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CFPB Releases Outline of Proposals to Block Pre-Dispute Arbitration Agreements in Class Litigation

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On October 7, 2015, the Consumer Financial Protection Bureau ("CFPB" or the "Bureau") released an outline[1] of proposals under consideration to ban class action waivers in contracts for consumer financial products and services. The announcement is not an official rule proposal, but instead represents a concrete step in that direction.

The proposal reflects the Bureau's concern about aspects of mandatory consumer arbitration provisions, which has been apparent for some time. Any final rule is likely to substantially reduce the usefulness of arbitration clauses for consumer lenders, increasing compliance costs and class action exposure significantly. If the rule ultimately results in less frequent use of arbitration, the substantial benefits to consumers that arbitration provides will also be reduced. While consumer groups and the class action bar are likely to welcome the proposal, legal challenges to any final rule are expected. In the meantime, the Bureau will continue to seek input from the public, consumer groups, industry, and other stakeholders before continuing with the process of a rulemaking.

Introduction and Summary

The outline contains two proposals. First, and most importantly, the CFPB is considering a prohibition on the application of pre-dispute arbitration agreements to cases filed in court on behalf of a class unless and until class certification is denied or the class claims are dismissed. Such a proposal is likely to involve model or mandatory language that companies would include in arbitration agreements.

Second, the CFPB is contemplating a requirement that covered entities submit arbitral disputes and awards to the Bureau. The CFPB is also considering whether to publish the disputes and awards to its website in order to make them publicly available.

These two proposals, if approved, would apply to most of the consumer financial products and services that the Bureau oversees, including[2]:

- credit cards;
- checking and deposit accounts;
- prepaid cards;

- money transfer services;
- certain auto loans;
- small-dollar or payday loans; and
- private student loans.

The Bureau is also considering several exclusions, including those for products or services that are: (1) already subject to arbitration rules issued by the Securities and Exchange Commission ("SEC") or the Commodity Futures Trading Commission ("CFTC"); or (2) provided by federal, state, local, and tribal governments.

The Bureau notes that the potential costs include:

- **Administrative costs due to contract revision**: Affected entities are likely to incur costs as a result of revising the language of their arbitration agreements to provide that the agreements do not apply to cases on a class basis.
- **Increased class litigation exposure**: Entities may incur additional expenses stemming from legal defense, court costs, settlements, and damages exposure.
- **Increased compliance costs**: These costs could include additional investment in compliance, changes to product design, and larger insurance expenses due to entities attempting to minimize any such additional class litigation exposure in the future.

Background

For the last few years, the CFPB has been examining the role of arbitration agreements in the resolution of consumers' disputes with providers of consumer financial products and services. This effort is in the wake of the Supreme Court's 2011 landmark decision in *AT&T Mobility LLC v. Concepcion,*[3] which held that the Federal Arbitration Act preempts state laws purporting to prohibit class-action waivers in arbitration agreements. The Dodd-Frank Act directed[4] the Bureau to study arbitration agreements in consumer financial contracts and authorized the Bureau to regulate their use if the Bureau finds that certain conditions are met.

In March 2015, the CFPB completed its study[5] of arbitration agreements and other methods for dispute resolution in markets for consumer financial products and services. Summarizing the report, CFPB Director Richard Cordray stated that "arbitration clauses restrict consumer relief in disputes with financial companies by limiting class actions that provide millions of dollars in redress each year." The report found that:

- tens of millions of consumers are subject to arbitration clauses on financial products—approximately 53 percent of all credit card agreements, 44 percent of checking accounts,

99 percent of payday loans, 92 percent of prepaid cards, 86 percent of student loans, and 88 percent of mobile phone agreements include arbitration clauses;
- courts award significantly higher awards to consumers than arbitrators do;
- class actions, intentionally barred by arbitration clauses, are a significant source of relief for consumers that become unavailable to consumers subject to arbitration clauses;
- arbitration clauses are not reducing prices for consumers; and
- many customers are not aware they have an arbitration clause in their financial products.

The study did not, however, include the benefits often cited in support of alternate dispute resolution in consumer cases, including increased efficiency, reduced costs, and parties' overall satisfaction with the process and results.

