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How Will the Consumer Financial Protection Bureau's Proposed Arbitration Clause Ban Impact You?

February 3, 2016

1:00 p.m. – 2:00 p.m.

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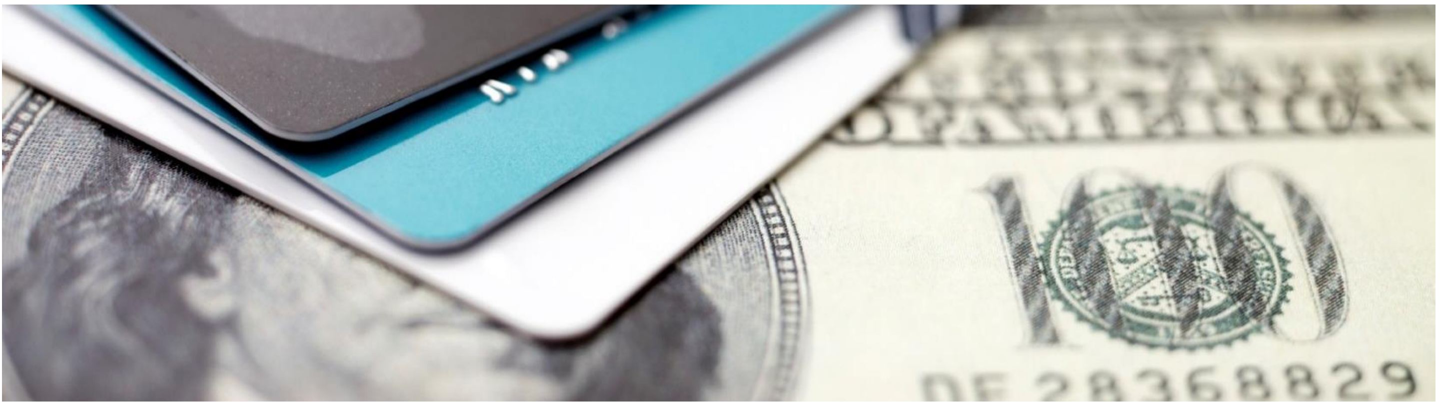


How Will the Consumer Financial Protection Bureau's Proposed Arbitration Clause Ban Impact You?

A practical conversation about what the proposed arbitration clause ban means for companies and consumers

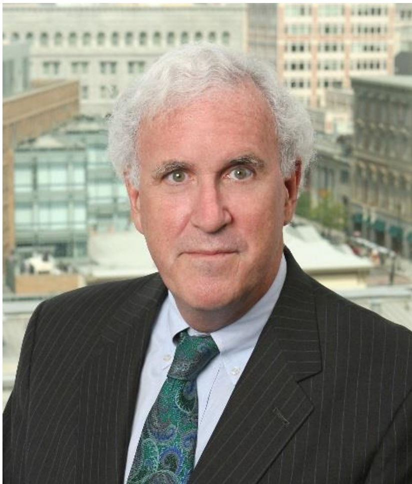
Time	Session
1:00– 1:05 p.m.	**Introduction** Allyson B. Baker, Esq. | Partner, Venable LLP
1:05– 1:20 p.m.	*Arbitration Rule:* **Overview of the CFPB's Proposal** The Proposed Framework, Study, and Statutory Background Peter S. Frechette, Esq. | Associate, Venable LLP
1:20– 1:35 p.m.	*In Perspective:* **Arbitration and Class Action Litigation** Review of the Interplay between Arbitration, the Federal Arbitration Act, Supreme Court Precedent, and Class Action Litigation Thomas E. Gilbertsen, Esq. | Partner, Venable LLP
1:35– 1:50 p.m.	*Tomorrowland:* **What's Next?** Possible Legal Challenges and What Industry Participants Can Expect Allyson B. Baker, Esq. | Partner, Venable LLP John F. Cooney, Esq. | Partner, Venable LLP Thomas E. Gilbertsen, Esq. | Partner, Venable LLP Peter S. Frechette, Esq. | Associate, Venable LLP
1:50– 2:00 p.m.	**Questions and Discussion**

Speakers

Allyson Baker is a trial attorney and civil litigator with more than a decade of experience in the federal government and private practice. Ms. Baker focuses on financial services litigation and law enforcement investigations involving consumer finance, financial fraud and complex financial transactions. She represents banks and nonbanks subject to law enforcement actions and investigations, especially those initiated by the Consumer Financial Protection Bureau (CFPB) and the Department of Justice (DOJ).

Ms. Baker represents numerous consumer finance companies in confidential investigations initiated by the CFPB's Office of Enforcement. She also routinely serves as litigation counsel for financial services companies, advises companies on all aspects of consumer financial laws, and provides strategic counsel to companies dealing with the CFPB and other law enforcement and regulatory agencies.

Allyson B. Baker, Esq.
Partner
Venable LLP



John Cooney focuses on economic regulatory, administrative, and constitutional litigation involving federal agencies at the trial and appellate levels. His areas of experience include financial services, white collar defense, environment, and separation of powers.

Mr. Cooney has 35 years of experience in regulatory policy making and regulatory litigation. He served as Assistant to the Solicitor General, Department of Justice (DOJ), and as Deputy General Counsel for Litigation and Regulatory Affairs, Office of Management and Budget (OMB). Mr. Cooney served as counsel for OMB's Office of Information and Regulatory Affairs, which reviews agency regulations on behalf of the President, and was involved in policy disputes involving legal interpretation of most major federal regulatory statutes.

John F. Cooney, Esq.
Partner
Venable LLP

Speakers

Thomas E. Gilbertsen, Esq.
Partner
Venable LLP

Tom Gilbertsen is a trial and appellate attorney solving competition (antitrust, unfair trade, intellectual property) and consumer protection (privacy, false advertising, deceptive practices) challenges for leading financial institutions and consumer product companies.

Mr. Gilbertsen appears as lead counsel in federal and state trial and appellate courts across the country, and also vigorously defends clients responding to investigations by the Federal Trade Commission (FTC), the United States Department of Justice (DOJ), the International Trade Commission (ITC) and various state attorneys general. Mr. Gilbertsen's current matters present issues under FIRREA, Sherman Act, Bankruptcy Code, state D&O liability statutes, state and federal privacy statutes, civil RICO, Electronics Fund Transfer Act, Fair Debt Collection Practices Act, various state consumer protection statutes, trade secret law, whistleblower statutes, and the law governing professional responsibility.

Sectors of recent focus include community and national banking, payment systems, third party payment processing, web analytics, consumer goods manufacturing, government sponsored enterprises, call centers and telemarketing, advertising/publishing, agribusiness, and private equity. Many of Mr. Gilbertsen's matters also take place in the context of intra-corporate disputes, restructuring and financially-distressed entities.

Peter S. Frechette, Esq.
Associate
Venable LLP

Peter Frechette is an associate at Venable LLP in the Regulatory Practice Group. Mr. Frechette handles matters involving regulation, investigation, and enforcement by various federal and state agencies. His practice focuses on advising clients concerning a wide array of regulations and other laws regarding banking and financial services, consumer protection, cybersecurity, and antitrust issues.

Mr. Frechette assists clients with ongoing regulatory compliance matters, civil and criminal investigations, and litigation before the Consumer Financial Protection Bureau (CFPB), Federal Trade Commission (FTC), Department of Justice (DOJ), Office of the Comptroller of the Currency (OCC), United States Postal Service (USPS), and State Offices of Attorneys General.

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Presentation

How Will the Consumer Financial Protection Bureau's Proposed Arbitration Clause Ban Impact You?

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How Will the CFPB's Proposed Arbitration Clause Ban Impact You?

February 3, 2016

Moderator:
Allyson B. Baker, Esq., Partner, Venable LLP

Panelists:
John F. Cooney, Esq., Partner, Venable LLP
Thomas E. Gilbertsen, Esq., Partner, Venable LLP
Peter S. Frechette, Esq., Associate, Venable LLP

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Agenda

- Overview of the proposal, statutory background, and the CFPB's study
- Review of the interplay between arbitration, the Federal Arbitration Act, Supreme Court precedent, and class action litigation
- Possible legal challenges
- Next steps for the rulemaking process
- The proposed rule's impact on class action litigation

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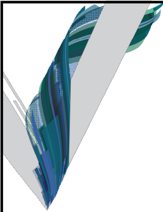

Arbitration Rule: Overview of the CFPB's Proposal

The Proposed Framework, Study, and Statutory Background

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Dodd-Frank Act Section 1028 (12 U.S.C. § 5518)

Section 1028. AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.

a) STUDY AND REPORT.—The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.

(b) FURTHER AUTHORITY.—The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers.

The findings in such rule shall be consistent with the study conducted under subsection (a).

(c) LIMITATION.—The authority described in subsection (b) may not be construed to prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person after a dispute has arisen.

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The Federal Arbitration Act (FAA)

Section 2 of the FAA states that:

> "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

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The CFPB's Proposal

Two elements to the CFPB's proposal:

1) Elimination of agreements that may create barriers to consumer participation in class actions.
   - Specifically, the proposal would require that any agreement explicitly state that the arbitration agreement is inapplicable to cases filed in court on behalf of a class unless and until class certification is denied or the class claims are dismissed.
   - The CFPB will likely provide model language that could be used (and would provide a compliance safe harbor).

2) Submission to the CFPB (and, potentially, public posting) of arbitral claims and awards.

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Potentially Affected Parties

According to the proposed framework (and subject to exclusions), the following parties may be affected:

- Banks and credit unions,
- Credit card issuers,
- Lenders (including: Certain auto lenders, Small-dollar or payday lenders, Auto title lenders, Installment and open-end lenders, Private student lenders, and Providers of other credit in certain other contexts),
- Loan originators that are not creditors,
- Providers of credit in the form of deferred third-party billing services,
- Providers and servicers of leases (including: Providers of certain auto leases for at least 90 days, Servicers of covered credit and auto leases),
- Other business related to money transfer (including: Remittance transfer providers, Providers of domestic money transfer services or currency exchange, General purpose reloadable prepaid card issuers, Certain providers of virtual currency products and services, Check cashing providers),
- Credit service/repair organizations,
- Debt settlement firms,
- Providers of credit monitoring services,
- Debt buyers, and
- Potentially, other providers of consumer financial products and services, such as payment processors.

