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Insights

CFPB Finalizes Arbitration Rule

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The Consumer Financial Protection Bureau (the “CFPB” or the “Bureau”) released their Final Rule on Arbitration (the “Final Rule” or the “Rule”) on July 10, 2017, containing very few changes from that initially proposed in 2016, and significantly limiting the use of pre-dispute arbitration provisions in consumer financial products and services. The Rule was published in the Federal Register on July 19, 2017, and becomes effective on September 18, 2017 (the “Effective Date”) with mandatory compliance required beginning March 19, 2018 (the “Compliance Date”). This Client Alert, while not intended to be an exhaustive analysis of the Final Rule, will provide a brief summary of the some of the key points of the Final Rule.

EXECUTIVE SUMMARY

The Final Rule prohibits a provider of consumer financial products and services from relying in any way on a pre-dispute arbitration agreement[1] entered into after the Compliance Date to avoid class action litigation.[2] While the Rule does not completely prohibit the use of pre-dispute arbitration provisions, it requires providers to give consumers additional and specific disclosures disclaiming the applicability of pre-dispute arbitration provisions to class actions,[3] and to provide the Bureau with detailed records of any subsequent arbitration. The CFPB will maintain a central repository of these records on a publicly available internet site. Agreements entered into by a provider prior to the Compliance Date are exempt from the scope of the Final Rule; however, any transfer or renewal of an agreement containing a pre-dispute arbitration provision by a third party is prohibited from relying on the provision to avoid class action litigation.

Financial services companies currently using arbitration provisions will be forced to either modify their agreements prior to the Compliance Date, or stop using arbitration as an avenue to resolve disputes entirely. Agreements that are entered into prior to the Compliance Date, but then subsequently assigned to a third party, should be carefully reviewed for the presence of pre-dispute arbitration provisions that may trigger disclosure requirements under the Final Rule.

ANALYSIS

I. **SCOPE**

A. **Who is Covered?**

The restrictions in the Final Rule apply directly to all covered “providers” of consumer financial products or services with limited exceptions, including a provider’s affiliate in certain circumstances.[4]

Most financial services companies will be considered a covered provider under the Final Rule. The restrictions in the Final Rule will also apply to an agreement created by a "covered person" as defined by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), if they later transfer ownership or servicing rights in the financial product or service to a third party. This provision of the Final Rule will likely impact auto-dealers.[5]

B. **What Products or Services are Covered?**

The CFPB intended the Final Rule apply to the "core consumer financial markets of lending money, storing money, and moving or exchanging money."[6] Accordingly, the Rule applies to products and services as defined by 12 U.S.C. § 5481(5), and includes:

- Providing an extension of credit defined as "consumer credit" when performed by a "creditor" under the Equal Credit Opportunity Act ("ECOA");
- "Participating in credit decisions" within the meaning of the ECOA when performed by a "creditor" with regard to "consumer credit" as those terms are defined in 12 CFR § 1002.2;
- Referring applicants or prospective applicants for "consumer credit" to creditors when performed by a "creditor" as those terms are defined in 12 CFR § 1002.2; or selecting or offering to select creditors to whom requests for "consumer credit" may be made when done by a "creditor" as those terms are defined in 12 CFR § 1002.2 unless the referral or selection is incidental to a business activity of that creditor that is not covered by the Rule;
- Acquiring, purchasing, selling or servicing an extension of covered consumer credit as defined under the ECOA;
- Extending or brokering an automobile lease as defined by the CFPB Larger Participant Rule on Auto Finance;[7]
- Providing services to assist with debt management, debt settlement, modify the terms of any extension of credit or avoid foreclosure;
- Providing a credit report, credit score, or any other information specific to a consumer from a credit report with limited exceptions;
- Providing savings accounts subject to the Truth in Savings Act;
- Providing accounts or remittance transfers subject to the Electronic Fund Transfer Act and Regulation E;
- Transmitting or exchanging funds, except when the product or service is offered by the person transmitting or exchanging the funds and it is not covered by the Final Rule;
- Accepting financial or banking data or providing a product or service to accept such data directly from the consumer for purposes of initiating payment by a consumer via any payment instrument, or initiating a credit card or charge card transaction for the consumer with limited exceptions;
- Check cashing, check collection and check guarantee services; or
- Collecting debt arising from any of the consumer financial products or services described in the Final Rule.[8]

