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COMMENTARY

CFPB Proposes New Rule on Mandatory Consumer Arbitration Clauses

Arbitration as a means of dispute resolution is intended to help consumers and businesses save time and money and achieve fair results when compared to traditional litigation. Millions of contracts for consumer financial products and services have a pre-dispute arbitration clause that requires consumers and financial institutions to resolve their disputes through arbitration, rather than through the court system.

On May 5, 2016, the Consumer Financial Protection Bureau ("CFPB" or "Bureau") issued a controversial notice of proposed rulemaking that would impose two severe limitations on the use and efficacy of pre-dispute arbitration clauses in contracts for consumer financial products and services:

- **Arbitration could not block class actions without court action.** First, the proposed rule "would prohibit providers from using a pre-dispute arbitration agreement to block consumer class actions in court and would require providers to insert language into their arbitration agreements reflecting this limitation."
- **Companies would be required to submit arbitration claims filed and awards issued to the CFPB for review and possible publication.** Second, "the proposal would require providers that use pre-dispute arbitration agreements to submit certain records relating to arbitral proceedings to the Bureau. The Bureau 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. The Bureau intends to publish these materials on its website in some form … to provide greater transparency into the arbitration of consumer disputes."

("CFPB Arbitration Proposal").[1]

In its accompanying news release, the CFPB stated the supposed benefits of banning arbitration clauses with class-action waivers and requiring reporting of all arbitration claims. The Bureau stated its rulemaking would finally provide "a day in court for consumers"; a "deterrent effect" by "incentiviz[ing] companies to comply with the law to avoid group lawsuits" so they are "held accountable for their conduct"; and "increased transparency" since the CFPB would now be able to collect information on all arbitration claims and awards to "better understand and monitor arbitration."[2] The CFPB Arbitration Proposal has not yet been published in the Federal Register, but it likely will be

shortly, after which point, comments must be received by the Bureau within 90 days.[3]

If the features of the Proposal are adopted in final form without change, companies that are subject to the jurisdiction of the CFPB would no longer be able to use arbitration clauses to prevent disaffected consumers from filing class actions in state or federal court, potentially leading to significantly larger liability and expense. While the Bureau is not currently proposing barring arbitration clauses entirely, this condition for class actions would effectively eviscerate the efficacy and cost savings associated with the use of arbitration clauses. In theory, companies would still be able to require the submission of individual disputes to arbitration; however, the Bureau's additional Proposal of creating a database of all arbitral claims and awards for public consumption would likely deter many companies from using such clauses in the first place due to the risk of heightened regulatory and public scrutiny.

Companies that are subject to the CFPB's oversight must take immediate steps to ensure their compliance with all applicable consumer financial services laws and to prepare for the CFPB's rulemaking. These steps could help to diminish companies' litigation, reputational, operational, and other risks that would result from the CFPB's anticipated placement of substantial limitations on the use of arbitration clauses to resolve disputes related to consumer financial products and services. Companies should also consider filing a public comment to shape the CFPB's Arbitration Proposal, or perhaps even bringing a legal challenge regarding the Bureau's authority and debatable bases for rulemaking.

Arbitration Clauses in Financial Products and Services Contracts

Millions of consumer financial products and services contracts, such as those for credit cards and mortgage loans, contain arbitration clauses. Arbitration clauses "require that disputes that may arise about that product or service be resolved through arbitration, instead of the court system. Where such a clause exists, either side can generally block lawsuits, including class actions, from proceeding in court."[4] Arbitration clauses "generally give each party to the contract two distinct contractual rights. First, either side can file claims against the other in arbitration and obtain a binding decision from the arbitrator. Second, if one side sues the other in court, the party that has been sued in court can invoke the arbitration clause to require that the dispute proceed, if at all, in arbitration instead."[5]

