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Due Process, Transparency and the Consumer Financial Protection Bureau

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''[T]ransparency is a core value, and . . . living by it will make us a better agency.''—Consumer Financial Protection Bureau website

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank'' or ''the Act'') and thereby created the Consumer Financial Protection Bureau (''the Bureau''). The Act gives the Bureau the power to enforce a wide range of consumer financial protection laws, and jurisdiction over the myriad companies and people who provide financial products or services. Many of the Bureau's powers, including its ability to seek penalties of up to a million dollars a day per violation, became effective on July 21, 2011.[1]

Even though the Bureau has gained broad enforcement authority, it has not established procedures that would allow the targets of potential enforcement actions to understand and respond to potential charges before they are made public. This is a serious gap. The stakes in enforcement matters are often high – both for the target and for an agency's credibility. The interests of both are well-served by a pre-enforcement process that tests the factual and legal basis of potential charges before they are made. Written, publicly available procedures governing that process make particular sense for the Bureau, which counts transparency as a core value.[2]

[1] *See* Dodd-Frank § 1058 (''[Subtitle E—Enforcement Powers] shall become effective on the designated transfer date.''); 75 Fed. Reg. 57252, 57253 (transfer date is July 21, 2011).

[2] ''[T]ransparency is a core value, and . . . living by it will make us a better agency.'' *Keeping It Sunny at the CFPB*, *http://www.consumerfinance.gov/keeping-it-sunny-at-the-cfpb* [visited Jun. 22, 2011]; *see alsohttp://www.consumerfinance.gov/open/* (''Transparency is at the core of our agenda, and it is a key part of how we operate. You deserve to know what the new bureau is doing for the American public and how we are doing it.'') [visited Jun. 22, 2011]. The Bureau's Assistant Director for Enforcement, Richard Cordray, has said that the Bureau will ''start in a deliberate and transparent manner. We're not going to come off doing random or crazy things. We will be communicating with the public and with industry, and we will be sensible about what we do.'' Jack Torry, *Cordray Waits Out Furor Over New Federal Consumer-Finance Agency*, THE COLUMBUS DISPATCH (Jun. 14, 2011).

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Fortunately, the Bureau need not start from scratch in establishing fair and responsible pre-enforcement procedures. Many federal agencies with broad enforcement authority have such written procedures, including the Office of the Comptroller of the Currency, the Federal Reserve, and the Federal Deposit Insurance Corporation.

One particularly helpful model is the Securities and Exchange Commission's ''Wells process.'' The Wells process is named after John A. Wells, a lawyer in private practice who was asked by SEC Chairman William J. Casey in 1972 to head up a committee of outside lawyers to work with the SEC to improve its enforcement programs. That consultative process led the Commission to create what is now known as the Wells process. The Wells process provides that prospective defendants are typically provided with notice of the charges against them, and the opportunity to respond, prior to the Commission filing an enforcement action. The Wells Process is set forth in an SEC Release and addressed in more detail in the agency's Enforcement Manual.[3]

Courts and commentators have long recognized that procedures like the Wells process add to the credibility and efficiency of the enforcement process. This article sets forth the case for the Bureau adopting written pre-enforcement procedures that provide due process to potential enforcement targets. Part I sets out the Bureau's statutory enforcement authority and the need for such procedures. Part II describes the SEC's Wells process and similar procedures at other agencies, and explains why the underlying policy rationales for such procedures apply with special force to the new Bureau. Part III suggests ways in which the Bureau could proceed with drafting such procedures.

I. The Bureau's Broad Enforcement Authority and Need For Pre-Enforcement Procedures

Title X of Dodd-Frank grants the Bureau extensive enforcement powers and broad discretion regarding its enforcement process. The Bureau generally has jurisdiction over: ''(A) any person that engages in offering or providing a consumer financial product or service; and (B) any affiliate of a person described in subparagraph (A) if such affiliate acts as a service provider to such person.''[4] The Bureau's subject matter jurisdiction encompasses a wide array of existing consumer protection statutes, as well as additional rules it is authorized to promulgate.[5] When the Bureau identifies a potential violation of these laws, it may investigate, conduct administrative proceedings, initiate civil litigation, and/or make referrals to the U.S. Attorney General.[6] The Bureau may sue in its own name, and seek monetary or equitable relief.[7] Together with other relief (such as rescission or reformation of contracts, refunds, disgorgement, and restitution), the Bureau (or a court) may impose three tiers of civil monetary penalties, ranging from $5,000 to $1 million per day for each violation.[8]

