Client Alert

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The CFPB Issues Its Final Arbitration Rule

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Ending months of speculation and insider reading of tea leaves, on July 10, 2017, the Consumer Financial Protection Bureau (CFPB or Bureau) issued a final rule regarding the use of arbitration agreements in specified consumer financial contracts (Final Rule). The Final Rule was published in the *Federal Register* on July 19, 2017. As was substantively expected, the Final Rule: 1) bars class action waivers; and 2) imposes reporting requirements for individual arbitrations conducted pursuant to pre-dispute arbitration agreements. The Final Rule is accompanied by more than 200 pages of Supplementary Information in which the CFPB largely repeats the findings of its earlier Report to Congress and the Supplementary Information that accompanied its Proposed Rule and concludes that class action litigation and CFPB monitoring of individual arbitrations are both "in the public interest" and "for the protection of consumers."[1]

BACKGROUND

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) mandated a CFPB study on the use of pre-dispute arbitration clauses in connection with the offering or provision of consumer financial products and services, with a report of its findings sent to Congress. The Dodd-Frank Act further authorized the CFPB to prohibit or impose conditions or limitations on the use of arbitration clauses by regulation if the CFPB determined that it would be in the public interest and for the protection of consumers to do so. However, any such regulation must be consistent with the findings of the CFPB's study.[2]

Through a series of preliminary steps, the CFPB has consistently signaled its intent to target class waivers.[3] Those efforts culminated in the CFPB's May 2016 Proposed Rule.[4] Although the Bureau received more than 100,000 comments on the Proposed Rule, industry insiders expected a Final Rule would issue relatively quickly. In its Fall 2016 Semiannual Regulatory Agenda, the Bureau indicated it expected to issue a Final Rule in early 2017. Industry analysts attributed the delay to the effective use of the Congressional Review Act to override more than a dozen regulations developed during the Obama administration and CFPB concern that a final arbitration rule could suffer the same fate. Other analysts attributed the delay to the possibility that President Trump could fire Director Cordray or that Director Cordray might resign to seek state political office, leaving the Bureau unable to fight for the Rule. Either way, Director Cordray proved the pundits wrong.

[1] Dodd-Frank Act § 1028(b).

[2] *Id.* §§ 1028(a), (b).

[3] *See* Client Alert, "CFPB Builds Its Case Against Arbitration Clauses" (Dec. 17, 2013); Client Alert, "The Other Shoe Has Dropped: CFPB Releases Report on Arbitration" (Apr. 9, 2015); Client Alert, "CFPB Announces Intent to Commence Arbitration Rulemaking" (Oct. 20, 2015).

[4] *See* Client Alert, "The Time Has Come: The CFPB Issues its Proposed Arbitration Rule" (May 12, 2016); 81 Fed. Reg. 32,829 (May 24, 2016).

WHAT DOES THE FINAL RULE PROVIDE?

Like the Proposed Rule, there are two parts to the Final Rule.[5] *First*, the Final Rule will prohibit covered providers of consumer financial products and services from relying on pre-dispute arbitration agreements to prevent consumers from pursuing class actions in court.[6] As if the ban itself were not sufficient, the Final Rule will require all arbitration agreements in contracts of covered providers to contain the following language: "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."[7]

Second, covered providers who include pre-dispute arbitration agreements in their contracts must submit the following information to the CFPB for each filed arbitration: a copy of the claims and any counterclaims; a copy of the pre-dispute arbitration agreement; the details of any awards; any communications the provider receives from the arbitrator or administrator regarding dismissal of arbitration because of failure of the provider to pay fees; and any communications the provider receives from an arbitrator or administrator that its pre-dispute arbitration agreement does not comport with fairness principles, rules, or other requirements of the arbitral forum.[8] The CFPB has added a provision to the Final Rule that it will make this information available, in redacted form, on a publicly available database, and use the data to evaluate whether it should ban the use of arbitration in consumer financial services contracts altogether.[9]

WHO IS COVERED?

