

CFPB Releases Proposed Rule on Pre-Dispute Arbitration Agreements

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Financial Institutions

Today, the Consumer Financial Protection Bureau (the “CFPB” or the “Bureau”) published a [proposed rule](#) substantially curtailing the ability of financial services providers and consumers to enter into voluntary pre-dispute arbitration clauses. The proposed rule would:

- prevent financial services providers from including arbitration clauses in consumer contracts unless those arbitration clauses expressly permit class actions to proceed in court; and
- require financial services providers to provide copies of consumer arbitration agreements, claims and decisions to the Bureau for possible publication.

The Bureau will accept comments on the proposal for a 90-day period following its forthcoming publication in the Federal Register. The deadline for comments will likely fall in the first half of August.

Statutory Basis for the Proposed Rule

The Bureau bases its proposed rule in section 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. That section required the Bureau to conduct a study on the use of arbitration agreements, and authorized the Bureau, by rule, to “prohibit or impose conditions or limitations on the use of an agreement . . . providing for arbitration . . . if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers.” Section 1028 specified that the findings in such a rule must be consistent with the Bureau’s study, and that the rule must apply only to agreements entered into more than 180 days after the rule’s effective date.

Overview of the Proposed Rule

Coverage

The proposed rule would apply to contracts involving the provision of a wide range of financial products and services to consumers. Such products and services include: extending credit; taking deposits; providing consumer reports; transmitting or exchanging funds; and managing and settling debts. A service is considered to be provided to consumers where it is “offered or provided for use by consumers primarily for personal, family, or household purposes”—a formulation that appears to exclude services provided to small businesses, even sole proprietorships.

As a general matter, the proposed rule purports to apply to agreements relating to qualifying financial products and services regardless of the provider. It is not, in other words, explicitly limited to contracts involving financial institutions. However, the proposed rule contains

exceptions for products that are not widely provided; for contracts entered into by Federal, state or Tribal authorities; for broker-dealers to the extent their arbitration agreements are regulated in a similar manner by the U.S. Securities and Exchange Commission; and, subject to further exceptions, for most non-financial merchants and retailers.

Limitations on the Use of Arbitration Agreements

The proposed rule would require that arbitration agreements relating to covered products expressly provide that they encompass only individual claims, and not class claims. The proposal includes mandatory language for inclusion in all covered pre-dispute arbitration agreements:

We agree that neither we nor anyone else will use 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 even if you do not file it.

If the covered provider is offering multiple products or services, some of which are not subject to the rule, the CFPB requires that the following language be included in the agreement:

We are providing you with more than one product or service, only some of which are covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau. We agree that neither we nor anyone else will use 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 even if you do not file it. This provision applies only to class action claims concerning the products or services covered by that Rule.

Submission of Arbitral Records

The proposed rule would also require covered providers of financial services that engage in arbitration pursuant to a pre-dispute arbitration agreement to submit copies of arbitration pleadings and awards to the CFPB. Specifically, providers must submit copies of:

- arbitration claims concerning consumer financial products within the scope of the rule, including the initial claim, any counterclaim, and the pre-dispute arbitration agreement;
- the judgment or award, if any, issued by the arbitrator;
- any communication that the arbitrator sends to the provider concerning failure to pay filing or administrative fees; and
- any communications related to a determination that a pre-dispute arbitration agreement concerning a covered consumer financial product does not comply with the “fairness principles, rules, or similar requirements” of the arbitration administrator.

The proposed rule would require providers to redact personal information of consumers before providing arbitration documents to the Bureau. The Bureau intends to publish at least some of these materials on its website to “provide greater transparency into the arbitration of consumer disputes.”

Effective Date and Preexisting Contracts

The proposed rule would come into effect 30 days after the final rule is published, which, in combination with the 180-day delay in application discussed above, would give covered providers 210 days before their new contracts are subject to the rule.

The proposed rule would not apply to preexisting arbitration clauses. However, it purports to apply when contracts containing such clauses are transferred between financial services providers (including, potentially, in connection with the merger or acquisition of a business).

The proposal is silent as to the status of an arbitration clause within a preexisting agreement that is supplemented or modified.

Is the Class Action Carve Out Supported by the CFPB Study?

Under section 1028, the proposed rule could be challenged on the grounds that it is not consistent with the findings of the Bureau's [arbitration study](#). Accordingly, the Bureau takes pains to ground the proposed rule in the study. In particular, the Bureau relies upon the finding that "tens of millions" of consumers are subject to arbitration clauses in contracts for financial products or services, and that very few of them ever file an individual arbitration claim. The Bureau also contrasts the recoveries in individual arbitrations with the amounts recovered in settlements of class actions, and argues that arbitration provisions deny the benefits of class action settlements to large numbers of consumers. In addition to these financial benefits, the Bureau argues that exposing financial institutions to class actions will result in increased deterrence and improved compliance. At the same time, the Bureau cites the study for the proposition that institutions that eliminated arbitration clauses did not increase prices and did not reduce extensions of credit.

The Bureau's effort to ground the proposed rule in its arbitration study is not entirely convincing. As commentators pointed out during the Bureau's Arbitration Field Hearing earlier today, the data in the Bureau's arbitration study showed that consumers, on average, receive *more* redress in arbitration than in court—and receive it faster and with less expense. In addition, while the Bureau justified its proposed rule by pointing to the total amounts recovered by consumers in class actions, the study may not have adequately assessed the net costs and benefits to consumers of such recoveries. In particular, the study pays relatively little attention to the costs of class action litigation, including the costs of class actions that result in no recovery for the class. The study also seems to simply assume that settlements—which routinely do not include any finding of wrongdoing—reflect redress for a legal violation. Finally, the Bureau's criticisms of arbitration are undermined by its own use of an alternative dispute resolution system—Bureau administrative proceedings—to pursue its enforcement agenda. See [The CFPB's Two Faces on Avoiding the Courts](#).

The Bureau should expect a wide range of comments on the proposed rule. However, the Bureau historically has not made substantial changes to proposed regulations in response to such comments. Accordingly, we anticipate that the Bureau's final rule will be similar to the proposed rule, and may face a challenge in court.

Financial Institutions

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