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Arbitration Rule Timeline

Date	Event
April 2012	The Bureau issues a Request for Information regarding arbitration clauses.
December 2013	The Bureau releases its preliminary study.
March 2015	The Bureau releases its final study and report to Congress.
October 2015	The Bureau releases a proposed framework for review by a panel of small businesses.
End of 2015	Various panels discuss the proposed framework with the Bureau.

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Moving Forward

- Notice of Proposed Rulemaking (NPRM) expected in the spring of 2016
- Public comment process (typically 30-90 days)
- Finalization of the proposed rule
- Implementation of the final rule (effective 180 days after publication)

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CFPB's Arbitration Study: Overview

The Study examines the following substantive areas:

- Clause incidence and features
- Consumer understanding and awareness
- Arbitration incidence and outcomes
- Class litigation incidence and outcomes
- Individual litigation incidence and outcomes
- Small claims court
- Class settlements
- Public and private enforcement
- Price and output effects of arbitration provisions

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CFPB's Arbitration Study: Elements

- Analyzed ~**850** consumer finance agreements to examine the prevalence of arbitration clauses and their terms.
- Reviewed ~**1,800** consumer finance arbitration disputes filed over a period of three years and ~**3,400** individual federal court lawsuits.
- Reviewed ~**42,000** credit card cases filed in selected small claims court in 2012.
- Looked at ~**420** consumer financial class action settlements in federal courts over a period of five years and ~**1,100** state and federal public enforcement actions in the consumer finance area.
- Conducted a telephonic survey of ~**1,000** consumers with credit cards concerning their knowledge and understanding of arbitration and other dispute resolution mechanisms.

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CFPB's Arbitration Study: Findings on Prevalence

53%: The market share of credit card issuers that include arbitration clauses;

44%: While fewer than 8% of banks and credit unions include arbitration clauses in their checking account agreements, those who do represent 44% of insured deposits;

92%: The percentage of prepaid card agreements the CFPB obtained that are subject to arbitration clauses;

86%: In the private student loan market, 86% of the largest lenders include arbitration clauses in their contracts;

99%: More than 99% of storefront locations in California and Texas include arbitration clauses in their agreements; and

88%: Among mobile wireless providers who authorize third parties to charge consumers for services, 88% of the largest carriers include arbitration clauses. Those providers cover more than 99% of the market.

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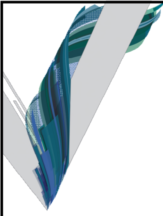

In Perspective: Arbitration and Class Action Litigation

Review of the Interplay between Arbitration, the Federal Arbitration Act, Supreme Court Precedent, and Class Action Litigation

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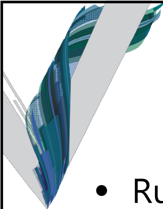

Consumer Class Action Dynamics

- Rule 23(b)(3) "spurious" class actions born in 1966
- Vests discretion in trial court to certify class where common class issues "predominate" over questions affecting individual members
  - Especially where individual recoveries are too small to pursue
- Consumer class actions became cottage industry in 1980s, fueled by broad consumer fraud statutes and statutory damage regimes
- Industry response: arbitration provisions with class action waivers
- Decisional law often conflicted about effect of these clauses:
  - Adhesion contracts not entitled to enforcement
  - Giving effect to unilateral offers in mass marketing
  - Arbitrability of class claims in absence of class waiver

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Discover Bank (Cal. 2005)

- Putative class action challenging bank's late payment fees
- Cardholders agreement included arbitration clause prohibiting class-wide arbitration, Delaware choice-of-law provision
- Discover Bank moved to compel arbitration, dismiss class claims
- Trial court enforced arbitration clause, but ruled class arbitration waiver was unconscionable
- Appeals court held FAA preempted state law rule against class arbitration waivers
- HELD: class action waivers unenforceable in consumer contracts of adhesion, and FAA does not preempt state court ruling

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AT&T Mobility LLC v. Concepcion (2010)

- *Discover Bank* Rule is preempted as an obstacle to FAA's purpose to promote arbitration agreements
- FAA enacted in response to judicial hostility to arbitration
- Puts arbitration agreements on equal footing with other contracts; special rules against arbitrating certain claims cannot stand
- Class arbitration "manufactured" by courts is inconsistent with consensual arbitration under FAA
- Opinion emphasized procedural fairness of AT&T Mobility arbitration clause and class action waiver

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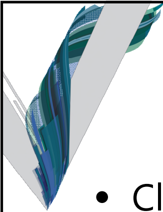

CompuCredit Corp. v. Greenwood **(2012)** ***American Express Co. v. Italian Colors Restaurant*** **(2013)**

- Class action plaintiffs claim that federal claims (CROA and Sherman Act) preempted credit card agreement's arbitration provision.
- Federal appellate courts held claims were non-arbitrable.
- FAA controls enforcement of arbitration agreements unless "overridden by a contrary congressional command."

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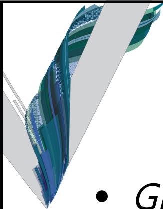

CompuCredit Corp. v. Greenwood **(2012)** ***American Express Co. v. Italian Colors Restaurant*** **(2013)**

- *Greenwood:*
  - CROA mandates disclosures advising consumers of "right to sue a credit repair organization" and prohibiting "any waiver" of CROA protections.
  - HELD: The mere fact that CROA creates federal claim and mandates related disclosure, but is silent on arbitrability of claims, is not "contrary congressional command" overriding FAA.
- *Italian Colors:* Lack of feasible procedural path for effective vindication of individual antitrust claims does ***not*** evince an intention to preclude class action waiver or violate public policy.

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Tomorrowland: What's Next?

Possible Legal Challenges and What Industry Participants Can Expect

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Possible Legal Challenges to an Arbitration Rule

The Bureau's Arbitration Study

- Under Section 1028(a), the CFPB was required to "conduct a study" of arbitration before it may issue a rule prohibiting or imposing conditions on the use of arbitration agreements in connection with "the offering or providing of consumer financial products or services."
- The findings in the rule must be "consistent with the study." This requirement offers little room for a successful procedural challenge to the CFPB's final rule.

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Possible Legal Challenges to an Arbitration Rule

Congress's Delegation of Authority to the CFPB

- Section 1028(b) authorizes the CFPB to prohibit or impose limits on the use of arbitration agreements concerning the offering of consumer financial products or services if it finds that such a prohibition or limitation on use of an arbitration agreement "is in the public interest and for the protection of consumers."
- The "public interest" standard is extremely broad and has been upheld by the Supreme Court in a series of cases since the 1940s as a constitutional delegation of Congress's authority to an agency.
- But for the presence of the Federal Arbitration Act, the CFPB undoubtedly could adopt a rule that prohibits or limits use of arbitration agreements if the facts support such a conclusion. Federal courts give substantial deference to agency findings of fact.

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Possible Legal Challenges to an Arbitration Rule

The Most Likely Legal Challenge

- There have been suggestions that Section 1028(b) could be challenged on the ground that Congress made an unconstitutional delegation of its authority to the CFPB by granting it authority to partially repeal the Federal Arbitration Act.
- *Greenwood* and *Italian Colors* would not be controlling in this challenge. They consider a State's authority to override a federal statute. They do not address Congress's authority to change federal law.
  - The challengers would argue that Section 1028(b) improperly grants an agency authority to partially repeal the FAA, and that only Congress may repeal a statute.
  - This argument would depend upon the *effects* of Section 1028(b) – that its *effect*, as applied, is to limit the types of arbitrations to which the FAA applies. The challengers would be forced to admit that Congress could accomplish this result, because a later Congress can always change the law adopted by a prior Congress. Their objection would be to the technique that Congress used to accomplish this goal.
  - The CFPB would argue that the delegation in Section 1028(b) is lawful. The text of the FAA would not be changed by its action. All that would change are the practical *effects* – the FAA would no longer apply in some cases involving consumers. And that change would occur pursuant to a statute adopted by Congress.
  - The CFPB defense would be highly technical – that the courts have upheld many statutes that authorize adoption of rules that have the effect of limiting the scope and effect of other statutes.

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Next Steps for the Rulemaking Process

- **NPRM:**
  - Public comment on the forthcoming Notice of Proposed Rulemaking
- **Final Rule:**
  - The timing of the finalization of any proposed rule lies with the agency, as it digests and considers public comments.
- **Compliance:**
  - Under Section 1028(d), the CFPB's final rule on arbitration agreements would be prospective and cannot become effective for 180 days after the effective date of the regulation (typically 30 days after publication in the Federal Register). Accordingly, the final rule would become operative **210** days after it is promulgated by the Bureau.

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Compliance & Class Action Considerations after CFPB's Rule

- Scope of the CFPB's proposal
- The *Concepcion* touchstone
- Procedural and substantive unconscionability
- Avoiding class arbitration
- Choice-of-law provisions
- Enforcing arbitration in absence of class claims
- Impact of defeating class certification

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Supplemental Materials

How Will the Consumer Financial Protection Bureau's Proposed Arbitration Clause Ban Impact You?

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CFPB

December 2, 2015

CFPB RELEASES FALL 2015 RULEMAKING AGENDA

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On November 20, 2015, the Consumer Financial Protection Bureau (CFPB) released its Fall 2015 rulemaking agenda. The agenda highlights the CFPB's focus and direction in the coming year, and reflects many of the themes in its **Fall 2015 Supervisory Highlights**. It also generally notes delays in the Bureau's rulemaking initiatives from the estimates in the Spring 2015 agenda. The agenda also highlights two new "long-term rulemaking efforts" in credit reporting and student loan servicing.

Anticipated Final Rules:

Mortgage servicing – The CFPB is working to finalize enhanced loss mitigation requirements and compliance with certain rules when the borrower is a potential or confirmed successor in interest or is in bankruptcy.

Prepaid accounts – The CFPB has proposed prepaid card protections that are similar to those for debit and payroll cards, as well as protections to prepaid accounts that access overdraft services or offer certain credit features. The Bureau expects to issue the final rule in March 2016. The Spring 2015 agenda had previously estimated that a final rule would be issued in January 2016.

*Implementation of the **HMDA rule**, Know Before You Owe disclosures, and other mortgage rules* – The CFPB is preparing a compliance guide and other support materials and programs to prepare for implementation of various parts of the rule starting in 2017 and 2018.

Forthcoming Proposals:

Arbitration – The CFPB is considering whether to **propose rules** that would prevent companies from including class action waivers in arbitration agreements. The CFPB is also considering whether to propose requiring that arbitration filings and awards be submitted to the Bureau.