The Final Rule covers a broad range of consumer financial contracts governing lending money, moving money, storing money, or transferring money.[10] A "provider" is defined as any entity that provides the following consumer financial products or services:

- Consumer credit services;
- Automobile leases;
- Debt relief services;
- Credit repair services, which were not included in the Proposed Rule;
- Credit reporting and monitoring;
- Deposit accounts, electronic funds transfer accounts, or money transfer services;[11]
- Payment processing services, check cashing, check collections, or check guaranty services; or
- Debt collection.[12]

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[5] The Final Rule adds a new Part 1040, Arbitration Agreements, to Title 12 of the Code of Federal Regulations. 82 Fed. Reg. 33,210 (July 19, 2017).

[6] Final Rule at 33,429 (to be codified at 12 C.F.R. § 1040.4(a)(1)).

[7] *Id.* (to be codified at 12 C.F.R. § 1040.4(a)(2)(i)).

[8] *Id.* at 33,430 (to be codified at 12 C.F.R. § 1040.4(b)(1)).

[9] Supplementary Information at 33,316; Final Rule at 33,340 (to be codified at 12 C.F.R. §§ 1040.4(b)(3), (4)).

[10] Final Rule at 33,428–29 (to be codified at 12 C.F.R. § 1040.3(a)).

[11] The Bureau recognized that the scope of transmitting and exchanging funds under the Dodd-Frank Act has not been interpreted by regulation and, more generally, that coverage under this subsection will require analysis of "the nature of a person's funds transmitting and exchange activities." Supplementary Information at 33,342. The Bureau concludes this ambiguity is beneficial "to the extent the application of the rule creates an incentive for the provider to develop a compliance system and creates class action exposure for providers who fail to meet their legal obligations," which are "the chief goals of this rulemaking." *Id.*

The Bureau describes these products and services as being "in or tied to the core consumer financial markets of lending money, storing money, and moving or exchanging money."[13] Merchants, retailers, or other sellers of non-financial goods are subject to the Rule only in certain specific situations, such as when they act as creditors.[14]

The Bureau made only a few changes to the enumerated exceptions in the Final Rule. These exceptions include persons regulated by the SEC, persons regulated by a state securities commission as broker dealers or investment advisors, and persons regulated by the CFTC.

The Final Rule includes a federal agency exclusion rather than an exclusion for the federal government and affiliates as had been proposed. It also excludes states, tribes, or other persons that qualify as an "arm" of a state or tribe under federal sovereign immunity law and whose immunity has not been abrogated by Congress. This is broader than the Proposed Rule, which would have excluded tribal governments only to the extent that they were providing services directly to consumers who reside in the tribe's territorial jurisdiction.[15] The Bureau explained that it shifted away from this approach in the Final Rule because there is no need for the Rule to apply to entities that "cannot be sued on any claims in a private lawsuit because they enjoy sovereign immunity."[16] As with the Proposed Rule, the exception does not apply to non-governmental entities that provide covered products or services on behalf of a state or tribal government.

The Final Rule also includes a *de minimis* exception for entities that have provided the covered services to fewer than 25 consumers and government entities.[17] The Bureau noted that there is little to no chance these entities would be sued in a class action because a challenged practice that impacts 25 or fewer consumers likely would fail to meet the numerosity requirement to certify a class under Rule 23 or state law analogues.[18]

Employers offering covered products or services as an employee benefit are excluded as well.[19] However, the exception does not apply to third parties that provide consumer financial products or services on the employer's behalf and employee benefits do not include consumer financial products and services provided to employees on the same terms as the employer makes available to the general public.[20] The CFPB added an exception for persons providing products or services in circumstances where they are excluded from its rulemaking authority.

[12] Final Rule at 33,428–29 (to be codified at 12 C.F.R. §§ 1040.2(d), 1040.3(a)).

[13] Supplementary Information at 33,325.

[14] Final Rule at 33,428–29 (to be codified at 12 C.F.R. §§ 1040.3(a)(1)(iii), 1040.3(b)(4)).

[15] Proposed Rule, 81 Fed. Reg. at 32,925 (proposed § 1040.3(b)(2)(ii)).

[16] Supplementary Information at 33,353.

[17] Final Rule at 33,429 (to be codified at 12 C.F.R. § 1040.3(b)(3)).

[18] Supplementary Information at 33,354.

