

# Consumer Finance Monitor (Season 8, Episode 13): Prof. Hal Scott Doubles Down on His Argument That CFPB is Unlawfully Funded Because of Combined Losses at Federal Reserve Banks

Speakers: Alan Kaplinsky and Hal Scott

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly podcast show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm, and I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. I'll be moderating today's program.

For those of you who want even more information, either about the subject that we're going to be discussing today or for that matter, anything else in the world of consumer finance, don't forget about our blog, which also goes by the same name as our podcast show, Consumer Finance Monitor. We've hosted the blog since the CFPB became operational in July of 2011, and there is a lot of relevant content there. We also regularly host webinars on subjects of interest to those in the industry. To subscribe to our blog or to get on the list for our webinars, please visit us at [ballardspahr.com](http://ballardspahr.com). If you'd like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, YouTube, Spotify, or whatever platform you use to access your podcast programs. Also, please let us know if you have any ideas for other topics that we should consider covering or speakers that we should consider inviting as guests on our show.

Today I'm very pleased to be joined by a repeat guest on our show, and we are going to be discussing an extremely important topic that relates to CFPB funding. First of all, let me introduce our guest. My guest is Hal Scott, Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Committee on Capital Markets Regulation.

Let me provide some background. I have a lot of questions for Hal, but before we delve into that, I think we have to do a little bit level setting because there's a lot here that has happened that is germane to what we're going to be discussing today. The Supreme Court came down with its opinion in the *CFSA* versus *CFPB* case on May 16th of last year, and it held that the funding mechanism established for the CFPB in the Dodd-Frank Act was constitutional, that it comported with the appropriations clause in the U.S. Constitution. Under that funding mechanism, the CFPB was to be funded up to a prescribed cap based on the budget of the Federal Reserve System, but they were to be funded up to that cap only out of the, "combined earnings of the Federal Reserve Banks."

Shortly after that, our guest today, Hal Scott, wrote an op-ed in the *Wall Street Journal* that was published on May 20th entitled 'The CFPB's Pyrrhic Victory in the Supreme Court. In that, Hal explained the beginning of September 2022 and thereafter, there have not been any combined earnings of the Federal Reserve Banks. Indeed, there have been combined losses of the Federal Reserve Banks, a cause created by the spike in interest rates over a two to three year period. The combined losses of the Federal Reserve Banks from September of 2022 through the end of last year totaled approximately \$1.9 billion. Nevertheless, the then-director of the CFPB continued on a quarterly basis to request funding from the Fed, and the Fed has continued to honor those requests.

When questioned about how the Fed has been able to justify its continued funding of the CFPB once the Federal Reserve Bank started incurring combined losses, in September of 2022, Chairman Jay Powell of the Federal Reserve Board at a hearing of the Senate Banking Committee on February 11th dismissed the suggestion that continued funding of the CFPB conflicted with the statute that created the CFPB, namely the Dodd-Frank Act. He said, this is his quote, "It's very clear on the law and the legislative history that we are still required to make those payments."

Unfortunately, there were no follow-up questions. If I had been there, I would've politely asked him to please provide the rationale for that claim. Why is it so clear? There was no further discussion of that matter at the hearing. Donald Trump was inaugurated as president on January 20th and last month, fairly early in the month, he dismissed Rohit Chopra as director, and he named his acting director initially just for a few days, Treasury Secretary Scott Bessent. A few days later he named OMB director Russell Vought. Vought fired CFPB probationary employees, and he put all their CFPB employees on administrative leave and told them to stop doing any work at all. In fact, the CFPB offices, the main office in D.C., the other satellite office, they were all shut down. Nobody was even allowed access to their former offices. In fact, the CFPB is essentially to this day shutdown, even though Trump did nominate Jonathan McKernan, a former FDIC board member, to be CFPB director.