Payday, auto title, and similar lending products – The Bureau states that it is concerned that lenders are offering these products without assessing the consumer's ability to repay, thereby forcing consumers to choose between re-borrowing, defaulting, or falling behind on other obligations. As part of its pre-rulemaking process, the CFPB issued a **preliminary proposal** as part of the Small Business Review process. The CFPB estimates that it will issue a proposed rule in February 2016 "after additional outreach and analysis."

Overdraft – The CFPB notes that its consumer protection concerns include consumer consent to overdraft coverage for certain electronic transactions, overdraft coverage limits, transaction posting order practices, overdraft and insufficient funds fee structures, and involuntary account closures. The Bureau is also conducting additional research and has begun consumer testing initiatives related to the opt-in process. The agenda indicates that the pre-rulemaking process for overdraft has been delayed—the Spring 2015 agenda had estimated an October 2015 date for further pre-rule activities; the new agenda moves that date to January 2016.

Debt collection – The Bureau is engaged in consumer testing initiatives to determine what information would be useful for consumers to have about debt collection and their debts and how that information should be provided to them. The Spring 2015 agenda had estimated that further pre-rulemaking activities would occur in December 2015.

Larger participants and non-depository lender registration – The Bureau expects to develop rules to define larger participants in markets for consumer installment loans and vehicle title loans, as well as rules to require registration of lenders in these markets or other non-depository lenders, which would facilitate the Bureau's supervision of such entities. While the prior agenda estimated a January 2016 date for additional activity, the new agenda estimates that further pre-rulemaking activity will not occur until September 2016.

Women-owned, minority-owned, and small businesses data collection – The Dodd-Frank Act requires the CFPB to develop rules that require financial institutions to report information about lending to women-owned, minority-owned, and small businesses. The CFPB notes that the first stage of its efforts under this statutory mandate "will focus on outreach and research."

Long-term Rulemaking Efforts:

The CFPB continues to evaluate rulemakings in credit reporting and student loan servicing. For credit reporting, the CFPB indicates that potential topics for consideration might include the accuracy of credit reports, including the processes for resolving consumer disputes, or other issues. For student loan servicing, possible topics for consideration might include specific acts or practices and consumer disclosures. The inclusion of these issues in the agenda signals the beginning of CFPB rulemaking attention in these areas.

Industry participants are encourages to monitor the Bureau's rulemaking activity and look for opportunities to engage with the CFPB on these topics. For more information on the CFPB's ongoing rulemaking activity, please contact Venable's **CFPB Task Force**.

ARTICLES

October 8, 2015

CFPB PROPOSES LIMITATIONS AND REQUIREMENTS FOR ARBITRATION AGREEMENTS

AUTHORS

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On October 7, the Consumer Financial Protection Bureau (CFPB) released an outline of its proposal for a possible rule regarding arbitration clauses in consumer financial product and service agreements.

There are two elements to the CFPB's proposal: (1) Elimination of agreements blocking consumer participation in class actions and (2) submission to the CFPB (and potentially public posting) of arbitral claims and awards.

Enable Consumer Access to Civil Class Actions

The proposal would prohibit the application of arbitration agreements to class action cases. Specifically, the proposal would require that any contract or agreement for a covered consumer financial product or service explicitly state that the arbitration agreement is inapplicable to cases filed in court on behalf of a class unless and until class certification is denied or the class claims are dismissed.

The CFPB's proposal indicates that the Bureau would likely provide form or model language, which would act as a safe harbor for companies that choose to employ the model language in their agreement.

Require Submission of Arbitral Claims and Awards

The second proposal would require covered entities that use arbitration agreements in their contracts with consumers to submit to the CFPB initial claim filings and written awards in consumer finance arbitration proceedings. The Bureau is also considering whether to publish the claims or awards to its website. This requirement would apply whether or not the arbitration administer publishes claims or rewards.

The proposal to submit arbitral claims and awards would apply to all arbitration proceedings involving a covered business, including individual and class arbitrations.

Scope of the Proposal

Companies affected by the proposal include those defined as covered entities in Sections 1002, 1027, and 1029 of the DFA. The CFPB is also considering whether to cover additional consumer financial products and services, such as payment processing.

Consumer financial products or services that may be excluded from the arbitration rule include those that are:

- Already subject to arbitration rules issued by the Securities and Exchange Commission or the Commodity Futures Trading Commission;
- Provided by persons when not regularly engaged in business activity (e.g., an individual who may loan money to a friend);
- Provided by the federal government;
- Provided by state, local, or tribal governments or other government entities to persons in their jurisdiction, or to persons outside their jurisdiction, if it is not credit that is subject to the Truth in Lending Act or Regulation Z; and
- Credit that a business extends for the consumer's purchase of its own nonfinancial goods or services when covered by Section 1027(a)(2)(B)(ii).

Next Steps

A **Small Business Review Panel** will review and provide feedback on the potential economic impacts of the proposals. The CFPB has posted a **list of questions** for small businesses participating in the Panel to determine the impact that the proposals would have on small businesses. Comments on the proposal and alternatives will inform the rule ultimately proposed by the CFPB.

ARTICLES

March 11, 2015

CFPB ARBITRATION STUDY MAY CREATE BASIS FOR REGULATION

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On March 11, 2015, the Consumer Financial Protection Bureau (CFPB) released its **Arbitration Study and Report to Congress (Arbitration Study)** based on a review of consumer finance agreements, arbitration disputes, class actions, and small claims filings, and a survey of credit card consumers regarding their knowledge and understanding of arbitration and other dispute resolution mechanisms.

The Arbitration Study found that consumers often do not understand, or are unaware of, the arbitration clauses in their finance agreements. At a field hearing, Director Cordray stated that arbitration clauses are often "take it, or leave it" and do not present consumers an opportunity to opt-out. He further noted that when consumers had opt-out options, they were often unaware of the option. The results of the study likely forecast the CFPB's future position on arbitration clauses in consumer finance agreements.

Arbitration Study Key Findings

- Few consumers take individual complaints to court or arbitration.
- The average amount of a consumer dispute is over $1,000. Consumers are unlikely to engage in any legal action (including arbitration) to settle disputes of amounts less than $1,000.
- On average, 32 million consumers a year claimed refunds, debt relief, or other redress through class actions. However, over 90 percent of the arbitration agreements it studied expressly prohibited consumer class actions in arbitration.
- In 1,060 cases filed between 2010 and 2012, arbitrators awarded a combined total of less than $400,000 to consumers. In the same period, arbitrators ordered consumers to pay $2.8 million, mostly in disputed debts.
- Mandatory arbitration may not result in lower prices or expanded access to credit for consumers.
- Consumers by and large do not understand the ramifications of an arbitration clause compared to class action litigation. Notably, the survey was limited to just over 1,000 credit card consumers.

With the release of the Arbitration Study, Section 1028(b) of the Dodd-Frank Act allows (but does not require) the CFPB to prohibit or condition arbitration clauses in consumer financial agreements, if such regulation is "in the public interest and for the protection of consumers."

* * * * *

For more information, please contact Venable's **CFPB Task Force**.

OCTOBER 7, 2015

SMALL BUSINESS ADVISORY REVIEW PANEL FOR POTENTIAL RULEMAKING ON ARBITRATION AGREEMENTS

OUTLINE OF PROPOSALS UNDER CONSIDERATION AND ALTERNATIVES CONSIDERED

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I. Introduction

As part of the Consumer Financial Protection Bureau's efforts to make consumer finance markets work for consumers, and in accordance with specific authority from Congress, the Bureau is examining the role of arbitration agreements in the resolution of consumers' disputes with providers of consumer financial products and services. Consumers and providers (*i.e.* the parties) may agree to arbitrate in two ways: they may agree to arbitrate a dispute after it has arisen or they may agree to arbitrate through contracts or clauses in contracts that require the parties to submit any future disputes between them to an arbitrator, rather than to a court.[1] The former are sometimes called "post-dispute arbitration agreements" and the latter are sometimes called "mandatory pre-dispute arbitration agreements" because they commit the parties to arbitration before there is a dispute between them. The proposals under consideration concern mandatory pre-dispute arbitration agreements only, which are typically referred to in this outline more simply as "arbitration agreements." Arbitration agreements were originally used primarily in contracts between businesses, but in recent decades have become increasingly common in consumers' contracts with businesses for everyday consumer products, including financial products and services.

Congress directed the Bureau to study arbitration agreements in consumer financial contracts and authorized the Bureau to regulate their use if the Bureau finds that certain conditions are met. In March 2015, the Bureau completed its comprehensive three-year study of arbitration agreements and other methods for dispute resolution in markets for consumer financial products and services (the Study).[2] Among other things, the Study found that contracts for consumer financial products and services frequently contain arbitration agreements mandating that future disputes between the parties be resolved in arbitration instead of in court, if either party so chooses. The Study also found that most of these arbitration agreements contain provisions stating that arbitration may not proceed on a class basis. Together, these provisions can effectively preclude all class proceedings, in court or in arbitration. The Study further found that few consumers bring formal individual disputes against their financial service providers, either in court or arbitration.[3]

The Bureau does not believe, based on available data, that the reason consumers take relatively few individual complaints to court or arbitration is that consumers do not have disputes with their consumer financial service providers. Instead, the relative dearth of individual court or arbitration filings may be explained by the fact that, where consumers know they are harmed, their individual injury may be too small to make it worth their time and effort to pursue a remedy for the harm, especially through a formal filing in court or arbitration. These small injuries may also make it more difficult for consumers to find an attorney to handle their cases. In addition, the Bureau believes, based on available data, that in some cases consumers may not know that they have suffered harm because some harms are not apparent to people who are not

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[1] In practice, under the latter type of arbitration agreement, a party sued in court may ask the court dismiss or stay the lawsuit so that the dispute can instead be decided by an arbitrator.

[2] Bureau of Cons. Fin Prot. *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* (Mar. 2015) ("Study"), *available at* http://www.consumerfinance.gov/reports/arbitration-study-report-to-congress-2015/.

[3] However, financial services providers filed hundreds of thousands of individual arbitration proceedings against consumers in periods before those covered by the Study.

experts in the law or because the harms are caused by practices that are not detectable by individuals.

