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Insurance Coverage for CFPB Investigations and Enforcement Actions

By: Gregory S. Wright, Stephanie C. Robinson and Nanci L. Weissgold

Many companies and individuals that are facing investigations or subsequent enforcement actions by the Consumer Financial Protection Bureau (“CFPB”) will be forced to incur substantial sums to defend such claims, to settle such claims, and/or to pay any judgments. In many cases, companies and individuals may have insurance coverage to pay for such costs, such as Directors and Officers liability insurance (“D&O Policies”) and Errors and Omissions liability insurance (“E&O Policies”). The availability of coverage will turn on the specific contract language in any insurance policy and the specific nature of the CFPB matter at issue.

Policyholders that are potentially subject to CFPB investigations should:

- Review the terms in their current insurance policies and potentially seek to negotiate enhancements to coverage during their next renewal cycle.
- When faced with a CFPB investigation, take prompt steps to provide appropriate notice to insurers in order to preserve their rights to coverage.
- Be prepared to contest attempts by insurers to deny or limit coverage for CFPB investigations.

I. Background on CFPB

The CFPB’s authority is broad and a full discussion of such authority is beyond the scope of this article. Because the availability of coverage under D&O and E&O Policies potentially is tied to certain phases of a regulatory investigation, we briefly review the typical steps in a CFPB investigation and/or enforcement action herein.¹

Generally speaking, the CFPB has broad authority over companies that offer consumer financial products and services (“covered persons”), as well as officers and directors of certain institutions.² Its powers also extend to third party vendors acting as service providers to covered persons.³ To date, the CFPB has focused on a wide range of industries and issues, such as credit card issuers, mortgage lenders, title companies, student lenders, payday lenders, and others.

The agency can conduct investigations “to determine whether any person is, or has, engaged in conduct that violates Federal consumer financial law.”⁴ This means that the CFPB may investigate companies for possible violations of a long list of laws, including but not limited to the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Real Estate Settlement Procedures Act, the Truth in Lending Act, and Title X of the Dodd-Frank Act, which makes it illegal to engage in any unfair, deceptive, or abusive act or practice.⁵

The CFPB generally has broad power to conduct examinations, during which the CFPB may request and review documents from the entity to be examined. Subject to approval by the Assistant Director of the Office of Enforcement or other designated officials, the CFPB also has the power to initiate investigations through the issuance of civil investigative demands (“CIDs”).⁶ The CID may direct a recipient to produce documents, submit tangible things, provide written reports, answer questions,

Insurance Coverage for CFPB Investigations and Enforcement Actions

and/or appear to provide testimony under oath. The demands may be enforced in district court. The agency has a duty to advise any person compelled to furnish discovery materials “of the nature of the conduct constituting the alleged violation that is under investigation and the provisions of law applicable to such violation.”⁷

Before the Office of Enforcement recommends that the CFPB commence enforcement proceedings, the Office of Enforcement has the discretion to “give the subject of such recommendation notice of the nature of the subject’s potential violations and may offer the subject the opportunity to submit a written statement in response.”⁸

The CFPB has broad power to bring administrative enforcement proceedings; refer matters to appropriate federal, state or other governmental agencies; or file lawsuits in federal court.⁹ The CFPB has power to seek “any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law,” including but not limited to damages or other monetary relief, civil monetary penalties, disgorgement, rescission or reformation of contracts, etc.¹⁰

Given the nature of the process, companies often incur substantial costs in defending an investigation, even prior to the commencement of any enforcement proceeding or lawsuit. Investigations can cause a significant strain on company resources, requiring staff time, assistance from outside counsel, and the use of vendors to process documents in accordance with the CFPB’s exacting document production specifications.

II. Potential Scope of Insurance Coverage for Investigations

In many cases, policyholders may have coverage under their D&O and E&O Policies for CFPB investigations and enforcement proceedings. The potential for coverage for regulatory investigations varies widely by insurer and by policy. Each insurer typically has developed its own standard forms (which vary widely with respect to coverage for investigations), and many policies are then modified by endorsement. In many cases, the terms of coverage may be negotiable during the renewal process. As such, the availability of coverage for CFPB investigations will turn on the specific facts and specific policy at issue.

