Comments of Financial Regulation and Consumer Protection Scholars on Docket No. CFPB-2018-0002

May 7, 2018

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Dear Ms. Jackson:

The Consumer Financial Protection Bureau (the "Bureau") has requested, in its notice dated February 5, 2018, "comments and information from interested parties to assist the Bureau in considering whether and how to amend the Bureau's Rules of Practice for Adjudication Proceedings." 83 Fed. Reg. 5055 (Feb. 5, 2018), Docket No. CFPB-2018-0002.

We are lawyers and law professors, some of whom have studied administrative adjudication by financial regulators, and the principal drafters of our comment have no financial or other relationship with parties that have participated in the Bureau's administrative proceedings. We can provide evidence that can inform the Bureau's assessment of where to direct its regulatory reform resources. Many of the below signatories also have experience in public enforcement of consumer protection laws. We appreciate the opportunity to submit these comments for your consideration.

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Introduction

In our view, the Bureau should put its limited regulatory reform resources to use in other, more pressing areas. We write to make three main points.

First, the Bureau has not made much use of its Administrative Law Judge (ALJ) program – and indeed, for a long time did not have its own ALJ. To begin, the Bureau borrowed an ALJ from the Securities and Exchange Commission. It has utilized administrative adjudication in eight contested matters in its entire history. All but two of these cases were settled, for, in the case of Auto Cash Leasing, a $10,000 civil monetary penalty,[1] in the case of Interstate Lending, a $4,000 civil monetary penalty,[2] in the case of Oasis Title Loans, a $20,000 civil monetary penalty,[3] in the case of Phoenix Title Loans, a $40,000 civil monetary penalty,[4] in the case of Presto Auto Loans, a $125,000 civil monetary penalty,[5] and in the case of 3D Resorts-Bluegrass, a $1 civil monetary penalty and a restitution order that could amount to $50,000.[6] These modest penalties were accompanied by other commitments from the defendants, but the sums involved do not raise the prospect of great hardships. There has been only one large award in the history of the Bureau's administrative proceedings – PHH Corp. was ordered to pay restitution and disgorgement in the amount of $6,442,399,[7] an award increased on review by the director, which in turn was reversed by the D.C. Circuit at both the panel and *en banc* level. *See* PHH Corp. v. Consumer Fin. Prot. Bureau, 881 F.3d 75, 83 (D.C. Cir. 2018).

Diverting regulatory reform resources to solve purported problems in a program that is utilized so rarely by the Bureau would be an inefficient use of the Bureau's limited, and very valuable, time. Indeed, there has not yet been a chance to see whether the current rules are good ones. Once more cases are sent to administrative adjudication, a more informed decision can be made about whether and how to reform the process. In the meantime, the Bureau would be poorly served by choosing to invest its resources in reforming a program that it barely makes use of, that

[1] The CFPB's order may be found at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/20170130_cfpb_2016-CFPB-0017_Document-026.pdf.
[2] The CFPB's order may be found at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201612_cfpb_0018-Document030-12202016.pdf.
[3] The CFPB's order may be found at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/2016-CFPB-0019_Document_017_11012016.pdf.
[4] The CFPB's order may be found at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201703_cfpb_2016-CFPB-0020_Document-027.pdf.
[5] The CFPB's order may be found at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201612_cfpb_0021-Document027-12202016.pdf.
[6] The CFPB's order may be found at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201312_cfpb_consent-order_3dresorts-bluegrass.pdf.
[7] The CFPB's order may be found at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201411_cfpb_recommend-decision-final_205.pdf.

has been adequately policed through judicial review, and where it can, at the Director's discretion, reduce Bureau usage still further.

Second, even though they are rarely utilized by the Bureau, administrative proceedings are not a miscarriage of justice that requires attention in the first place. Empirical studies of ALJ decision-making in financial regulation matters, one of which one of us conducted, show that defendants win about as often before ALJs as they do in federal court. *See* David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1184-85 (2016). And decades of precedent establish the principle that the lengthy process afforded defendants in formal administrative proceedings is comparable to that of federal court and is adequate under the law. ALJ cases are resolved more quickly, as a general matter, than district court cases, but the Supreme Court has consistently held that those cases are comparable with regard to the quality of process provided. we expand upon this point in the discussion below.