We released an earlier podcast show with Hal on June 6th of last year, which was shortly after he had written the May 20th op-ed in the Wall Street Journal. At that time, the naysayers hadn't yet chimed in, so we didn't appreciate then all the arguments that they would make in support of the legality of continued funding of the CFPB, notwithstanding these combined losses of the Federal Reserve Banks.

As the CFPB continued suing companies in court during the Rohit Chopra directorship, the company started raising as a defense, the illegality of the CFPB's funding. That issue has been raised probably in about 13 or 14 cases since these enforcement lawsuits got filed. In none of those cases, has the court reached the real core issue of whether or not the Federal Reserve Banks have had any combined earnings beginning in September 2022 up to the present. Hal Scott's argument is it has not had combined earnings. In fact, it's had 1.9 billion of losses so far with that amount growing every single month.

The issue got teed up, this funding issue in a lot of the cases, three of the cases got the motions to dismiss were denied, but they were denied on other grounds. It didn't deal with the core issue. There were other bases that the court used to essentially dismiss the motion to dismiss that had been filed. Now after Vought started shutting down operations at the CFPB, he also at that time said he was not going to seek or accept any quarterly funding from the Fed under the Dodd-Frank Act. Interestingly enough, he didn't give as a reason, the illegality of the funding. He just said he wasn't going to need the money, there was money in the reserve, and he didn't go into a great deal of explanation about it.

Two lawsuits have been filed fairly recently, and one of them was filed by unions that represent CFPB employees. Another was filed by the city of Baltimore, both of them in federal court, claiming that the plan of Vought and the Trump administration was to shut down the CFPB right from the beginning. All the evidence is there, the firing of probationary employees, putting on administrative leave the rest of them, not accepting any funding, taking down the signage on the CFPB office in Washington D.C. dismissal of now, I think it's seven enforcement lawsuits have been dismissed. A number of third party contracts have been basically rejected by the CFPB. They claim they no longer need them.

That's what that lawsuit deals with. CFPB is interposed as a general defense, we're not shutting down the CFPB. We're right sizing the CFPB. We have different thoughts than the prior administration about how the CFPB ought to be run. Our policies are different, our priorities are different, and that's all that's reflected in the actions that have been taken to date. That's a lot of background, I recognize it. First of all, Hal, a very warm welcome and I really appreciate your coming on our show today to bring our audience up to date on this issue.

Hal Scott:

Thanks, Alan.

Alan Kaplinsky:

Okay. You've written two articles and they're both, they have been published on the website of the Committee on Capital Markets Regulation. One of them was called Understanding the CFPB's Funding Problem, and then there's an addendum to that article called the Fed's Accounting Methodology Cannot Expand Its Statutory Authority to Fund the CFPB. Let's start with a very basic question and what's your basis for concluding that beginning in September 2022, the Federal Reserve Bank started running up these losses and had no combined earnings, as that term was used in Dodd-Frank?

Hal Scott:

Well, it's not just an argument. It's a fact. They had no combined earnings. Dodd-Frank requires the funding to come out of combined earnings. The argument is they shouldn't have been funding the CFPB.

Alan Kaplinsky:

You're saying, I mean, I guess you're saying that any common definition of earnings connotes profits, and it doesn't mean revenues, right?

Hal Scott:

Yep. Some people have raised that argument that the Fed had revenue, well, that's not, it's like income, not earnings. Okay. Lots of companies have income, but they don't have earnings if their expenses exceed their income. The fact that they had income or revenue is not under normal accounting earnings. Okay. I thought that argument was pretty weak even from the start.

Alan Kaplinsky:

Right. Okay. Certainly under GAAP, Generally Accepted Accounting Principles, there's no doubt that if the Federal Reserve Banks were required to apply GAAP in their accounting, there would really be no issue at all. I mean, I think it'd be open and shut. Isn't it true that the Federal Reserve Banks aren't required to use GAAP?

Hal Scott:

That is true. The Federal Reserve Act gives the Fed the authority to use different accounting if they so desire.

