7 (12 USC § 531).

⁴ FEDERAL RESERVE BANKS, *Combined Quarterly Financial Report* 4 (Sept. 30, 2022), <https://www.federalreserve.gov/publications/files/quarterly-report-20221129.pdf>.

began to exceed its interest income.⁵ The Fed continued to lose money through 2023 and realized a net loss of \$114 billion for the year.⁶ The Fed realized a net loss for 2024 of approximately \$78 billion,⁷ and is on pace to realize \$60 billion in additional losses in 2025.⁸

Individual reserve banks, particularly the Atlanta and St. Louis reserve banks, have periodically posted profits since 2022 and remitted them to the Treasury - these totaled \$670 million for 2023⁹ - but the losses of these and the other 10 reserve banks have substantially outweighed these profits, such that the Fed has realized continued losses on a combined basis.

Dodd-Frank provides that the CFPB can only be funded from the “combined earnings of the Federal Reserve System.” Despite the Fed’s lack of combined earnings, it has provided approximately \$1.9 billion in funding to the CFPB since September 2022. This funding violates the statute.

I now respond to three potential counterarguments to this conclusion.

i. It is irrelevant that individual reserve banks have earnings.

It could perhaps be claimed that the CFPB can be funded by those individual reserve banks that have realized earnings since 2022. But in contrast to the Federal Reserve Act’s explicit requirement that each reserve bank calculate its earnings and make remittances to the Treasury individually, Dodd-Frank explicitly specifies that the CFPB’s funding come from the “combined” earnings of the Fed. It is thus irrelevant that individual banks had earnings, since the other banks realized losses that caused the Fed to realize a combined loss. And in any event transfers from the minimal profits of the Atlanta and St. Louis banks of approximately \$100 million constitute a small fraction (less than 10%) of the total \$1.9 billion the Fed has sent to the CFPB since September 2022. The balance of the funding came from reserve banks with no earnings.

⁵ Miguel Faria-e-Castro & Samuel Jordan-Wood, *The Fed’s Remittances to the Treasury: Explaining the ‘Deferred Asset’* FEDERAL RESERVE BANK OF ST. LOUIS (Nov. 21, 2023), <https://www.stlouisfed.org/on-the-economy/2023/nov/fed-remittances-treasury-explaining-deferred-asset>.

⁶ FEDERAL RESERVE BANKS *Combined Financial Statements as of and for the Years Ended December 31, 2023 and 2022 and Independent Auditors’ Report* 4 (Mar. 18, 2024), <https://www.federalreserve.gov/aboutthefed/files/combinedfinstmt2023.pdf>.

⁷ FEDERAL RESERVE BANKS, *Combined Quarterly Financial Report* (Sept. 30, 2024), <https://www.federalreserve.gov/aboutthefed/files/quarterly-report-20241122.pdf> (showing net loss before remittances of \$88 billion through Q3 2024); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Federal Reserve Balance Sheet: Factors Affecting Reserve Balances – H.4.1* (Dec. 26, 2024), <https://www.federalreserve.gov/releases/h41/> (showing a \$215 billion deferred asset for earnings remittances to Treasury, which is \$15 billion greater than the value of that asset as reported on the Q3 2024 balance sheet, implying roughly \$15 billion in losses for Q4 2024).

⁸ BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Federal Reserve Balance Sheet: Factors Affecting Reserve Balances – H.4.1* (Feb. 6, 2025), <https://www.federalreserve.gov/releases/h41/> (showing a \$220 billion deferred asset for earnings remittances to Treasury, which is \$5 billion greater than the value as of Dec. 25, 2024, implying roughly \$5 billion in losses during the first month of 2025).

⁹ FEDERAL RESERVE BANKS, *supra* note 6 at 62.

ii. “Combined earnings” are not revenue.

