

CFPB Issues Proposed Rule on Privileged Information Obtained from Supervised Entities and House Passes Bill that Would Authorize It, But Concern Remains About Erosion of Attorney-Client Privilege

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On March 12, 2012, the Consumer Financial Protection Bureau (the Bureau) announced a proposed rule (the Proposed Rule)¹ to codify protections for privileged information obtained by the Bureau from financial institutions and other entities it supervises.² The Proposed Rule provides that any supervised entity that submits privileged material to the Bureau (such as communications with counsel) in the course of the supervisory process does not waive the privilege. On March 26, 2012, the House of Representatives passed H.R. 4014, a bill that if enacted into law would provide clear statutory authority for the Proposed Rule. Serious concern remains, however, that even if authorized by statute the Bureau's policy of requiring supervised entities to provide privileged material to the Bureau, even without waiver of privilege, will ultimately result in erosion of the attorney-client privilege.

The Proposed Rule came about because of controversy generated by Bulletin 12-01, which the Bureau issued on January 4, 2012. In Bulletin 12-01, the Bureau advised institutions that it supervises that, upon request, they must disclose privileged material to it. The Bureau also gave its assurance that such disclosure would not result in a waiver of privilege because the submission of privileged material was involuntary.³

Bulletin 12-01 caused a hubbub in legal and business circles because of the serious consequences if the Bureau's assurance turns out to be unfounded. Waiver of privilege means that the confidential communications a client shared with its lawyers in reliance on the attorney-client privilege could end up in the wrong hands and actually be used against the client. Concern was also expressed that the Bureau's position might in fact be unfounded. Specifically, the Bureau's position appears to conflict

DISCLOSURE OF PRIVILEGED MATERIAL TO THE BUREAU IS A RISKY PROPOSITION, MADE RISKIER STILL BY THE PROSPECT THAT THE MATERIAL COULD THEN BE TRANSFERRED TO A STATE AGENCY OUTSIDE THE CONTROL OF THE BUREAU.

with 12 U.S.C. § 1828(x) – the statute that provides that the submission of information to a “Federal banking agency” shall not be construed as waiving, destroying, or otherwise affecting any privilege.”⁴ “Federal banking agency” is a defined term that clearly does not include the Bureau. Notably, when Congress passed the Dodd-Frank Act, which created the Bureau, it did not amend the definition of “Federal banking agency” to include the Bureau.

Against this backdrop, the Bureau came out with the Proposed Rule, which “is intended to govern all claims, in Federal and State court, that an entity has waived any applicable privilege by providing information requested by the Bureau pursuant to its supervisory or regulatory authority.” According to the Bureau, it “continues to adhere” to the position it took in Bulletin 12-01, “that the submission of privileged information in response to requests made pursuant to the Bureau's examination authority

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does not result in a waiver of any privilege with respect to third parties.” Nonetheless, it decided to exercise its rule-making authority “in order to provide maximum assurance to its supervised entities”

In addition to providing that any supervised entity that submits privileged material to the Bureau in the course of the supervisory process does not waive the privilege, the Proposed Rule also provides that the Bureau’s provision to another federal agency or a state agency of privileged material received from a supervised entity does not waive the privilege. Unlike Bulletin 12-01, the Proposed Rule clearly applies to all entities subject to the Bureau’s supervisory authority. In Bulletin 12-01 the Bureau made reference only to banks.

The million-dollar question is whether the Bureau has the authority to enact the Proposed Rule. As support for its rulemaking authority, the Bureau has stated that it relied on:

- its authority to “prescribe rules regarding the confidential treatment of information obtained from persons in connection with the exercise of its authorities under Federal consumer financial law”
- its general rulemaking authority to prescribe rules it determines are “necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof,” and
- its authority to “prescribe rules to facilitate the supervision of [nondepository institutions] and assessment and detection of risks to consumers.”

The Bureau construes these statutory sources as indirectly giving it a power that Congress did not give it expressly when it passed the Dodd-Frank Act.

After the Bureau announced the Proposed Rule, the House passed H.R. 4014. This bill was one of several introduced to give the Bureau clear authority to request and receive privileged material from supervised entities without resulting in a waiver of the privilege. H.R. 4014 would amend 12 USC sections 1821(t)⁵ and 1828(x) to add the Bureau to the statutory definition of “Federal banking agency.”⁶ Like the Proposed Rule, H.R. 4104 would apply all entities subject to the Bureau’s supervisory authority, not just depository institutions. H.R. 4104 is expected to pass the Senate.

PEPPER POINTS

Unless and until the Senate passes H.R. 4014, it remains to be seen whether the Proposed Rule, assuming it becomes final, can withstand judicial scrutiny. In our view, there is a reasonable possibility that a reviewing court would hold that, if Congress had intended for the Bureau to be able to obtain privileged information from supervised entities without resulting in a waiver of privilege, it would have amended the statutory definition of “Federal banking agency.” As a result, absent a legislative solution, supervised entities faced with a request from the Bureau for privileged material will find themselves in a dilemma – comply with the request and risk waiver of the privilege or defy the Bureau and risk administrative sanctions and the prospect of an angered regulator. One option would be to work with the Bureau as much as possible to limit and narrow the request for privileged material, and if the entity is regulated by a Federal banking agency, coordinate disclosure through the bank regulator as part of a joint examination process. Another option would be to seek a judicial ruling, but that comes with cost and uncertainty too. Clearly a legislative solution like H.R. 4014 would address these problems.