Alan Kaplinsky:

Yeah. For an example, under GAAP, you'd have to mark to market securities held in your portfolio for resale, and the Fed doesn't have to do that. They account for all their marketable securities at cost and not at the current fair market value. Let me know what the method of accounting is that they used, which ended up enabling the Fed to reflect so-called "comprehensive income," I'm a little bit uncertain what that means, beginning in September 2022. If you could walk, me and our listeners through it slowly, because the system seems to be designed by the Fed to never show any accounting losses at all and never show negative equity.

Hal Scott:

That's correct. I think the easiest way to understand this is on the balance sheet, although the ultimate issue is on the income statement here, where the earnings are. Let's start on the balance sheet. The Fed has used what they call deferred asset accounting. Okay. Without using this on the balance sheet, as these losses progressed, they would be showing negative equity, because the losses Fed has some capital, that capital was overcome, used up by these losses, and eventually they would've been showing negative equity on their balance sheet. They employed something called deferred asset accounting to cancel out these losses and therefore not show negative equity.

What's the idea? Well, the idea is that when the Fed does have earnings, they have to send those earnings to the Treasury in the form of remittances. The Fed's profits are used by the government to reduce the burden on taxpayers. Okay. Fed profits are a source of revenue for the government. Their argument was that well look for several years because of these losses, we don't have to send money to the government. That's kind of a deferred asset, and we're going put that asset on our balance sheet to cancel out the loss. That's on the balance sheet.

Alan Kaplinsky:

Right. While we stay with the balance sheet and you're talking about what's on the asset side, what is the equity portion of the balance sheet look like?

Hal Scott:

Well, there's capital and they don't show any losses, although these losses have come forward. They say, "Well, we got an asset to offset those losses so there's no change on the right side of the balance sheet." The only change is on the left side where they put on this deferred asset.

Alan Kaplinsky:

The theory I take it, Hal, is that based on the supposition that eventually there's going to be earnings again or profits again from the Federal Reserve Banks, when if interest rates continue to decrease, and eventually those they're going to have earnings that they're going to be able to keep. They're not going to have to turn them over to the Treasury or remit them because they first, before they have to start remitting again, they have the right to recover their losses.

Hal Scott:

Their losses, correct.

Alan Kaplinsky:

Right. That's the theory. That's a big leap, right? Number one, they're still losing money right now. We don't know for sure interest rates.

Hal Scott:

They show this, they show this. It's not like we don't know that they're not losing money, but they're using this deferred asset accounting to offset it. It's not like they're lying to us. They're using an accounting method to cancel out the loss.

Alan Kaplinsky:

Yeah. Now let's turn to the income statement.

Hal Scott:

What do they do on the income statement, which is relevant to the earnings question here? On the income statement, they first show negative net income, their losses. They then cancel out the losses with the amount of this deferred asset, basically the same amount of their loss. Below that, they show a little positive because they have some income from some affiliations, just minor.

Alan Kaplinsky:

Or I guess fees, fee income probably of some sort.

Hal Scott:

Yep. The bottom bottom line is called comprehensive income, which is slightly positive. Okay. All of this is irrelevant, because the statute says combined earnings, it doesn't say comprehensive income, which is a term the Fed itself invented as far as I can tell. Really it's the line before they cancel out with the deferred asset that's relevant, where they show their net income is negative. Okay. Net income is really the same as earnings. All of this accounting ledger domain, if you want to call it that, is interesting. As lawyers, we know that the statute says combined earnings.

Alan Kaplinsky:

Yeah. Am I right, Hal, that the word earnings itself, put aside the combined, but the word earnings doesn't actually appear anywhere on the income statement, right?

Hal Scott:

Net income does.

Alan Kaplinsky:

Net income.

Hal Scott:

Which is pretty close to earnings, and that's negative.

