

## *CFPB Announces Early Warning Notice Process for Potential Enforcement Targets*

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On November 7, 2011, the Bureau of Consumer Financial Protection (“CFPB”) announced its intent to implement an Early Warning Notice process to provide subjects of potential enforcement action, with notice of the possible action, and an opportunity to submit a written response before the CFPB initiates enforcement action.<sup>1</sup> The Bulletin represents a significant step by the CFPB towards promoting an atmosphere of open communication, fairness, and transparency with respect to the entities subject to its supervisory and enforcement authority; however, the new process also presents potential regulatory risks for enforcement targets.

### **Background**

Sections 1024 and 1025 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“DFA”) provide the CFPB with supervisory and enforcement authority over nonbank providers of financial products and services and large insured depository institutions and credit unions.<sup>2</sup> On October 13, 2011, the CFPB provided those entities a first look at how it would undertake its new mandate to ensure compliance with federal consumer financial protection laws with the release of its first Supervision and Examination Manual.<sup>3</sup> Concurrent with the release of the manual, the CFPB also issued examination procedures for mortgage servicing, and indicated that it would release similar guides to explain specific examination procedures organized by product and line of business in the future.<sup>4</sup> In making the general examination manual and servicing procedures public, the CFPB stated its intent to enable “financial services providers [to] know what to expect during their examinations” in the interests of “building a constructive relationship with the companies we supervise.”<sup>5</sup>

With the issuance of the Bulletin, the CFPB has similarly indicated an interest in enhanced transparency with respect to how it intends to undertake its enforcement function with respect to its regulated entities. Notably, the CFPB has stated that it intends to issue a series of bulletins, beginning with CFPB Bulletin 2011-4, regarding the procedures and priorities of its Office of Enforcement in order “to inform the public in a transparent manner about some of the types of legal violations that the Office intends to investigate for potential enforcement action, and the procedures and methods that it will use to do so.”<sup>6</sup>

### ***Overview of Early Warning Notice Bulletin***

CFPB Bulletin 2011-4, sets forth an Early Warning Notice process through which the CFPB’s Office of Enforcement may provide advance notice to potential subjects of enforcement action prior to initiating enforcement proceedings.<sup>7</sup> As described, the notice would give the subject of potential action notice of

the nature of the potential violation(s) and offer the entity the opportunity to submit a written response explaining why the CFPB should not proceed with the potential action.<sup>8</sup> According to the CFPB, the objective of the notice process “is to ensure that potential subjects of enforcement actions have the opportunity to present their positions to the [CFPB] before an enforcement action is recommended or commenced.”<sup>9</sup> Such notice would be at the CFPB’s discretion, and may not be appropriate in certain circumstances, such as in cases of ongoing fraud or when the Office of Enforcement needs to take action quickly.

With respect to the written response that may be submitted by a notice recipient, the Bulletin notes that any such statement should be focused on “legal and policy matters relevant to the potential enforcement proceedings.” In addition, any factual assertions relied upon or presented in the statement must be made under oath by a person with personal knowledge of those facts. The statement generally must be submitted within 14 calendar days after the notice, limited to no more than 40 pages, and submitted on 8.5 by 11 inch paper, double spaced, and in at least 12-point type. Significantly, however, such submissions “may be discoverable by third parties in accordance with applicable law.”<sup>10</sup>

In announcing the Early Warning Notice process, which had been recommended by some commenters,<sup>11</sup> the CFPB noted that it was modeled on “similar procedures that have been successful at other federal agencies.”<sup>12</sup> In particular, the Securities and Exchange Commission (SEC) has had a similar notice process dating back to the early 1970s referred to as the “Wells Notice,” named after the chair of the advisory committee that had recommended the notice process.<sup>13</sup> The objective of the Wells Notice is to provide the SEC, prior to authorizing an enforcement proceeding, “the contentions of both its staff and the adverse party concerning the facts and circumstances which form the basis for the staff recommendation.”<sup>14</sup> Similarly, as explained by Raj Date, Special Advisor to the Secretary of the Treasury for the CFPB, the Early Warning Notice is intended to “strike a balance between the goal of fairness to those being investigated and our mission to protect consumers.”<sup>15</sup>

Although the Early Warning Notice process potentially provides entities that may be subject to future enforcement proceedings the opportunity to state their case to the CFPB regarding why such an action is unnecessary or unwarranted, important questions regarding the process remain. As noted above, any written submission by a respondent is potentially discoverable by third parties in accordance with applicable law, which raises the significant possibility that such communications will not be subject to privilege. In particular, because the CFPB is not a Federal banking agency, the written response will be unlikely to be afforded the same privileges from discovery generally given to information provided to bank regulators.<sup>16</sup> Thus, a company considering whether to respond to an Early Warning Notice must take into consideration that the response may not be privileged or kept confidential, and could potentially be used against the respondent in any future enforcement proceeding. The response may also be discoverable in later civil litigation by private parties.

