ALERT MEMORANDUM

CFPB Issues Final Rule on Arbitration Agreements in Financial Products and Services Contracts

July 13, 2017

On July 10, 2017, the Consumer Financial Protection Bureau ("CFPB") finalized a rule governing arbitration agreements in consumer finance contracts. Most importantly, the new rule prohibits providers of certain consumer financial products and services from including in their contracts arbitration clauses that waive any right to bring class action lawsuits. Covered providers involved in an arbitration pursuant to a pre-dispute arbitration agreement would also be required to submit specified arbitral records to the CFPB. The rule, if it comes into force, would significantly curtail the current industry practice of requiring arbitration clauses with class action waivers in these types of contracts, which the Supreme Court has ruled are valid in a recent series of cases. The rule should apply to agreements entered into more than 241 days after the rule's publication, but it remains to be seen whether before this time, Congress will take action to repeal the rule, as certain lawmakers have indicated they want to do.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors:

NEW YORK

Jonathan I. Blackman
+1 212 225 2490
jblackman@cgsh.com

Carmine D. Boccuzzi Jr.
+1 212 225 2508
cboccuzzi@cgsh.com

Inna Rozenberg
+1 212 225 2972
irozenberg@cgsh.com

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

Matthew D. Slater
+1 202 974 1930
mslater@cgsh.com

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), passed in 2010, authorized the creation of the CFPB, an agency responsible for consumer protection in the financial sector. The CFPB began operation in 2011. Dodd-Frank also directed the CFPB to study the use of pre-dispute arbitration agreements in consumer financial products and services contracts and authorized the CFPB to regulate their use if it would protect consumers and promote the public interest.[1]

In 2015, the CFPB published a study on this issue (the "Study").[2] Based on a review of contracts for credit cards, checking accounts, prepaid cards, payday loans, student loans, and mobile wireless services, the Study found that consumer financial contracts routinely include arbitration agreements, with larger providers even more likely to use them.[3] The Study also found that roughly 90% of these arbitration agreements contain provisions prohibiting class action arbitrations, with most of those containing an "anti-severability" provision stating that the entire arbitration agreement is unenforceable if the class arbitration waiver is deemed unenforceable. The Study further noted that following a quantitative analysis with respect to the credit card marketplace, no statistically significant evidence could be found that prices for or the availability of credit were affected by the existence of arbitration agreements.[4]

The most significant finding of the Study – and the one on which the CFPB ultimately relied for its rulemaking – is that pre-dispute arbitration agreements are being used to prevent consumers from seeking relief from legal violations on a class basis. At the same time, few consumers bring individual lawsuits or arbitrations against their financial service providers because their individual injuries are so small that it is difficult to find an attorney to handle the case to pursue an individual remedy. Thus, the CFPB expressed concern that many consumers are prevented from obtaining remedies to which they are entitled.[5]

In response to the results of the Study, on October 7, 2015, the CFPB issued an outline of proposals to regulate the use of arbitration agreements in consumer financial products and services contracts. These proposals were presented to the Small Business Review Panel, which issued a report on December 11, 2015 encouraging the CFPB to "continue to evaluate the costs to small entities of defending class actions."[6] The CFPB also met with other stakeholders and industry

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 1028, 124 Stat. 1376, 2004.

2 *See* CONSUMER FINANCIAL PROTECTION BUREAU, "Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)" (Mar. 2015).

3 *Id.* at 9-10. The study found that 53% of the credit card market, 44% of the insured deposits in the checking account market, 92% of a sample of prepaid card agreements, 99% of payday loan agreements from California and Texas and 99% of the mobile wireless market use arbitration agreements. *See* CONSUMER FINANCIAL PROTECTION BUREAU, "Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Outline of Proposals Under Consideration and Alternatives Considered," at 8 (Oct. 2015).

4 Notice of Proposed Rulemaking, *Arbitration Agreements*, 12 Fed. Reg. 1040 (proposed May 5, 2016) at 79.

5 *See* Notice of Proposed Rulemaking at 90.

6 SMALL BUSINESS REVIEW PANEL, "Final Report of the Small Business Review Panel on the CFPB's Potential Rulemaking on Pre-Dispute Arbitration Agreements," at 34 (Dec. 11, 2015).

representatives and considered their recommendations.[7]

Description of the Final Rule

As we previously reported in our May 16, 2016 alert memorandum, on May 5, 2016, the CFPB issued a Notice of Proposed Rulemaking to prohibit class action waivers and to regulate the use of pre-dispute arbitration agreements in contracts between consumers and covered providers of consumer financial products and services.[8] There are no substantive changes between the notice of proposed rulemaking and the final rule announced on July 10, 2017.[9]

The rule applies to providers of consumer financial products and services in the markets of lending money, storing money, and moving or exchanging money. Specifically, most providers engaged in the following activities will be affected: extending or servicing consumer credit; extending or brokering of automobile leases; providing services to assist with debt management or settlement; providing consumer reports or credit scores; providing certain account and remittance transfers; transmitting or exchanging funds and other payment processing services such as check cashing; and collecting debt arising from these kinds of products and services.[10] Thus, the rule applies to a widespread group of entities, including banks, credit unions, credit card issuers, auto and auto title lenders, payday, installment and open-end lenders, student loan lenders, prepaid card issuers, virtual currency providers, debt settlement firms, and providers of credit monitoring services.