Alan Kaplinsky:

Right. Right. Right. Although I hear what you're saying about all of that is not really relevant to what Congress meant when it used combined earnings in Dodd-Frank, I'd still like to know why. Do you have any conjecture at all as to why the Fed would account in the manner that you've described for these losses? I mean, I thought maybe I was just being too suspicious here, I thought it might be a way for the Fed to hide the fact that most of their Federal Reserve Banks are insolvent.

Hal Scott:

They're not really hiding it, Alan. I mean, everybody can read the financial statements, not just of the Fed as a whole, but of the individual reserve banks and see how this accounting method is nullifying their loss, but the loss is there, then it's nullified. It's not like they're hiding the loss. They're just using an accounting method to overcome it.

Alan Kaplinsky:

There's nothing in your view nefarious about this?

Hal Scott:

No.

Alan Kaplinsky:

Okay. All right. Well, that's good to know. Okay. Why don't they use GAAP? Is that just convention that government entities never use GAAP and they come up with their own method of accounting?

Hal Scott:

Well, I think we could have a serious discussion about that, but Congress authorized this in the Federal Reserve Act. We really have to have a discussion with Congress about that. What I think, as you point out, the Fed's not marking the market. Their portfolio is another way to not show some losses that they would otherwise have in normal times. I think perceptually, our central bank doesn't want to look like it's bankrupt. Now in fact, it doesn't make much difference in terms of their function because they print money. Okay. Many people misunderstand the fact that the Fed could lose tons and tons of money and still performance function. Okay. However, it doesn't look good for the central bank to be bankrupt. I think in terms of presentation, it's sort of like we want to have an accounting method that doesn't show that. Not that we're hiding the losses, those losses are there for people to see, but our balance sheet, we're still positive equity. Okay. It's a perception issue. Again, I don't think it's nefarious or nefarious they would've hidden losses themselves, they don't do that.

Alan Kaplinsky:

All right, so let's turn, if we can Hal, to some of these counter arguments that have been made by people who think that you're wrong, that when Dodd-Frank used the term combined earnings, they really were really thinking about revenue in a conventional sense. Isn't it true, one argument they make is that there were two Federal Reserve Banks, I think one was St. Louis, I can't remember the other one, that continued to be profitable.

Hal Scott:

Atlanta. Atlanta is the other one.

Alan Kaplinsky:

Atlanta, that they were profitable in September 2022 and may in fact have continued to generate profits throughout up to the present day. Why is that not a good argument?

Hal Scott:

Because the statute says combined earnings. It doesn't say the earnings of individual Federal Reserve Banks. The fact that two were profitable as a whole, the combined earnings of the Fed were, as you put it, losses of 1.9 billion. Congress used the term combined earnings.

Alan Kaplinsky:

That's pretty clear. Yeah. What about the other argument that gets made all the time, made by the CFPB under Rohit Chopra when he was opposing the motions to dismiss that had been filed. His argument was, "Oh, come on now, you mean to tell me that back in 2010 and 2011, when Congress in the aftermath of the economic and financial meltdown of 2008 and Congress decided they were going to create this new agency that was going to focus very much on consumer protection, anybody thought at that time that this agency, that their entire basis for funding was going to dry up?" Nobody ever thought of it. Any evidence in the legislative history, any discussion of this point or any focus on it?

Hal Scott:

Well, there was kind of two relevant things in the legislative history. Number one, there was a prior draft of the funding mechanism, which basically would've, I think, been interpreted as revenue. Okay. That draft was superseded by combined earnings. That's pretty good argument why revenue isn't the thing you should be using here because they had a draft that would basically have allowed them to fund the CFPB with revenue as opposed to earnings, and that draft was discarded.

Now, I am told, this is not in the legislative history, that there was discussions about this. Okay. I'm told that from people who are in the room when those discussions were had. Okay. This is within the congressional people who were there and kind of people said, "Well, it should really be earnings." When somebody said, "Well, what if they don't have earnings?" "Well, it's never happened. The Fed is always going to have earnings." As far as I can determine on a combined basis, what we're looking at has never occurred since the creation of the Fed. I think they just kind of rejected that.