Dodd-Frank imposes some procedural structure on these broad enforcement powers. The Bureau must follow detailed procedures with respect to investigations and discovery,[9] cease-and-desist proceedings,[10] and other adjudicatory proceedings.[11] The Bureau is also subject to the Administrative Procedures Act,[12] and Dodd-Frank requires that the Bureau ''prescribe rules establishing such procedures as may be necessary to carry out'' hearings and adjudication proceedings.[13] Most importantly, no penalty may be assessed without ''notice and an opportunity for a hearing.''[14]

However, the Act is silent about what due process, if any, will be afforded before charges are filed. This leaves open some fundamental questions: Will targets be notified of the charges against them prior to a public filing? Will they have a full and fair opportunity to persuade the Bureau not to proceed? Will this process include the opportunity to review the evidence and understand the legal theories on which the Bureau plans to proceed?

The absence of answers to these questions is a serious problem for at least four related reasons. ***First***, fortunes and reputations are often lost in the publicity that follows the filing of charges against a person or company by a government agency – regardless of the ultimate outcome of the enforcement action. This problem was apparent when the SEC created its pre-enforcement procedures in 1972[15] – and the problem is

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[3] *See* 37 Fed. Reg. 23,829 (Nov. 9, 1972) (codified at 17 C.F.R. § 202.5(c)); William J. Casey, Chairman, U.S. Sec. & Exch. Comm'n, *Address to the New York Bar Association* (Jan. 27, 1972); U.S. Sec. & Exch. Comm'n, Rpt. Of the Advisory Com. on Enforcement Policies and Practices (June 1, 1972).

[4] Dodd-Frank Act § 1002(6) (defining ''covered person'').

[5] *See id.* § 1054(a) (authorizing the Bureau to commence civil actions against ''any person [that] violates a Federal consumer financial law''); *id.* § 1002(14) (defining Federal consumer financial law to include ''. . . the laws for which authorities are transferred [from other agencies] under subtitles F and H, and any rule or order prescribed by the Bureau under this title . . . ,'' among others); *id.* § 1053(a) (authorizing the Bureau to conduct hearings and adjudications to enforce ''(1) the provisions of this title, including any rules prescribed under this title; and (2) . . . enumerated consumer law, and any regulations or order prescribed thereunder . . .,'' among others); *id.* § 1002(12) (defining enumerated consumer law to include numerous pre-existing consumer protection statutes).

[6] *Id.* §§ 1052, 1053, 1054, 1056.

[7] *Id.* § 1054.

[8] *Id.* § 1055. The Act also sets forth criteria that the Bureau shall consider when imposing penalties. *See id.* § 1055(c)(3) (requiring the Bureau to account for the following when imposing penalties: ''(A) the size of financial resources and good faith of the person charged; (B) the gravity of the violation or failure to pay; (C) the severity of the risks to or losses of the consumer, which may take into account the number of products or services sold or provided; (D) the history of previous violations; and (E) such other matters as justice may require''); *id.* § 1055(c)(2) (establishing a three-tiered penalty system in which penalties for standard violations may not exceed $5,000 per day, penalties for reckless violations may not exceed $25,000 per day, and penalties for knowing violations may not exceed $1,000,000 per day).

[9] *Id.* § 1052 (establishing and detailing the Bureau's power to issue subpoenas and civil investigative demands, and mechanisms to address non-compliance with the same).

[10] *Id.* § 1053(b) (establishing and detailing procedures to be following in connection with cease-and-desist orders and hearings concerning the same).

[11] *Id.* § 1053.

[12] *Id.* § 1053(a) (''The Bureau is authorized to conduct hearings and adjudication proceedings with respect to any person in the manner prescribed by chapter 5 of title 5, United States Code . . . .'').

[13] *Id.* § 1053(e).

[14] *Id.* § 1055(c)(5)(A).