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") required the CFPB to study arbitration agreements and submit its findings in a report to Congress ("CFPB Study").[6] In sharp contrast to the intent of arbitration clauses, the CFPB Study, released in March 2015, concluded that the overwhelming majority of consumers are unaware whether their financial products and services contracts require resolution of disputes through arbitration or through litigation, and even when consumers are aware of arbitration clauses, very few consumers (fewer than 7 percent, according to the CFPB Study) understand what arbitration means or requires.[7] According to the CFPB Study, the existence of arbitration clauses in contracts for financial products and services is unknown to most consumers, and even if consumers are aware, generally they do not understand how such clauses operate. More than three quarters of credit card consumers do "not know whether their credit card agreement contain[s] an arbitration clause," and among consumers "whose contract include[s] an arbitration clause, fewer than 7 percent recognized that they could not sue their credit card issuer in court."[8] According to the CFPB Study, more than 50 percent of outstanding credit card loans and 99 percent of payday loan agreements are subject to arbitration clauses, as are approximately 44 percent of insured deposits and most student loan contracts.[9]

Based on the findings of its Study, on October 7, 2015, the CFPB published an outline of proposals for future rulemaking regarding the use of pre-dispute arbitration clauses in contracts for consumer financial products and services, which included (i) prohibiting pre-dispute arbitration clauses from foreclosing class litigation; and (ii) requiring submission of any arbitral claims and awards to the CFPB for collection and possible publication ("CFPB Proposal Outline"). While the Bureau did not entertain a proposal that would have "prohibit[ed] entirely the use of pre-dispute arbitration agreements," together the Proposals would severely limit the use and benefits of arbitration clauses in contracts for consumer financial products and services, including for credit cards,

checking and deposit accounts, prepaid cards, money transfer services, certain auto loans, payday loans, and private student loans.[10] In issuing its Proposal Outline, the CFPB analyzed the effect of legal precedent upholding the validity of arbitration clauses and the availability of class-action waivers, but nevertheless concluded it has authority under the Dodd-Frank Act to issue rules limiting the scope of such clauses.[11] After announcing its Proposal Outline, the CFPB engaged in stakeholder outreach activities, including convening a Small Business Advocacy Review Panel. This Panel published its own report ("Small Business Panel Report") on December 11, 2015, which expressed concerns about the impact of the proposals on the efficacy of arbitrations and the costs to small businesses as compared to larger entities.[12]

There are varying views of the advantages and disadvantages of arbitration. Some believe that the cost savings of arbitration are overstated, and that because most arbitration clauses also contain class-action waivers, which prevent consumers from filing formal claims as a group, the amounts consumers may successfully recover are artificially reduced.[13] After comparing consumer prices for credit card issuers that eliminated their arbitration clauses versus prices for credit card issuers that maintained them, the CFPB Study concluded there was no "statistically significant evidence of an increase in prices among those companies that dropped their arbitration clauses and thus increased their exposure to class action litigation risk."[14] "Using the same 'difference-in-differences' methodology," the CFPB was "unable to identify evidence that companies that eliminated arbitration clauses reduced their provision of credit to consumers relative to companies that did not change their arbitration clauses."[15] Shortly after the CFPB Study was released, 58 House and Senate Democrats wrote to the director of the CFPB "urg[ing] the CFPB swiftly to undertake a rulemaking to eliminate the use of forced arbitration clauses in [consumer financial products or services] contracts."[16]

Others believe that arbitration and other alternative dispute resolution mechanisms are less expensive, faster, and more efficient than traditional litigation, in no small part because arbitrations are subject to their own streamlined procedures as opposed to those in state and federal courts that include time-consuming and costly discovery obligations.[17] Scholars and industry groups, including the American Bankers Association ("ABA"), the Consumer Bankers Association ("CBA"), and the Financial Services Roundtable ("FSR"), expressed immediate and strong criticism of the CFPB Study's methodologies and conclusions.[18] For instance, the ABA, CBA, and FSR contend that consumers who prevail in arbitration actually recover "166 times more in financial payments than the average class member in class action settlements," thereby undermining a central tenet of the CFPB Study.[19] Supporters of the merits of arbitration clauses claim these cost savings are passed to consumers in the form of lower prices and greater availability of credit. Scholars also noted that the "CFPB's data do not allow for meaningful comparison between arbitration and class actions" because the data set in the CFPB Study consisted of a "false apples-to-oranges comparison between class action *settlements* and arbitral *awards*."[20] Additionally, some commentators claim that there is little evidence to suggest arbitration clauses are as pronounced or restrictive as the CFPB Study suggests, given "abundant competition in the financial services marketplace to accommodate customers who prefer to resolve disputes via litigation as opposed to arbitration." [21] Rather, according to these commenters, the data show that "85 percent of credit card issuers and 92.3 percent of banks do not include arbitration provisions in their customer contracts."[22] Based on these and other concerns, more than 80 House and Senate Republicans wrote to the director of the CFPB criticizing what they saw as "the flawed process [that] produced a fatally-flawed study" and asking that the CFPB reopen the study and seek public comment before embarking on any rulemaking.[23]

