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Client Alert

Insurance Coverage & Recovery Practice Group

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Maximizing Insurance Coverage for CFPB Investigations and Enforcement Actions

Seven years removed from the 2008 financial crisis, an increasing number of financial institutions are now finding themselves in the crosshairs of the Consumer Financial Protection Bureau ("CFPB"), a new federal agency created by the Dodd-Frank Act and charged with protecting consumers from violations of federal consumer financial laws. Although the agency is less than four years old, the CFPB already has targeted a large number of mortgage lenders, credit card companies, auto lenders, student loan companies, banks, and other financial institutions through investigations and enforcement actions. In doing so, the CFPB has settled a large number of claims through consent orders directing financial institutions to pay hundreds of millions of dollars. To take just a few recent examples, the CFPB obtained a $37.5 million settlement with Flagstar Bank involving alleged unlawful activities in processing loan modification applications;[1] a $2 billion settlement with Ocwen Financial Corporation involving alleged misconduct in mortgage loan servicing;[2] and a $727 million settlement with Bank of America in a case involving discriminatory credit card practices allegations.[3] Of course, on top of these record settlement costs, companies have been forced to defend themselves against these investigations, incurring millions of dollars of defense costs in the process.

The only good news when facing a CFPB investigation or lawsuit, if there is such a thing, is that most financial institutions have valuable insurance policies that may reimburse—or at least defray—some of the CFPB-related losses. While insurers may argue that coverage for CFPB investigations should be unavailable because the damages being requested are "uninsurable," directors and officers ("D&O") and errors and omissions ("E&O") policies increasingly provide coverage for defense costs associated with regulatory investigations. These policies may also cover settlements with the CFPB of alleged misconduct that are reached before a final adjudication, in the same way that these policies cover similar investigations by the Securities & Exchange Commission, the Department of Justice, and other regulatory agencies. Indeed, even commercial general liability ("CGL") policies may provide coverage for CFPB investigations depending on the nature of the misconduct alleged. Given the huge amounts of damages and defense costs that are potentially at stake in a CFPB investigation or lawsuit, it is a mistake to leave these policies on the table.

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I. Background on the CFPB

The CFPB has vast authority over companies that offer consumer financial products and services, as well as the officers and directors of certain types of financial institutions and third-party vendors.[4] To date, the CFPB has focused on a wide range of industries and issues, such as banks, credit card issuers, mortgage lenders, title companies, student lenders, and payday lenders. However, the agency is taking an increasingly expansive view of its jurisdiction, as evidenced by a complaint the CFPB recently filed against mobile telecommunications provider Sprint Corporation,[5] suggesting that any large company invoicing its customers may be a target.

In regulating the consumer financial sector, the CFPB implements, examines for compliance with, and enforces "Federal consumer financial law."[6] Federal consumer financial law as defined by the CFPB includes a veritable alphabet soup of federal statutes. The CFPB can also investigate unfair, deceptive, or abusive acts and practices in connection with consumer financial products and services.

During an investigation, the CFPB can issue civil investigative demands ("CIDs").[7] A CID may direct a recipient to produce documents, submit tangible things, provide written reports, answer questions, or appear to provide testimony under oath. In so directing, the CFPB must advise the recipient "of the nature of the conduct constituting the alleged violation that is under investigation and the provisions of law applicable to such violation."[8] If the CID recipient fails to comply, the CFPB must seek to enforce the CID in federal court. As with any federal regulatory investigation, the cost of producing documents and preparing witnesses to testify under oath can be substantial.

While conducting its activity, the CFPB will often use a variety of methods to notify its target of its concerns. For example, the CFPB may send a Potential Action and Request for Response ("PARR") Letter, a Notice and Opportunity to Respond and Advise Letter, or an Early Warning Notice.[9]

Finally, the CFPB can refer matters to appropriate federal or state agencies, bring administrative enforcement proceedings, or file lawsuits in federal court.[10] When bringing enforcement proceedings, the CFPB can seek many kinds of relief—including damages, civil monetary penalties, restitution, disgorgement, unjust enrichment, rescission, reformation, and public notification.[11]

II. Finding Coverage for CFPB Defense Costs and Settlements

Because the CFPB is a relatively new entity, many of the coverage issues implicated by its activities have not been tested in litigation. Often, government enforcement activity triggers D&O and E&O policies, which, depending on a policy's definition of the term "Claim," may respond to CFPB claims and investigations alleging "Wrongful Acts."

