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THE DODD-FRANK ACT'S BANKING AND FINANCIAL COMPANY ENFORCEMENT PROVISIONS

RICHARD M. ALEXANDER, ROBERT M. CLARK, AND JEREMY W. HOCHBERG

The authors summarize the enforcement-related provisions of the new financial reform law.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Act”) provides the Board of Governors of the Federal Reserve System (“Federal Reserve”) with primary enforcement authority over nonbank financial companies that the newly created Financial Stability Oversight Council (“FSOC”) determines should be subject to Federal Reserve supervision. The Act also delineates which regulators have primary and back-up enforcement authority over subsidiaries of nonbank financial companies and nonbank subsidiaries of depository institution holding companies.

Additionally, the Act establishes the Bureau of Consumer Financial Protection (“CFPB”) and provides it with the authority to enforce federal consumer financial laws through either administrative proceedings or civil actions. The CFPB will have primary authority to enforce federal consumer financial laws with respect to certain nonbank covered persons, as defined in the Act, as well as insured depository institutions or insured credit unions with total assets of more than \$10 billion. Smaller depository institutions will remain subject to the primary enforcement authority of their prudential regulators. This article summarizes the enforcement-related provisions of the Act.

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TITLE I: FINANCIAL STABILITY

Federal Reserve's Enforcement Authority over Nonbank Financial Companies and Their Subsidiaries

Title I of the Act establishes the primary and back-up enforcement authorities over nonbank financial companies that the FSOC determines should be subject to supervision by the Federal Reserve, as well as their subsidiaries. The Federal Reserve will have primary enforcement authority over nonbank financial companies that are made subject to Federal Reserve supervision. The Act provides that nonbank financial companies supervised by the Federal Reserve and their nonbank subsidiaries will be subject to the same enforcement provisions of Section 8 of the Federal Deposit Insurance Act ("FDI Act")¹ as if they were insured depository institutions, including cease and desist orders, removal and prohibition orders, and civil money penalties.

The Act also provides the Federal Reserve with back-up enforcement authority over "functionally regulated subsidiaries" of nonbank financial companies supervised by the Federal Reserve.² In this regard, the Federal Reserve may recommend to the primary federal regulator for a functionally regulated subsidiary of a nonbank financial company that an enforcement action be brought against the subsidiary if it determines that a condition, practice, or activity of the subsidiary does not comply with the regulations or orders prescribed by the Federal Reserve under the Act. If the primary federal regulator does not take a supervisory enforcement action against a functionally regulated subsidiary that is acceptable to the Federal Reserve within 60 days, the Federal Reserve will have back-up enforcement authority as if the subsidiary were a bank holding company.

FDIC's Back-Up Enforcement Authority to Protect the Deposit Insurance Fund

The Act expands the scope of the existing back-up enforcement authority of the Federal Deposit Insurance Corporation ("FDIC") over insured depository institutions under Section 8(t) of the FDI Act to encompass back-up enforcement authority over depository institution holding companies. The

Act provides that if the FDIC determines that the conduct or threatened conduct of a depository institution holding company that is not in a sound condition threatens the Deposit Insurance Fund, the FDIC may take an enforcement action, provided that the appropriate federal banking agency did not act within 60 days of receiving a recommendation by the FDIC to take an enforcement action.

TITLE VI: REGULATION OF BANK AND SAVINGS ASSOCIATION HOLDING COMPANIES AND DEPOSITORY INSTITUTIONS

Federal Reserve's Examination and Enforcement Authority Over Nonbank Subsidiaries of Depository Institution Holding Companies

Title VI of the Act requires the Federal Reserve to examine activities engaged in by a nonbank subsidiary of a depository institution holding company that are permissible for a banking institution “in the same manner, subject to the same standards, and with the same frequency” as would be required if such activities were conducted by the lead insured depository institution of the depository institution holding company. If the Federal Reserve does not conduct an examination in the required manner, the appropriate federal banking agency for the lead depository institution may recommend that the Federal Reserve perform the examination. The appropriate federal banking agency has backup examination authority if the Federal Reserve does not begin an examination within 60 days of a recommendation.

A federal banking agency that conducts an examination pursuant to its back-up examination authority may recommend to the Federal Reserve that it take an enforcement action against the nonbank subsidiary if the federal banking agency determines that the subsidiary “poses a material threat to the safety and soundness of any bank subsidiary of the depository institution holding company.” If the Federal Reserve fails to take an enforcement action within 60 days of the recommendation, the agency that made the recommendation may take the recommended enforcement action as though the nonbank subsidiary were a bank subsidiary. These provisions will take effect on the so-called Transfer Date, which is one year after the date of enactment of the Act, unless extended.