C. Who is not Covered?

The Final Rule does NOT apply to:

- Broker dealers to the extent that they are providing products or services subject to rules promulgated or authorized by the U.S. Securities and Exchange Commission with respect to pre-dispute arbitration agreements;
- A Broker Dealer or Investment Advisor regulated by a state Securities Commission;
- A person regulated by the Commodity Futures Trading Commission as defined by 12 U.S.C. § 5481(20), or a person with respect to any account, contract, agreement, or transaction to the extent subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act, 7 U.S.C. § 1 et seq.;
- A federal agency or any State, Tribe, or other person to the extent such person qualifies as an "arm" of a State or Tribe under Federal sovereign immunity;
- Any person who provides a covered financial product or service to no more than twenty-five (25) consumers in the current or preceding calendar year; or
- Merchants, retailers, or other sellers of nonfinancial goods or services, including anyone who purchases or acquires an extension of consumer credit from these entities, provided their activities fall within the exemption from CFPB rulemaking established by the Dodd-Frank Act.[9]

II. REQUIRED DISCLOSURES AND SUBMISSION OF ARBITRAL RECORDS

The Final Rule does not limit the use of pre-dispute arbitration provisions in cases that are not considered class actions;[10] however, starting on the Compliance Date it mandates several new requirements for their use, including added disclosures, amendments to agreements, and the submission of arbitral records to the CFPB that the Bureau plans to make publicly available.[11]

The Final Rule requires any agreement entered into by a provider after the Compliance Date contain the following disclosure:

> *"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."[12]*

If a pre-dispute arbitration clause is for multiple products and services, only some of which fall within the scope of the Final Rule, then the following alternative disclosure is required:

> *"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. The following provision applies only to class action claims concerning the products or services covered by that Rule: 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."[13]*

If an agreement was entered into between two parties prior to the Compliance Date containing a pre-dispute arbitration provision, it will not be required to comply with the provisions of the Final Rule; however, if the provider transfers his or her interest in the agreement to a third party, within sixty (60) days[14] the transferee has to either amend the agreement to include the language required by the

Final Rule, or provide the consumer the following disclosure:

> *"We agree not to rely on any pre-dispute arbitration 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." [15]*

In the event the pre-dispute arbitration agreements existing previously applied to multiple products, only some of which were subject to the Final Rule, then the transferee can add the following language to the disclosure referenced above:

> *"This notice applies only to class action claims concerning the products or services covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau."*

The Final Rule provides that a provider requiring a consumer to submit to arbitration pursuant to a pre-dispute arbitration agreement must submit within sixty (60) days of their filing with the arbitrator or receipt of information filed by others, a copy of the following records in a redacted form to protect the personal identifying information of the individuals:

- Information related to any claim filed in arbitration by or against the provider, including:
  - the initial claim and any counterclaim;
  - the answer to any initial claim and/or counterclaim;
  - the pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;
  - any judgment or award issued by the arbitrator or arbitration administrator;
  - information as to whether an arbitrator or arbitration administrator refuses to administer or dismisses a claim due to the providers failure to pay the required filing or administrative fees and any communication the provider receives from the arbitrator related to the refusal;
  - any communication the provider receives from an arbitrator or an arbitration administrator related to a determination that a pre-dispute arbitration agreement does not comply with the administrator's fairness principles, rules or similar requirements, if such a determination occurs;[16] and
  - any submission to a court that relies on pre-dispute arbitration agreement in support of the provider's attempt to seek dismissal, deferral, or stay of any aspect of a case, including the pre-dispute agreement the motion or filing relies upon.[17]

The Final Rule provides that the Bureau shall establish and maintain this information on its publicly available web site to ensure the records are easily accessible.

FINAL RULE IMPLEMENTATION

The Final Rule faces strong opposition from the financial services industry in the coming weeks and months leading up to its Effective Date. The Republican controlled Congress has already moved to strike down the Rule through the Congressional Review Act, a process whereby Congress may nullify administrative rules through an expedited legislative review. While the House of Representatives has already passed House Joint Resolution 111 to overturn the Final Rule, timing of a similar resolution and its likelihood of success in the Senate is less certain. Should legislative efforts fail, the financial services industry is widely expected to file suit challenging the legitimacy of the Final Rule.

