

SEC Provides an Enforcement Roadmap for the CFPB

William McLucas and Eric Mogilnicki
JUL 20, 2011 5:36pm EDT

The Consumer Financial Protection Bureau established by the Dodd-Frank Act will open its doors on July 21. The new bureau will have broad responsibility for enforcing a wide range of laws against people and companies that provide financial products and services.

Just as the SEC shook off a controversial beginning to become a powerful and accepted regulator of the securities markets, the bureau soon will have the opportunity to demonstrate that it can be effective in promoting transparency and fairness in the market for consumer financial products and services.

One early measure of the bureau's commitment to transparency and fairness will be how it approaches its own enforcement processes.

Dodd-Frank gave the bureau broad enforcement authority, but it left the bureau to decide for itself what kind of process it would follow before bringing public enforcement charges. This is a critical issue, as the mere filing of charges can devastate a company and wreck its stock price — even if those charges are later disproven. The effect on an individual's reputation can be even more dramatic and irreversible.

However, the bureau has said nothing to date about whether and how it will allow potential targets to defend themselves before public charges are filed. This silence is particularly surprising because the bureau's leaders have publicly promised both transparency and immediate, aggressive enforcement activity.

We think the bureau could go a long way towards addressing these concerns by following a proven path pioneered by the Securities and Exchange Commission. When the SEC created its modern Enforcement Division in 1972, it reached out to a group of outside lawyers, led by John A. Wells, for feedback and ideas to help establish rules that would ensure due process in the commission's enforcement processes. The commission used that input to create what is now known as the "Wells process," which features written, publicly available procedures that describe how targets of commission enforcement actions will typically receive notice of proposed charges and the opportunity to defend themselves before those charges made public.

Courts and commentators have long recognized that the Wells process furthers fairness and transparency, and adds credibility and efficiency to the SEC enforcement process. There have been situations in which a Wells submission has persuaded the SEC staff, or the commissioners themselves, to abandon a planned enforcement action. Absent such a pre-enforcement process, a person or company may be forced to fight their way through the entire enforcement process, often at substantial financial cost and irreparable reputational damage, to defend themselves against charges that lack an adequate factual or legal basis. Worse, many would be forced to settle a case to avoid those harms, even if the charges were flawed from the start.

Providing pre-enforcement due process is also beneficial to an agency that is committed to getting it right. At the SEC, the Wells process provides the commissioners with a way of testing their staff's recommendations before they are hardened into a public charge. This preserves the commission's credibility by weeding out cases that do not stand up to scrutiny. And in those cases where the SEC chooses to proceed with an enforcement action, this process helps the commission winnow and shape its charges in light of likely defenses.

More generally, the existence of thoughtful, written pre-enforcement procedures helps demonstrate that an agency will balance its law enforcement mission with a healthy regard for the due process rights of those it regulates. That is why the Federal Reserve, OCC and FDIC each have a process that, like the Wells process, provides for the advance notice of potential charges, along with the opportunity to respond.

The new Consumer Financial Protection Bureau needs a fair, written pre-enforcement process. The bureau has a budget that could grow to \$500 million, and it has the authority to seek fines of up to a million dollars a day per violation. For these and other reasons, it is already under attack from those who believe its power is not subject to adequate checks and balances. Further, it appears highly likely that the bureau will not be led by a Senate-confirmed director any time soon — despite the president's nomination of former Ohio Attorney General Richard Cordray. Though Special Assistant Elizabeth Warren has assembled a first-rate team at the bureau, there is no substitute for a leader chosen through political consensus — particularly in the case of a new agency, which lacks a track record that demonstrates the quality of its judgment and prosecutorial discretion. Under all these circumstances, the bureau should take every opportunity to demonstrate that it will be open to conflicting points of view, even in enforcement matters.

Congress rarely creates a new regulatory agency, and the year that has followed passage of Dodd-Frank only underscores how infrequently the stars align as they did in the summer of

2010. The opportunity before the bureau is fleeting as well. The first six months of its activity could very well determine whether it takes its place beside the SEC and other agencies as a respected regulator, or continues to be treated like a political football.

An important source of respect and legitimacy for any agency lies in its willingness to provide due process to those it regulates. Building strong due process protections into the bureau's enforcement procedures will help build a stronger and more effective agency.

William McLucas, a partner at WilmerHale and chair of the firm's securities department, formerly served as the director of enforcement at the Securities and Exchange Commission. Eric Mogilnicki, a partner and vice chair of the firm's Consumer Financial Protection Bureau working group, formerly served as chief of staff to Senators Edward M. Kennedy and Paul G. Kirk