But behind the issue of statutory authority lies a deeper and more troublesome problem – whether the Bureau should have unfettered power to force supervised entities to hand over privileged materials. It seems likely or even inevitable that the Bureau or other federal or state agencies to which it transfers privileged material will use that privileged material against the entity that provided it or at the very least to the detriment of that entity. We are concerned that this will result in a serious erosion of the attorney-client privilege.

This concern is heightened for nonbank entities, which before the Dodd-Frank Act were never subject to the supervision of any Federal banking agency. Nonbank entities are different in many ways from banks. Among other things, nonbanks do not receive the federal support provided to banks and other depository institutions in the form of FDIC deposit insurance. Regulators at Federal banking agencies typically insist that non-governmental third parties seeking confidential information from banks through discovery or subpoenas enter into agreements protecting and maintaining legally recognized privileges, particularly sensitive bank information associated with an examination. We question whether nonbank entities supervised by the Bureau should receive less legal protection.

We are also concerned that the Bureau has set no standards for when it may demand the disclosure of privileged material. Theoretically, the Bureau could request material concerning a supervised entity's plans to sue the Bureau or defend itself from Bureau action, and since the request could bear on areas broadly covered by the Bureau's jurisdiction, beyond what would typically be requested in an examination by a Federal banking regulator, the Proposed Rule could result in a total abrogation of privilege.

We are further concerned that there may be a privilege "gap" if the Bureau discloses to state agencies – such as state banking agencies or attorneys general – privileged material it obtained from supervised entities. Traditionally, federal regulators have relied on Memoranda of Understanding (MOUs) when sharing privileged information with state authorities. The Bureau has entered into an MOU with the Conference of State Bank Supervisors. While it provides that the sharing of nonpublic information pursuant to the MOU will "in no way constitute[] a waiver of ... any applicable privileges," it also states that "[n]o provision of this MOU is intended to, and no provision of the MOU shall be construed to, limit or otherwise affect the authority of a party to administer, implement, or enforce any provision of Federal consumer financial law or State consumer protection law."⁷ This kind of ambiguous language could present a loophole for the use of privileged material by a state agency against the entity that provided it to the Bureau. In general, we think that disclosure of privileged material to the Bureau is a risky proposition, made riskier still by the prospect that the privileged material could then be transferred to a state agency outside the control of the Bureau.

Persons or entities concerned about the Proposed Rule may wish to submit comments by April 16, 2012.

ENDNOTES

- 1 Available at http://files.consumerfinance.gov/f/201203_cfpb_Proposed_Rule_Privileged_Information.pdf.
- 2 The Bureau supervises banks, thrifts, and credit unions with more than \$10 billion in assets and their affiliates and service providers as well as certain nondepository (nonbank) entities that offer or provide to consumers: (1) origination, brokerage, or servicing of residential mortgage loans secured by real estate, and related mortgage loan modification or foreclosure relief services; (2) private education loans; and (3) payday loans. In addition, the Bureau has the authority to supervise any "larger participant of a market for other consumer financial products or services," as defined by rule by the Bureau. On February 8, 2012, the Bureau issued a proposed rule to establish the initial larger participant rule for two markets: consumer debt collection and consumer reporting. The Bureau also supervises service providers of nonbank entities that are subject to the Bureau's supervision.
- 3 For a discussion of Bulletin 12-01, see Pepper Client Alert - Consumer Financial Protection Bureau Tells Supervised Institutions Not to Worry About Waiver of Privilege, available at http://www.pepperlaw.com/publications_update.aspx?ArticleKey=2272 concerning Bureau Bulletin 12-01, available at http://files.consumerfinance.gov/f/2012/01/GC_bulletin_12-01.pdf.
- 4 12 U.S.C. § 1828(x) provides that "[t]he submission by any person of any information to any Federal banking agency ... for any purpose in the course of any supervisory or regulatory process of such agency ... shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to such information ..."
- 5 12 U.S.C. § 1821(t) provides that certain federal agencies, including "Any Federal banking agency," may share privileged information with each other without waiving any privilege that may apply to that information.
- 6 The American Bar Association came out strongly in support of H.R. 4014 and S. 2099. See http://www.americanbar.org/content/dam/aba/administrative/government_affairs_office/2012feb21_attyclientprivissue_1.authcheckdam.pdf and http://www.americanbar.org/content/dam/aba/administrative/government_affairs_office/2012feb21_cfpbprivissue_1.authcheckdam.pdf.
- 7 See MOU between the Bureau, the Conference of State Bank Supervisors and other signatories thereto, available at <http://www.csbs.org/regulatory/Cooperative-Agreements/Documents/CFPB%20CSBS%20MOU.pdf> (last visited March 20, 2012).