While the outcome of these efforts is uncertain, in the interim, financial services providers who currently use arbitration provisions in their agreements should carefully review the final Rule, and begin preparing for compliance by March 19, 2018.

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[1] 12 C.F.R. 1040.2(c) Pre-dispute arbitration agreement means an agreement between a covered person as defined by 12 U.S.C. 5481(6) and a consumer providing for arbitration of any future dispute concerning a consumer financial product or service covered by § 1040.3(a).

[2] 12 CFR § 1040.4 Limitations on the use of pre-dispute arbitration agreements. (a) Use of pre-dispute arbitration agreements in class actions. (1) *General rule.* A provider shall not rely in any way on a pre-dispute arbitration agreement entered into after the date set forth in § 1040.5(a) with respect to any aspect of a class action that concerns any of the consumer financial products or services covered by § 1040.3, including to seek a stay or

dismissal of particular claims or the entire action, unless and until the presiding court has ruled that the case may not proceed as a class action and, if that ruling may be subject to appellate review on an interlocutory basis, the time to seek such review has elapsed or such review has been resolved such that the case cannot proceed as a class action.

[3] 12 CFR § 1040.4(a)(2) Limitations on the use of pre-dispute arbitration agreements. (a) Use of pre-dispute arbitration agreements in class actions. (2) Provision required in covered pre-dispute arbitration agreements. Upon entering into a pre-dispute arbitration agreement for a product or service covered by § 1040.3 after the date set forth in § 1040.5(a): (i) Except as provided in paragraphs (a)(2)(ii) or (iii) of this section or in § 1040.5(a), a provider shall ensure that the agreement contains the following provision: “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.”

[4] 12 CFR § 1040.2(c) defines “provider” to mean: (1) A person as defined by 12 U.S.C. 5481(19) that engages in offering or providing any of the consumer financial products or services covered by § 1040.3(a) to the extent that the person is not excluded under § 1040.3(b); or (2) An affiliate of a provider as defined in paragraph (c)(1) of this section when that affiliate is acting as a service provider to the provider as defined in paragraph (c)(1) of this

section with which the service provider is affiliated consistent with 12 U.S.C. 5481(6)(B).

[5] See Official Interpretation to 12 CFR §1040.2(c)(ii). For example, an automobile dealer that extends consumer credit is a covered person under 12 U.S.C. § 5481(6). Its pre-dispute arbitration agreement would therefore fall within the scope of the definition in § 1040.2(c). However, an automobile dealer excluded from the Bureau’s rulemaking authority in circumstances described by Dodd-Frank section 1029 would not be required to comply with the requirements in § 1040.4, because those requirements apply only to providers, and such dealers are excluded by § 1040.3(b)(6) and therefore are not providers under § 1040.2(d). The requirements in § 1040.4 would apply, however, to the use of the automobile dealer’s pre-dispute arbitration agreement by a different person that meets the definition of provider, such as a servicer or purchaser or acquirer of the automobile loan, when the agreement was entered into after the compliance date.

[6] See Final Rule, Section Analysis (Sec. 1040.3)

[7] 12 C.F.R. § 1090.108

[8] 12 C.F.R. § 1040(3)(a)

[9] This exemption applies to merchants, retailers and other sellers of nonfinancial good or services to the extent they provide, purchase or acquire an extension of consumer credit that is of the type described in 12 U.S.C. 5517(a)(2)(A)(i) and they would be subject to the Bureau’s authority only under 12 U.S.C. 5517(a)(2)(B)(i) but not 12 U.S.C. 5517(a)(2)(B)(ii) or (iii)

[10] 12 CFR § 1040.2(a) Class action means a lawsuit in which one or more parties seek class treatment pursuant to Federal Rule of Civil Procedure 23 or any State process analogous to Federal Rule of Civil Procedure 23.

[11] There is a limited exception to the disclosure requirements of the Final Rule for pre-packaged general-purpose reloadable prepaid card agreements pursuant to the 12 CFR § 1040.5(b)

[12] 12 CFR 1040.4(a)(2)(i)

[13] 12 CFR § 1040.4(a)(2)(ii)

[14] 12 CFR § 1040.4(a)(2)(iii)(b) requires amendment or added disclosure within sixty (60) days of “entering into” the pre-dispute arbitration agreement.

[15] 12 CFR § 1040.4(a)(2)(iii)

[16] 12 CFR § 1040.4(b)

[17] 12 CFR § 1040.4(b)