In an attempt to justify its continued receipt of Fed funding notwithstanding these combined losses, the CFPB has argued in several enforcement actions that “earnings” really means “revenue.” This is contrary to basic accounting terminology, where earnings are equal to revenue minus expenses.¹⁰ It also conflicts with the legislative history of Dodd Frank: A preliminary draft of the legislation stipulated that the Fed was to fund the CFPB up to a specified percentage of the Fed’s “total system expenses.”¹¹ This formulation would have permitted the Fed to fund the CFPB so long as it had any revenue, up to the specified cap. But Congress rejected that formulation in favor of the current one. If Congress had intended for the CFPB’s funding to be drawn from the Fed’s revenue, it would have been unnecessary to depart from this earlier version or to refer to “combined earnings.”

The attempt to equate combined earnings with revenue also conflicts with how Congress in Dodd Frank funded the Office of Financial Research. It provided that the Fed could give this agency “any amount sufficient to cover the expenses of the Office” without reference to “combined earnings.” This formulation leaves the Fed free to fund the OFR so long as it has revenue available to do so. This contrasting funding structure confirms that when Congress intends to make the Fed’s revenue available to an agency, it knows how to do so. Congress would not have adopted a unique formulation tied to “combined earnings” if it had intended to adopt a similarly unbounded funding structure for the CFPB.

The creators of the CFPB may have been comfortable sourcing the CFPB’s funding from the Fed’s net income because the Fed had historically never lost money, and they did not expect it to do so in the future. This expectation proved to be false. But this cannot alter the language of the statute.

iii. “Combined earnings” are not “comprehensive income.”

The Fed may be contending that they had “combined earnings” because their deferred asset accounting methodology resulted in positive “comprehensive income.” But if the Fed loses money, it has no earnings to remit to the Treasury. How can accounting methodology result in a different outcome? The answer is that it cannot.

Each year the Fed publishes the consolidated financial results of the 12 reserve banks in statements audited by KPMG. As shown in Figure 1 below, its \$114 billion loss in 2023 is recorded on the Fed’s 2023 income statement as a “net loss before providing for remittances to Treasury.” Under the Federal Reserve Act the Fed is not required to remit future earnings to the Treasury until it

¹⁰ See, e.g., SECURITIES & EXCHANGE COMMISSION, *Non-GAAP Financial Measures* (Dec. 13, 2023), <https://www.sec.gov/corpfin/non-gaap-financial-measures.htm> (“Earnings’ means net income as presented in the statement of operations under GAAP.”).

¹¹ WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2009, H.R. 4173, 111th Cong. § 4111(a) (as introduced in House, Dec. 2, 2009), <https://www.congress.gov/bill/111th-congress/house-bill/4173/text/rfs>.

recoups this loss and again has a surplus.¹² Instead of entering remittances to the Treasury as a “\$0” figure, the income statement records the accrual of a deferred asset as a *negative* entry under “earnings remittances to Treasury.” This deferred asset reflects that the Fed expects reserve banks to earn future profits which they will not have to remit to the Treasury until they return to a surplus position.

Businesses subject to income tax commonly accrue deferred assets when they realize losses that they can use to reduce tax liabilities with respect to future income. The value of such an asset is typically only a fraction of the loss, equivalent to the marginal tax rate. But here the Fed is required to remit 100% of its excess earnings to Treasury. The Fed’s accounting thus totally offsets its losses by the fact that they will not have to send remittances to the Treasury until they generate enough earnings in the future to recoup old losses. As Note 12 to the Fed’s 2023 financial statements explains, the deferred asset “represents the amount of net excess earnings the Reserve Banks will need to realize in the future before remittances to the Treasury resume.”¹³

This line item therefore has the effect of cancelling out the Fed’s net loss in calculating its bottom-line comprehensive income. As a result, the Fed reported positive comprehensive income of \$1.5 billion for 2023 despite its substantial economic losses. To our knowledge this is the first time the Fed has lost money and also the first time it has used this deferred asset accounting on a combined basis.