The principal features of the new arbitration rule are the following.

First, covered providers are prohibited from using a pre-dispute arbitration agreement to block consumer class actions in court, and providers must insert language into their arbitration agreements reflecting this limitation.[11] This rule stems from the CFPB's findings in its Study and its further analysis – in particular, that "individual dispute resolution mechanisms are an insufficient means of ensuring that consumer financial protection laws and consumer financial product or service contracts are enforced" and that "the class action procedure provides an important mechanism to remedy consumer harm."[12]

Second, covered providers using pre-dispute arbitration agreements are required to submit to the CFPB certain records relating to the arbitral proceedings, including the claim, the arbitration agreement, the award, and certain communications with the arbitrator and administrator. The CFPB plans to use this information to monitor arbitral proceedings to determine whether there are developments that raise consumer protection concerns warranting further action. In addition, the materials will be published, in some form, on the CFPB website, with redactions as necessary.[13]

Compliance with the new rule is required for any pre-dispute arbitration agreement entered into on

7 *See* Notice of Proposed Rulemaking at 130.

8 *See generally id.*

9 *See* https://www.consumerfinance.gov/arbitration-rule/.

10 Bureau of Consumer Financial Protection, Final Rule, Arbitration Agreements, 12 CFR Part 1040 (published July 10, 2017) ("Final Rule"), at 3-5.

11 *See id*. at 1-3.

12 *Id.* at 150, 180.

13 *See id*. at 3, 340-54.

or after the date that is 241 days after publication of the final rule in the Federal Register.[14]

The Future of Arbitration in Consumer Financial Contracts?

The CFPB has stated that its aim is not "to prohibit arbitration agreements entirely."[15] In its Notice of Proposed Rulemaking, the CFPB wrote that "providers would still be able to include them in consumer contracts and invoke them to compel arbitration in court cases not filed in court as class actions. In addition, the class proposal would not foreclose the possibility of class arbitration so long as the consumer chooses arbitration as the forum in which he or she pursues the class claims and the applicable arbitration agreement does not prohibit class arbitration."[16]

At the same time, the CFPB has explained that "[s]ome companies and industry trade associations have argued that, if the class proposal were adopted, providers would likely remove their arbitration agreements entirely and this would impair consumers' ability to resolve their individual disputes. … [I]f providers can no longer block class actions some stakeholders have stated that the arbitration agreement serves no purpose."[17] Thus, the new arbitration rule may end up being the final blow to any kind of arbitration clauses in consumer financial contracts, or making them of little relevance, since few consumers would pursue individual remedies that would be subject to arbitration, and financial institutions would be unwilling to take the risks of class litigation in arbitral forums, that tend to be less rigorous than courts and from which there is no right to appeal.

However, the political situation in Washington may rescue arbitration in this context. During the public comment period and thereafter, the CFPB received over 113,000 comments.[18] Some of the comments were critical of the proposed rule, including those from the U.S. Chamber of Commerce and the National Association of Federal Credit Unions.[19] Notably, the House Committee on Financial Services commented that "testimony [at a subcommittee hearing] demonstrated the Bureau's Proposed Rule may not be 'in the public interest.'"[20]

In fact, the Republican chair of the committee, Representative Jeb Hensarling of Texas, recently stated that the rule "should be thoroughly rejected by Congress" under the Congressional Review Act, which provides Congress about 60 legislative days to overturn agency rulemaking. The current Congress has already used the law to reverse 14 rules promulgated during the Obama Administration.[21]

In light of the current uncertainty as to the arbitration rule's future, it may be advisable for

14 *See id*. at 614-15.

15 Notice of Proposed Rulemaking at 139.

16 *Id*. at 138-39.

17 *Id*. at 136.

18 *See* https://www.regulations.gov/document?D=CFPB-2016-0020-0001.

19 U.S. Chamber of Commerce, Public Comment to CFPB-2016-0020, Aug. 22, 2016 (commenting that "the proposed rule would drastically limit, if not eliminate, the use of arbitration in consumer financial contracts while conferring little to no benefit on consumers in return"); National Association of Federal Credit Unions, Public Comment to CFPB-2016-0020, Aug. 19, 2016 (expressing "several serious concerns about the arbitration rule").

20 U.S. House of Representatives, Committee on Financial Services, Public Comment to CFPB-2016-0020, Aug. 22, 2016.

21 Silver-Greenberg & Corkery, "U.S. Agency Moves to Allow Class-Action Lawsuits Against Financial Firms," N.Y. TIMES, July 10, 2017.

affected companies not presently using arbitration agreements with class action waivers, but which would like to do so, to take action before the compliance date of the final rule. Under the Supreme Court's current jurisprudence, class action waivers in pre-dispute arbitration agreements with consumers are enforceable, even when the cost of pursuing an individual claim would be prohibitively expensive.[22] If the final rule survives, this precedent would no longer be applicable to covered contracts entered into between consumers and entities operating in the financial products and services sector after the rule's compliance date.

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[22] *See DirecTV, Inc. v. Imburgia*, 136 S. Ct. 463 (2015); *American Express v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013); *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).