Given that few consumer harms appear to be resolved through the filing of formal individual disputes against their financial services providers, the Bureau believes that it is important that the other methods that exist to remedy consumer harms remain available. While the Bureau and other government enforcement agencies can remedy some of these harms through public enforcement actions and supervisory oversight, these agencies have limited resources. Therefore, the Bureau believes that consumers are better protected and the market is fairer for those companies that comply with the law when consumers also are able to obtain relief by grouping their own disputes against providers of consumer financial products or services in private proceedings, including litigation. Indeed, the Study shows that these aggregated actions – typically class action litigation – have provided significant benefits to consumers, through cash settlements and other benefits made available to them and from agreements by companies to stop harmful behavior. Class litigation may also benefit consumers through the deterrent impact of those settlement agreements on other companies' conduct.

For these and other reasons, the Bureau is concerned that arbitration agreements effectively prohibit class proceedings, including litigation, and that they prevent many consumers from obtaining remedies when they are harmed by their providers of consumer financial products or services. The Bureau is further concerned that the contractual prohibitions on class proceedings reduce the deterrent effect of such proceedings and deprive consumers of positive changes companies may make to avoid liability or to remediate harm. They also may facilitate the adoption by companies of business practices that could harm consumers by reducing the risks associated with unlawful behavior.

In accordance with its authority under section 1028(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Bureau has preliminary determined that a regulation that would prohibit the application of pre-dispute arbitration agreements to class litigation in court would protect consumers, serve the public interest, and be consistent with the Study. This proposal would not prevent consumers and providers of covered consumer financial products and services from agreeing to arbitrate disputes on a class basis, as long as class litigation remains an option. The Bureau believes that consumers and the broader consumer finance market will benefit by allowing consumers to pursue relief for violations of law through class proceedings against providers of covered consumer financial products or services without the impediment of arbitration agreements. Through such proceedings, the Bureau expects that consumers will receive monetary relief when companies violate the law and that companies will change their practices to comply with the law, which will benefit consumers.

The Bureau is not proposing for consideration a ban on all pre-dispute arbitration agreements or other conditions or limitations on the use of such agreements at this time. The Bureau's present assessment based on the evidence obtained thus far is inconclusive as to arbitration of individual consumer financial disputes. The Bureau is concerned, however, that pre-dispute arbitration agreements that require arbitration of individual claims may have in the recent past led to harms to many consumers and is further concerned that these types of harms may recur. Specifically, in the early 2000s, companies filed hundreds of thousands of arbitrations seeking to collect debts from consumers before a single arbitration administrator that was alleged by Minnesota's attorney general to have institutional conflicts of interest.[4] Cognizant of this recent

[4] Without admitting to the allegations, this administrator agreed to permanently cease administering consumer arbitrations pursuant to a consent decree resolving litigation against it. *See* Consent Decree entered in *Minnesota v. Nat'l Arb. Forum, Inc., et al.*, No. 27-CV-09-18550 (July 17, 2009).

history, the Bureau wants to prevent harm to consumers in individual consumer arbitrations.

To better understand arbitrations that occur now and in the future, the Bureau is therefore considering proposals that would facilitate ongoing Bureau as well as public monitoring of consumer financial arbitrations. Specifically, the Bureau is considering a proposal that would require companies that use arbitration agreements with consumers for certain types of consumer financial products or services to submit claims filed and awards issued in any arbitration proceedings to the Bureau. The Bureau is further considering periodically publishing the claims or awards on its website.

To begin the rulemaking process, the Bureau along with the Office of Management and Budget (OMB) and the Small Business Administration Office of Advocacy (SBA) will convene a Small Business Review Panel (Panel) to consider the potential impact of the proposals the Bureau is considering on small businesses. Following completion of the Panel process, consideration of the Panel's recommendations, and other stakeholder outreach, the Bureau expects to commence a rulemaking.

II. Background

Companies often provide consumer financial products and services under the terms of a standard-form, written contract. In addition to being governed by such contracts, the relationship between a consumer and a financial service provider is generally governed by consumer protection laws at the state level, federal level, or both. These laws create legal rights for consumers and impose responsibilities on covered providers of financial products and services. Some of these laws can be enforced directly by consumers by bringing private lawsuits against the financial service provider, while others are subject to enforcement only by government actors.

Absent an agreement to the contrary, if a dispute arises between a consumer and a company as to whether one party or the other has violated the contract or a privately enforceable law, the party who believes that a violation has occurred has the right to seek resolution of the dispute in a court of law, either by filing an individual lawsuit or by filing or participating in a class lawsuit. A class lawsuit is one in which, in defined circumstances, one or more plaintiffs may file suit on behalf of similarly situated individuals. If the class is certified by the court, members of a class — for example, customers of a company who have been affected by a particular practice — may be eligible to obtain relief without initiating their own lawsuits. Conversely, if the defendant prevails in a class case after the class is certified, members of the class may be bound by the decision and thereby precluded from initiating their own lawsuits with respect to the issues in the class case. Filings and decisions in both class cases and individual cases filed in court are generally a matter of public record.

The parties to a contract can also agree to alternative means of resolving disputes that arise between them. A common form of alternative dispute resolution provided for in contracts is final and binding arbitration in which one or more privately-chosen arbitrators are empowered to resolve the dispute. These arbitration agreements generally give each party to the contract two distinct rights. First, either side can file disputes against the other in arbitration and obtain a decision from the arbitrator. The arbitrator's decisions are generally not appealable in court, meaning a party who disagrees with a decision has very limited options to have that decision reconsidered or reversed, and that party cannot ignore the arbitrator's decision and pursue the dispute again in court. Second, if one side sues the other in court, the party that has been sued

in court can use the arbitration agreement to require that the dispute proceed, if at all, in arbitration instead.[5]

Arbitration agreements were originally used primarily between companies that bargained with each other to create tailored contracts. Early on, courts were often hostile to such arrangements, and Congress in 1925 passed the Federal Arbitration Act to require that, subject to a few exceptions, courts enforce arbitration agreements.[6] Arbitration agreements are now often used in standard-form contracts where both parties do not have equal bargaining power, such as in contracts between companies and their employees, investors, or consumers. These agreements have spread rapidly in the last few decades, and their use has become a contentious legal and policy issue. Courts have focused on various issues raised by the use of arbitration agreements and the application of laws governing contracts and the Federal Arbitration Act in such standard-form contracts. One issue is whether arbitration agreements that ban class proceedings in arbitration should be enforced given that they effectively allow companies to shield themselves from all class proceedings. They do so because companies sued in a class case in court can use an arbitration agreement to seek dismissal of the court case in favor of an arbitration in which no class proceedings are permitted. Before 2011, lower courts were divided on whether arbitration agreements that bar class proceedings were unenforceable because they violated some states' laws. In 2011, in *AT&T Mobility LLC v. Concepcion*,[7] the Supreme Court resolved this divide by holding that the Federal Arbitration Act preempted California state law that would have prohibited the enforcement of an arbitration agreement barring class proceedings in a consumer case.

As is mentioned above, arbitration agreements in consumer contracts have been the subject of legislation and regulation. For example, since 1976, commodities merchants have been permitted to use arbitration agreements only when customers voluntarily agree to arbitrate disputes before they arise. These merchants must offer their products to consumers even when a customer does not agree to pre-dispute arbitration.[8] As another example, arbitration agreements that apply to class litigation have been prohibited in securities broker dealer contracts since 1992.[9] The Military Lending Act and its implementing regulations, which were recently expanded by the Department of Defense to reach most forms of credit accessed by servicemembers and their families, prohibit arbitration agreements in consumer credit contracts with certain covered servicemembers or their dependents.[10] In addition to providing the Bureau the authority to regulate the use of arbitration agreements in consumer financial contracts, the Dodd-Frank Act prohibited all arbitration agreements in consumer mortgages[11] and included authority for the Securities and Exchange Commission to regulate arbitration agreements in contracts between consumers and securities broker-dealers or investment advisers.[12] The

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[5] These arbitration agreements typically do not apply to lawsuits in small claims court, however, where disputes under a specified dollar amount often can be resolved quickly and without an attorney.

[6] 9 U.S.C. 1 through 16.

[7] 131 S. Ct. 1740 (2011).

[8] 17 CFR 166.5(b)-(c), implementing 7 U.S.C. 21(b)(10)(A).

[9] Financial Industry Regulatory Authority (FINRA) Rule 2268(f).

[10] 10 U.S.C. 987, as implemented by 32 CFR 232.8(c).

[11] Dodd-Frank Act section 1414(a). That prohibition was implemented in Regulation Z by the Bureau's Loan Originator Compensation Rule. 12 CFR 1026.36(h).

[12] Dodd-Frank Act section 921.

Department of Health and Human Services also recently proposed regulations that would regulate the use of arbitration agreements in long-term care contracts with consumers.[13] Finally, the Federal Trade Commission also interprets federal law as prohibiting arbitration agreements in warranties for consumer products.[14]

A. The Bureau's Study of Arbitration Agreements

The Dodd-Frank Act required the Bureau to study the use of arbitration agreements in connection with consumer financial products or services.[15] As a preliminary step toward such a study, the Bureau published a Request for Information in 2012 that sought comments on the appropriate scope, methods, and data sources that the Bureau should consider in its study of arbitration agreements.[16] The Bureau received 60 comments in response to the request and met with numerous commenters and other stakeholders to discuss their concerns as it considered how to construct its study. The Bureau released Preliminary Results of its study on December 12, 2013.[17] Following the public release of the Preliminary Results, the Bureau again met with numerous stakeholders to seek additional feedback before the Bureau prepared the final Study. After completing additional work and analysis, the Bureau released the Study on March 10, 2015. Among other things, the Study used a detailed analysis of empirical evidence, including consumer contracts and court data, to describe how individual and aggregated disputes between consumers and consumer finance companies have been resolved both in arbitration and in the courts.

The Bureau believes that its Study is the most comprehensive empirical study of consumer financial arbitration ever conducted. Specifically, the Study analyzed over 850 consumer finance agreements between companies and consumers, over 1,800 consumer finance arbitration disputes filed over a period of three years, a sample of the nearly 3,500 individual consumer finance cases filed in federal court over the same time frame, all of the 562 consumer finance class cases filed in federal court and in selected state courts during the same time period, 40,000 small claims filings over the course of a single year, more than 400 consumer financial class settlements in federal courts over a period of five years, and more than 1,100 state and federal public enforcement actions relating to consumer finance. The Study further included a

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[13] Centers for Medicare & Medicaid Services, Medicare and Medicaid Programs; Reform of Requirements for Long-Term Care Facilities; Proposed Rule (July 16, 2015), 80 FR 42168, 42264 (proposing to require that arbitration agreements be explained in understandable language, acknowledged by the resident, provide for a convenient venue and a neutral arbiter, entered into on a voluntary basis, not be made a condition of admission, and not restrict or discourage communication with government authorities).