Interestingly, the only CFPB-related insurance coverage litigation of which we are aware to date involves CGL/umbrella coverage issued to auto lender Ally Financial. In that case, Ally is seeking "personal injury" coverage under an endorsement providing discrimination coverage, because the underlying case against Ally involves allegations that Ally committed discriminatory lending practices in violation of the Equal Credit Opportunity Act.[12] While the outcome of this matter is still uncertain, it illustrates the need to review all potentially available coverages when faced with a CFPB claim or investigation, including CGL policies.

Regardless of the policy at issue when seeking coverage for a CFPB claim or investigation, a policyholder should always assess its ability to seek coverage for both defense costs, and the costs of any settlement or judgment.

While every policy is different, and coverage always turns on the terms and conditions of the particular policy at issue, the key questions when attempting to secure coverage for CFPB defense costs and settlements under any type of policy

are twofold: (1) when does a claim exist that triggers either an obligation to defend or pay defense costs; and (2) which portion of the settlement costs may be covered loss under the policy?

A. Coverage for CFPB *Defense Costs*

D&O, E&O, and CGL policies may impose a duty to defend on the insurer, or they may include a promise to pay covered defense costs arising out of a "Claim." Traditionally the term "Claim," was defined narrowly to mean civil lawsuits, which could exclude coverage for a CFPB investigation until the agency files a lawsuit in federal court. However, the definition of "Claim" is broader in most D&O and E&O policies, and while the definition varies, it may include the following within the scope of coverage:

- Written demands for monetary relief;
- Formal or informal regulatory investigations;
- Subpoenas and/or informal requests to produce documents;
- Subpoenas to officers, directors, or employees to provide sworn testimony;
- Notice that an enforcement proceeding may be commenced against a policyholder, such as a notice of charges, written requests to interview, formal investigative orders, and other similar documents;
- Stand-alone coverage for pre-suit regulatory investigations

The CFPB's formal filing of an administrative proceeding or a federal court action should satisfy most policy definitions of "Claim," and thereby trigger the insurer's obligation to pay defense costs. Moreover, case law discussing insurance coverage for other types of regulatory investigations demonstrates that even if a policy does not expressly provide coverage for regulatory investigations, policyholders may have strong arguments for obtaining coverage for defense costs at earlier points in the CFPB investigative process. For example, in *MBIA v. Federal Insurance Company*, the Second Circuit found that a policyholder was entitled to coverage for the costs of responding to a subpoena issued by the New York Attorney General.[13] In so finding, the court reasoned that a businessperson would view a subpoena as a formal or informal investigative order and rejected the insurer's "crabbed view" that a subpoena is a "mere discovery device."[14] Conversely, however, in analyzing a different policy definition of "Claim," the Sixth Circuit reversed a summary judgment order in favor of a policyholder because, in particular, a CID did not affirmatively accuse the policyholder of any wrongful acts and could not, therefore, constitute a "Claim."[15] While this case law may or may not be instructive in the CFPB context—and case law varies across jurisdictions—any policyholder that receives a CID, PARR Letter, or early warning notice from the CFPB should promptly notify its insurers, as these documents unquestionably will trigger the need to incur defense costs, and failing to provide timely notice could limit or negate the coverage.

B. Coverage for CFPB *Settlement Costs*

In addition to providing coverage for defense costs, insurance coverage may be available to fund at least part of, if not all of, a settlement of a CFPB investigation or enforcement action.

Most D&O and E&O policies exclude various categories of relief from the definition of "Loss," including punitive damages, matters uninsurable under applicable law, costs of providing non-monetary relief, or penalties. The CFPB often seeks these types of relief from the financial institutions that it targets in investigations or enforcement actions. However, most policies also define "Loss" to include coverage for "settlements," and most CFPB investigations and claims ultimately are resolved by settlements. Thus, policyholders often have good arguments that CFPB settlements should be covered under their D&O or E&O policies. Nevertheless, the labels used by the CFPB and financial institutions to characterize settlement payments may complicate efforts to obtain insurance in at least three ways.

