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CFPB Proposed Rule on Consumer Finance Arbitration

On May 5, 2016, the Consumer Financial Protection Bureau (CFPB) presented for public comment its proposed rule prohibiting the use of mandatory pre-dispute arbitration clauses that waive class action lawsuits. The proposed rule would require providers to explicitly disclose to consumers that the arbitration agreement may not be used to prevent the consumer from being part of a class action lawsuit. Only after the class claims are dismissed or class certification is denied may a case proceed to arbitration. The proposed rule would also require submission of the records of the arbitration to the CFPB so that it may monitor arbitration results in order to ensure fairness to consumers. The CFPB is also holding open the possibility that arbitration results would be published by the CFPB. Private arbitrations are rarely reported and contain no real record of proceedings.

The disclosures, if approved, would require all new arbitration provisions to state: “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.” The proposed rule would end the use of what CFPB Director Richard Cordray described as “gotcha” clauses, during his prepared remarks at the unveiling of the rule.

The effect of the proposed rule would, essentially, gut arbitration as a cost effective and attractive means for industry to resolve consumer financial disputes while further expanding class action litigation as the supposedly preferred and likely sole remaining vehicle to resolve disputes involving consumer financial products and services. The provisions would apply to roughly 50,000 firms, including banks, credit unions, credit card issuers, certain auto lenders, auto title lenders, payday lenders, private student lenders, loan servicers, debt settlement firms, foreclosure rescue firms, prepaid card issuers, installment lenders, money transfer services, and certain payment processors. The cost to industry to maintain defensive litigation strategies may well overshadow any savings usually associated with arbitration, thereby preventing companies from being able to effectively engage in both.

The proposed rule, which excludes mortgages and home equity lines of credit, follows the CFPB’s March 2015 Study and report to Congress on the use pre-dispute consumer arbitration clauses. Section 1028(b) of the Dodd-Frank Act, which authorized the CFPB's report, permits the CFPB to "prohibit or impose conditions or limitations" on the use of consumer financial arbitration if the CFPB finds such prohibition, condition or limitation to be "in the public interest and for the protection of consumers," as supported by the Study. The Dodd-Frank Act, in section 1028(c), makes clear though that this proposed rule may not restrict consumers from entering into voluntary arbitration *after* a dispute has arisen, although post-dispute arbitration agreements are usually insufficient to waive class actions.

The CFPB likens its proposed limitations as part of an evolution consistent with Congress's prohibition of the use of arbitration in connection with mortgage loans, permitting the SEC to regulate arbitration agreements in consumer contracts with broker-dealers or investment advisors through FINRA, and with regard to prohibiting arbitration in certain whistleblower proceedings. After the Study, the CFPB convened a Small Business Review Panel (SBREFA Panel) and used those results to support its determination that small financial service companies may experience additional compliance costs and other impacts, including the expense of defending even one class action. However, the CFPB concluded that these concerns were not sufficient to override the public interest supposedly served by the proposed rule banning class action waivers.

The CFPB's rationale for the proposed class action waiver ban is largely based on its finding in the Study that class actions "better enable consumers to enforce their rights under Federal and State consumer protection laws and the common law and obtain redress when their rights are violated." The CFPB found that the threat of class action litigation increases a company's costs for compliance and may cause companies to forgo new initiatives because they may increase the risk of class action liability. This may further reduce innovation in financial products and services. But, according to the CFPB, these potential costs and losses are outweighed by the benefits to consumers from class action litigation.

In actuality, the CFPB's Study contradicts the CFPB's preference for class action litigation. Specifically, the Study found that consumers recover, on average, $32.25 from class actions, while arbitration results typically average $5,389 per claim. The Study also documented that arbitration was less expensive, with the consumer's share of costs capped at $200 per claim, and that the time to resolution was much faster than class action litigation. As well, the U.S. Supreme Court has long favored arbitration, with its most recent expressions making clear that the Federal Arbitration Act preempts state efforts to find class action waivers in pre-suit arbitration clauses unconscionable in *AT&T Mobility v. Concepcion* (2011). The Court continued to reinforce the strong federal preference for arbitration in *America Express v. Italian Colors Restaurant* (2013), and, most recently in *DirectTV v. Imburgia* (2015).

Therefore, it is likely that challenges may abound to the proposed rule if it is adopted in final form. These challenges would include that the rule is not consistent with Dodd-Frank's Section 1028(b)'s requirements that any prohibition, condition, or limitation to consumer financial arbitration be: (i) in the public interest, (ii) for the protection of consumers, and (iii) supported by the Study. Moreover, the single-head agency structure of the CFPB removable only for cause by the president has recently created a potential constitutional separation of powers concern in *PHH Mortgage v. CFPB*, which was argued to a panel of the D.C. Circuit Court of Appeals April 12, 2016 that was less than receptive to the CFPB's position. A decision is expected sometime soon, to likely be followed by review in the U.S. Supreme Court.

The adverse impact to the banking and financial services industry cannot be fully gauged if the proposed rule is adopted. But, it appears without question that a return to the days of unrestrained class actions will yield large recoveries for consumer class action attorneys, minimal actual recoveries for class members, and industry cost increases that will be passed on to consumers. The proposal remains open for public comment for 90 days from publication in the Federal Register.

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