[15] *See, e.g.,* Letter from Arthur F. Mathews (former SEC Associate Director) to the Advisory Committee on Enforcement

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only greater today, in the age of the internet and 24-hour financial news networks. As an American Bar Association Task Force on the SEC's Rules found, ''in most cases a severe sanction is imposed and damage inflicted, as a practical matter,'' as soon as the Commission files a public complaint.[16] The same is true of the mere disclosure of a potential charge. Accordingly, due process *before* an enforcement action is disclosed or commenced – absent some exigent circumstances – is critical to a fair enforcement regime.

Second, the current debate over the Consumer Financial Protection Bureau strongly argues for thoughtful pre-enforcement procedures. Critics of the nascent Bureau already believe that its power is too great, with too few checks and balances.[17] Such concerns will only be heightened if, as seems almost certain, the Bureau will be making important enforcement decisions without a Senate-confirmed Director.[18] Under these circumstances, establishing pre-enforcement procedures would lend credibility and structure to the Bureau's enforcement efforts.

Third, the foregoing issues are amplified by the promise of the Bureau's leadership to undertake immediate and aggressive enforcement activity.[19] The President's nomination of former Ohio Attorney Richard Cordray to head the Bureau (Cordray had already been slated to serve as the Bureau's Assistant Director for Enforcement) is a clear signal that enforcement will be a top priority. Indeed, Cordray is already on the record as promising to move quickly and aggressively with enforcement actions.[20] While a more measured pace might allow for public confidence and Bureau procedures to grow organically, this proposed surge of immediate enforcement activity requires detailed and immediate planning.

Finally, written pre-enforcement procedures are one way in which Warren and Cordray can make good on their promises of fair, careful, clear, and consistent enforcement.[21] A pre-enforcement process will subject potential charges to intense scrutiny before they are made. That scrutiny will help the Bureau carefully review the facts, the law and the equities before it announces an enforcement action.

For all of these reasons, the Bureau should adopt pre-enforcement procedures. Fortunately, there are models that have proven effective over time at agencies with similar authority – most particularly the Wells process of the Securities and Exchange Commission.

II. The Wells and Other Pre-Enforcement Processes Serve as a Model

Federal regulatory agencies concerned with financial institutions and consumer protection have, to varying degrees, adopted pre-enforcement procedures tailored to their missions and objectives. An examination of some of these procedures, and the policy objectives that gave rise to them, underscores why the Bureau should adopt pre-enforcement procedures, and points to the SEC Wells process as a particularly apt model.

Numerous federal agencies have adopted procedures that are designed to create pre-enforcement dialogue with a potential target. The Office of the Comptroller of the Currency (''OCC''), prior to commencing litigation seeking a monetary penalty, issues a letter to a potential defendant providing notice of the alleged violation and the opportunity to respond.[22] The Board of Governors of the Federal Reserve System (''FRB'') has a similar policy: before assessing a civil penalty, the General

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Policies and Practices 30 (May 23, 1972) (noting that targets ''usually are concerned with the continuing blasts of adverse publicity showering upon them, first by public institution of charges by the Commission, and later upon the conduct of a hearing or the announcement of the terms and conditions of a settlement subsequently negotiated. Such continuous publicity may be extremely unfair, particularly where serious allegations publicized upon institution of an action, are dropped subsequently by Staff and the Commission in accepting a consent settlement of the action'').

[16] Report of the Task Force on SEC Rules Relating to Investigations, 42 Bus. Law 789 (1987) (''in most cases, a severe sanction is imposed and damage inflicted, as a practical matter, by the publicity generated from the filing of the Commission's complaint or administrative order''); *see also* Milton V. Freeman, *Wells Submissions and a Proposal to Limit Unfairness to Targets of SEC Investigations, in John M. Fedders & Arthur F. Mathews*, 1 Securities Law & Enforcement Institute 581, 582-83 (1982) (noting that SEC has recognized ''when public proceedings begin, the injury to reputation cannot be erased even if the charges are found to be groundless and the persons vindicated''); 17 C.F.R. § 200.66 (SEC Canons of Ethics provides, ''The power to investigate carries with it the power to defame and destroy.'').