Despite the back and forth, on May 5, 2016, the CFPB published its Arbitration Proposal. The Proposal was met with immediate and swift opposition from some industry groups. The ABA claimed, "'Consumers will get less and pay more if the CFPB's proposal to sideline arbitration and promote class actions is ultimately adopted. … When needed, arbitration is an efficient, fair and low-cost method of resolving disputes in a fraction of the time—and at a fraction of the cost—of expensive litigation.'"[24] And the president of the CBA stated, "Arbitration has long provided a faster, better, and more cost-effective means of addressing consumer disputes than litigation or class action lawsuits. The real winners of today's proposal are trial attorneys, not consumers…." [25] The CFPB's own study shows consumers are better served by arbitration, noting that 60 percent of class

action lawsuits provide consumers with no benefit.[26] Finally, the American Financial Services Association opined that "[d]espite a wealth of evidence suggesting that the bureau's interpretation of its own study is flawed, today's rule, in its present form, would have a negative impact on customers by taking away a valuable tool to resolve disputes" and vowed it "will comment on the proposed rule and will continue its ongoing dialogue with the CFPB."[27]

Of course, certain consumer groups, like the National Consumers League, "applaud[ed]" the CFPB's Arbitration Proposal, cheering its perceived benefits for individual customers to litigate their disputes with financial services companies in court.[28] Lawmakers also weighed in on both sides of the debate. Congressman Jeb Hensarling (R-TX), the chairman of the House Financial Services Committee, stated, "This move—which will apply to some of the most common financial contracts including credit cards, checking accounts, and even cell phones—essentially hands over the keys of the CFPB's luxury office building to the wealthy, powerful, and politically well-connected trial lawyer lobby."[29] On the other side of the aisle, Senator Sherrod Brown (D-OH), the ranking member of the Senate Banking, Housing and Urban Affairs Committee, praised the CFPB "proposal to ban this unjust and unfair practice [as] a major victory for consumers. I will push the CFPB to finalize the rule as soon as possible, and will fight against efforts to weaken it."[30]

Steps to Take Now

Companies that are subject to CFPB supervision and regulation, and that rely upon arbitration clauses in contracts for consumer financial products and services, must take steps now to prepare for the Rulemaking and also to reduce reputational, operational, litigation, and other risks. Parties should also strongly consider filing public comments to the CFPB's Arbitration Proposal to express their positions and concerns, with the aims of reshaping or challenging the final rule.

Below are several key steps to consider:

- Conduct a review of your compliance management system. Evaluate your consumer compliance management system to identify and fill any gaps in processes and procedures that inure to the detriment of consumers under standards of unfair, deceptive, and abusive acts or practices, and that could result in groups of consumers taking action.
- Ensure clear and timely customer communications. Clearly and timely communicate with consumers regarding changes in policy and price increases.
- Commit sufficient resources to customer service. Devote adequate resources to customer service, including training of customer service representatives.
- Adhere to an effective consumer complaint system. Ensure that your consumer complaint processes are effective and provide feedback throughout the company.
- Make sure arbitration clauses are prominent and understandable. Ensure that contract arbitration clauses are brought to the attention of the consumer at the time of entering the agreement for consumer financial products and services, using prominent and understandable language. If the Arbitration Proposal becomes final in current form, arbitration clauses in new contracts may not include class-action waiver language.
- Be prepared for class action litigation. If the Arbitration Proposal becomes final in current form, be prepared to litigate consumer disputes in court.
- Consider legal options. Consult internally and with counsel regarding filing a public comment to the Arbitration Proposal or challenging its bases in court. Recent court rulings suggest agency actions will be scrutinized absent statutory basis or consideration of required factors.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

Lisa M. Ledbetter
Washington
+1.202.879.3933
lledbetter@jonesday.com

Gregory R. Hanthorn
Atlanta
+1.404.581.8425
ghanthorn@jonesday.com

Michael A. Carvin
Washington
+1.202.879.7643
macarvin@jonesday.com

C. Hunter Wiggins
Chicago
+1.312.269.1554
Washington
+1.202.879.7656
hwiggins@jonesday.com

Jeremy P. Cole
Chicago
+1.312.269.4093
jpcole@jonesday.com

Sanjay Narayan
New York
+1.212.326.3735
snarayan@jonesday.com

Endnotes

1 Bureau of Consumer Financial Protection, Arbitration Agreements, 12 C.F.R. Part 1040 (May 3, 2016) ("CFPB Arbitration Proposal").