Restriction on Bank Conversions

Title VI of the Act places restrictions on the conversion of banks that have outstanding enforcement actions. It provides that a national bank or federal savings association may not convert to a state bank or state savings association, and vice versa, if the institution is subject to a formal enforcement action, a memorandum of understanding with respect to a “significant supervisory matter,” or a final enforcement action by a state attorney general. However, the restriction on conversions from a federal depository institution to a state depository institution does not apply if the federal banking agency provides notice of the proposed conversion. The notice must include a plan to address the significant supervisory matter that is consistent with the safe and sound operation of the institution and the agency that issued the cease and desist order must not object to the conversion within 30 days of the notice.

Upon an application for a conversion, the institution’s current regulator must notify the prospective regulator of any ongoing supervisory or investigative proceedings that it believes are likely to result in a formal enforcement order or memorandum of understanding in the near term absent the proposed conversion. The current regulator must also provide the prospective regulator with access to all investigative and supervisory information related to the proceedings.

TITLE X: BUREAU OF CONSUMER FINANCIAL PROTECTION

CFPB’s Enforcement Authority over Nondepository Covered Persons

Title X of the Act creates the CFPB and provides it with examination and enforcement authority over nondepository covered persons who are (i) mortgage originators, brokers, or servicers; (ii) payday lenders; (iii) private education lenders; (iv) larger participants of a market for consumer financial products; or (v) are found to engage in conduct that poses risks to consumers. The CFPB is required to issue regulations, after consulting with the Federal Trade Commission (“FTC”), to further define the nondepository covered persons who are subject to the CFPB’s examination and enforcement authority within one year of the Transfer Date. The Act provides the CFPB with “exclusive” enforcement authority to enforce federal consumer financial laws

against these nondepository covered persons.³ The effective date of this provision is the date of enactment of the Act.

CFPB's Enforcement Authority over Entities with Assets in Excess of \$10 Billion

The Act provides the CFPB with primary authority to enforce a federal consumer financial law with respect to any insured depository institution or insured credit union with total assets of more than \$10 billion (large institution), whereas smaller institutions remain subject to the primary enforcement authority of the prudential regulator.⁴ Any federal agency, other than the FTC, that is authorized to enforce a federal consumer financial law may recommend to the CFPB that the CFPB initiate an enforcement proceeding against a large institution. If the CFPB does not initiate an enforcement proceeding within 120 days of receipt of such recommendation, the agency that made the recommendation may initiate an enforcement proceeding, including performing follow-up supervisory and support functions, to assure compliance with such proceeding. The prudential regulators may enforce compliance with the requirements imposed by Title X of the Act under the Federal Credit Union Act, Section 8 of the FDI Act, or the Bank Service Company Act. The effective date of this provision is the Transfer Date.

Prudential Regulators' Enforcement Authority over Entities with Assets of \$10 Billion or Less

Insured depository institutions and insured credit unions with total assets of \$10 billion or less will remain subject to the primary enforcement authority of the prudential regulator, with respect to the enforcement of federal consumer financial laws. The CFPB is required to notify the prudential regulator and recommend appropriate action when it has reason to believe that such an entity has engaged in a material violation of a federal consumer financial law. Upon receiving a recommendation, the prudential regulator must respond to the CFPB within 60 days. Notably, the Act provides that a service provider to "a substantial number" of insured depository institutions and insured credit unions with total assets of \$10 billion or less will be subject to the enforcement authority of the CFPB.

Interagency Dispute-Resolution Process

The Act contains an interagency dispute-resolution process in connection with an examination of a large institution, which is immediately effective upon enactment of the Act. The CFPB and the prudential regulator of a large institution are required to coordinate and conduct simultaneous examinations of the entity unless the entity requests the examinations to be conducted separately. If the proposed supervisory determinations of the CFPB and a prudential supervisor conflict, the entity may request that the agencies present a joint statement of coordinated supervisory action within 30 days. The insured depository institution or insured credit union may appeal to a three person governing panel if the agencies fail to resolve their differences and issue a joint statement, or if one agency attempts to unilaterally take supervisory action without the consent of the other agency. The governing panel will consist of representatives of the CFPB and the prudential regulator who have not participated in, and do not report to a person who has participated in, the material supervisory determinations under appeal. Additionally, the third member of the panel will consist of, on a rotating basis, either a representative of the Federal Reserve, the FDIC, the National Credit Union Administration, or the Office of the Comptroller of the Currency that is not involved in the dispute.