[17] For instance, Representative Patrick McHenry, chairman of the House Oversight Subcommittee on the Troubled Asset Relief Program and Financial Services, has said that, ''once fully operational, the bureau will possess virtually unchecked discretion to identify financial products and services that the director determines to be 'unfair, deceptive, or abusive.' '' Ben Protess, *Warren and Republicans Spar Over Bureau's Power*, N.Y. Times Dealbook (May 24, 2011). House Financial Services Chairman Spencer Bachus has also called the agency ''[likely] the most powerful agency that's ever been created in Washington.'' He added: ''You have a lot of discretion and a lot of power, but I see very little accountability.'' *Republicans Say New Consumer Bureau Too Powerful*, CBS News (Mar. 16, 2011).

[18] *E.g.,* Ben Protess, *Director or No, Wall Street's Newest Cop Is Ready for Duty*, NY Times (Jun. 21, 2010) (reporting that the Bureau is slated to begin bringing its enforcement actions on July 21 without a Director in place, and predicting that the confirmation process for any Director is likely to be difficult); Josh Boak, *Consumer Financial Protection Bureau Can Open Without Chief*, Politico (Jun. 17, 2011) (similar).

[19] Jean Eaglesham, *Warning Shot on Financial Protection*, Wall Street Journal, at C1 (Feb. 9, 2011).

[20] Jean Eaglesham, *Warning Shot on Financial Protection*, Wall Street Journal, at C1 (Feb. 9, 2011); *see also* Brady Dennis, *For Financial Enforcer, a Bigger Stage*, Washington Post, at A15 (Mar. 30, 2011).

[21] Elizabeth Warren, *Remarks to the National Association of Attorneys General Presidential Initiative Summit*, (Apr. 11, 2011) *athttp://www.consumerfinance.gov/speech/remarks-to-the-national-association-of-attorneys-general-presidential-initiative-summit/*; Richard Cordray, *Partnering: The Consumer Financial Protection Bureau and State Attorneys General*, (Mar. 8, 2011) *athttp://www.consumerfinance.gov/speech/partnering-the-consumer-financial-protection-bureau-and-state-attorneys-general/*; Elizabeth Warren, *Testimony of Elizabeth Warren Before the House Financial Services Committee*, (Mar. 16, 2011) *athttp://www. consumerfinance.gov/speech/testimony-of-elizabeth-warren-before-the-house-financial-services-committee/*.

[22] *See* Office of the Comptroller of the Currency, *Policies and Procedures Manual 5000-7 (REV)* at 5 (Jun. 16, 1993).

Counsel sends the parties letters advising them of Board staff's intent to recommend a penalty and inviting them to offer any mitigating evidence.[23] The FDIC has a similar policy as well.[24]

The Bureau should follow the lead of these financial regulatory agencies and adopt written pre-enforcement procedures. However, these banking regulators operate in a sphere defined by concern for bank stability, confidentiality and constant dialogue between regulators and bank officials.[25] In sharp contrast, the Bureau is not concerned with financial stability, and appears poised to focus on public, adversarial actions towards financial institutions. Indeed, Professor Warren has made clear that the Bureau will be quite unlike existing bank regulators.[26] In light of its mission and methods, the Bureau should look to the SEC – which has a similar focus on consumer protection and enforcement – for a model for its pre-enforcement policy.

The SEC Enforcement Manual contains a detailed description of the Wells process. The process begins with a Wells Notice, which ''identifies the specific charges the staff is considering recommending to the Commission.'' The recipient is then given the opportunity to provide a statement ''arguing why the Commission should not bring an action against them,'' and to request a meeting with the staff. This process helps to ensure that the Commissioners and the SEC staff can understand and weigh the defenses to a potential action before it is filed. All of these steps may be omitted or altered ''if prompt enforcement action is necessary to protect investors.''[27]

The Wells process works to the advantage of both potential targets and the SEC. ''It is in no one's interest for the SEC to institute an enforcement action based on a mistaken view of the evidence or the law.''[28] Or, as the Director of the SEC New York Regional Office recently explained, the Wells process ''is fair to [targets] and it helps us make more effective and correct decisions. It's just basic common sense.''[29] This pre-enforcement dialogue not only provides a target with the opportunity to persuade the SEC to pare down or drop proposed enforcement actions,[30] it gives the SEC a preview of the respondent's prospective defenses, and so helps the SEC craft its strongest cases and claims.[31] By winnowing claims and facilitating early settlement discussions,[32] the Wells process also helps the SEC uses its resources efficiently.[33]

