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The CFPB Issues Rule Prohibiting Certain Arbitration Clauses

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On July 10th, in a 775-page release, the Consumer Financial Protection Bureau (CFPB) issued its long-awaited final arbitration rule (the "Rule") pertaining to consumer finance contracts. The Rule largely mirrors the proposed rule from May 2016, with a few modifications. At a high level, once the Rule becomes effective, covered providers will be precluded from relying on pre-dispute agreements to arbitrate certain class action disputes. The Rule, however, will not preclude arbitration of non-class action disputes or class action disputes unrelated to the consumer finance laws that are the subject of the CFPB's jurisdiction.

The Rule is important for three reasons: (1) it prohibits covered providers from relying on waivers to block class action lawsuits; (2) it prohibits the inclusion of class action lawsuit waiver provisions in contracts pertaining to a broad swath of consumer products and services, or "covered products and services," and (3) it requires covered providers to not only alter their form agreements, but to submit arbitration-related court and arbitration filings to the CFPB for watchdog purposes.

While the Scope of the Rule is Broad, Not All Finance Companies Are Within the Rule's Reach
The Rule applies to a broad range of consumer finance companies that offer or provide certain types of consumer financial products or services, or "covered transactions," including:

- extensions of credit and participating in credit decisions;
- providing accounts and remittance transfers subject to the EFTA
- providing accounts subject to the Truth in Savings Act
- auto leasing and brokering of auto leases;
- debt management, settlement and repair;
- credit report remediation;
- consumer report providers; and

- check cashing and debt collectors, which is defined more broadly than the term is traditionally employed in the Fair Debt Collection Practices Act context

While the Rule is broad in its scope, it specifically excludes a few entities and transactions, including:

- broker-dealers and investment advisors;
- employers;
- entities regulated by the SEC, CFTC or a State securities commission;
- Federal agencies, States and Tribes;
- entities and affiliates that provide covered services to no more than 25 consumers in the current year and the preceding year; and
- merchants and retailers of nonfinancial goods that fall outside the CFPB's authority.

Requirements of the Rule

The Rule carries three (3) primary requirements:

- The "General Rule" makes it illegal for covered providers to "rely in any way on a pre-dispute arbitration agreement…with respect to any aspect of a class action" that concerns any covered product or service, including to "seek a stay or dismissal of particular claims or the entire action…."
- Covered providers must change the language of their arbitration agreements to delete class action waivers and to include the following notice: "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." Where the agreement existed previously between other parties, the company must amend the arbitration provision to contain the required language or provide written notice that the company waives any right to block a class action.
- Covered providers are required to submit arbitration-related filings from court cases and arbitrations to the CFPB for review. The filings will be monitored by the CFPB and posted on an Internet site for public access.

The Effective Date of the Rule
The effective date of the Rule is 60 days after it 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 effective date. As such, the Rule will apply to arbitration agreements entered into 241 days after publication in the Federal Register.

Several Challenges to the Rule Have Been Threatened
The Rule may face challenges from a number of different angles. For example, Congress could seek to reverse the Rule using the Congressional Review Act ("CRA"). Under the CRA, an agency action can be overridden by a resolution approved by a simple majority vote of both chambers of Congress and signed by President Trump. Reports indicate Senator Tom Cotton of Arkansas has already begun the CRA process.

The Rule may also be challenged through a lawsuit on grounds that the CFPB erred or overstepped its authority. Specifically, the CFPB's authority underpinning the Rule is the Dodd-Frank Wall Street Reform and Consumer Protection Act, which authorized the CFPB to issue regulations regarding arbitration only if they (1) are in the public interest; (2) for the protection of consumers; and (3) consistent with findings from a study by the CFPB. A finding that any one of these three prerequisites to action is absent could doom the Rule. Not surprisingly, the CFPB devoted hundreds of pages in the 775-page release to rebutting the multitude of comments it received (the agency received approximately 110,000 comments), many of which claimed that the Rule is an abuse of authority and contradicts an honest reading of its own study.

Another challenge to the Rule may also occur through the Financial Stability Oversight Council (the "FSOC"), which was established as part of the Dodd-Frank. If the FSOC concludes that the Rule would put at risk the safety and soundness of the United States banking system or the stability of the financial system, the Rule can be set aside. On July 10, the Office of the Comptroller of the Currency sent a letter to the CFPB raising concerns that the Rule would place at risk that the safety and soundness of the banking system. While the OCC has not requested the FSOC to set aside the Rule, the letter indicates that the OCC is considering such a challenge.

What Should Consumer Finance Companies Do? While final implementation of the Rule may be stopped by Congress, litigation or the FSOC, the success of any of these actions is not guaranteed. So covered providers should prepare for the implementation of the Rule and contact their professional advisors to determine whether they and/or their products or services are covered by the Rule, and if so, the steps necessary to comply with the Rule. It is notable that the Rule includes a safe harbor for "genuine" mistakes as to its coverage.

Covered providers should also review their current consumer contracts to see whether they already include arbitration provisions, and if not, whether an arbitration provision should be added prior to the effective date of the Rule. Again, arbitration agreements entered into prior to the Rule's effective date will remain enforceable.

In the event the Rule is not stopped, covered providers should amend their form contracts to include the express terms required by the Rule. They may also take the opportunity to re-evaluate the entirety of the arbitration agreement, including whether to permit class arbitrations and whether to continue to require individual arbitrations since those are unaffected by the Rule. Attention should also be given to whether a specific state's laws can or should be designated in the agreement and the use of other contractual terms to help protect the company from litigation and the costs associated with it.

Finally, covered providers should consider how to build Rule compliance into their general compliance management system, including compliance with the arbitration-filing submission requirement.

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