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Class (Not) Dismissed: CFPB Proposes New Rule Prohibiting Mandatory Arbitration Clauses, Encourages Consumer Class Action Law Suits

By The Global Banking & Payment Systems and Complex Litigation & Arbitration Practices

The Consumer Financial Protection Bureau ("CFPB" or "Bureau") recently proposed a potentially sweeping rule aimed at substantially restricting and altering the use of mandatory arbitration clauses in certain consumer financial contracts.[1] The proposed rule sets forth new regulations that (1) prohibit covered providers[2] from entering into an agreement with a consumer that requires arbitration of any future dispute between the parties to bar the consumer from filing or participating in a class action with respect to a covered consumer financial product or service, and (2) require covered providers that are involved in an arbitration pursuant to a pre-dispute arbitration agreement to submit specified arbitral records to the CFPB.[3]

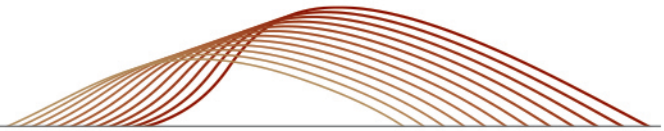
With a potential wave of class action lawsuits on the horizon, financial institutions and non-bank financial companies subject to the CFPB's jurisdiction should carefully review the proposed rule, and consider submitting a comment to the CFPB detailing any benefits to arbitration that may have been overlooked in the Bureau's analysis, including any specific internal statistics on dispute resolution, timing, or remedial actions undertaken.

A. Procedural Background

Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") directs the CFPB to study the use of arbitration agreements in connection with the offering of consumer financial products and services.[4] The Act also mandates that, after the CFPB had completed the study and reported to Congress, the CFPB would be authorized to issue regulations that "prohibit or impose conditions or limitations" on the use of pre-dispute arbitration agreements, if the CFPB "finds that such prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers."[5] In March 2015, the CFPB published its arbitration study, and based on the results of that study, the Bureau issued its proposed arbitration rule on May 5, 2016. Interested parties will have a 90-day comment period starting from the date the proposed rule is published in the *Federal Register*.

B. Scope of the Proposed Rule

The CFPB's proposed rule contains two major components. ***First***, covered providers may not utilize pre-dispute arbitration agreements to prevent a consumer from filing or participating in a class action



related to the provision of financial products or services. This requirement would only apply to new contracts entered into more than 180 days after the final rule's effective date.

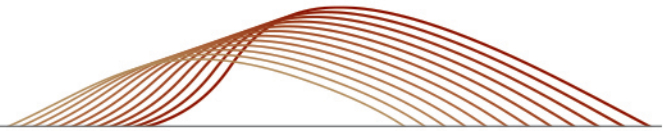
The rule further requires that providers which utilize pre-dispute arbitration agreements must include specific CFPB proscribed language in their agreements to ensure that consumers are aware that the agreement does not limit their ability to participate in a class action lawsuit.

Second, the proposed rule mandates that banks and financial companies that utilize pre-dispute arbitration agreements provide the CFPB with documentation related to all arbitration actions so that the Bureau may gather more data and continue its evaluation.[6] Significantly, this requirement only applies to entities that use some sort of mandatory arbitration clause and specifically does *not* apply to voluntary arbitration agreements entered into between providers and consumers after a dispute has arisen.

Providers engaged in the following activities are explicitly covered by the CFPB's proposed rule:

- ***Consumer credit decisions***: Extending or regularly participating in decisions regarding consumer credit under Regulation B implementing the Equal Credit Opportunity Act ("ECOA"), engaging primarily in the business of providing referrals or selecting creditors for consumers to obtain such credit, and the acquiring, purchasing, selling, or servicing of such credit;
- ***Auto leasing***: Extending or brokering of automobile leases as defined in CFPB regulation;
- ***Debt management or settlement***: Providing services to assist with debt management or debt settlement, modify the terms of any extension of consumer credit, or avoid foreclosure;
- ***Credit reporting***: Providing directly to a consumer a consumer report as defined in the Fair Credit Reporting Act, a credit score, or other information specific to a consumer from a consumer report, except for adverse action notices provided by an employer;
- ***Consumer accounts and remittance transfers***: Providing accounts under the Truth in Savings Act and accounts and remittance transfers subject to the Electronic Fund Transfer Act;
- ***Certain funds transfers and payment processing activity***: Transmitting or exchanging funds (except when integral to another product or service not covered by the proposed rule), certain other payment processing services, and check cashing, check collection, or check guaranty services consistent with the Dodd-Frank Act; and
- ***Debt collection***: Collecting debt arising from any of the above products or services by a provider of any of the above products or services, their affiliates, an acquirer or purchaser of consumer credit, or a person acting on behalf of any of these persons, or by a debt collector as defined by the Fair Debt Collection Practices Act.[7]