[14] 16 CFR 703.5(j); FTC Final Revised Interpretations, 80 FR 42710, 42718-20 (Jul. 20, 2015).

[15] Dodd-Frank Act section 1028(a) ("The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.").

[16] Consumer Financial Protection Bureau, Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements 4 (Apr. 27, 2012) (Docket No. CFPB-2012-0017). The Bureau subsequently received and considered additional feedback from interested persons in connection with its survey of credit card customers. Agency Information Collection Activities; Comment Request (Jun. 7, 2013) (Docket No. CFPB-2013-0016).

[17] Consumer Financial Protection Bureau, *Arbitration Study Preliminary Results* (Dec. 12, 2013) ("Preliminary Results"), *available at* http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf.

national survey of over 1,000 credit card consumers to learn more about their knowledge and understanding of arbitration and other dispute resolution mechanisms.

The Study made a number of important findings, including that tens of millions of consumers use consumer financial products that are subject to arbitration agreements.[18] For example, the share of contracts that include arbitration agreements is 53% of the credit card market,[19] 44% of insured deposits in the checking account market, 92% for a sample of prepaid card agreements obtained by the Bureau, 99% for a sample of storefront payday loan agreements from California and Texas agreements, and 99% of the mobile wireless market. The Study also found that in the credit card, checking account, and payday loan markets, arbitration agreements are more prevalent in contracts involving larger providers of financial services than smaller providers.[20] In the credit card market, 75% of the largest issuers used arbitration agreements, while 42% of the smaller and mid-sized bank issuers did so. In the checking account market, 46% of the largest banks used arbitration agreements, as compared to 7% of the small and mid-sized banks studied. In the payday market, all of the 11 large lenders studied had arbitration agreements, as compared to 84% of a sample of smaller lenders.

Section 2 of the Study also provided data on the use of arbitration agreements by entities of different sizes. Entities generally qualify as "small" under SBA standards if their assets, revenues, or employee count fall below thresholds established by SBA, which are assigned by industry classifications in the Census.[21] The table below summarizes the data on the use of arbitration agreements from the Study for selected markets, and breaks out this data further to identify prevalence of these agreements for small entities for which data on size is generally publicly available (banks and credit unions) in certain markets (checking/debit cards, credit cards, private student loans, and prepaid GPR cards):

Market/product	**Prevalence of Arbitration Clause Data for Small Entities and Observations**
Checking/debit cards	Of a random sample of banks not among the largest 100, 7% used arbitration agreements for their accounts (section 2.3.2). Over half of the banks in this 7% appear small.
Credit cards	24 credit card agreements reported to the Bureau by banks not among the largest 50 issuers had arbitration agreements (section 2.3.1). Eight of these 24 banks that appear to be small.
Prepaid GPR cards	Among the banks issuing the 52 prepaid GPR card agreements sampled (section 2.3.3), we found that only one bank was small, and that card agreement included an

[18] Study, *supra* note 2, section 1.4.1.

[19] But for a settlement of an antitrust lawsuit involving four large credit card issuers, the market share of credit card consumers whose contracts would include arbitration agreement would have been 94%. Study, *supra* note 2, section 2.3.1.

[20] The Study did not delineate small providers in the three other markets studied.

[21] *See* U.S. Small Business Administration, "Table of Small Business Size Standards Matched to North American Industry Classification System Codes," available at https://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf.

	arbitration agreement. Outside of that sample, we have also found 4 other small banks whose prepaid GPR cards were reviewed in the Bureau's 2014 Study of Prepaid Account Agreements; it appears that 3 of these banks include arbitration agreements in their prepaid GPR cards.[22]
Private student loans	A widely offered student loan product (section 2.3.5) includes an arbitration agreement and appears to be used by over 150 small credit unions.[23]

With respect to the market for short-term smaller-dollar loans, the Bureau notes that size standards for this market are generally tied to firm revenue. However, nonbank firms are a significant portion of this market, and information concerning their revenues does not appear to be consistently available. Nonetheless, the Bureau notes that 84% of storefront payday lenders (not among the 11 largest participants) in a sample of such lenders in California and Texas used arbitration agreements (section 2.3.4).

As noted, arbitration agreements provide that, at the election of either party, claims must be decided in arbitration rather than in court. The Study showed that less than 2% of consumers surveyed said that they would seek out a lawyer in response to a dispute with their credit card company and less than 1% said that they would initiate legal proceedings without mention of an attorney.

Consistent with the findings in the survey, consumers in fact initiated a relatively small number of individual cases against their financial service providers either in arbitration or in court. Between 2010 and 2012, across six different consumer finance markets, 1,847 arbitration disputes were filed with the American Arbitration Association (AAA), the largest administrator of arbitration agreements within the consumer finance field. An unknown number of these cases were filed by companies, rather than consumers. Most of the claims filed in arbitration were for large dollar amounts. Only about 25 arbitration disputes per year involved affirmative

[22] The Bureau's study of prepaid account agreements is available at http://files.consumerfinance.gov/f/201411_cfpb_study-of-prepaid-account-agreements.pdf. In addition to the account agreements reviewed in the arbitration study and in the prepaid account agreement study, the Bureau also has identified an additional small bank issuer whose GPR prepaid card includes an arbitration agreement. Finally, other entities, such as nonbank program managers, participate in delivering prepaid GPR card services to consumers. It may be likely that some program managers for cards in the sample were small. *See* CFPB, Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z); Proposed Rule (Dec. 23, 2014), 79 FR 77102, 77283-77285 (Bureau's 2014 proposal to regulate prepaid accounts finding over 100 entities that are small or potentially small participating in the prepaid account market). Nonetheless, data concerning the revenues of such program managers does not appear to be consistently publicly available.

[23] Credit unions offering this product are listed at http://www.studentchoice.org/. Credit unions and banks across the country, including a number of small entities, also partner with Sallie Mae to originate private student loans with arbitration agreements (the Smart Option Student Loan).

consumer claims for $1,000 or less.[24] The average and median affirmative consumer claim amounts were $27,000 and $11,500, respectively.

The Study similarly found that few consumers file individual cases in federal court. Across five markets, between 2010 and 2012, the Study found an average of just over 1,150 individual consumer financial cases per year filed in federal court.[25] When looking at cases filed against credit card issuers in small claims court, the numbers were similarly low. In 2012, consumers in jurisdictions with a combined total population of around 85 million filed fewer than 870 small claims court credit card claims against issuers representing 80% of credit card loans outstanding. These low numbers of formal claims may be due to the fact that consumers are able to resolve harms with their consumer financial service providers informally through contacting the company's customer service representatives. The Study showed, however, that at least for disputes concerning banks' checking account overdraft policies, informal dispute resolution provided relief to few consumers who were harmed.[26]

In contrast to the relatively few individually-filed claims, the Study found evidence that class litigation provides a potential means of securing relief for a much larger number of consumers. Across substantially all consumer finance markets, the Study showed that at least 32 million class members per year were eligible for relief pursuant to class settlements approved by federal courts between 2008 and 2012. The settlements totaled $540 million per year in cash, in-kind relief, and attorneys' fees and expenses, with roughly 18% of that going to expenses and attorneys' fees. Further, these figures do not include the value to consumers of class settlements requiring companies to change their behavior, although this value is potentially substantial since the Bureau did not quantify it.

The Study further provided evidence that arbitration agreements provide a substantial barrier to pursuing claims on an aggregated (*i.e.* class) basis. Almost all of the arbitration agreements studied prohibit arbitration from proceeding on a classwide basis. Indeed, the Study found only two class arbitration cases filed with the AAA in six markets studied over a period of three years.

Further, arbitration agreements are more likely to be used to stop cases filed on behalf of a class than in cases filed on an individual basis. Among the 1,205 individual federal court cases studied, companies moved to compel arbitration in only 12 cases or less than 1%. In contrast, out of 562 class cases filed over three years in federal court and selected state courts, the Study found that arbitration agreements were cited as the basis for a motion to dismiss or stay the case in 94 cases (about 17% of the class cases) and courts dismissed or stayed about half of those cases.[27] Outside of those 562 cases analyzed, the Study further identified more than 60 other class consumer finance cases dismissed or stayed on the basis of arbitration agreements since 2011, for a total of over 100 class cases identified in the Study as blocked by arbitration agreements. For most of the cases analyzed in the Study, information was not available as to whether the relevant contracts contained arbitration agreements. In the 40 class cases where

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[24] See the Study for an explanation of "affirmative" consumer claims. Study, *supra* note 2, section 5.2.1. In general, the Study treated claims under federal or state statute as an affirmative consumer claim, as distinguished from a claim involving disputed debt.

[25] Other than the small claims filing discussed in this paragraph, the Study did not review other individual cases filed in state court.

[26] Study, *supra* note 2, section 8.3.8.

[27] In the other half, the court either did not rule on the motion relying on the arbitration agreement or denied it. Study, *supra* note 2, section 6.7.1.

the Study was able to ascertain that the case was subject to an arbitration agreement (in a subset of cases involving credit card issuers), motions to compel arbitration were filed 65% of the time.

Government actors, including the Bureau, are also able to file lawsuits to remedy aggregate harms to consumers. The Study showed, however, that private class lawsuits pursued claims that government actors typically did not. In reviewing 114 identified private consumer finance settlements in class cases, the Study was unable to identify an overlapping public enforcement proceeding in 66% of these 114 filings. With regard to the relationship between state and federal enforcement actions and private class litigation, the Study identified 740 enforcement actions filed between 2008 and 2012 by regulators in 20 states and four municipalities and counties, and another 410 cases that were filed by federal regulators. In 88% of these, the Study did not find an overlapping private class complaint. The Study also did not find that arbitration agreements led to lower prices for consumers, at least in the credit card market, subject to limitations noted in the Study.[28] The Study did not find a statistically significant difference in the differences in total cost of credit to consumers between four large credit card issuers that agreed to remove arbitration agreements from their consumer financial contracts as a requirement in the settlement of an antitrust lawsuit and issuers that did not agree to do so.