For example, some D&O Policies afford coverage for “Loss arising from a Claim alleging Wrongful Acts,” such as negligence, misrepresentations, breaches of duties, and other acts, errors, or omissions.¹¹ Similarly, E&O Policies may cover Loss arising from a Claim alleging Wrongful Acts committed while providing professional services. In many policies, insurers will use a definition of professional services that is industry-specific.

D&O Policies and E&O Policies are generally triggered by the filing of a “Claim.” The definition of Claim varies widely, including but not limited to the following:

- Some policies may not cover investigations at all.
- Some policies cover only Insured Persons with respect to regulatory investigations.
- Some policies apply upon commencement of a formal investigation or after service of a subpoena or similar document.
- Some policies apply when the regulator provides some notice that an enforcement proceeding may be commenced against an Insured.
- Some policies apply if there has been a request for a tolling agreement.

Insurance Coverage for CFPB Investigations and Enforcement Actions

Generally speaking, courts have adopted canons of construction that require provisions granting coverage to be construed broadly, exclusions to coverage to be construed narrowly, and ambiguities to be construed against the insurance company that drafted the language at issue. Courts also should construe insurance policies to comport with a policyholder's reasonable expectations based on regulatory schemes that apply to the policyholder.

Based on such principles, many courts have held that policyholders are entitled to coverage for the costs of defending regulatory investigations in other contexts and have rejected insurer attempts to avoid their obligations to cover such Claims. For example, in *MBIA v. Federal Insurance Co.*,¹² the Second Circuit held that a policyholder was entitled to coverage for the costs of responding to a subpoena issued by the New York Attorney General. In that case, the policy covered certain "regulatory proceeding[s] ... commenced by a ... formal or informal investigative order or similar document." In so holding, the court rejected the insurer's "crabbed view" that a subpoena is a "mere discovery device," holding that a business person would view a subpoena as a formal or informal investigative order. Similarly, in *National Stock Exchange v. Federal Ins. Co.*,¹³ a district court held that the policyholder was entitled to coverage for the costs of defending an SEC investigation after the SEC issued a formal order. In that case, the policy covered "formal regulatory proceedings commenced by a formal investigation order." The insurer argued that the SEC's Formal Order did not trigger coverage on the grounds that an SEC investigation could not be a "proceeding" (which the insurer argued was limited to SEC enforcement actions). The court rejected this argument out of hand, reasoning that if the insurer had wanted to exclude formal investigations, it could have drafted its policy more clearly.

Again, the availability of coverage will be determined on a claim-by-claim basis, but policyholders facing CFPB claims potentially can take advantage of case law addressing coverage for other types of regulatory investigations. Further, in the context of applying policy language to CFPB investigations, insurers and courts should consider the formal process related to the issuance of the CID, the penalties associated with failure to comply with the CID, and the fact that the CFPB is required to provide notice of "alleged violations" when the CID is issued. Under many policies, these requirements may meet the definition of Claim.

III. Other Coverage Issues

In addition to the issue of whether the definition of Claim includes regulatory investigations, numerous other issues may impact the ability to obtain coverage for CFPB investigations and enforcement actions.

Notice. Many policies require the policyholder to report any Claim "as soon as practicable." Insurers often will attempt to contest coverage if they believe that a policyholder did not meet its duty to do this. While policyholders often will have grounds to dispute such arguments, policyholders should carefully consider if and when to provide notice of any CFPB matter in order to preserve their rights to coverage.