First, insurers generally will refuse coverage for any payments categorized as a civil monetary penalty In fact, CFPB consent orders contain language under which the investigation target promises not to seek indemnification for any penalty from an insurer.[16] While the CFPB, the SEC, and other regulatory agencies increasingly require this language as a condition to settlements, this language should be avoided whenever possible. Similarly, when negotiating settlements with the CFPB, financial institutions should attempt to negotiate settlements that avoid characterizing the nature of the settlement payment.

Second, insurers often will argue that public policy prohibits coverage for any relief labeled "disgorgement" or "restitution,"[17] and restitution or consumer redress often represents the largest monetary part of a CFPB settlement. However, courts increasingly are limiting the scope of insurers' "uninsurability" defense to narrow circumstances where restitution or disgorgement is ordered in a final, non-appealable adjudication. Consistent with the strong public policy favoring settlements, the unambiguous coverage typically provided for "settlements" in the definition of "Loss," and the fact that "final adjudication" exceptions in disgorgement and conduct exclusions must have meaning, courts usually will reject "uninsurability" defenses when cases are resolved before a final adjudication.[18]

Third, quantifying damages at the time a settlement is reached with the CFPB may present problems. In particular, CFPB settlements often include ongoing payments that can vary depending on the number of claimants post settlement. Similarly, the CFPB has agreed to settlement provisions involving a settlement fund, in which some estimated funds are returned to the investigation target if the estimate was too large.

Beyond these common issues, other barriers to coverage under CGL policies may exist. For example, satisfying the definitions of "Personal Injury, Property Damage and/or Advertising Liability" in CGL policies may be difficult, given the often intangible harm alleged by the CFPB to have occurred to third-party consumers. Policyholders with CGL policies may also have trouble fitting an "occurrence" into a covered policy period given the wide-ranging and often historical conduct investigated by the CFPB. More generally, insurers may seek to deny coverage based on exclusions, which tend to vary from policy to policy. Nevertheless, given the amount of defense costs and damages potentially at stake, companies faced with CFPB investigations and claims should carefully review all of their available policies with coverage counsel to maximize their coverage.

III. Takeaways

While case law concerning coverage for CFPB investigations and enforcement actions has not yet developed to provide financial institutions with much guidance on their ability to obtain coverage for CFPB-related losses, most coverage disputes will turn on the specific language in your policy and the facts of the particular case. Moreover, the fact that companies have been successful in obtaining coverage for SEC and similar types of federal regulatory investigations and enforcement actions confirms that coverage should be available when the CFPB comes calling as well. To maximize your potential coverage in the event of a CFPB investigation or enforcement action, it is critical that financial institutions promptly take the following steps:

Gather All Policies and Closely Review Their Terms. Do not assume your CFPB losses are either covered or uncovered. As policy terms vary and may be subject to different interpretations, consult with coverage counsel to assist in evaluating coverage.

Provide Prompt Notice of All Claims and Potential Claims. Policies often require policyholders to notify the insurer "immediately," "as soon as possible," or "as soon as practicable" after the policyholder becomes aware of a potential claim or occurrence. Failure to comply with notice provisions may preclude coverage. In addition, most D&O and E&O policies allow (but do not require) policyholders to give notice of circumstances that could reasonably give rise to a potential future claim during the policy period. When to give notice is a strategic decision that should be discussed

with your coverage counsel and your defense counsel. Even if you are uncertain whether your business has received a "Claim" from the CFPB, you should consider giving a notice of circumstances to the insurers.

Obtain Consent for Defense Costs. Policies usually require prior insurer approval to incur defense and related costs. Although insurers generally cannot deny reasonable consent requests, and may waive their right to contest the reasonableness of defense costs if they fail to promptly honor their policy obligations, the failure to request insurer consent to defense costs may create grounds for the insurer to limit or deny coverage for all pre-consent costs, and to second-guess the "reasonableness" of the attorney's fees charged by your preferred defense counsel.