The CFPB believes that the proposals under consideration are consistent with the study and meet the standards for exercise of the Bureau's rulemaking authority under section 1028(a) of Dodd-Frank. Before it releases an official rule proposal, the CFPB is seeking input from the Small Business Review Panel about the proposals pursuant to the consultation process outlined in the Small Business Regulatory Enforcement Fairness Act ("SBREFA").[6]

This could amount to be the second regulatory change involving arbitration clauses in recent months. In July, the U.S. Department of Defense ("DOD") announced a final rule amending the Military Lending Act's implementing regulations and prohibiting consumer lenders from enforcing arbitration clauses against qualifying military borrowers.

Proposals Under Consideration

First, the Bureau is considering a proposal to require any pre-dispute arbitration agreement included in a contract for a consumer financial product or service offered by a covered entity to provide explicitly that the arbitration agreement is inapplicable to cases filed in court on behalf of a putative class unless and until class certification is denied or the class claims are dismissed. The Bureau justifies the proposal under consideration on the grounds that class action waivers block consumers from participating in class litigation, thereby reducing their monetary relief and the deterrent effects from class actions.

The CFPB is not considering at this time a proposal that would prohibit entirely the use of pre-dispute arbitration agreements. The Bureau notes that the proposal being considered would permit an arbitration agreement that allows for class arbitration provided a consumer could not be forced to participate in class arbitration instead of class litigation. The proposals being considered also would not affect the ability of consumers and companies to agree to arbitrate disputes after they arise.

Second, the CFPB is considering a proposal to require covered companies to submit to the Bureau all initial claim filings made by or against them in consumer financial arbitral disputes, and any decisions or awards resulting from those claims. Moreover, the Bureau is considering publishing information about those disputes and awards on its website. Before collecting or publishing any arbitral claims or awards, the Bureau states that it would ensure that these activities comply with privacy considerations. The proposal under consideration would not require changes to the text of

arbitration agreements, the conduct of proceedings, or the content of written awards. The Bureau contends that this requirement would allow the CFPB to better monitor and identify problematic business practices. The proposal under consideration would apply equally to individual arbitration proceedings and any arbitration that could proceed on an aggregated basis.

Next Steps

This is the first public step in the CFPB's potential rulemaking process. In addition to consulting with the Small Business Review Panel, the Bureau states that it will continue to seek input from a wide range of stakeholders before issuing any proposed regulations. If and when the proposals under consideration become proposed rules, we expect numerous comments from various industry participants and other observers.

A class action waiver ban would impose a number of costs on affected entities, including a surge in class action litigation and a corresponding increase in administrative, litigation, court, settlement, and insurance costs.

Effective Date

The effective date of any final rule is likely more than a year into the future. The Small Business Review Panel's process will likely take several months,[7] with a proposed rule and comment rulemaking process to follow. Once the comment period closes, the CFPB will review and analyze the comments received and decide whether any adjustments are needed before issuing a final rule. We anticipate that it will likely take the CFPB several months to a year to finalize the rule once it is proposed. Even then, arbitration clauses in existing contracts will remain enforceable because of likely grandfathering provisions, meaning some provisions would continue in effect for many years.

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[1] Consumer Financial Protection Bureau, *Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Outline of Proposals Under Consideration and Alternatives Considered* (Oct. 7, 2014).

[2] The Bureau suggests that the proposed rule may also cover additional consumer financial products and services, including payment processing.

[3] 563 U.S. 333 (2011).

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, § 1028(a), Pub. L. No. 111-203, 124 Stat. 1376, 2004 (2010).

[5] Consumer Financial Protection Bureau, *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* (Mar. 2015).

[6] U.S.C. § 609(b). The Bureau followed the same approach when it released its outline of proposals under consideration concerning small-dollar lending in March 2015. The SBREFA consultation process provides a mechanism for the Bureau to obtain input directly from small financial services providers early in the rulemaking process about new regulatory requirements it is contemplating. SBREFA directs the Bureau to convene a Panel when it is considering a proposed rule that could

have a significant economic impact on a substantial number of small entities. Within 60 days of convening, the Panel is required to complete a report on the input received from the small entity representatives ("SERs") during the Panel process. The Bureau will consider the SERs' feedback and the Panel's report as it prepares the proposed rule.

[7] In March 2015, the CFPB released an outline of proposals related to payday, car title, and installment lending. The Bureau consulted with the Small Business Review Panel and, seven months later, is still drafting the proposed rule.

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