Third, if the Bureau does wish to devote its resources to reforming its administrative proceedings, we have reviewed those rules and the questions in the Bureau's request for information, and recommend one small change. We find its proceedings to be consistent with the way those proceedings work in other agencies. The SEC has, however, recently extended the length of time for decision from four to eight months. A longer timeline, while still being short and efficient for all parties, gives the defendant more time to prepare the case. The Bureau could do something similar with its own rocket docket, though it may be that section 1081.400, which permits a 300 day timeframe without Director approval, meets this need. We expand on this point in the discussion section below.

Discussion

Formal administrative proceedings vary somewhat between agencies, but all such proceedings must meet the minimum requirements of the Administrative Procedure Act, and so broadly involve an impartial decisionmaker, the opportunity to present evidence, a hearing, cross-examination, and a panoply of other procedural rights. As the Bureau has observed, "The APA is designed to guarantee the decisional independence of administrative law judges and ensure fairness in administrative proceedings before federal government agencies."[8] ALJs conduct hearings "in a manner similar to federal bench trials," giving parties the opportunity to submit briefs, and preparing decisions that contain proposed findings of fact and conclusions of law.[9]

The Supreme Court has confirmed that procedural protections offered by administrative hearings are comparable to federal district court procedures. *See e.g.*, Fed. Mar. Comm'n v. S.C. Ports Auth., 535 U.S. 743, 758 (2002) ("[T]he role of the ALJ . . . is similar to that of an Article III judge."); Butz v. Economou, 438 U.S. 478, 513 (1978) ("[T]he role of the modern . . . administrative law judge . . . is 'functionally comparable' to that of a judge."). The Court has held that the fact that proceedings that are brought inside an agency before an ALJ indicate that the requirements of due process are satisfied rather than violated. *See e.g.*, Marshall v. Jerrico, Inc., 446 U.S. 238, 248–52 (1980) (holding that a civil penalty system permitting payment of

[8] CFPB, Administrative Adjudication Proceedings, https://www.consumerfinance.gov/administrative-adjudication-proceedings/ (last visited April 17, 2018).
[9] Office of Administrative Law Judges, U.S. SEC & Exchange Commission, https://www.sec.gov/alj (last visited Mar. 28, 2018).

fines assessed by an administrative law judge to a federal agency did not violate due process because it was "the administrative law judge, not the [Employment Standards Administration], who performs the function of adjudicating child labor violations"); Withrow v. Larkin, 421 U.S. 35, 58 (1975) (broadly affirming the consistency of agency adjudicative procedures with due process). Moreover, there is no evidence that ALJs treat defendants unfairly.

While the CFPB has a relatively short history using ALJs, the SEC has used ALJs for many decades. Thus, studies of SEC ALJs are illustrative as the Bureau evaluates its ALJ rules. These studies have uniformly found that SEC ALJs are impartial and are not more favorable to the SEC than federal judges are.

One of us conducted a study of a five-year sample of SEC ALJ cases. *See* David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1184-85 (2016). According to a regression analysis, no one ALJ was more or less likely to rule for the SEC than any other SEC ALJ. And while the agency lost only a handful of cases during that period, in either administrative proceedings or in federal court, the ALJs did not award the SEC the full relief the agency had sought in 29% of cases. The results of the SEC study are consistent with the rule-of-thumb rate for victories by any federal agency in federal court which, when various studies are pooled, comes out to about 69%. David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135, 170 (2010). The 71% success rate for administrative proceedings, in other words, was right in line with the success rate of most agencies in federal court.