Figure 1: Excerpt from the Fed’s 2023 income statement¹⁴

Reserve Bank and consolidated variable interest entities net (loss) income before providing remittances to the Treasury		(114,300)
Earnings remittances to the Treasury, net	Note 12	(116,063)
Net income (loss) after providing for remittances to the Treasury		<u>1,763</u>
Change in prior service costs related to benefit plans	Notes 9, 10, 11	103
Change in actuarial (losses) gains related to benefit plans	Notes 9, 10, 11	(379)
Total other comprehensive (loss) income		<u>(276)</u>
Comprehensive income		<u><u>\$ 1,487</u></u>

But positive comprehensive income does not indicate that the Fed earned money in 2023, as the negative net income figure and the absence of combined positive remittances to the Treasury make clear. And positive comprehensive income does not constitute “combined earnings” within the meaning of the Dodd Frank Act.

As explained above, the common meaning of “earnings” is net income. However, comprehensive income as calculated on the Fed’s financial statements bears no relation to the Fed’s net income. This is because any such loss is automatically cancelled by the accrual of a deferred asset that

¹² Federal Reserve Act § 7(a)(3)(B) (requiring remittances of earnings to the Treasury only once the “aggregate amount of the surplus funds of the Federal reserve banks” exceeds \$6.785 billion).

¹³ FEDERAL RESERVE BANKS, *supra* note 6, at Note 12.

¹⁴ *Id.* at 4.

relates solely to the distribution of the Fed's *future* earnings. The effect of the accrual of this asset is to make comprehensive income insensitive to the Fed's losses. Comprehensive income is thus categorically inconsistent with the meaning of "net income" or "earnings." This interpretation would also conflict with the intent of Congress: As noted above, Congress discarded a prior version of the Dodd-Frank provision that would not have conditioned CFPB transfers on whether the Fed had earnings, thus allowing for transfers regardless of whether the Fed had positive or negative economic income. Adopting "comprehensive income" as the measure of earnings, for purposes of funding the CFPB, would revert to this discarded formulation. It is a principle of statutory construction that Congress "does not intend *sub silentio* to enact statutory language that it has earlier discarded in favor of other language."¹⁵

Furthermore, equating "earnings" with "comprehensive income" would entail that the Fed's transfers to the CFPB in 2015 and 2018 violated Dodd-Frank. For both those years, the Fed realized earnings, but remittances to the Treasury for the year exceeded earnings as a result in part of certain lump sum remittances to reduce the Fed's surplus as mandated by statute, such that comprehensive income was negative.¹⁶ If "earnings" referred to "comprehensive income," then the Fed had no funds that it could validly transfer to the CFPB for either such year.

II. HOW TO CLOSE THE CFPB

On February 8, the CFPB's acting director, the head of OMB, Mr. Vaught, ordered CFPB staff to cease all "supervision and examination" activity and notified the Federal Reserve that the CFPB would not be requesting further funding, because it is not "reasonably necessary" to carry out the CFPB's duties given the shuttering of the CFPB's activities and the CFPB's existing accumulated surplus of \$711 million (the result of past illegal Fed funding).¹⁷

Relying on general executive authority to shut down the CFPB is open to the legal challenge that Congress has specifically created the CFPB and its creation cannot be closed by the executive. A better rationale would be to rely on its illegal funding, which is now contrary to what Congress provided. However, the illegal funding theory is only sufficient to close down the CFPB as long as the Fed is unprofitable. It would also create uncertainty surrounding the effect and enforcement of CFPB rules, particularly those that predate the Fed's losses. All CFPB rules promulgated after 2022 should be invalid since the agency was then operating illegally. Note the sweep of an illegal

¹⁵ *INS v. Cardoza-Fonseca*, 480 U.S. 421, 442-43 (1987).

¹⁶ FEDERAL RESERVE BANKS, *Combined Financial Statements as of and for the Years Ended December 31, 2015 and 2014 and Independent Auditors' Report* (Mar. 8, 2016), <https://www.federalreserve.gov/aboutthefed/files/combinedfinstmt2015.pdf>; FEDERAL RESERVE BANKS, *Combined Financial Statements as of and for the Years Ended December 31, 2018 and 2017 and Independent Auditors' Report* (Mar. 8, 2019), <https://www.federalreserve.gov/aboutthefed/files/combinedfinstmt2018.pdf>.