There was another part of the legislative history. At the same time the Fed was funding the CFPB, they also funded, and this is in the statute, a newly created Office of Financial Research within the Department of the Treasury. OFR is the abbreviation, Office of Financial Research. They do financial research and all sorts of stuff. The Fed was under the statute creating this new agency. The Fed was to fund it, and there were no limits placed at all on earnings, nothing. Fed just funds it. Okay.

If either of those two methods had been adopted here, we would have a very different discussion, but they were not. Okay. It was not revenue, it was earnings. It was not nothing. It was earnings. Okay. I think the legislative history, Alan, actually supports my interpretation pretty strongly because the Congress now, you could say, "Well, why didn't the Congress gets smart and say, Hey, this could happen." Well, they didn't do it. Congress does a lot of things we don't understand after the fact, and we have to go to the language and the history. The history, I think, is pretty clear that they knew how to do something else, but they didn't do that.

Alan Kaplinsky:

Yeah, yeah. I want to ask you another question. I mentioned in my introductory remarks that this issue really didn't get teed up until after the Supreme Court decided CFSA versus CFPB. Why do you suppose to have any, I mean, why is it that CFSA didn't focus on the issue? Was it a timing issue you think?

Hal Scott:

Well, that case dealt with a regulation from 2018. Okay. It was the legitimacy of the CFPB promulgating a specific regulation in 2018. Okay. In 2018, they had lots of money. This issue, that's why I call it, I didn't call it the Wall Street Journal puts the title on op-eds. The authors have nothing to do with it. They put the pyrrhic victory title up there, although I use the term of the op-ed because it turned out that that's good in 2018, okay? There was no statutory issue in 2018 because they had earnings. There was no statutory issue in the case.

The only issue was constitutionality and what the Supreme Court said then was, look, they had earnings, those earnings supported remittances that were given to the Treasury in form of surplus, and it was okay for the government or the Congress to say that part of those earnings could be shoved over to the CFPB rather than go to them. Okay. The statutory, the important thing, looking back on it, I should have been clearer on this, that the statutory issue was not an issue in that case at all because there were earnings. What we're dealing with today is a far different situation.

Alan Kaplinsky:

Right. Right. Right. Okay. A proponent of continued Fed funding to the CFPB might suggest, and they I think have suggested, that the Fed's policy recording payments as operating expenses indicates that transfers to the CFPB are permissible, notwithstanding the Fed's losses. How do you respond to that?

Hal Scott:

Well, by the way, all these arguments that we're ginning up here, as you pointed out in your introduction, the Fed has yet to tell us exactly why they think they have the legal authority to do this. At some point they're going to have to come forward and explain it. I think if you look at the expense thing, somebody could argue, "Hey, we account for these things as a normal expense, and so the fact that our net income was negative is irrelevant. It's just an expense." Alan, the statute says combined earnings, it doesn't say expenses. Okay. You keep coming back to these two words, which are very clear in the statute.

Alan Kaplinsky:

Right. Let me ask you another related question. One of the courts, the federal courts that rejected the motion to dismiss filed by a defendant in a CFPB enforcement action, basically said that even if the CFPB was unlawfully funded since September 2022, that doesn't disable the CFPB from prosecuting an enforcement action. In other words, we are assuming, through these discussions, that if there's unlawful funding, then everything the CFPB did when it was using this unlawful funding is illegal or invalid. One court said one thing has nothing to do with the other.

Hal Scott:

Alan, send me that opinion because I'm not sure I've seen that. My response to that is, if you have an agency that is operating illegally, why should anything? It does have validity. Okay. The agency is operating illegally, and so you say, "Oh, well, they might be operating illegally, but they can still enforce things." I don't think so. You could have an argument about that. I think there's something to that argument, but I would think the better way to see this is to say, if you have an agency operating illegally, and by the way, that's only after September 2022. Okay. Another thing you could say, "Well, what about regulations that were promulgated earlier, like the one in the Supreme Court case?" I'm not saying that should be a melody. Okay, that was legally done. Okay. Enforcement actions that are ongoing after 2022 when they should have not been operating at all, I would argue, should not have any validity, although I can see that you could argue that both ways.