Definition of Loss. D&O and E&O Policies typically cover "Loss," which is often defined to include reasonable "Defense Costs" in defending or investigating a Claim, as well as certain damages, settlements, judgments, etc. The definition of Loss varies by policy, but coverage may vary with respect to certain types of relief such as fines and penalties or multiplied damages. In certain policies, coverage may be available provided that relevant state law does not prohibit such coverage as a matter of public policy. Even if a policy excludes certain "fines or penalties" from the definition of Loss, the meaning of this policy language is often disputed. For example, certain courts will conduct a detailed

Insurance Coverage for CFPB Investigations and Enforcement Actions

examination of the statutory purpose behind the “fine” at issue and will distinguish between “fines” that are designed to compensate a plaintiff (potentially covered) and others that are designed to punish the defendant (potentially not). Further, insurers often will argue that public policy prohibits coverage for any relief that is labeled as “disgorgement” or “restitution.” But again, courts have not always agreed and/or have limited this “public policy exception” to narrow circumstances, such as when a criminal is forced to return an ill-gotten gain.

Exclusions. Of course, D&O and E&O Policies typically contain numerous exclusions and conditions that may limit coverage. Such terms would need to be analyzed in the context of a specific claim. Generally speaking, when faced with a new type of exposure (such as CFPB investigations), insurers often tend to start by denying coverage whenever possible. As seen above, courts have rejected attempts by insurers to limit their contractual obligation to cover other types of regulatory investigations in certain cases. Even if insurers initially respond with denials, policyholders should be prepared to advocate their positions through negotiations or coverage litigation in order to receive the full benefit of their policies.

Renewals. In addition, in many cases, the terms of D&O and E&O Policies may be negotiable during the renewal process. Even if they are not currently facing a CFPB investigation, policyholders should consider reviewing the terms in their existing policies and/or seeking to add endorsements during the renewal cycle. In certain cases, small changes can be outcome determinative when a Claim is filed.

IV. Summary

D&O and E&O Policies may be a valuable corporate asset to recoup losses incurred in CFPB investigations and enforcement actions. Policyholders that are facing CFPB inquiries should carefully review the terms of their existing insurance policies and take steps to preserve and maximize their odds of obtaining coverage.

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Insurance Coverage for CFPB Investigations and Enforcement Actions

¹ We note that, although this alert focuses on insurance coverage for CFPB investigations, a similar analysis would apply in the context of actions taken by other governmental agencies.

² See, e.g., Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) at §§ 1002(6) (defining “covered person”), 1002(25) (defining “related person”), 1024-1026 (describing the CFPB’s supervision and enforcement authority over various types of entities), 1036 (making it unlawful to violate a federal consumer financial law or engage in any unfair, deceptive, or abusive act or practice), 1052-1054 (describing the CFPB’s investigative, adjudicative, and litigation authority).

³ See CFPB Bulletin 2012-03 (Service Providers) for the CFPB’s analysis of service provider relationships.

⁴ See CFPB Supervision and Examination Manual (Oct. 2012), Overview (“Manual”), at 7 (citing Dodd-Frank Act at § 1051).

⁵ *Id.* at 1-2.

⁶ See Dodd-Frank Act § 1053.

⁷ 12 C.F.R. § 1080.5.

⁸ See CFPB Bulletin 2011-04 (Enforcement), Early Warning Notice.

⁹ See Manual, at 7.

¹⁰ *Id.*

¹¹ These coverages may vary based on industry and type of entity.

¹² *MBIA v. Fed. Ins. Co.*, 652 F.3d 152 (2d Cir. 2011).

¹³ *Nat’l Stock Exch. v. Fed. Ins. Co.*, 2007 WL 1030293 (N.D. Ill. 2007).

Consumer Financial Services Practice Contact List

K&L Gates' Consumer Financial Services practice provides a comprehensive range of transactional, regulatory compliance, enforcement and litigation services to the lending and settlement service industry. Our focus includes first- and subordinate-lien, open- and closed-end residential mortgage loans, as well as multi-family and commercial mortgage loans. We also advise clients on direct and indirect automobile, and manufactured housing finance relationships. In addition, we handle unsecured consumer and commercial lending. In all areas, our practice includes traditional and e-commerce applications of current law governing the fields of mortgage banking and consumer finance.

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