If an arbitration proceeding ultimately is commenced, the provider must provide to the CFPB (a) information about any claims or counterclaims, (b) the original pre-dispute agreement, (c) the judgment or award resulting from the arbitration, and (d) any communication the provider receives related to an arbitrator refusing to administer a claim due to the provider's failure to pay any filing or



administrative fees. All materials must be provided to the CFPB within 60 days of when they are filed or received by the provider.

Pursuant to the proposed rule, these otherwise confidential arbitration materials would become publically available "in some form" on the CFPB website. The CFPB has noted, however, that it will only make items public "with appropriate redaction or aggregation as warranted."[8] While the CFPB has indicated that it expects the compliance burden associated with such reporting to be low, "especially given the benefit of the proposal," there is no independent cost and benefit analysis to support this assertion.[9]

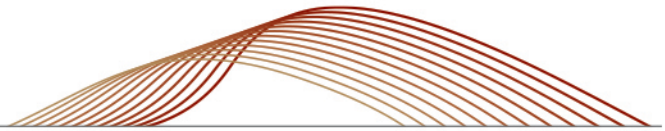
When the CFPB announced its proposed arbitration rule, it noted that "[m]any banks and financial companies avoid accountability by putting arbitration clauses in their contracts that block groups of their customers from suing them. Our proposal seeks comment on whether to ban this contract gotcha that effectively denies groups of consumers the right to seek justice and relief for wrongdoing."[10] The CFPB seems to only view these arbitration clauses as an unfair "gotcha" to consumers as they relate to class actions. The proposed rule does not entirely ban arbitration agreements, and providers are permitted to rely on arbitration agreements provided a presiding court has previously determined the action may not proceed on a class basis and the period for appeal has elapsed.

C. The CFPB's Foundation for the Proposed Rule and Associated Issues

As noted above, the CFPB undertook an empirical study on arbitration clauses in consumer financial services contracts.[11] The CFPB study, which is over 700 pages, is not without its critics, and those looking to challenge the proposed rule are likely to focus on the study's methodology and failure to include a non-biased, independent peer review.

The CFPB study also appears to be based on limited information, as it only examines arbitration data through 2012. This timeframe does not account for a significant amount of the CFPB's supervisory, enforcement, and rulemaking activity since that time. By way of example, the CFPB brought seven enforcement actions through the end of 2012, while from 2013 through April 2016, the CFPB filed 124 enforcement actions.[12] Nowhere in its own study does the CFPB take into account its more than $11 billion in recovery for consumers over the last five years—all of which must be returned to consumers, used for financial education, or returned to the U.S. Treasury.[13]

Moreover, it is unclear whether the current system of arbitration actually falls short in addressing harm to consumers. The CFPB report broadly concludes that "[c]onsumers rarely consider bringing formal claims in any forum, arbitration or litigation, as a response [to seeing incorrectly-assessed fees on a credit card bill, for example]."[14] In addition, the report found that an average of 616 individual arbitration cases were filed per year during the period under review across six product markets, with some of these cases being mutually submitted by both the consumer and the company.[15] This relatively low number of disputes filed could signal that banks and consumer financial companies generally provide effective redress to consumers on a case-by-case basis, eliminating the need for escalation of disputes in many cases, without the need for formal dispute resolution procedures. Notwithstanding any regulatory requirements, most companies providing consumer-facing goods and services recognize that responsiveness to consumer concerns is good business, and have embedded procedures for immediate redress of consumer harm into their internal policies and corporate cultures.