[19] Final Rule at 33,429 (to be codified at 12 C.F.R. § 1040.3(b)(5)).

[20] Supplementary Information at 33,358 (to be codified at 12 C.F.R. pt. 1040, cmt. 3(b)(5)–1).

POSSIBLE CHALLENGE TO THE RULE?

The Final Rule faces a number of significant legal hurdles. Most significantly, Republican majorities in both houses of Congress could deploy the Congressional Review Act (CRA) to kill the Final Rule before it takes effect. The CRA empowers Congress to review new federal rules issued by federal agencies and to nullify those rules through an expedited legislative process. The law provides Congress with 60 legislative days (or days in which Congress is in a particular session) to overturn a rule by submitting a "joint resolution of disapproval," which only requires approval by a simple majority in both chambers.[21] Importantly, the CRA establishes a special set of "fast track" legislative procedures that effectively makes a joint resolution of disapproval filibuster-proof in the Senate. If the resolution is signed by the President, the CRA provides that the rule at issue cannot take effect and may not be issued in "substantially the same form" again unless Congress approves the rule with a new law. Although the CRA had been used successfully only once since its enactment in 1996, the current Congress and administration have used it to overturn more than a dozen rules.

If it survives the CRA, the Final Rule will almost certainly be subject to further legal challenge by industry participants and trade groups. The CFPB may have difficulty meeting its burden to prove that such a Final Rule is in the "public interest," will "protect consumers," and is "consistent with the study,"[22] given the results and limitations of its study. We described many of these issues in greater detail in our prior Client Alert. It is unlikely that the CFPB's additional 218 pages of support for the Final Rule will satisfy its opponents or remedy certain shortcomings in the original study.

WHEN WILL THE FINAL RULE TAKE EFFECT AND WHICH AGREEMENTS WILL BE COVERED?

Barring a successful court challenge or invocation of the CRA, the Final Rule's effective date is September 18, 2017.[23] The Final Rule will apply only to those agreements entered into on or after March 19, 2018.[24]

The Bureau adopted the exceptions to this forward-looking timing set out in the Proposed Rule. For example, agreements entered into before the effective date will be covered by the Final Rule if account ownership changes, for example, in a merger or sale of a portfolio.[25] Modifications, amendments, or implementation of terms do not create a new agreement subject to the Final Rule. However, a provider will be considered to have entered into a new contract if the provider provides a new product or service subject to a pre-existing arbitration agreement.[26]

The Final Rule includes a narrow exception for pre-packaged general-purpose reloadable prepaid cards that are on store shelves as of the compliance date. Although these providers will be bound by the class action waiver ban, they need not include the required language in the customer agreement for cards that were packaged prior to the compliance date if they do not have a way to contact the consumer. If the provider has contact information or later obtains it, the provider must contact the consumer and provide an amended agreement containing the mandatory language.[27]

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[21] *See* 5 U.S.C. § 802(a).

[22] Dodd-Frank Act § 1028.

[23] 82 Fed. Reg. 33,210, 33,210.

[24] Final Rule at 33,430 (to be codified at 12 C.F.R. § 1040.5(a)).

[25] *Id.* at 33,429 (to be codified at 12 C.F.R. § 1040.4(a)(2)(iii)).

[26] Commentary at 33,432 (to be codified at 12 C.F.R. pt. 1040, cmts. 4–1(ii)(A), 4–1(i)(A)).

[27] Final Rule at 33,430 (to be codified at 12 C.F.R. § 1040.5(b)); Commentary at 33,435 (to be codified at 12 C.F.R. pt. 1040, cmts. 5(b)–1, 5(b)(2)–1).

WHAT CAN COVERED ENTITIES DO NOW?

Notwithstanding its uncertain future, covered entities should begin to make contingency plans in the event the Final Rule goes into effect. Companies with arbitration agreements that include class waivers should consider how they will manage what would become two customer populations: those with whom they have an arbitration agreement with a class waiver and those with whom they do not. Companies that do not have arbitration agreements are considering whether to add them before the anticipated effective date of the Final Rule. To the extent companies intend to use arbitration agreements entered into after the Final Rule's effective date, they also should begin planning for submission of the data on individual arbitration required by the Final Rule.

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