The Wells process also helps build institutional credibility. In a 1996 debate over a proposal to grant preferential treatment to small businesses during SEC enforcement actions, Congressman John Dingell read into the record a letter from the Chairmen of the SEC that stated ''The Commission's enforcement program is well-recognized for its fairness. As a general practice, potential defendants are given the opportunity through 'Wells' submissions to directly address the merits of proposed SEC enforcement actions before they are instituted by the Commission.''[34] The adoption of a Wells process by the Financial Industry Regulatory Authority (''FINRA'') has likewise figured in defenses of its fairness.[35] Conversely, the failure to follow the Wells process has subjected the SEC to criticism. The Court of Appeals for the Eighth Circuit once chastened the SEC for failing to adhere to the Wells process in a particular case: ''had [the defendant] been afforded the opportunity to make a Wells Submission. . .we believe that this litigation would never have occurred.''[36]

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[23] *See Supervisory Letter 91-13 (FIS)* (Jun. 3, 1991) *at http://www.federalreserve.gov/boarddocs/srletters/1991/SR9113.HTM* (setting forth letter procedure); *Supervisory Letter 97-6* (ENF) (Mar. 24, 1997) *at http://www.federalreserve.gov/boarddocs/srletters/1997/SR9706.HTM* (procedure applies to all monetary penalties).

[24] Federal Deposit Insurance Corporation, *Risk Management Manual of Examination Policies* § 14.1 (Feb. 2, 2005) *athttp://www.fdic.gov/regulations/safety/manual/section14-1.html*.

[25] The Administrative Conference of the United States (a federal agency tasked with improving federal agencies) examined bank regulators in 1987, and noted the absence of a full Wells process. The Conference found ''[t]he utility of such a procedure for bank enforcement actions, which tend to be purely informal, confidential and administrative, is doubtful.'' 1987 ACUS 1215, 1220.

[26] *See* Elizabeth Warren, *Testimony Before the House Financial Services Committee* (Mar. 24, 2011) (drawing contrast between the Bureau and the financial regulatory agencies that historically had responsibility for consumer financial protection).

[27] Secs. and Exch. Comm'n. Div. of Enforcement, *Enforcement Manual* § 2.4 (Feb. 8, 2011).

[28] Kenneth B. Winer & Samuel J. Winer, *Effective Representation in the SEC Wells Process*, 34 Rev. Sec. & Commodities Reg. 59, 62 (2001).

[29] Stephen Joyce, *SEC Official Says Wells process Has Become Too Formal, 'Divorced' from Original Purpose*, SEC. REG. & LAW REPORT, Sept. 22, 2010 (quoting SEC Regional Director George S. Canellos).

[30] Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 380-81 (2008); Harvey L. Pitt et al., *A Constructive Appraisal of the SEC's Enforcement Program*, 822 PLI/CORP. 271, 286 (Advanced Securities Law Workshop 1993); Kenneth B. Winer & Richard G. Wallace, *Goldman Sachs and the Wells Process*, LAW360 (May 24, 2010); Theirry Olivier Desmet, *The Pitfalls of Wells Submissions: A Summary After In Re Initial Public Offering Securities Litigation*, 33 SEC. REG. L.J. 2-3, Spring 2005 (allows defense counsel to point out comparisons to sanctions sought in similar actions); Gary G. Lynch and Katherine M. Choo, *Wells Submissions: Effective Representation Following the Completion of the Staff's Investigation*, 703 PLI/CORP. 283, 294 (Advanced Securities Law Workshop 1990).

[31] *See* Harvey L. Pitt et al., supra note 33, at 284-85; Desmet, supra note 33, at 6 (''Wells submissions are useful to the staff in identifying its weakest cases or. . .charges. . . .In that sense. . .it [] maximizes the staff's efficiency, allowing it to conserve its precious resources.'').