D. Action Items

Financial institutions and non-bank financial companies subject to the CFPB's jurisdiction should consider whether it would be appropriate to submit a comment letter in response to the CFPB's proposed rule. In addition, CFPB-regulated entities should consider the following action items:

- Analyze current consumer agreements to determine the presence and volume of mandatory arbitration provisions that could be impermissible depending on the scope of the final rule;
- Review customer complaint logs to identify those products and services that elicit the most frequent consumer complaints and could potentially serve as the basis for consumer class action lawsuits; and
- Consider submitting a comment to the CFPB detailing any benefits to arbitration that may have been overlooked in the Bureau's analysis, including any specific internal statistics on dispute resolution, timing, and remedial actions undertaken.

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1 *See* Consumer Financial Protection Bureau, Arbitration Agreements, Docket No. CFPB-2016-0020 (proposed May 3, 2016) (to be codified at 12 CFR Part 1040) [hereinafter Proposed Rule], *available at* http://files.consumerfinance.gov/f/documents/CFPB_Arbitration_Agreements_Notice_of_Proposed_Rulemaking.pdf

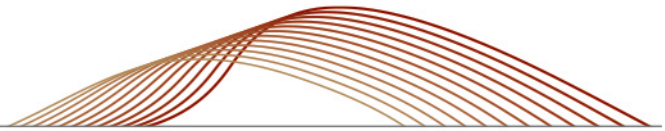
2 Any person that engages in offering or providing a consumer financial product or service and any service providers, which generally includes generally extending credit and servicing loans, deposit-taking, money transmission, payment processing, certain financial advisory services, credit reporting, and debt collection. 12 U.S.C. § 5481(6), (15).

3 *See* Proposed Rule at 1.

4 12 U.S.C. § 5518(a).

5 *Id.*

6 *See* Proposed Rule, at 140.



[7] *Id.* at 3–4.

[8] *Id*. at 141.

[9] *See* Congressional Research Report, *Cost-Benefit and Other Analysis Requirements in the Rulemaking Process*, at 16, 21 (Dec. 9, 2014). The CFPB proposed rules are not required to be assessed by the Office of Management and Budget, but nothing prevents the CFPB from requesting such an assessment.

[10] Press Release, Consumer Financial Protection Bureau Proposes Prohibiting Mandatory Arbitration Clauses That Deny Groups of Consumers Their Day in Court, CFPB (May 5, 2016), *available at* http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-proposes-prohibiting-mandatory-arbitration-clauses-deny-groups-consumers-their-day-court/.

[11] Consumer Financial Protection Bureau, Arbitration Study, Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) (Mar. 10, 2015) [hereinafter CFPB Arbitration Study], *available at* http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf. Among other findings, the CFPB study noted the following: (1) tens of millions of consumers are covered by arbitration clauses, but only an average of 600 arbitration cases and 1,200 individual federal lawsuits are filed by consumers each year; (2) for cases filed in 2010 and 2011, arbitrators awarded consumers a combined total of less than $175,000 in damages and less than $190,000 in debt forbearance; (3) across substantially all consumer finance markets, at least 160 million class members were eligible for relief over the five-year period studied, with settlements totaling $2.7 billion in cash, in-kind relief, and attorney's fees and expenses (roughly 18 percent of those settlement awards went to expenses and attorneys' fees); (4) arbitration clauses can be used to block class actions in court, and while it is rare for companies to try to force an individual lawsuit into arbitration, it is common for arbitration clauses to be invoked to block class actions; and (5) there is no statistical evidence that arbitration clauses lead to lower prices for consumers. *See* Consumer Financial Protection Bureau, Arbitration Study, Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) (Mar. 10, 2015) [hereinafter CFPB Arbitration Study], *available at* http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

[12] *See* CFPB, Enforcement Action Database, *available at* http://www.consumerfinance.gov/policy-compliance/enforcement/actions/.

[13] CFPB, Financial Report of the Consumer Financial Protection Bureau (Nov. 16, 2015), *available at* http://files.consumerfinance.gov/f/201511_cfpb_report_fiscal-year-2015.pdf (stating "the Bureau's enforcement activity has resulted in more than $11 billion in relief for over 25 million consumers").

[14] CFPB Arbitration Study at 1.4.2.

[15] *Id*. at 1.4.3.