In addition, it is not clear whether a recipient of an Early Warning Notice from the CFPB will have the opportunity to review portions of the CFPB’s investigative file to assess the merits of the evidence forming the basis for the CFPB’s staff recommendations, or to meet with CFPB staff to discuss the substance of the notice, both of which are permitted under the SEC’s Wells notice process at the discretion of SEC staff.<sup>17</sup>



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<sup>1</sup> See CFPB Bulletin 2011-04 (Bulletin). The Bulletin can be found at: <http://www.consumerfinance.gov/wp-content/uploads/2011/11/EarlyWarningNotice.pdf>.

<sup>2</sup> DFA Section 1024, once a permanent director is in place, grants the Bureau exclusive rulewriting, examination, and enforcement authority over any nonbank covered person who offers or provides origination, brokerage, or servicing services in connection with residential mortgage products, payday loans, or private education loans; is a "larger participant" of a market for other consumer financial products or services as defined by Bureau rules; or the Bureau has reasonable cause to determine poses risks to consumers with regard to the offering or provision of consumer financial products or services. DFA Section 1025 grants the Bureau exclusive supervisory and primary enforcement authority over insured depository institutions and insured credit unions with total assets exceeding \$10 billion and their affiliates. Insured depository institutions and credit unions with total assets of \$10 billion or less generally remain subject to the exclusive supervisory and enforcement authority of their prudential regulator under DFA Section 1026.

<sup>3</sup> The Supervision and Examination Manual can be found at: [http://www.consumerfinance.gov/wp-content/themes/cfpb\\_theme/images/supervision\\_examination\\_manual\\_11211.pdf](http://www.consumerfinance.gov/wp-content/themes/cfpb_theme/images/supervision_examination_manual_11211.pdf).

<sup>4</sup> See "A Guide to CFPB's Supervision," CFPB press release (October 13, 2011), available at <http://www.consumerfinance.gov/guide-cfpb-supervision/>.

<sup>5</sup> The CFPB outlined its approach to supervising large depository institutions and credit unions in a July 21, 2011 Treasury press release. See "Consumer Financial Protection Bureau Outlines Bank Supervision Approach," Treasury press release, available at [www.consumerfinance.gov/pressrelease/consumer-financial-protection/](http://www.consumerfinance.gov/pressrelease/consumer-financial-protection/). For an overview of the CFPB's bank supervisory approach, please see our article, "CFPB Initiates Large Bank Supervision Program," Stay Current (July 2011), available at <http://www.paulhastings.com/assets/publications/1962.pdf>.

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<sup>6</sup> See CFPB Bulletin 2011-4, "Early Warning Notice" (November 7, 2011).

<sup>7</sup> In July 2011, the CFPB issued interim final rules to establish rules and procedures for its conduct of adjudication proceedings under DFA Section 1053, once it has determined that an enforcement proceeding is appropriate. See 76 Fed. Reg. 45338 (July 28, 2011).

<sup>8</sup> A sample Early Warning Notice is attached to the Bulletin.

<sup>9</sup> See CFPB Bulletin 2011-4.

<sup>10</sup> Ibid.

<sup>11</sup> See, e.g., William McLucas and Eric Mogilnicki, "SEC Provides an Enforcement Roadmap for the CFPB," American Banker, July 20, 2011.

<sup>12</sup> See "Consumer Financial Protection Bureau plans to provide early warning of possible enforcement actions" CFPB press release (November 7, 2011), available at <http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-plans-to-provide-early-warning-of-possible-enforcement-actions/>.

<sup>13</sup> See Securities and Exchange Commission Division of Enforcement Manual 23-29 (August 2, 2011) (SEC Division of Enforcement Manual), available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

<sup>14</sup> See id. at 26.

<sup>15</sup> See "Consumer Financial Protection Bureau plans to provide early warning of possible enforcement actions" press release.

<sup>16</sup> See 12 U.S.C. 1828(x).

<sup>17</sup> See SEC Division of Enforcement Manual at 25.