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CFPB Releases Final Rule Banning Certain Pre-Dispute Arbitration Agreements

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On July 10, 2017, the Consumer Financial Protection Bureau (CFPB or the Bureau) announced its long-anticipated final rule[1] to prohibit the use of pre-dispute arbitration agreements to block consumer class actions in contracts for consumer financial products and services. As expected, the final rule largely adopts the proposed rule[2] released on May 5, 2016, which we previously covered in detail here.[3] The issuance of the final rule comes at a politically uncertain time for the Bureau, and the rule could be overturned by Congress and the President before it even has a chance to take effect.

While the Bureau's final rule reflects concerns about the effects of mandatory consumer arbitration provisions, it will likely result in increased compliance costs and class action exposure for consumer lenders. In his speech announcing the final rule, CFPB Director Richard Cordray stressed the importance of class action lawsuits as a means to redress consumer harm and incentivize compliance by large financial institutions. Director Cordray specifically cited the Wells Fargo matter regarding unauthorized account opening and the inability of consumers to participate in a class action to address consumer harm, and lamented that "private companies have been able to override Congress's decisions and sidestep accountability under the law, and millions of consumers have found the courtroom doors locked through mandatory arbitration clauses."[4]

Background

The final arbitration rule is the culmination of a process dating back to the Bureau's inception. On April 24, 2012, the CFPB initiated a public inquiry into the use of arbitration and arbitration clauses in consumer financial products. The inquiry was largely in response to the U.S. Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*,[5] which held that the Federal Arbitration Act preempts state law purporting to prohibit class action waivers in arbitration agreements. The Bureau's public inquiry resulted in preliminary findings leading to the Bureau's final report[6] on arbitration in March 2015. Seven months after the report, in October 2015, the Bureau released an outline of its proposed rules subject to a Small Business Review Panel, followed by a Final Report[7] of the panel in December 2015. The proposed rule was released on May 5, 2016.

Overview of Rule

Key Prohibitions and Requirements

The final rule would prohibit covered lenders, defined as “providers,” from using pre-dispute arbitration agreements agreed to after a 180-day grandfather period to block class actions related to covered consumer financial products and services. The rule does not forbid arbitration agreements outright, but providers are precluded from including a provision in an arbitration agreement that would prohibit consumers from leading or participating in a class action. The rule also permits arbitration agreements that provide for class arbitration, provided that a consumer is not required to participate in class arbitration instead of class litigation in court. Lastly, the rule directs that providers who continue to utilize permissible arbitration agreements after the compliance date must include the following language as part of the agreement:

> We agree that neither we nor anyone else will rely on this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action filed by someone else.8

Effective Date

The final rule's effective date is 60 days after it is published in the *Federal Register*, but the compliance date for providers is 180 days after the effective date (any arbitration agreements during the first 180 days are grandfathered).

Covered Products and Services

The rule would cover the following providers of consumer financial products and services engaged in lending money, storing money, and moving/exchanging money, including providers engaged in:

- extending consumer credit or activities related to extending consumer credit (such as referrals, credit monitoring, acquiring or selling consumer credit, and servicing consumer credit);
- extending and brokering automobile leases as defined by the Bureau;
- providing debt management services, debt settlement services, credit repair services, modification services of extensions of credit, and foreclosure prevention services;
- providing consumer reports and credit scores directly to consumers;
- storing funds or other monetary value for consumers (such as providing deposit accounts);
- providing consumer services related to the movement or conversion of money (such as certain types of payment processing activities, transmitting and exchanging funds, and cashing checks); and
- collecting debt arising out of any of the above products or services.

Limitations and Exclusions

The final rule applies only to pre-dispute arbitration agreements agreed to 180 days after the effective date of the final rule. Existing consumer contracts containing arbitration clauses are not affected. The rule is also limited to consumer financial products and services (those products and

services primarily for personal, family or household purposes), and it explicitly does not apply to extensions of commercial credit.[9] The final rule also excludes the following persons:

- persons regulated by the Securities and Exchange Commission (SEC);
- persons regulated by a state securities regulator as broker-dealers or investment advisors;
- persons regulated by the Commodity Futures Trading Commission (CFTC) or with respect to contracts/transactions subject to CFTC jurisdiction;
- all federal agencies, states, recognized Indian tribes and others with sovereign immunity;
- persons not subject to the Bureau's rulemaking authority, including auto dealers and attorneys, among others;
- merchants and retailers of nonfinancial goods and services, to the extent they offer products and services not subject to Bureau rulemaking authority;
- employers, to the extent they provide consumer financial products and services to employees as an employee benefit; and
- persons that do not regularly offer consumer financial products or services (i.e., providing to 25 or fewer consumers in each of the current and preceding calendar years).