Alan Kaplinsky:

Right. Why do you suppose, and this is something that has really puzzled me, why do you suppose Russell Vought as acting director, when he decided he was going to take a quarterly funding from the Fed, that was the perfect opportunity it seems to me for him to say, number one, he could have said, "I don't need the money right now, but number two, it would be illegal for me to quest or accept the funds." Why is it in this litigation where it's ongoing right now, where two unions in the city of

Baltimore are arguing that the Trump administration is acting illegally by shutting down the agency? They haven't raised that issue there either, and I can't figure that out. If it's a good argument, why wouldn't they make it?

Hal Scott:

It's just a big part of the current mystery. Okay. I've thought about that. Of course, I've got this great argument, why isn't it putting it out there? It's just really disappointing to me. As I've talked to people, both in and out of the administration, I've come up with some possibilities. Okay. The first one is this, well, using your argument, Hal, we could shut down CFPB, but once the feds got earnings, again, it can arise, it can come back to life. It's good for maybe a couple of years here, but we're not really getting a long-term solution to CFPB. My response to that is, well when Trump's gone, what do you think's going to happen? I mean, all you're doing is keeping it around and letting it do things for a while, some things. Wouldn't you be better off closing it for two years and then fight the battle of its staying around.

Alan Kaplinsky:

Work on some legislation.

Hal Scott:

That's right. Remember, legislation for the Republicans is very hard to come by because they have a very precarious majority in the house and in the Senate. Normally in the Senate, legislation requires 60 votes. Okay. Now, there are exceptions to that, one of which is through reconciliation. Okay. If you can do something in the reconciliation, bill, the great bill that Trump is hoping to have here.

Alan Kaplinsky:

Yeah, a beautiful bill.

Hal Scott:

A beautiful, great, beautiful bill, one beautiful bill, then you only need 50 votes and they have 50 votes. Okay. They have 50 votes in the Senate. Well, why don't they want to do that? Well, this goes to really in the first instance, what's proper to do under reconciliation. What is very clear is that you can do anything in reconciliation that has a budgetary impact. Okay. Clearly shutting down the CFPB on this legality argument would have a budgetary impact. Money that otherwise would've gone to CFPB can now go to Treasury, and the CFPB is sitting on a surplus of 700 plus million dollars, which would go back to the government. That's enough. It's clear that in reconciliation, they could shut it down.

What is not clear at all, and I'm currently researching this, is well, could you, having shut it down, redesign it or reallocate the consumer protection functions to other agencies? As you know, Alan, before Dodd-Frank, consumer protection was in the banking agencies and in the FTC. People might be uncomfortable with the idea of we're just going to shut this thing down, and we're not going to be able there to say what happens in lieu of it. What if somebody says, "You shut it down. There's no consumer protection anymore." Okay. There could be possibly some political fallout from that. Okay. I'm speculating here, but I'm speculating on the basis of some conversations I've had.

That's one kind of thing that we can't really, all we can do is shut it down, that's not enough. It could come back to life. We really need to get a grip on CFPB. By the way, we're in control right now. We're in control for four years. We can shut it down the way we shut it down without getting this funding argument. We can do a lot of stuff. Now, here's my problem with that. Okay. In these federal cases that you cited, Baltimore and the union case, a defense of the people supporting CFPB will be, "Well, wait a second. Congress created the CFPB. Okay. You can't just nullify the creation and not just created it, said it was what it was supposed to do." Okay. They're not using funding here. You can't just buy presidential power, have the authority to nullify the congressional creation of this agency by closing its headquarters, by firing all the people. You have nullified its performing a function which Congress asked to perform. Okay.

