

Client Alert

May 2016

CFPB Rule Would Prohibit the Type of Arbitration Clause Used in Many Consumer Financial Contracts

Introduction and Summary of Proposed Rule

On May 5, 2016, the Consumer Financial Protection Bureau (“CFPB”) issued its much-anticipated proposed rule on arbitration clauses in consumer contracts. The new rule follows a study by the CFPB which concluded that arbitration clauses are generally unfair to consumers because they prevent individuals from having their day in court, which in turn, leads many financial institutions to operate with impunity. To address these perceived problems, the CFPB proposes a new rule that would make class action waiver clauses unenforceable, contrary to a recent decision by the United States Supreme Court finding them enforceable. With this move by the CFPB, financial institutions should recognize that they may need to re-write their consumer contracts and ready themselves for an increase in class action litigation.

The Rule Will Apply to Contracts with “Providers”

The proposed rule would apply broadly to “providers” of a number of consumer financial products and services, most notably:

- Credit cards
- Checking accounts
- Payday and other small dollar loans
- General purpose reloadable prepaid cards
- Private student loans
- Auto purchase loans and
- Mobile Wireless Agreements

The proposed rule also includes a set of narrow exemptions. The CFPB also seeks comment on whether adopting a small entity exemption would advance the purposes of the proposed rule.

The Rule Will Make the CFPB an Arbitration Watchdog

The new rule would also require providers to submit to the CFPB certain information pertaining to arbitrations by or against the provider concerning any of the covered consumer financial products. 12 CFR § 1040.4(b).

The provider must submit the following:

- The initial claim and any counterclaim;
- The pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;
- The judgment or award, if any, issued by the arbitrator or arbitration administrator; and

- If an arbitrator or arbitration administrator refuses to administer or dismisses a claim due to the provider's failure to pay required filing or administrative fees, any communication the provider receives from the arbitrator or an arbitration administrator related to such a refusal.

According to the proposed rule, the CFPB intends to use the information it collects to "continue monitoring arbitral proceedings to determine whether there are developments that raise consumer protection concerns that may warrant further Bureau action."

With this oversight element of the new rule, the CFPB aims to gain insight on the types of claims brought to arbitration and the way in which arbitrators resolve them. In addition, this requirement will allow the CFPB to monitor whether the law is being enforced consistently; it will also allow the CFPB to uncover legal violations.

Effective Date of Proposed Rule

The proposed effective date is 30 days after the rule is published in the Federal Register. The rule would apply only to agreements entered into **after** the end of the 180-day period beginning on the regulation's effective date. As such, the rule will apply to arbitration agreements entered into 211 days after publication in the Federal Register. Comments must be received within 90 days of the rule's publication in the Federal Register.

What Do Consumer Finance Companies Have to Do?

The rule not only prevents "covered providers" from inserting class waiver clauses into their consumer contracts, but requires the following terms in all new consumer contracts:

"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."

12 CFR § 1040.4(2)(i). The rule provides for a variation of this disclaimer under certain limited circumstances.

The new rule, if adopted, will likely be challenged, potentially on the basis that the CFPB has overstepped its agency authority and/or that the rule conflicts with both the FAA and the United States Supreme Court's ruling in *AT&T Mobility v. Concepcion*, 563 U.S. 333 (2011), but the outcomes of any such challenges are far from clear. In the meantime, consumer finance companies should consult with counsel to discuss revisions to their standard form contracts in anticipation of the new rule. Companies should also consider other possible ways to mitigate class and collective action risk and consider other means – whether through a forum selection clause, jury waiver, or otherwise – to limit litigation risk altogether.

Cites:

<http://www.consumerfinance.gov/about-us/blog/cfpb-proposes-prohibiting-mandatory-arbitration-clauses-deny-groups-consumers-their-day-court/>

http://files.consumerfinance.gov/f/documents/CFPB_Arbitration_Agreements_Notice_of_Proposed_Rulemaking.pdf

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