With respect to the few individual arbitrations that were filed with AAA, the Study found differences as compared to individual court cases with regard to filing fees, attorney representation rates, and time to completion. Filing fees for arbitrations were slightly lower than in court. In the time range covered by the Study, AAA charged $125 to file a claim under $10,000 and $375 to file a claim up to $75,000 compared to $400 to file any claim in federal court.[29] The Study also found that nearly 37% of consumers proceeded without attorney representation in the arbitration cases studied, compared to about 6% of cases filed on an individual basis in federal court.[30]

With respect to the time it takes for a consumer to resolve a dispute in arbitration as compared to court, the Study found that arbitration cases were resolved in a median of 150 days (although cases may have proceeded in court before being sent to arbitration) as compared to a median of 127 days for individual cases filed in federal court.[31]

As to outcomes in individual arbitration, the Study found that less than one third of the claims filed were resolved by arbitrators; the majority of cases ended in what may have been a settlement between the parties, rather than an arbitrator's decision.[32] In litigation, over half of the individual cases filed in federal court ended in a known settlement and another 40% resulted in what may have been a settlement.[33] Of the cases resolved by arbitrators, consumers prevailed in about 20% of affirmative claims they asserted, whereas companies prevailed in about 93% of

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[28] Study, *supra* note 2, section 10.

[29] AAA now charges a $200 flat fee for filing all claims.

[30] The Study further showed that companies were represented by counsel in the majority of arbitration disputes. Study, *supra* note 2, section 5.5.3.

[31] The time to resolve class cases filed in court was longer than for either individual arbitration disputes or court cases, likely because class cases are more complex than individual cases. For class cases filed in federal court, the time to close was a median of just over 200 days. For class cases filed in selected state court, the time to closure was a median of 255 days for one of the years studied and 407 for the other year studied.

[32] Study, *supra* note 2, section 5.6.6.

[33] Study, *supra* note 2, section.2.2.

affirmative claims they asserted.[34] In federal individual litigation, consumers won a judgment against a company in 6.8% of all of the cases studied (none of the individual cases were filed by companies against consumers).[35] The Study was careful to point out, however, that these differences in outcomes could be attributable to "selection bias," the differences in the types of claims submitted for arbitral decision by consumers and companies.

Since the Study was released, the Bureau has invited feedback from and engaged with key stakeholders including through roundtable discussions with both industry and consumer groups. The Bureau continues to be receptive to input and anticipates that the SBREFA and rulemaking processes will provide further opportunities for comment from interested stakeholders.

B. Regulatory Authority

The Dodd-Frank Act gives the Bureau the authority to issue regulations that would "prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties," if doing so is "in the public interest and for the protection of consumers." Section 1028(b) also requires that "[t]he findings in such rule shall be consistent with the Study."

The Bureau believes that the proposals under consideration are consistent with the Study and meet the standards for exercise of the Bureau's rulemaking authority under section 1028(b). The Bureau seeks input regarding all aspects of the proposals, including whether they are the most effective means of furthering consumer and public interests in light of the Study and other evidence regarding use of arbitration agreements in connection with contracts for consumer financial products and services.

The Bureau anticipates that the impact of the proposals under consideration, if adopted, would vary in type and magnitude for the different types of entities covered by the proposals. The differential impact of the proposals under consideration likely would result from, among other things, variation in existing practices with regard to consumer financial contracts generally and the use of arbitration agreements specifically, as well as varying levels of exposure to consumer financial litigation and arbitration.

III. The SBREFA Process

Pursuant to the consultation process prescribed in the Small Business Regulatory Enforcement Fairness Act (SBREFA),[36] the Bureau is seeking input about the rulemaking proposals it is considering. The SBREFA consultation process provides a mechanism for the Bureau to obtain input directly from small financial services providers early in the rulemaking process about new regulatory requirements it is contemplating. SBREFA directs the Bureau to convene a Panel when it is considering a proposed rule that could have a significant economic impact on a substantial number of small entities. The Panel includes representatives from the Bureau, SBA,

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[34] Study, *supra* note 32.

[35] Study, *supra* note 33.

[36] 5 U.S.C. 609(b), *available at* https://www.sba.gov/advocacy/regulatory-flexibility-act.

and OMB. SBREFA requires the Panel to meet with a selected group of individuals who are representative of small entities that are likely to be subject to the rules that the Bureau may issue. The industries that would be covered by the proposal the Bureau is considering will be discussed in part IV.C.

During the Panel outreach meeting, small entity representatives (SERs) will provide the Panel with important feedback on the potential economic impacts of complying with proposed regulations. They may also provide feedback on regulatory options under consideration and regulatory alternatives to minimize these impacts. In addition, the Dodd-Frank Act directs the Bureau to collect the advice and recommendations of the SERs concerning whether the proposals under consideration might increase the cost of credit for small businesses and not-for-profits and concerning alternatives to minimize any such increase.[37]

Within 60 days of convening, the Panel is required to complete a report on the input received from the SERs during the Panel process. The Bureau will consider the SERs' feedback and the Panel's report as it prepares the proposed rule. Once the proposed rule is published, the Panel's final report will be placed in the public rulemaking record. The Bureau welcomes further feedback from the SERs during the public comment period on the proposed rule.

The Bureau is convening a Panel to obtain input from the selected SERs on proposals under consideration for arbitration agreements. The Bureau has prepared this Outline for the SERs in order to provide the necessary background and facilitate the Panel process. The Bureau also recommends that SERs review the Study. However, the Panel process is only one step in the full rulemaking process. No providers of consumer financial products or services will be required to comply with new regulatory requirements before a proposed rule is published, public comment is received and reviewed by the Bureau, a final rule is issued, and 180 days passes from the effective date of the regulation, as required by Dodd-Frank Act section 1028(d). One of the specific questions on which the Bureau will seek input during the SBREFA process is how long small entities would need to implement the proposals under consideration.

The Bureau is also conferring with other federal agencies, as well as tribal and possibly other governments, and is seeking feedback from a wide range of other stakeholders on the proposals under consideration.

IV. Proposals Under Consideration to Limit the Use of Pre-Dispute Arbitration Agreements

As reflected in the Study, while consumers do not typically take individual disputes concerning their agreements for consumer financial products or services to arbitration or to court, the Bureau is concerned that arbitration agreements limit aggregate relief to consumers, principally by preventing consumers from filing and participating in consumer finance class proceedings. As to the few consumer financial arbitrations that do occur, the Bureau is concerned that there is a potential for significant consumer harm if arbitration agreements were to be administered in biased or unfair ways.

The proposals below cover: (1) prohibiting the application of arbitration agreements as to class cases in court; and (2) requiring submission to the Bureau of arbitral disputes (*i.e.*, claims in

[37] 5 U.S.C. 603(d).

arbitration) and awards and potentially also publication of those disputes and awards on the Bureau's website. Both of these proposals would apply to pre-dispute arbitration agreements "between a covered person and a consumer for a consumer financial product or service" as identified in part IV.C, subject to certain limited exceptions described in more detail at part IV.C.[38] The Bureau is not considering at this time a proposal that would prohibit entirely the use of pre-dispute arbitration agreements. The proposals being considered would not affect the ability of consumers and companies to agree to arbitrate disputes after they arise. The Bureau seeks feedback on all aspects of the proposals under consideration.

A. Proposals to prohibit the use of pre-dispute arbitration agreements in class litigation

1. Why is the Bureau considering proposals to prohibit the use of pre-dispute arbitration agreements in class litigation?

As noted above, the Study shows that individual consumers rarely file disputes against their consumer financial service providers, either in court or in arbitration. Survey results reported in the Study similarly show that only around 2% of consumers surveyed would consult an attorney or pursue an individual lawsuit as a means of resolving a small-dollar dispute.[39] While the Study does not address the question of *why* consumers do not file individual disputes in either forum, it may be because the amounts at stake are too small to make it rational for either the consumer or attorneys who may represent the consumer to pursue on an individual basis.[40] It may also be the case that individual, unrepresented consumers are unable to detect that their financial services provider has acted in a manner that may give rise to a legal claim.[41]

The Bureau recognizes that informal dispute resolution systems exist at companies to address some individual disputes about which consumers are aware.[42] However, companies' informal systems are voluntary and are primarily designed to benefit those consumers who pursue them. Many more consumers may be harmed by the same wrongful practice without realizing it or without filing their own disputes. An obvious drawback of such an approach for consumer protection is that companies can choose not to resolve disputes raised by customers who complain or can resolve disputes with those customers while maintaining practices that violate

[38] Covered financial products and services are defined in Dodd-Frank Act section 1002(15)(A), subject to limitations and exceptions set forth in sections 1002(15)(B)-(C), 1027, and 1029 of the Act.

[39] Study, *supra* note 2, section 3.4.2.

[40] *See, e.g., Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) ("The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.") (Emphasis in original.)

[41] For example, most consumers lack expertise to identify violations of antitrust law or to detect systemic widespread discrimination that might violate federal or state law.

[42] Consumers can also opt to submit a complaint to the Bureau about certain consumer financial goods and services. Complaints benefit the public and the financial marketplace by informing the Bureau's work; however, the Bureau's informal complaint system is not a substitute for consumers' rights to bring formal disputes. Consumer Financial Protection Bureau, *Submit a Complaint*, at http://www.consumerfinance.gov/complaint/.

the law or harm consumers who never complain. Indeed, the Study showed that at least for the class case settlements concerning banks' checking account overdraft policies, informal dispute resolution did not provide relief to many consumers harmed by the overdraft policies.

Given the relatively few disputes filed by individual consumers and the inherent limits of informal dispute resolution, the Bureau believes that existing avenues of aggregate legal relief should be available to consumers who may be harmed by their consumer financial service providers. The Bureau believes that the availability of such avenues for consumers not only facilitates relief in specific cases, but also strengthens incentives for consumer financial service providers to engage in robust compliance and customer service on an ongoing basis. While the Bureau and other government actors can and do file lawsuits against companies that cause harm to large numbers of consumers, government resources to pursue such lawsuits are limited.

A common form of aggregate relief for consumers is private class litigation. Class litigation procedures were developed in part because "the amounts at stake for individuals may be so small that separate suits would be impracticable."[43] Indeed,

> [t]he policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her own rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.[44]

For this reason, class cases are particularly relevant in consumer financial markets where it is less likely for any individual consumer to incur large losses as a result of a particular common practice even though, in aggregate, losses may be substantial.[45] Indeed, a number of the federal consumer financial protection laws administered and enforced by the Bureau explicitly acknowledge the relevance of private enforcement under class litigation by including these remedies in their statutory scheme.[46] Most class cases also provide finality to companies because settlements or judgments that occur in class cases bind consumers who have not opted out. This, in turn, can, for example, reduce the likelihood of a public enforcement action or the magnitude of relief paid in any such actions that are brought.