There you are in conflict on another basis with congressional intent. Okay. When all of this comes to Supreme Court, the Supreme Court is going to have to wrestle if they don't raise the funding argument with the extent of presidential power to



nullify the functioning of an agency that Congress created. Okay. By the way, Alan, this isn't the only place that this is an issue. Trump is using this presidential power argument in connection with those to downsize and stop USAID another example of this. Okay. I don't know whether Congress legislated USAID and looked into it, but they're going to have problems where they are trying to close and dismantle agencies that Congress has created. The beauty of my argument is there's a special reason here, only applies to CFPB, but they could say, "Look, if we trot out the special reason, we're undercutting our general assertion of authority in all the other cases. If we have to use the funding argument to justify CFPB, we're undercutting our general claim that we have executive power to do this anyway."

Alan Kaplinsky:

Well, I don't buy that because lawyers, all good lawyers make arguments in the alternative, right? Yeah. I mean, we don't want any more funding because number one, we don't need it, number two, it's illegal in any event.

Hal Scott:

It's not that they don't need it, it's they don't want it. Okay. Okay. Yeah. This is politics, Alan. This is not just law here. If I'm sitting there as President Trump's chief of staff, and I'm interested in working with Elon to close down a lot of stuff here where I'm basically relying on presidential power, I might just roll the dice and say, "That's what we're going to argue across the board." Okay. I don't want to get into some special reason I haven't CFPB. I'm speculating. Okay.

Another speculation. This is really a thing though. We're not just arguing here with CFPB. We're arguing at the Federal Reserve. We're basically saying, "Powell, you have acted illegally." Okay. Slap in the face. Okay. It's worse than what he did with Zelensky. You can imagine Powell in the room saying, "How could you get away with this? You've been a criminal for the last two years." Okay. I don't know that they want that kind of confrontation with the Fed when they're trying to get the Fed to help them out on the economy.

That could be another reason that they don't want to use this argument, because I was very careful when I put this argument forward in my Wall Street Journal op-ed, to not get at the Fed. It was like, how can the CFPB continue to function? In the second op-ed I wrote, which was in January, I guess I said, "It's kind of telling that the Fed has been quiet about all this." Okay. Then later Powell said, "There's no problem here." I think there's an issue about whether either side wants to have a confrontation with the other side over funding. All of this is speculation, but these are some of the thoughts I've had.

Alan Kaplinsky:

Do you think that this funding issue might still get raised by the, let's just say hypothetically, that in these two cases that you mentioned, city of Baltimore, the union case, courts enter a preliminary injunction in favor of the plaintiffs saying, "Stop what you're doing. Rehire the people that you fired. Put the signage back and start operating and start doing business." What do they do then? They haven't made this funding argument. Do they then pull the argument out of the woodwork and say, "Hey, wait, slow down. We've got this other thing."

Hal Scott:

I have pointed out to the administration that in the briefing of these cases, they might've been well served to make the alternative argument to preserve the argument. They did not. That's all I can tell you. I think that if I were a judge, I wouldn't let them come back with this argument unless they have put it in their briefs, unless they raised it. Where I think this could still come into play is in the private actions, the enforcement actions where the defendants have raised the issue. Court may rule in their favor on it or not, that could get probably up to the Supreme Court. Ultimately, I think through that private mechanism, this argument will see the light of day.

Alan Kaplinsky:

Maybe, although they've already gotten rid of one of the cases that is the CFPB, the new CFPB, they've already voluntarily dismissed a bunch of cases, including a case that where the funding issue was raised. I suppose if they don't want to litigate that funding issue, they'll just dismiss any case in which it's raised.

Hal Scott:

You're absolutely right, because this is going on in all the agencies of the government. The FCC has the same problem. They brought all these enforcement actions with the current administration to squeeze with, and now you've got the new team in charge of the FCC. Okay. They don't want to defend their position, so they're going to get rid of these cases. I don't know if any of those 13 or 14 cases would be hard to get rid of. Maybe you're in a much better position to figure that one out than I am. If they could get rid of them all, okay, then that avenue would not accept.

