ALERT MEMORANDUM

CFPB Issues Rulemaking on Arbitration Agreements in Financial Products and Services Contracts

May 16, 2016

On May 5, 2016, the Consumer Financial Protection Bureau ("CFPB") proposed a rule that would govern two aspects of consumer finance dispute resolution. First, the new regulations would prohibit providers of certain consumer financial products and services from including in their contracts arbitration clauses that prohibit class action lawsuits. Second, covered providers involved in an arbitration pursuant to a pre-dispute arbitration agreement would be required to submit specified arbitral records to the CFPB. If the proposed rule becomes final, it will significantly impact the current industry practice of including 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 addressing the issue. As the CFPB has indicated that the proposed rule would apply only to agreements entered into more than 211 days after rule publication, affected companies may wish to consider whether to amend the dispute resolution provisions currently used.

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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"), focusing on: (1) the prevalence of arbitration agreements in consumer financial products and services contracts; (2) consumers' understanding of dispute resolution systems; (3) how arbitration and court procedures differ; (4) the characteristics of individual consumer financial arbitrations; (5) the characteristics of consumer financial litigation; (6) use of small claims court for consumer financial disputes; (7) consumer financial class action settlements; (8) the relationship between public enforcement and consumer financial class actions; and (9) whether arbitration agreements lead to lower prices.[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 bar 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 proposed rulemaking – is that pre-dispute arbitration agreements

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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)," at 7-9 (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*, __ Fed. Reg. __ (proposed May 5, 2016) at 79.

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 and pursuing a remedy becomes unjustified. 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 representatives. According to the CFPB, it has considered the recommendations received in preparing its proposed rulemaking.[7]

CFPB's Notice of Proposed Rulemaking

On May 5, 2016, the CFPB announced its Notice of Proposed Rulemaking that would impose two sets of limitations on the use of pre-dispute arbitration agreements in contracts between consumers and covered providers of consumer financial products and services.

First, the CFPB regulations would prohibit providers from using a pre-dispute arbitration agreement to block consumer class actions in court and would require providers to insert language into their arbitration agreements reflecting this limitation.[8] This proposed rule stems from the CFPB's findings in its Study – in particular, that "individual dispute resolution mechanisms are an insufficient means of enforcing consumer financial laws and contracts; public enforcement cannot be relied upon to fully and effectively enforce all of these laws and private contracts; and class actions, when not blocked by arbitration agreements, provide a valuable complement to public enforcement and a means of providing substantial relief to consumers."[9] Thus, the CFPB concluded that precluding providers from blocking class actions through the use of arbitration agreements would better enable consumers to enforce their rights and obtain redress, and that the potential of class action liability

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).

7 *See* Notice of Proposed Rulemaking at 130.

8 *See id.* at 4.

9 *Id.* at 95.

would potentially deter illegal conduct and encourage investment in compliance.[10]

Second, the regulations would require providers using pre-dispute arbitration agreements to submit to the CFPB certain records relating to arbitral proceedings, including the claim, the arbitration agreement, the award, and certain communications with the arbitrator and administrator.[11] 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.[12] In addition, the materials will be published, in some form, on the CFPB website, with redactions or aggregation as necessary.[13]

The CFPB's proposal applies to providers of consumer financial products and services in the markets of lending money, storing money, and moving or exchanging money.[14] Specifically, most providers engaged in the following activities would 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. Thus, the proposal has the potential to apply 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 Future of Arbitration in Consumer Financial Contracts?

The CFPB has stated that it "is not proposing to prohibit arbitration agreements entirely." 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."[15]

However, if the CFPB's proposed rule becomes final, the industry might see a considerable shift away from the use of arbitration agreements in consumer contracts. As the CFPB itself has

[10] *See id*. at 117.

[11] *See id*. at 4, 140-41.

[12] *See id.* at 140.

[13] *See id*. at 141.

[14] *See id.* at 155.

[15] *Id.* at 138-39.

acknowledged, "Some 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."[16] If this becomes the prevailing view among financial products and services providers, then the CFPB's new rule would effectively function as a prohibition on including arbitration clauses in consumer financial contracts.[17]

Once the Notice of Proposed Rulemaking is published in the Federal Register later this month, the public has 90 days to submit comments to the CFPB.[18] At the close of that period, the CFPB will analyze the comments and determine whether to move forward with issuing a final rule – which could be in the original or an amended form – or whether to withdraw the proposal (which is unlikely to occur).[19]

The current draft of the rule provides that "[c]ompliance with this part is required for any pre-dispute arbitration agreement entered into after" the date that is 211 days after publication of the final rule in the Federal Register.[20] The CFPB has indicated that it interprets the phrase "entered into" to include "any circumstance in which a person agrees to undertake obligations or gains rights in an agreement."[21]

In accordance with the foregoing interpretation, the CFPB is proposing to publish an official interpretation following the rule, which would provide examples of what it means to enter into a pre-dispute arbitration agreement after the compliance date. These examples are (a) providing to a consumer a new product or service where the provider is a party to the pre-dispute arbitration agreement; (b) acquiring or purchasing a covered product subject to a pre-dispute arbitration agreement and becoming a party to that agreement; and (c) adding a pre-dispute arbitration agreement to an existing product or service. The CFPB is also proposing to include the following examples of actions that would not constitute entering into a pre-dispute arbitration agreement after the compliance date: (a) modifying, amending or

16 *Id.* at 136.

17 *See* Jeff Bater, "CFPB Plans May 5 Hearing on Arbitration; Expected to Propose Rule" (Bloomberg BNA Apr. 22, 2016).

18 *See* Notice of Proposed Rulemaking at 1.

19 Jessica Silver-Greenberg & Michael Corkery, "Rule on Arbitration Would Restore Right to Sue Banks" (N.Y. Times May 5, 2016).

20 Notice of Proposed Rulemaking at 364. This part of the proposed rule is based on the Dodd-Frank provision that CFPB's rulemaking authority may only extend to agreements between consumers and covered entities entered into after the end of the 180-day period beginning on the regulation's effective date, which the CFPB is proposing be 30 days after a final rule is published in the Federal Register. *See id.* at 5, 83.

21 *Id.* at 202.

implementing the terms of a product or service subject to a pre-dispute arbitration agreement entered into before the compliance date; or (b) acquiring or purchasing a product subject to a pre-dispute arbitration agreement but not becoming a party to that agreement.[22]

In light of the CFPB's proposal with respect to a compliance date, any final rule is likely to apply only to those arbitration agreements entered into after the summer of 2017.[23] Accordingly, the upcoming months will prove to be a critical time for affected companies that use or are interested in using arbitration agreements with class action waivers in their contracts with consumers. Financial product and service providers may wish to analyze whether the CFPB's proposed rulemaking is applicable to them, and may want to consider participating in the rulemaking process.

In addition, it may be advisable for affected companies not presently using arbitration agreements with class action waivers, but who would like to do so, to take action before the compliance date of any 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.[24] If the CFPB's proposed rulemaking becomes final, this precedent may no longer be applicable to many contracts subsequently entered into between consumers and entities operating in the financial products and services sector.

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[22] *See id.* at 371.

[23] *See* Bater, *supra*.

[24] *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).