Class cases can provide significant relief to consumers who have been harmed by their consumer financial service providers. Conservatively, the Study found settlements in class cases provided, in federal courts alone, $540 million in gross relief to at least 34 million consumers per year on average over a five-year period.[47] Class litigation settlements sometimes also require behavior

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[43] 1966 Adv. Comm. Notes, 28 U.S.C. App., p.698.

[44] *Amchem Prod., Inc. v. Windsor*, 521 U.S. 591, 617 (1997) (*citing Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)).

[45] *See, e.g.*, *In Re Checking Account Overdraft Litig.*, MDL 2036 (consolidated class claims against financial institutions for posting transactions from highest-to-lowest transaction size the banks thereby causing consumers to pay more in overdraft fees than they would have had the transactions been posted in a more neutral order).

[46] *See, e.g.*, the Electronic Fund Transfer Act, 15 U.S.C. 1693f(e); the Fair Debt Collection Practices Act, 15 U.S.C. 1692k(a)(2)(B); the Truth in Lending Act (including the Consumer Leasing Act and the Fair Credit Billing Act), 15 U.S.C. 1640(a)(2)(B); and the Equal Credit Opportunity Act, 15 U.S.C. 1691e(b).

[47] This total is a conservative estimate because it does not include the value of companies' agreements to change their behavior.

changes on the part of defendants (*i.e.* agreements to stop the allegedly harmful conduct at issue) and, through public attention on these cases, arguably affect or influence the business practices of companies more broadly. The Bureau believes that class cases may improve industry compliance with the law to the extent the threat of class litigation deters companies from engaging in conduct that could violate consumer protection laws or their contracts with consumers.

Arbitration agreements can be and are used to dismiss class cases that consumers file in court. As noted, the Study shows that at least tens of millions of consumers have consumer finance contracts that contain arbitration agreements. The Study further shows that most arbitration agreements can be used to move class lawsuits from court to arbitration, where class proceedings are typically prohibited under the arbitration agreement.[48] Companies often successfully use arbitration agreements in consumer financial class litigation cases filed in court to block access to any form of class proceeding (and thus class relief) for those claims.[49] For example, in cases involving credit card issuers with arbitration agreements, the Study found that credit card issuers known to have arbitration agreements used them to move for stay or dismissal of the case in 65% of the class litigation cases.[50] The Study found over 100 examples of federal court consumer finance class cases dismissed or stayed on the basis of an arbitration agreement since 2010 alone – preventing virtually all of the consumers who may have been part of those classes from pursuing classwide relief to which they may have been entitled under the law or the terms of their contracts. In addition, it is likely that some class cases were never filed in the first instance because attorneys aware of arbitration agreements and the existing case law knew that they had little chance of being allowed to pursue the case. Moreover, as the Study showed, consumers rarely choose to file individual arbitrations instead.

The Bureau understands that class lawsuits have been subject to significant criticism that regards them as an imperfect tool that can be expensive and cumbersome for all parties. However, the Bureau notes that Congress, state legislatures, and the courts have mechanisms for managing and improving class procedures over time. On balance, the Bureau believes that consumers are significantly better protected from harm by consumer financial service providers when they are able to aggregate claims. Accordingly, the Bureau believes that ensuring that consumers can pursue class litigation related to covered consumer financial products or services without being curtailed by arbitration agreements protects consumers, furthers the public interest, and is consistent with the Study.

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[48] Specifically, the Study reports that 93.9% of the credit card arbitration agreements, 88.5% of the checking account arbitration agreements, 97.9% of the prepaid card arbitration agreements, 88.7% of the storefront payday loan arbitration agreements, 100.0% of the private student loan arbitration agreements, and 85.7% of the mobile wireless arbitration agreements in our sample contained terms that expressly prohibit arbitration from proceeding on a class basis. Study, *supra* note 2, section 2.5.5.

[49] *See, e.g.,* Study, *supra* note 2, section 6.7.2. Except for the analysis of cases against credit card issuers, the Study was not able to determine what percentage of cases involved a claim in which an arbitration agreement existed and which could have been relied upon in a motion to compel arbitration. Nevertheless, such motions to compel arbitration are filed in far greater proportion of class litigation cases (16.7%) than federal individual cases (less than 1%).

[50] *Id.*

2. Requirement that pre-dispute arbitration agreements provide they are inapplicable to class litigation

To address the concerns discussed above, the Bureau is considering a proposal to require any arbitration agreement included in a contract for a consumer financial product or service offered by an entity subject to the proposals to provide explicitly that the arbitration agreement is inapplicable to cases filed in court on behalf of a class unless and until class certification is denied or the class claims are dismissed. As specified by the Dodd-Frank Act and discussed in more detail in part IV.C below, this requirement would apply to arbitration agreements entered into at least 180 days from the effective date of any regulation.[51] The Bureau expects that such a proposal would include model or mandatory language that companies can include in arbitration agreements to comply with a rule. The Bureau believes that this approach would prevent companies from using an arbitration agreement to support a motion to compel arbitration in a class case, at least until class certification is denied or the class claims are dismissed.

This proposal seeks to address consumer harm caused by arbitration agreements that block consumers from filing or participating in class litigation, thereby reducing monetary and behavioral relief potentially available to consumers as well as reducing the deterrent effects from class cases.[52] As noted above, there is precedent in securities law for a rule that precludes arbitration agreements from blocking class litigation. Since 1992, the Financial Industry Regulatory Authority (FINRA), a self-regulatory organization overseen by the Securities and Exchange Commission, has required arbitration agreements adopted by broker-dealers to include language disclaiming the application of the arbitration agreement to class cases.[53]

3. Alternatives considered

As noted in part IV.B.3 below, the Bureau considered prohibiting arbitration agreements entirely. That alternative, like the proposal discussed above, would ensure consumer access to class proceedings. However, for the reasons discussed below, the Bureau is not considering that proposal.

The Bureau considered an alternative proposal to address consumers' access to class proceedings. That alternative would have given consumer financial services providers discretion to use arbitration agreements that required that class proceedings be conducted in arbitration instead of court, provided those arbitration proceedings satisfied minimum standards of fairness. Put another way, the alternative proposal would have prohibited companies from using their arbitration agreements to block class proceedings altogether, but would have allowed them unilaterally to choose whether such proceedings were conducted in court or administered in arbitration.

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[51] The effective date is discussed in greater detail below in part III.C.

[52] As discussed in more detail in part IV.A.3 below, this proposal would not prohibit an arbitration agreement from allowing class arbitration in addition to class litigation.

[53] FINRA Rule 2268(f). FINRA, formerly the National Association of Securities Dealers, also serves as an arbitral administrator for disputes concerning broker-dealers and its rules further prohibit broker-dealers from enforcing an arbitration agreement against a member of a certified or putative class case. FINRA Rule 12204(d). *See also* S.E.C. Release No. 31371 (1992) (approving FINRA Rule 2268(f)).

For reference, the rules of arbitration administrators such as AAA and JAMS (another large arbitration administrator) include procedures, derived from class action litigation procedures, for administering class arbitrations. These class arbitration procedures, discussed in the Study (Section 4.8), set out a three-step process: first, the arbitrator determines whether the arbitration agreement authorizes class arbitration; second, if the arbitration agreement authorizes class arbitration, the arbitrator determines whether a class should be certified, applying similar standards to those used in class litigation in court; third, if a class is certified (and the case does not settle), the arbitrator proceeds to resolve the case on the merits, resulting in a binding arbitration award.[54] A court may review decisions of the arbitrator only on limited grounds, as described in the Study.

There is little evidence, however, that these class arbitration rules have been widely applied in the resolution of consumer finance disputes. The Study found only two class arbitrations filed in AAA between 2010 and 2012 relating to the credit card, checking account/debit card, payday loan, prepaid card, private student loan, and auto loan markets. For this and other reasons, the Bureau rejected consideration of such an alternative proposal allowing companies to require class arbitrations for consumer finance claims because it is not confident that class arbitration is a reliable setting for aggregated resolution of consumer finance claims. The Bureau has reason to believe that few, if any, companies would choose to adopt arbitration agreements that permit class arbitration, rather than class litigation were the Bureau to adopt this option. Indeed, the Study noted that most arbitration agreements with class arbitration prohibitions also contain an "anti-severability" provision stating that if a court concludes that the no-class arbitration provision is not enforceable, the entire arbitration agreement also should be deemed to be unenforceable to prevent a court or arbitrator from mandating class arbitration, thereby demonstrating that companies have effectively chosen class litigation in court over class arbitration. Relatedly, industry groups have expressly stated that class litigation is preferable to class arbitration. For example, in response to the Bureau's 2012 Request for Information, an industry trade association contended that, if forced to submit to class arbitration, industry uniformly would abandon arbitration agreements – thereby risking exposure to class litigation instead.[55]

Notwithstanding these concerns about class arbitration, the Bureau notes that the proposal being considered would permit an arbitration agreement that allows for class arbitration provided a consumer could not be forced to participate in class arbitration instead of class litigation. In other words, an arbitration agreement that allowed a consumer to choose whether the claim is filed in a class case in court or in arbitration would be permissible under the proposal (but one that permitted the claim to only be filed in arbitration would not be permissible).

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[54] Under the AAA procedures, the party filing the class arbitration pays a preliminary filing fee of $3,350 for the first step of the case. If the case proceeds past the first step (determination as to whether the arbitration agreement permits class arbitration), the party filing the case also pays a supplemental filing fee. If the case proceeds to the third stage (following class certification), the arbitrator can allocate administrative fees for the arbitration based on the law and the arbitration agreement.

[55] *See also* Brief for Chamber of Commerce of the United States of America as Amicus Curiae in Support of Plaintiff-Appellants, *Marriott Ownership Resorts, Inc. v. Sterman*, No. 15-10627 at 9 (11th Cir. Apr. 1, 2015) ("Class arbitration is a worst-of-all-worlds Frankenstein's monster: It combines the enormous stakes, formality and expense of litigation ... with exceedingly limited judicial review of the arbitrators' decisions.").

B. Proposals to impose conditions on the use of pre-dispute arbitration agreements by requiring submission of arbitral claims and awards

1. Why is the Bureau considering proposals to condition the use of pre-dispute arbitration agreements by requiring submission of arbitral claims and awards?