CFPB's Enforcement Powers

Subtitle E of Title X of the Act empowers the CFPB with enforcement authority that is generally similar to that of the other federal banking regulators, with a few notable exceptions. The CFPB may bring an administrative proceeding against a person or entity for a violation of a federal consumer financial law, as the federal banking agencies may do under Section 8 of the FDI Act. However, unlike the federal banking agencies, the CFPB may bring a civil action in federal district court or any other court with competent jurisdiction. When bringing a civil action, the CFPB must notify the U.S. Attorney General and the appropriate prudential regulator. The CFPB may represent itself in such proceedings. The statute of limitations on bringing an action under Title X of the Act is three years after the date of discovery of the violation to which an action relates.

The Act provides that the CFPB may engage in joint investigations with the Secretary of the U.S. Department of Housing and Urban Development, the U.S. Attorney General, or both. The CFPB may also issue subpoenas for testimony or documents, issue civil investigative demands, and conduct hearings and adjudicative proceedings. The process for initiating a hearing or appealing the decision of a hearing is similar to the process governing the federal banking agencies.

The CFPB may seek the following relief in an administrative proceeding or court action:

- Rescission or reformation of contracts;
- Refund of money or return of real property;
- Restitution;
- Disgorgement or compensation for unjust enrichment;
- Payment of damages or other monetary relief;
- Public notification of the violation;
- Limits on the activities or functions of the person; and
- Civil money penalties.

The CFPB's restitution authority appears to be broader than that of the federal banking agencies because it does not require the agency to prove that the respondent was unjustly enriched in connection with a violation or practice or that the violation or practice involved a reckless disregard for the law, applicable regulations, or prior order.

PRESERVATION OF STATE ENFORCEMENT POWERS

The Act specifically authorizes state attorneys general and other state regulators to bring civil actions or other appropriate actions available under state law to enforce the provisions of Title X or regulations issued thereunder. A state regulator may bring a civil action to enforce the provisions of Title X with respect to any entity that is state chartered, incorporated, licensed, or otherwise authorized to do business under state law. The Act does not alter or

limit the authority of a state attorney general or any other regulatory agency to bring an action arising solely under a law in effect in that state.

Before initiating an administrative proceeding or court action against a covered person, a state attorney general or state regulator must provide prior notice to the CFPB and the prudential regulator. However, if such notice would be impracticable, the state attorney general or state regulator may provide the notice immediately upon instituting the action or proceeding. The notice must identify the parties, the alleged facts, and whether there may be a need for coordination. The CFPB may intervene, remove the action to the appropriate U.S. district court, and be heard on all matters arising in the action.

NOTES

¹ 12 U.S.C. § 1818.

² The term “functionally regulated subsidiaries” means any company that is:

- (i) a broker or dealer that is registered under the Securities Exchange Act of 1934;
- (ii) a registered investment adviser, properly registered by or on behalf of either the Securities and Exchange Commission or any state, with respect to the investment advisory activities of such investment adviser and activities incidental to such investment advisory activities;
- (iii) an investment company that is registered under the Investment Company Act of 1940;
- (iv) an insurance company, with respect to insurance activities of the insurance company and activities incidental to such insurance activities, that is subject to supervision by a state insurance regulator; or
- (v) an entity that is subject to regulation by the Commodity Futures Trading Commission, with respect to the commodities activities of such entity and activities incidental to such activities.

³ The term “federal consumer financial law” is broadly defined to mean the provisions of Title X, the laws for which authorities are transferred to the CFPB, and certain “enumerated consumer laws” including the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Real Estate Settlement Procedures Act, the Truth-in-Lending Act, and the Truth-in-Savings Act, among other laws. It also includes any rule or order prescribed by the CFPB under Title X, an enumerated consumer law, or the laws for which authorities are transferred to the CFPB. Notably, it does not include the Federal Trade Commission Act, thus preserving the FTC’s authority

to enforce the Federal Trade Commission Act against nonbank entities engaged in financial activities.

⁴ The term “prudential regulator” means the appropriate federal banking agency for insured depository institutions, insured depository holding companies, and their subsidiaries, and the National Credit Union Administration for insured credit unions.