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CFPB Publishes Final Rule on Pre-Dispute Arbitration Agreements

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Financial Services

Today the Consumer Financial Protection Bureau (the "CFPB" or the "Bureau") published a final rule substantially curtailing the ability of financial services providers and consumers to enter into pre-dispute arbitration clauses. The final rule, like the proposed rule that preceded it, 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 final rule will become effective 60 days after its publication in the *Federal Register*, but apply only 180 days after its effective date.

History of the Final Rule

The final rule comes almost seven years after the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which required the Bureau to conduct a study on the use of arbitration agreements, and then authorized the Bureau to issue a rule consistent with that study. The Act anticipates that the rule would "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." Under the Act, such a new rule applies only to agreements entered into 180 days after the rule's effective date.

The final rule is accompanied by descriptions of some of the over 110,000 comments received by the Bureau during the notice-and-comment period. Most substantive concerns with the data underlying the rule are discounted by the Bureau, many by the rejoinder that the Dodd-Frank Act does not require the Bureau to require research on "every conceivably relevant question or to exhaust every conceivable data source." For example, the concern that the Bureau study did not adequately account for the role of government consumer protection is brushed aside on the grounds that "the Bureau does not believe this is a necessary subject of study." Accordingly, the changes from the proposed rule to the final rule are largely minor.

Overview of the Final Rule

Effective Date and Pre-existing Contracts

The combination of the 60 days before the effective date and the 180-day delay in the rule's application gives covered providers 240 days before any contracts are subject to the rule. After that date, the rule will apply to new contracts and to contracts that are transferred between financial services providers (including, potentially, in connection with the merger or acquisition of a business). The final rule will also apply to any new financial product or service added to a pre-existing contract, but not to the previously offered product or service.

In short, existing disputes, and further disputes involving existing contracts between the original parties to those contracts, should fall outside the scope of the final rule. However, providers who are subject to the rule are likely to face a number of thorny questions in determining what changes to existing contracts, product and service offerings, and relationships may trigger the application of the rule in the future. In addition, there will eventually be periods of time when otherwise similarly situated consumers have access to different dispute resolution mechanisms depending upon when they originally contracted with the provider.

Coverage

The final rule will apply to contracts involving the provision of financial products and services "within the core markets of storing, lending, and moving money." Such products and services include (with some exceptions):

- extending consumer credit;
- extending automobile leases;
- providing debt management or debt settlement assistance;
- providing a consumer report, credit score, or similar information to a consumer;
- providing consumer deposit accounts;
- providing consumer accounts offering electronic fund transfers;
- providing remittance transfers;
- transmitting or exchanging funds;
- accepting financial or banking data to initiate a payment by a consumer or a credit card or charge card transaction for a consumer;
- providing check cashing, check collection, or check guaranty services; and
- collecting 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."

As a general matter, the final rule applies to agreements relating to qualifying financial products and services regardless of the provider. Importantly, the rule is not limited to contracts involving financial institutions. However, the final rule contains exceptions (subject to further, specific limitations) for broker-dealers; investment advisors; Federal, State, and Tribal authorities; persons regulated by the CFTC; and merchants, retailers and other sellers of nonfinancial goods or services if they engage in only limited extensions of consumer credit.

Limitations on the Use of Arbitration Agreements

The final rule requires that arbitration agreements relating to covered products expressly provide that they encompass only individual claims, and not class claims. To reflect that requirement, the final rule mandates the inclusion of the following language in all covered pre-dispute arbitration agreements entered into after the rule goes into effect:

> 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.

The final rule permits providers to include specific alternative contract language if an arbitration provision is in a contract that applies to multiple products or services, and only some of those products or services are covered by the final rule.

Submission of Arbitral Records

The final rule also requires 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 final rule requires 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.

Potential Challenges to the Final Rule

The Congressional Review Act

The final rule could be invalidated by a Congress under the Congressional Review Act (the "CRA"). Under the CRA, 5 U.S.C. § 801 et seq, Congress has sixty legislative days to pass a joint resolution disapproving of agency rules. Such a resolution of disapproval is not subject to a filibuster in the Senate, but would require Presidential approval (or a veto override). The CRA process has been used fourteen times to date by the current Congress, but was not used to defeat the Bureau's most recent rule on prepaid cards. If the arbitration rule is invalidated under the CRA, the Bureau may not promulgate a "substantially similar" rule.

Challenge Based on Lack of Support in the CFPB Study

The Dodd-Frank Act requires that any final rule be consistent with the findings of the Bureau's arbitration study. *See* 12 U.S.C. § 1028. Accordingly, the Bureau takes pains to ground the rule in the study. In particular, the Bureau contrasts recoveries in individual arbitrations with recoveries in settlements of class actions, and argues that exposing financial institutions to

class actions will result in increased deterrence and improved compliance. However, the data in the Bureau's arbitration study can also be read to show that consumers receive more redress in arbitration than in court—and receive it faster and with less expense. In addition, the Bureau study analyzed the potential benefits of class actions for the years 2008-2012 -- before the CFPB enforcement program began playing a role similar to class actions in policing the marketplace. *See* *The CFPB's Flawed Case for Banning Class Action Waivers*.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services practice:

Eric Mogilnicki	+1 202 662 5584	emogilnicki@cov.com
Andrew Smith	+1 202 662 5049	andrewsmith@cov.com
Sonya Winner	+1 415 591 7072	swinner@cov.com
David Stein	+1 202 662 5074	dstein@cov.com