2 Consumer Financial Protection Bureau, "CFPB Proposes Prohibiting Mandatory Arbitration Clauses that Deny Groups of Consumers their Day in Court" (May 5, 2016) ("CFPB Arbitration Proposal News Release").

3 CFPB Arbitration Proposal.

4 Consumer Financial Protection Bureau, "Consumer Financial Protection Bureau Study Finds That Arbitration Agreements Limit Relief for Consumers" (Mar. 10, 2015) ("CFPB Study News Release").

5 Consumer Financial Protection Bureau, "Arbitration Study" at 4 (March 10, 2015) ("CFPB Study").

6 Dodd-Frank Act, § 1028(a).

7 CFPB Study News Release.

8 CFPB Study News Release.

9 CFPB Study News Release; CFPB Study at 10.

10 Consumer Financial Protection Bureau, "Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements; Outline of Proposals Under Consideration and Alternatives Considered" at 14, 19-20 (Oct. 7, 2015) ("CFPB Proposal Outline"); see Consumer Financial Protection Bureau, "CFPB Considers Proposal to Ban Arbitration Clauses that Allow Companies to Avoid Accountability to Their Customers" (Oct. 7, 2015) ("CFPB Proposal Release"); Yuka Hayashi, "Sue the Bank? You May Get Your Shot," *The Wall Street Journal* (Oct. 7, 2015); Jenna Greene, "Say Goodbye to Mandatory Arbitration—And Hello to Class Actions," *Am Law Litigation Daily* (Oct. 6, 2015).

11 CFPB Proposal Outline at 5-7, 12.

12 Consumer Financial Protection Bureau, "Final Report of the Small Business Review Panel of the CFPB's Potential Rulemaking on Pre-Dispute Arbitration Agreements" at 33-35 (Dec. 11, 2015) ("Small Business Panel Report").

13 Consumer Financial Protection Bureau, "Consumer Financial Protection Bureau Finds That Arbitration Agreements Limit Relief for Consumers" ("CFPB Fact Sheet") at 2-4; *see* CFPB Study News Release.

14 CFPB Study at 18.

15 CFPB Study at 18.

16 Letter from Sen. Al Franken *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau at 1 (May 21, 2015) ("Democrat letter").

17 *See* Jenny N. Perkins, "CFPB Holds Field Hearing on Arbitration Report," CFPB Monitor (March 13, 2015).

18 *See, e.g.*, Jason Scott Johnston & Todd Zywicki, "The Consumer Financial Protection Bureau's Arbitration Study, A Summary and Critique" at 6, Mercatus Working Paper, Mercatus Center at George Mason University, Aug. 2015; Letter from American Bankers Association *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau (May 21, 2015) ("May 21 ABA Letter"); Letter from American Bankers Association *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau at 2 (July 13, 2015) ("July 13 Trade Group Letter").

19 July 13 Trade Group Letter at 4.

20 Johnston, "The Consumer Financial Protection Bureau's Arbitration Study" at 6 (adding that the Bureau did not have access to arbitral settlements).

21 July 13 Trade Group Letter at 4.

22 July 13 Trade Group Letter at 4.

23 Letter from Rep. Patrick McHenry *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau at 1 (June 17, 2015), ("Republican letter").

24 American Bankers Association, "CFPB Proposal Would Undermine Benefits to Arbitration" (May 5, 2016).

25 Consumer Bankers Association, "3 Industry Groups Find Similar Concerns with CFPB Arbitration Proposal" (May 6, 2016).

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27 American Financial Services Association, "AFSA Opposes CFPB Proposed Rule on Arbitration" (May 5, 2016).

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29 Ryan Rainey, Morning Consult, "CFPB Arbitration Rule Prompts Reactions from Industry, Lawmakers, Advocacy Groups" (May 5, 2016).

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