The rule would also permit providers of general-purpose reloadable prepaid cards to continue selling packages that contain noncompliant arbitration agreements, so long as they make compliant changes as soon as the consumer registers a prepaid card. Notably, to the extent a covered provider obtains the rights to a contract with a pre-dispute arbitration agreement which was originally agreed to by a *non-covered* person, that covered provider would not be able to rely on the arbitration agreement.

Reporting Requirements

Providers that use pre-dispute arbitration agreements after the compliance date would also be required to submit certain records relating to arbitral proceedings to the Bureau. The rule requires submission of (i) records filed in an arbitration proceeding that rely on a pre-dispute arbitration agreement, (ii) any communication a provider receives from the arbitrator in which the arbitrator determines that a pre-dispute arbitration agreement does not comply with “due process or fairness standards” and (iii) communications a provider receives from an arbitrator who dismisses or refuses to arbitrate an action due to a provider's failure to pay the required administrative or filing fees. These records are required to be filed within 60 days of communication to the provider in a redacted form approved by the Bureau, and will be subject to public disclosure on the Bureau's website and as part of its compliance reporting. The Bureau would likely use this data to further promulgate rule changes and to publicize reports on the use of pre-dispute arbitration agreements under the new rule.

Congressional Review Act Issues

Although the final rule is being published in the coming days, there is real uncertainty as to whether it will take effect. First, the final rule is subject to review by Congress under the Congressional Review Act (CRA), which gives Congress 60 legislative days to repeal the final rule through simple majorities in both chambers and with the president's signature. To date this year, Congress has

passed, and the President has signed into law, 14 separate CRA resolutions to repeal rules promulgated at the end of the Obama Administration.[10] Congress has already shown a willingness to overturn the arbitration rule this year; repealing the Bureau's authority to restrict arbitration is a key component of the Financial Choice Act 2.0,[11] which passed the House of Representatives last month. Indeed, Director Cordray admitted to this uncertainty in his speech announcing the final rule, saying, "I am, of course, aware of those parties who have indicated they will seek to have the Congress nullify this new rule."[12] And on July 11, Senator Tom Cotton (R-AR) began circulating a resolution to rescind the rule via the CRA, while both Senate Banking Committee Chairman Mike Crapo (R-ID) and House Financial Services Committee Chairman Jeb Hensarling (R-TX) also indicated support for overturning the rule.[13]

Notably, however, Congress recently opted *not* to overturn the Bureau's prepaid rule, which became final in late 2016 and was a candidate for CRA repeal earlier this year. Given this success—along with political pressure in support of the arbitration rule from a variety of interest groups and Congress' current focus on healthcare and other matters—Director Cordray evidently took a calculated risk that the arbitration rule might survive a CRA nullification effort or, at a minimum, judged that this was a politically opportune time to take action.

Compliance Takeaways

The Bureau has been focused for more than five years on the industry's use of pre-dispute arbitration agreements. Some major players in the industry have had time to adjust to and prepare for the implementation of this final rule, but others regularly include these agreements today. Entities that heavily rely on these pre-dispute arbitration agreements can continue to utilize the language for the next 240 days (including 60 days for the rule to take effect and the 180-day grandfather period). If the final rule goes into effect, following the compliance date, covered providers can expect additional exposure to class action litigation; increased court, settlement and insurance costs; and increased compliance costs arising out of Bureau reporting.

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[1] Consumer Financial Protection Bureau, Arbitration Agreements: Final rule (July 10, 2017).

[2] Consumer Financial Protection Bureau, Arbitration Agreements: Proposed rule (May 5, 2016).

[3] WilmerHale Client Alert, CFPB Releases Long-Awaited Proposal on Pre-Dispute Arbitration Agreements (May 6, 2016).

[4] Prepared Remarks of CFPB Director Richard Cordray on the Arbitration Rule Announcement (July 10, 2017).

[5] 563 U.S. 333 (2011).

[6] Consumer Financial Protection Bureau, *Arbitration Study: Report to Congress* (March 2015).

[7] Consumer Financial Protection Bureau, *Final Report of the Small Business Review Panel on the CFPB's Potential Rulemaking on Pre-Dispute Arbitration Agreements* (Dec. 11, 2015).

[8] *See* final rule at p. 539–540.

[9] *See* final rule at p. 403, FN 839 ("[B]y proposing to cover only credit that is 'consumer credit' under Regulation B, the Bureau was making clear that the proposal would not have applied to business loans.")

[10] *See* website of Speaker of the House, Congressional Review Act Progress in Review (accessed

July 10, 2017).

[11] Financial Choice Act 2.0.

[12] Prepared Remarks of CFPB Director Richard Cordray on the Arbitration Rule Announcement (July 10, 2017).

[13] *See* Rob Tricchinelli, *Senate Republican Kicks Off Attempt to Gut CFPB Arbitration Rule*, Bloomberg BNA (July 11, 2017); *see also* Zachary Warmbrodt, *Crapo intends to lead effort to block CFPB arbitration rule*, Politico Pro (July 11, 2017).

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