We can be even more specific: the record for cases brought in federal court by the SEC is very similar to the agency's record in administrative proceedings. A comparison between the cases brought by the SEC in the Southern District of New York during the five years following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act and administrative proceedings the SEC commenced against defendants during the same period are revealing. The district, which covers Manhattan, is ground zero for securities enforcement in the federal courts. The judges have extensive experience with securities fraud cases, both civil and criminal, and some of the judges have a reputation for putting the agency through its paces. Of the 119 such reported cases in the district, the SEC success rate was high; it received a positive result in 111 of the tracked cases, a 92% win rate.

Over the sample period, these results make the SEC look like a comparably victorious enforcer regardless of the forum in which it chose to pursue enforcement; there is no statistically significant distinction between the rates of success. With 8 failures in Manhattan district court in the five years following the passage of Dodd-Frank, and only 6 losses in the 168 enforcement proceedings the SEC brought before its ALJs during the same period, a 96% win rate, there is little evidence that the forum chosen by the SEC resulted in stark advantages for the agency either way.

Other empirical studies of the ALJs have also found no evidence of bias towards the agency. *See* Urska Velikonja, *Are the SEC's Administrative Law Judges Biased? An Empirical Investigation*, 92 WASH. L. REV. 315 (2017); Joseph A. Grundfest, *Fair or Foul?: SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation*, 85 FORDHAM L. REV. 1143, 1178 (2016) ("there is no statistically significant difference between the SEC's success rate before ALJs and its success rate in federal court").

All the evidence suggests, in sum, that defendants receive abundant process in formal administrative proceedings, and that they do as well in those proceedings as they do in federal court. There is no injustice in administrative proceedings in general that would be solved by increasing the procedural burdens on those proceedings. Nor has the Bureau utilized enforcement proceedings in contested cases frequently enough to reveal any problems with those proceedings, making a redo premature.

We finish with some specific comments addressing some of the Bureau's specific questions, and describe why most of the rules should not be altered. In the final comment, we propose one modest change that might be worth the Bureau's consideration if it does decide to revisit the administrative proceedings rules:

1. The Bureau has asked whether "a policy of proceeding in federal court in all instances would be preferable." Administrative proceedings benefit both the Bureau and other agencies when it comes to recording settlements and processing uncontested enforcement actions. In these cases, administrative proceedings can serve as an efficient alternative for vindicating agency policy without the expense and complications of going to federal court. These cost savings inure to respondents as well as to agencies.

Although it has only diverted eight initially contested cases to administrative proceedings, the Bureau has filed 110 stipulation and consent orders before ALJs during this period; these cases were settled the day they were brought, and therefore required little process from the agency adjudicator. The SEC, for its part, has relied on its administrative law judges to handle settlements and enforcement actions against nonreporting companies, or to process follow-on civil sanctions, after court convictions for violations of the securities laws. This sort of routine enforcement work makes up the bulk of what those agency ALJs do. The Bureau would benefit from having the option of pursuing administrative cases in these contexts even if it decided to handle contested and other enforcement matters in federal court. At the very least, this option should be preserved. But of course, in addition to uncontested cases, administrative proceedings can be useful in contested actions as well. As mentioned above, administrative proceedings provide the Bureau with an option that will save both the Bureau and the defendant time and resources, while still providing the defendant sufficient due process.

2. The Bureau has asked whether it should "expressly adopt the Federal Rules of Evidence" and in particular the hearsay rule. Anyone who has appeared before an adjudicator knows that the adjudicator can discount third party evidence, and no one thinks that the hearsay rule, as expressed in the Federal Rules of Evidence, with all of its exceptions, is a paragon of consistency. The Bureau sensibly adopted section 1081.303(b) to establish rules of evidence that were "consistent with general administrative practice." It would be far better to retain the usual rules of evidence that non-jury adjudications employ.