Alan Kaplinsky:

Well, so far there's only been one. There's 38 enforcement cases that were pending when Chopra got fired, and there's only one of seven cases CFPB voluntarily dismissed. Most of them did not raise the funding argument. Only in one case did it raise the funding argument. There's one case, I don't know why this case got singled out, but one case where the CFPB said, "We're going to continue to prosecute the case." I don't know why. I don't think it's the case where the funding argument was raised. I don't know.

Hal Scott:

The way I see it now is that the government's not going to raise this argument. By the way, I think it would be very different. I think what's still open is a good question, is whether reconciliation can be used, because of its budgetary impact, to solve the consumer protection question going forward in a reconciliation bill. This is something I'm currently looking at. My guess is can't because it's not budgetary. Okay. When you get down to it, all the government says, "Hey, we're in control of the CFPB. We can do whatever we want now with it. We don't want to use this funding argument. It's possibly undercutting our grand fuss of presidential power." Although when they get to Supreme Court, they could get a rude awakening on that one. "We don't want to confront the Fed. We're trying to get Powell to help the economy get better so we can keep our majority in two years." It's frustrating to me. I've got this great argument, but the practicalities that people take into account in the real world, is they don't want use it so far.

Alan Kaplinsky:

I got to say, just so people don't misunderstand my position, I've always, when I read your first op-ed and I did my own research, I concluded you were right. I thought it was an argument that should be made, certainly if you're defending an enforcement case. It borders on malpractice not to make an argument that's available to you. That's on the one hand.

On the other hand, there are a lot of folks in the industry that say, "We don't want the CFPB to go away. It will create utter chaos." They've got all these regulations that the mortgage industry is relying upon. There are a lot of regulations that the industry has gotten used to, and they don't want to see drastic change. They're worried about what happens if the CFPB is shuttered. I mean, the companies, banks, they're general pretty conservative. As much as they don't like what went on with Rohit Chopra, they don't like a lot of what he did, might I even say most of what he did, they're worried about the devil you know is better than the devil you don't know. I guess that's one way of putting it. They're worried about what the future might entail.

Hal Scott:

Well, I think there are people in the banking industry that didn't like the Fed having control of this issue because if the Fed did something bad to them, the way the Fed operates, it's kind of not transparent. It's done through supervision. It's informal and so forth. Now, Chopra did a lot of things they didn't like to them, but he did them openly. In some sense, there are people in the banking industry I've talked to said, "I'd rather had a bad open actor than a moderate secret actor." It all goes to what's going to happen to this function if it's not done by the CFPB. Okay. I think we could come up with a solution to that if we wanted to.

I'll say one final thing though. Whatever is done with the CFPB, the idea that it should be funded by the Fed is an outrage. Okay. It should be funded through the normal congressional appropriations process like everything else. Okay. If all they can

accomplish in resolution is to do that, that would be a great thing stepping forward. I don't know anyone on the conservative side or an industry that wants the Fed to fund CFPB.

Alan Kaplinsky:

Yeah. Absolutely right. Number one priority is definitely to get rid of that funding mechanism and subject CFPB to Congressional appropriations, just like the Federal Trade Commission and most other executive agencies. That's number one. The number two priority is substitute the governance of the CFPB, get rid of the sole director and create a five-member bipartisan commission. I guess that could not be done through budget reconciliation.

Hal Scott:

I have it.

Alan Kaplinsky:

Yeah, that would be tough. The appropriations piece of it, I think could be, and even that would be a huge, very important, very positive development. Okay. Well, we've come to the end of our podcast show today, Hal, and again, I want to thank you very much for taking the time to be on our show. I hope that our listeners now have a better understanding of this issue because you really did a deeper dive, I should say, than what was in your first op-ed. You really have gotten to the bottom of that accounting peculiarity or why the Fed accounted for its earnings in the way it did.

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