[32] *See* Kenneth B. Winer & Samuel J. Winer, *Effective Representation in the SEC Wells Process*, 34 Rev. Sec. & Commodities Reg. 59, 65 (2001) (wells process often facilitates settlement).

[33] *See* Harvey L. Pitt et al., supra note 33, at 284-85; Desmet, supra note 33, at 6.

[34] 142 Cong. Rec. H2972, H2984.

[35] *See* Mary L. Schapiro, *Remarks by Mary L. Schapiro, SIA Compliance & Legal Division Conference* (Apr. 4, 2005) *at http://www.finra.org/Newsroom/Speeches/Schapiro/p013752* (describing the value of the Wells process during her tenure as Vice Chair and President of NASD Regulatory Policy and Oversight). Schapiro served as CEO of FINRA until 2009, when she became Chairman of the SEC.

[36] *SEC v. Zahareas,* 374 F.3d 624, 629 (8th Cir. 2004); *see also In Re IPO Sec. Litig.*, No. 21 MC 92(SAS), 2004 WL 60290 (S.D.N.Y. Jan. 12, 2004) (outlining the significant benefits of making a Wells Submission, and explaining how the codification of existing practice into the specific discretionary rule, 17

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The policy reasons underlying the SEC's Wells process apply with special force to the Bureau. Like the SEC, the Bureau has broad authority to conduct investigations; to conduct enforcement proceedings either administratively or in federal court; to sue in its own name; and to seek a wide range of potential civil remedies. These vast enforcement powers create a correspondingly strong obligation to exercise discretion and provide due process.

Moreover, the new Bureau has additional, unique reasons to ensure that its enforcement targets have been carefully chosen, and provided with due process. The Bureau stands up into a headwind of political opposition, and its enforcement activities are likely to be the public face of the agency – particularly early on, as regulations are still being drafted. Unfortunately, the Bureau will have to face that headwind, and make those enforcement decisions, without the guidance and gravitas of a Senate-confirmed Director. These considerations all counsel the Bureau to take every step it can to demonstrate its commitment to due process, and to ensure that its enforcement decisions have the benefit of intense scrutiny before they become public.

III. Next Steps

Just as the Wells process provides a model for the Bureau, its creation offers some guidance for the Bureau's consideration of its pre-enforcement procedures. The Bureau need not and should not replicate the Wells Committee, which was small and homogenous. Professor Warren has recruited an exceptional staff to the Bureau, and it could take the lead in creating such procedures. However, the Bureau should, like the SEC, consult lawyers with experience defending providers of financial products and services. This will not only add an important perspective to the Bureau, but it will begin the process of building open communication between the Bureau and the bar.

The Bureau's efforts should also make use of the extensive experience and commentary on the Wells process in establishing a process for the Bureau. For example, a 1987 Task Force of the American Bar Association proposed thoughtful reforms, including measures to expand the circumstances in which an enforcement action is preceded by a Wells notice, and safeguards to ensure that the Wells notice is detailed enough (and the time allotted is long enough) to allow the target to make a meaningful response.[37] Other proposed Wells process reforms that are worthy of consideration by the Bureau include calls to open the entire investigation file to the potential target, and to ensure that submissions cannot be used against the potential target in any ensuing enforcement action or litigation.[38]

At the end of the day, however, the details of the policy will matter less than the simple fact that the Bureau has a written policy that demonstrates its respect for due process by affording potential defendants with an opportunity to be heard before charges are filed. Such a policy will mark an important step for the Bureau on the path already blazed by the SEC – from political football to a permanent place in the regulatory landscape.

C.F.R. § 202.5(c), afforded all parties the benefits of ''present[ing] their client's position to the Commission before charging decisions were made'').

[37] *See* ABA Committee on Federal Regulation of Securities, *Report of the Task Force on SEC Rules Relating to Investigations*, 42 BUS. LAW. 789 (1987).

[38] *See* Mitchell E. Herr, *SEC Enforcement: A Better Wells Process*, 32 SEC. REG. L.J., Spring 2004, at 56, 59-66 (expanding upon the recommendations); Kenneth B. Winer & Samuel J. Winer, *Effective Representation in the SEC Wells Process*, 34 Rev. Sec. & Commodities Reg. 59, 62 (2001).

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