3. Permitting defendants to be "afforded the opportunity to stay a decision of the Director pending appeal by filing a *superseadeas* bond, consistent with Federal Rule of Civil Procedure 62(d)" poses two different problems, depending upon the meaning of the inquiry. If the point of such a change would be to permit litigants to avoid Director review of a preliminary decision by an ALJ, the amendment would not be consistent with the separation of powers doctrines expressed by cases such as Free Enterprise Fund v. Public Company Accounting Oversight

Board, 130 S. Ct. 3138 (2010), which stood for the proposition that executive officers accountable to the President had to make the final decisions in administrative adjudications. Staying an interim executive branch action before an officer of the United States could review the decision would unconstitutionally permit the courts to review enforcement actions before politically accountable executive branch officers had a chance to conduct their own review of the initial decisions made in those actions. Similar problems would be posed if the stay of a Director decision would be automatic, under the agency's rules, upon the posting of a bond. On the other hand, if the amendment of the rules is meant to make the *superseadeas* bond more available in judicial proceedings reviewing the Director's decision, then the Federal Rules of Civil and Appellate Procedure would apply, and the Bureau's own administrative proceedings rules would be irrelevant.

4. The Bureau asks whether there should be changes to the requirements that the Bureau make documents available to the party for inspection, and whether there should be changes to the requirements for issuing subpoenas, specifically whether counsel for a party should be entitled to issue subpoenas without leave of the hearing officer. These provisions both work to ensure that administrative proceedings are fair and efficient. The production rule ensures that defendants have access to all materials the Bureau relied on in its investigation. This renders the traditional discovery process unnecessary, and therefore the subpoena power much less useful. The hearing officer's input on a subpoena request ensures that frivolous requests do not delay the process, and presents very minimal due process concerns because the party already has access to all the same information that the Bureau possesses.

5. The Bureau asks whether it should revise the limitations on the number of expert witnesses that may be called as provided in 12 CFR 1081.210(b). As discussed above, it is well established that the administrative hearings at the SEC afford defendants appropriate due process, including limits on the number of expert witnesses that may be called. Expert witnesses are sometimes valuable, but can increase the complexity and costs of proceedings for all parties, their use should accordingly be measured. The long history of ALJ utilization of experts, at the SEC and elsewhere, in proceedings that the Supreme Court has reviewed dozens of times without complaint, suggests that there is no concern that limitations on expert witnesses infringe on due process rights. The Bureau also asks whether it should incorporate the Federal Rules of Civil Procedure in regards to the required disclosures of expert witnesses. It is reasonable to expect an ALJ to have the legal competence necessary to understand an expert witness' function and qualifications without recourse to the full panoply of procedures required by the court procedural rules.

6. Regulated industry has indicated that it finds mandatory arbitration to be an attractive way to resolve consumer disputes. In many ways, the benefits of efficiency and cost that accrue to mandatory arbitration also accrue when the CFPB enforces claims through ALJs. Both processes would seem to ultimately lower costs to consumers and regulated industry.

7. A benefit to both the agency and regulated industry is the fast nature of administrative proceedings. The Bureau's rules call for proceedings to commence within 30 to 60 days of the notice of charges, and currently disfavors motions for extensions of time. If the Bureau does decide to re-examine its procedural rules, it might lengthen the window for this process to guarantee that the proceedings are resolved within a year, rather than within six months. The

SEC doubled the length of time between complaint and hearing to eight months from four.[10] It did so after complaints that defendants had insufficient time to prepare for litigation, while the agency could spend unlimited time investigating a case before filing. On the other hand, formal proceedings that last too long are expensive and burdensome for both defendants and the agency. Finally, it may be that section 1081.400, which permits a 300 day timeframe for the resolution of administrative proceedings without Director approval, meets this need, though the question has come up so infrequently, that it is not entirely clear (it is true, however, that in one case, administrative proceedings did not commence until seven months after the filing of the complaint). It might be appropriate to ensure that administrative proceedings are resolved within one year.

Conclusion

For the foregoing reasons, the Bureau should not revisit its administrative proceedings regulations. Administrative adjudication in and of itself is not a problematic process, but rather is a process that provides sufficient due process and saves both sides time and expense. Further, the Bureau should not choose to invest its resources in reforming a program that it barely makes use of, that has been adequately policed through judicial review, and where it can reduce Bureau usage further at the Director's discretion. Please do not hesitate to get in touch with David Zaring if you have any questions about this comment, or wish to enlarge upon the issues therein in any way.

[10] 17 C.F.R. § 201.360.