Keep Insurers Updated and Get Consent for Settlement. Most policies require the policyholder to cooperate with the insurer, including by furnishing reasonably requested information. Further, because settlement of a CFPB matter may occur very soon after a "Claim" materializes, insurers may be more likely to contest a settlement on grounds that they did not consent. Most policies require the policyholder to get the insurer's prior consent to any settlement that may involve the insurer's funds. Although most policies require that the insurer's consent "may not unreasonably be withheld," failure to obtain insurer consent may risk negating coverage for the settlement. It is important to follow the policy's consent-to-settlement requirement to avoid a potential technical defense to coverage and to engage the insurer early enough before settlement so that the policyholder has a record of cooperation and reasonableness of the proposed settlement amount if the insurer later unreasonably withholds consent. Moreover, engaging coverage counsel during the settlement process may limit the risk that settlement payments are labeled in such a way to limit or defeat coverage.

Engage Coverage Counsel Early. Claims from regulatory investigations that lead to administrative or judicial adjudication are complex and may contain potential coverage defeating traps. Experienced coverage counsel is critical at the outset to assist with properly notifying the insurers and will work with your in-house and underlying defense counsel, risk manager, and brokers to maximize the insurance recovery for your loss.

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[1] CFPB Press Release, September 29, 2014, available at http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-flagstar-bank-for-violating-new-mortgage-servicing-rules/ (last visited Mar. 5, 2015).
[2] CFPB Press Release, December 19, 2013, available at http://www.consumerfinance.gov/newsroom/cfpb-state-authorities-order-ocwen-to-provide-2-billion-in-relief-to-homeowners-for-servicing-wrongs/ (last visited Mar. 5, 2015).
[3] CFPB Press Release, April 9, 2014, available at http://www.consumerfinance.gov/newsroom/cfpb-orders-bank-of-america-to-pay-727-million-in-consumer-relief-for-illegal-credit-card-practices/ (last visited Mar. 5, 2015).
[4] *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).
[5] CFPB Press Release, December 17, 2014, available at http://www.consumerfinance.gov/newsroom/cfpb-sues-sprint-for-cramming-consumers-with-unauthorized-third-party-charges/ (last visited Mar. 5, 2015).
[6] *See* CFPB Supervision and Examination Manual (Oct. 2012), Overview ("Manual"), at 1.
[7] *See* Dodd-Frank Act § 1053.
[8] 12 C.F.R. § 1080.5.
[9] *See* CFPB Bulletin 2011-04 (Enforcement), Early Warning Notice (suggesting sample language of "the staff expects to allege that your client violated […]" and of "the staff may seek […] against your client.").
[10] *See* Manual, at 7.

[11] *See* Manual, at 7.
[12] *See Steadfast Insurance Co. v. Ally Financial Inc*., No. 652957/2014 (in the Supreme Court of the State of New York, County of New York); *Ally Financial, Inc. v. Ace Property and Casualty Insur. Co*., No. 13-15184 (in the United States District Court for the Eastern District of Michigan).
[13] *MBIA v. Fed. Ins. Co*., 652 F.3d 152 (2d Cir. 2011).
[14] *Id*. at 160.
[15] *See Employers' Fire Ins. Co. v. ProMedica Health Sys., Inc*., 524 F. App'x 241 (6th Cir. 2013).
[16] *See, e.g., In re DriveTime Auto. Grp, Inc.*, No. 2014-CFPB-0017 (CFPB Admin. Proceeding), Doc. 1 at 23, available at http://files.consumerfinance.gov/f/201411_cfpb_consent-order_drivetime.pdf (last visited Mar. 5, 2015).
[17] *See, e.g., Level 3 Communications, Inc. v. Federal Insurance Co*., 272 F.3d 908 (7th Cir. 2001).
[18] *See U.S. Bank Nat. Ass'n v. Indian Harbor Ins. Co.*, 12-CV-3175, 2014 WL 3012969 (D. Minn. July 3, 2014); *see also J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 992 N.E.2d 1076 (N.Y. 2013).