¹⁷ Brian Schwartz & Dylan Tokar, *CFPB to Close Office After Vought Tells Staff to Halt All Supervision* WALL STREET JOURNAL (Feb. 9, 2025), <https://www.wsj.com/finance/regulation/vought-moves-to-defang-cfpb-telling-staff-to-halt-all-supervision-19f1ac9f>.

funding basis for closure would have a much wider sweep in invalidating rules than would use of the Congressional Review Act which could only invalidate rules enacted during the final 60 days of the last Congress. But even with this wider sweep, rules preceding the Fed's losses would still have validity. While the CFPB could not practically enforce any rules once it was closed, whenever those rules were promulgated, firms might still face third party liability for violating those still valid rules.

What about a more permanent solution?

In my Wall Street Journal op-ed of February 1, I questioned whether reconciliation (which only requires 50 votes) could be used to permanently abolish the CFPB since ending CFPB funding would not result in more remittances to the Treasury and thus would not impact the budget, an impact required by the reconciliation process.¹⁸ This was an error on my part since closing the CFPB would in fact result in more Treasury funding.

This is because, as explained in Part I, there are individual reserve banks that do operate at a profit now and fund the CFPB, so these banks would have more funds to send to the Treasury now if they were not funding the CFPB. Further, the shutdown of the CFPB would permit the \$712 million¹⁹ in the CFPB's accumulated fund to go the Treasury, saving the taxpayers additional money.

So, Congress can decide what to do with the CFPB permanently and it can do it now through reconciliation. It could decide to eliminate it entirely or cut back its mission and make it subject to the normal appropriations process. In the same legislation it can decide what to do about existing CFPB rules (i.e., whether to abolish them or assign their enforcement to other agencies) and about consumer protection in the future — return it to where it resided before Dodd-Frank, in the banking agencies or the FTC, or leave consumer protection in the hands of the states.

¹⁸ Hal Scott, *Rohit Chopra Is Out. Now Shutter the CFPB* WALL STREET JOURNAL (Feb. 1, 2025), <https://www.wsj.com/opinion/chopra-is-out-now-shutter-the-cfpb-consumer-financial-protection-bureau-70ab88bb>.

¹⁹ Megan Messerly et al., *Vought cuts off CFPB Funding, Saying It's Not Necessary to Run the Agency* POLITICO (Feb. 9, 2025), <https://www.politico.com/news/2025/02/09/vought-cuts-off-cfpb-funding-00203261>.

ADDENDUM: THE FED’S ACCOUNTING METHODOLOGY CANNOT EXPAND ITS STATUTORY AUTHORITY TO FUND THE CFPB

The following discussion is an addendum to the foregoing analysis showing that Fed funding of the CFPB is not permitted while the Fed is losing money. This discussion explains why the Fed’s accounting methodologies do not alter this conclusion.

The Federal Reserve Act requires the Fed to issue financial statements and to engage an annual independent audit of those statements.¹ The Federal Reserve Act is silent as to the accounting methodologies that govern the preparation of the Fed’s financial statements and thus arguably provides the Fed with broad discretion to set its own accounting methodologies.² The Fed’s Board of Governors has therefore adopted “specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank” and that depart in several respects from Generally Accepted Accounting Principles (“GAAP”).³ These methodologies are detailed in the Fed’s “Financial Accounting Manual” (“FAM”).⁴ The most significant divergence from GAAP is that the Fed accounts for its portfolio of “open market” financial assets at cost, rather than at fair value, as GAAP requires.⁵

A proponent of continued Fed funding to the CFPB might suggest that two of the Fed’s accounting policies indicate that transfers to the CFPB are permissible notwithstanding the Fed’s losses: (1) recording payments to the CFPB as operating expenses, and (2) the presentation of positive “comprehensive income” notwithstanding the Fed’s negative net income. In neither case is the suggestion correct.

(i) *CFPB Transfers as Operating Expenses*

FAM does not specify any special accounting principles with respect to payments to the CFPB and Fed transfers to the CFPB appear as operating expenses on the Fed’s financial statements. Whether the presentation of this payment as an operating expense is consistent with normal GAAP accounting, or whether it should be presented as a distribution out of the Fed’s net income, is irrelevant. The issue is whether the payment is legally justified. The Dodd Frank Act provides that the Fed can only make this payment if it has “combined earnings.” As my prior analysis explained, the Fed’s income statement reports the difference between the Fed’s annual revenue and annual expenses as “net income (loss) before remittances to Treasury.” And since September 2022 net income has been negative—so there are no “combined earnings.”

