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CFPB Issues Rule Banning Class Action Waivers In Arbitration Provisions

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On July 10, 2017, the Consumer Financial Protection Bureau issued its long-awaited final rule banning class action waivers in arbitration provisions for covered entities, as well as requiring the covered entities to provide information to the CFPB regarding any efforts to compel arbitration. This rule is of significance to any financial services company that utilizes consumer contracts containing arbitration provisions. The Rule is scheduled to take effect in mid-2018 and will govern contracts executed after that time.

Covered Entities and Products

Section 1028(b) of the Dodd-Frank Act gives the CFPB authority to promulgate regulations that prohibit or impose conditions on arbitration agreements for consumer financial services or products.

On May 5, 2016, the CFPB announced proposed rules that would restrict the ability of financial institutions to enter into mandatory arbitration clauses with consumers, including an outright ban on provisions that would prohibit consumers from pursuing class actions in court. After a period allowing for public comment, the proposed Rule was made final on July 10, 2017.

The Rule will take effect 60 days after July 10, 2017 and will apply only to agreements executed 240 days after the effective date of the rules (the “compliance date”), which will be approximately March 10, 2018.

Subject to certain enumerated exemptions, the Rule applies to most “consumer financial products and services” that the CFPB oversees, including those that involve lending money, storing money, and moving or exchanging money, as well as to the “affiliates” of such companies when the “affiliate is acting as that person’s service provider.”

In particular, according to the CFPB, for a product or service to be covered under the Rule, it must be *both* of the following:

- A consumer financial product or service. Generally, this prong of the definition requires that a financial product or service be offered or provided to consumers primarily for personal, family, or household purposes or that it be offered or provided in connection with another financial product or service that is offered or provided to consumers primarily for personal, family, or household purposes.
- Included in the Rule’s list of covered consumer financial products and services. Generally, the Rule defines covered products and services by reference to particular statutes or regulations. Generally, the list includes extending consumer credit, participating in consumer credit decisions, engaging in certain creditor referral or selection activity for consumer credit, acquiring or selling consumer credit, servicing an extension of consumer

credit or collecting a consumer debt arising from a product or service covered by the Rule, extending or brokering certain automobile leases, providing consumers with information derived from their consumer credit file, engaging in credit repair or debt management activities, providing consumer asset accounts including deposit accounts and prepaid accounts, providing remittance transfers, accepting financial data for the purpose of initiating certain payments or card charges, and providing check cashing, check guaranty, or check collection services.

The Substance of the Rule

The Rule contains requirements that apply with regard to a provider's use of a "pre-dispute arbitration agreement" that is entered into on or after the compliance date. The Rule defines "pre-dispute arbitration agreement" to mean an agreement that is: (1) between a covered person and a consumer; and (2) that provides for arbitration of any future dispute concerning a covered consumer financial product or service. The form or structure of the agreement is not determinative. An agreement can be a pre-dispute arbitration agreement under the Rule regardless of whether it is a standalone agreement, an agreement or provision that is incorporated into, annexed to, or otherwise made a part of a larger contract, is in some other form, or has some other structure.

The Rule prohibits a provider from relying on a pre-dispute arbitration agreement entered into after the compliance date with respect to any aspect of a class action that concerns any covered consumer financial product or service. That prohibition may apply to a provider with respect to a pre-dispute arbitration agreement initially entered into between a consumer or a covered person other than the initial provider, such as debt collectors seeking to collect on the contract or assignees of the contract. The CFPB also specifically stated that the Rule applies to "indirect automobile lenders," using them as an example of covered entities.

The Rule requires that, upon entering into a pre-dispute arbitration agreement, a provider must ensure that certain language set forth in the Rule is included in the agreement. Generally, the required language informs consumers that the agreement may not be used to block class actions.

The Rule also requires providers that use pre-dispute arbitration agreements to submit certain records relating to arbitral and court proceedings to the CFPB. The requirement to submit these records applies to: (1) specified records filed in any arbitration or court proceedings in which a party relies on a pre-dispute arbitration agreement; (2) communications the provider receives from an arbitrator pertaining to a determination that a pre-dispute arbitration agreement does not comply with an due process or fairness standards; and (3) communications the provider receives from an arbitrator regarding a dismissal of or refusal to administer a claim due to the provider's failure to pay required filing or administrative fees.

The CFPB will use that information it collects to continue monitoring arbitral and court proceedings to determine whether there are developments that raise consumer protection concerns that may warrant further Bureau action. The CFPB is also finalizing provisions that will require it to publish the materials it collects on its website with appropriate redactions as warranted, to provide greater transparency into the arbitration of consumer disputes.

Practical Significance

The Rule is in direct contradiction of the strong federal policy favoring arbitration. Indeed, the CFPB's Rule is contrary to with the long-standing federal policy – as repeatedly expressed by the Supreme Court in interpreting

the FAA – of enforcing arbitration provisions as written. It is inevitable that the CFPB's rules will be challenged in court, with the ultimate validity perhaps turning on the quality of the CFPB's study and analysis of the issues. The Supreme Court may again need to ultimately weigh in. In addition, the term of current CFPB director, Richard Cordray, is scheduled to end his term in July 2018, and there is possibility he will leave before then. In sum, the issuance of the final rule is very likely not to be the final word.

Troutman Sanders advised clients both within and outside the CFPB's authority in developing and administering consumer arbitration agreements, and has a nationwide defense practice representing financial institutions and other consumer facing companies in a plethora of types of class actions and individual claims. We will continue to monitor these regulatory developments and any related litigation.

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