¹ FEDERAL RESERVE ACT §§ 11, 11B.

² FEDERAL RESERVE ACT § 7.

³ See, e.g., FEDERAL RESERVE BANKS, *Combined Financial Statements as of and for the Years Ended December 31, 2023 and 2022 and Independent Auditors’ Report* Note 3 “Significant Accounting Policies” (Mar. 18, 2024),

⁴ BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Financial Accounting Manual for Federal Reserve Banks* (Apr. 2024), <https://www.federalreserve.gov/aboutthefed/files/bstfinaccountingmanual.pdf>.

⁵ FEDERAL RESERVE BANKS, *supra* note 3.

(ii) *Positive Comprehensive Income*

When the Fed realizes a net loss before remittances to the Treasury, it accrues a deferred asset equal to the value of future earnings the Fed must realize before it is required to resume remittances. The accrual of this asset is recorded as a negative entry under “remittances to Treasury” and thus reduces the value of the net loss. As a result, “comprehensive income” has been positive since September 2022 notwithstanding the Fed’s net losses.

To our knowledge the Fed has not before Q4 2022 recorded such a deferred asset on its combined financial statements. In 2011, however, the New York Fed recorded positive net income for the year but also recorded a deferred asset corresponding to a loss that it realized from the revaluation of an interest in an affiliated entity.⁶ This loss was minor relative to the New York Fed’s net income, and as such the New York Fed still had both positive net income and positive comprehensive income for the year regardless of the accrual of the deferred asset. By contrast, in 2023, the value of the Fed’s combined losses was so great that the Fed recorded combined negative net income, and the accrual of the deferred asset transformed negative net income into positive comprehensive income. Neither instance changes the fact that adding back losses to net income in the form of an accrued asset is irrelevant to the extent of the Fed’s statutory authority to fund the CFPB when the Fed has incurred a substantial economic loss.

The Fed also cannot claim that any contrary interpretation of “combined earnings” implied by its accounting methodologies or financial statements is entitled to deference from a reviewing court in interpreting the statutory “combined earnings” requirement. Before 2024, the Supreme Court’s *Chevron* decision directed courts to defer to a federal agency’s interpretation of an ambiguous statute, even if the court would find the interpretation to be incorrect.⁷ However, the Supreme Court overturned the *Chevron* principle in its 2024 *Loper Bright* decision. In *Loper Bright*, the Court considered the legality of an interpretation of a federal statute by an agency of the Department of Commerce.⁸ The lower court – the D.C. Circuit – had applied *Chevron* to rule that because the statute was ambiguous, and the agency’s interpretation was “reasonable,” the court was required to defer to the agency’s interpretation of the statute. The Supreme Court however overruled the lower court and *Chevron*, holding instead that under Article III of the Constitution, the courts must use their “independent judgement” to determine the “best” meaning of a statute applicable to a federal agency. For the reasons explained in my prior analysis, the meaning of “combined earnings” is in my view not ambiguous. However, even if a court were to find ambiguity in that term, neither the Fed’s presentation of CFPB payments or its calculation of “comprehensive” income on its financial statements are entitled to deference in determining the correct interpretation of the statute.

⁶ Seth Carpenter et al., FEDERAL RESERVE BOARD *The Federal Reserve’s Balance Sheet and Earnings: A Primer and Projections* 11(2) INT’L JOURNAL OF CENTRAL BANKING 237, 246 (2015), <https://www.ijcb.org/journal/ijcb15q2a7.pdf>.

⁷ *Chevron v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984).

⁸ *Loper Bright Enterprises et al. v. Raimondo* 603 U.S. __ (2024).

In summary, if the Fed lacks “combined earnings” as Congress intended that term, further Fed payments to the CFPB are not authorized, regardless of how the Fed presents its financial results or accounts for its payments to the CFPB.