The benefits and drawbacks of arbitration in individual proceedings, as well as the frequency of individual arbitration, have long been contested. The Bureau believes that the Study provides the most comprehensive data on individual consumer financial arbitration frequency and outcomes to date.

The Study found that filing an arbitration case is slightly less costly than initiating a case in federal court and that the time to resolution in arbitration is similar to the time to resolution of an individual case filed in federal court.[56] As to outcomes, the Study found that consumers prevailed on affirmative claims significantly less often than companies in arbitration, although the Study does not establish whether this is because of the types or relative merits of claims brought in arbitration by both consumers and companies.

It is important to note that the Study was limited to cases handled by AAA between 2010 and 2012; the Study did not review arbitrations administered by other firms during other periods. For example, the Study noted but did not review individual arbitrations administered by the National Arbitration Forum (NAF), which for a number of years prior to the period covered by the Study was the predominant administrator of consumer finance arbitrations. NAF primarily handled debt collection disputes, including 214,000 consumer arbitrations in 2006 alone. The Minnesota Attorney General filed suit against NAF in 2009 alleging state law fraud and other claims arising from allegations that NAF shared common ownership with a number of firms that filed debt collection claims before it. As is noted above, NAF agreed to permanently stop handling consumer arbitrations to resolve this litigation. Afterwards, both AAA and JAMS voluntarily stopped accepting debt collection disputes unless the consumer agreed to arbitration after the debt collection dispute arose. However, AAA and JAMS could end their voluntary moratoria at any time or entities could choose other providers.

The Bureau believes that there is a potential for consumer harm if arbitration agreements were to be administered by biased administrators (as was alleged in the case of NAF) or individual arbitrations were otherwise conducted in an unfair manner. Thus, the Bureau is considering a limited intervention that would serve to deter the emergence of such unfair arbitrations and also to shed sunlight on any unfairness that might emerge, while at the same time would impose minimal regulatory burdens on current arbitration activity.

[56] The time to close for class court cases, though, is longer than for both individual arbitrations and individual court cases.

With respect to claims, the Bureau is considering collecting them, as well as potentially publishing them on its website. The collection of claims would permit the Bureau (and the public, if the Bureau chose to publish them) to monitor arbitrations on an ongoing basis and to identify trends in arbitration proceedings (such as changes in the frequency with which claims are filed or to the subject matter of the claims filed). The monitoring and publication of claims further could assist the Bureau and the public in identifying potentially problematic business practices that harm consumers, particularly since many claims settle before an award is rendered.

As to submission of awards, the Bureau is similarly considering publishing them on its website . The Bureau believes that the submission requirement under consideration would prevent the types of harm outlined above and that publication would provide transparency as to how different arbitrators decide cases, signaling to attorneys for consumers and companies which sorts of cases favor and do not favor consumers, in order that better pre-arbitration case assessment can take place.[57] Making awards public may also generate public confidence in the arbitrators selected for a specific case as well as the arbitration system, at least for administrators whose awards tend to demonstrate fairness and impartiality. While the Bureau does not expect that arbitral awards would be deemed precedential in a court or arbitration, publication may help develop understanding of the facts and law at issue in those disputes. Consumers, public enforcers, and plaintiffs' attorneys could review the published information for trends that warrant further action.

2. Requirement to submit arbitral claims and awards to the Bureau

The Bureau is considering a proposal to require covered entities that use arbitration agreements in their contracts with consumers to submit initial claim filings and written awards in consumer finance arbitration proceedings to the Bureau through a process the Bureau would expect to establish as part of this rulemaking. The Bureau is also considering whether to publish the claims or awards to its website, making them available to the public. Before collecting or publishing any arbitral claims or awards, the Bureau would ensure that these activities comply with privacy considerations. This aspect of the proposal under consideration would not require changes to be made to the text of companies' arbitration agreements, alter the conduct of arbitration proceedings, or impose requirements on the content of written awards and, as discussed below in part V, would impose minimal costs on covered entities.

Currently, the two main administrators of consumer financial arbitrations do not require publication of claims or awards in matters between consumers and providers of financial services. Specifically, AAA does not currently require publication of consumer claims or awards although it "may choose to publish an award."[58] JAMS also does not publish its claims or

[57] The Bureau already publishes narratives and outcomes data concerning consumer complaints filed with the Bureau. The Bureau has stated that it "believes that greater transparency of information does tend to improve customer service and identify patterns in the treatment of consumers, leading to stronger compliance mechanisms and customer service. . . . In addition, disclosure of consumer narratives will provide companies with greater insight into issues and challenges occurring across their markets, which can supplement their own company-specific perspectives and lend more insight into appropriate practices." Consumer Financial Protection Bureau, Disclosure of Consumer Complaint Narrative Data, Docket No. CFPB-2014-0016, at 14 (Mar. 12, 2015). Similarly, the Bureau understands that state law data requirements generated information used to identify certain problematic practices in NAF.

[58] AAA Rule R-43(c).

awards. (NAF also did not publish these items when it administered consumer arbitrations.) Arbitration administrators are, however, currently required to publish data about certain consumer finance arbitrations (although not the awards themselves) pursuant to California law.[59]

Some arbitration providers already require publication of awards for disputes concerning matters other than consumer finance. A self-regulatory organization, FINRA, requires publication of all awards in disputes between customers and broker-dealers and publishes them on its public website.[60] In addition, AAA requires the publication of awards in all employment arbitrations and awards and dockets for all class arbitration proceedings before it.

It is important to note that the proposal under consideration would apply equally to individual arbitration proceedings and any arbitration that could proceed on an aggregated basis. Consumer financial class arbitrations may occur, whether because the parties agree to them post-dispute or because an arbitration agreement that allows a consumer to choose whether to file a class case in court or in arbitration would be permissible under the proposal, as is discussed in part IV.A. Particularly in light of the concerns raised about class arbitration, this data would also be helpful to the Bureau, consumers, companies, and possibly to other regulatory entities and academics who study consumer finance.

3. Alternatives considered

The Bureau considered alternative proposals to address individual arbitrations, including prohibiting the use of arbitration agreements in individual cases outright or requiring arbitration agreements to specify use of arbitration administrators that have procedures to ensure that individual arbitrations are administered in accordance with principles of fundamental fairness. The Bureau is not considering a proposal to prohibit arbitration agreements or to require safeguards for fundamental fairness for individual disputes at this time. The Bureau is not doing so because the evidence obtained thus far, including evidence analyzed in the Study, shows that few individual consumer finance claims are administered now and is inconclusive due in part to the low number of claims resolved in arbitration.[61] Further, the proposal to require submission of claims and awards which the Bureau would consider publishing may be sufficient to protect consumers from the risk of harm that may occur without mandated safeguards.

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[59] Cal. Civ. Proc. Code § 1281.96 (requiring administrators of consumer arbitrations in California to publish at least quarterly 12 data points on each arbitration). A recent study indicated that many arbitration administrators in California did not comply with the requirement or only partially complied. David J. Jung, *et al.*, Reporting Consumer Arbitration Data in California: An Analysis of Compliance with California Code of Civil Procedure Section 1281.96 (Dec. 2013)*, available at* http://gov.uchastings.edu/docs/arbitration-report/2014-arbitration-update.

[60] FINRA Code of Arb. Proc. for Customer Disputes, Rule 12904(e) (requiring publication of the parties' names); Rule 12904(h) ("All awards shall be made publicly available."). All FINRA arbitrations are on a searchable database. FINRA Arbitration Awards Online at http://finraawardsonline.finra.org/.

[61] With respect to the alternative of prohibiting the use of arbitration agreements in individual cases, the Bureau believes that the cost of such an alternative to small entities would be comparable to the cost of the proposals under consideration or less, because the effect of both would be the same as to class proceedings and there are relatively few individual consumer finance cases in either arbitration or litigation.

In rejecting these alternative proposals at this time, the Bureau notes that further interventions, up to and including prohibiting the use of arbitration agreements in all cases, may become appropriate. One benefit among others of the submission requirement being considered is that the Bureau can more effectively monitor arbitrations to determine if such regulation is needed in the future.

C. Effective Date and Coverage

1. Effective Date

As directed by the Dodd-Frank Act, the Bureau anticipates that the proposals, if adopted, would become operative no earlier than 180 days after the effective date of a final rule.[62] The Bureau currently contemplates setting an effective date of 30 days after the rule is published. Thus, the Bureau anticipates that such a rule would not apply to arbitration agreements entered into before 210 days after a rule is published by the Bureau. The Bureau seeks input from the SERs on the feasibility of complying with the proposals under consideration in that timeframe. Specifically, the Bureau seeks input on how and when contracts containing arbitration agreements are created and distributed and whether such practices might make compliance by the proposed effective date difficult. This input would then determine whether the Bureau should consider an alternative (*i.e.*, longer) compliance date for all entities or for some or all small entities in particular that would be covered by the proposal under consideration.

2. Coverage

Small entities that might be affected by this rulemaking within the meaning of SBREFA include those that provide the following financial products or services for consumer purposes, as defined in Dodd-Frank section 1002 and subject to the limitations in Dodd-Frank sections 1027 and 1029:

- extensions of credit by a creditor or credit card issuer under the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the Bureau's Regulation Z (12 CFR Part 1026), or by a creditor under the Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.) and the Bureau's Regulation B (12 CFR Part 1002), or the brokering, servicing, acquiring, or purchasing of any such credit, extending or brokering automobile leases as defined in Bureau regulations (to be codified at 12 CFR 1090.108), or providing debt relief services for such credit or automobile leases under the Telemarketing Sales Rule (16 CFR Part 310); and
- accounts with depository institutions under the Truth in Savings Act (12 U.S.C. 4301) and the Bureau's Regulation DD (12 CFR Part 1030) and the National Credit Union Administration's implementing regulations (12 CFR Part 707); and
- products or services subject to the Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) and the Bureau's Regulation E (12 CFR Part 1005), transmitting or exchanging funds under Dodd-Frank Act section 1002(15)(A)(iv), or check cashing under Dodd-Frank Act section 1002(15)(A)(vi); and

[62] Dodd-Frank Act section 1028(d) ("Notwithstanding any other provision of law, any regulation prescribed by the Bureau under subsection (b) shall apply, consistent with the terms of the regulation, to any agreement between a consumer and a covered person entered into after the end of the 180-day period beginning on the effective date of the regulation, as established by the Bureau.").

- obtaining information from a credit reporting agency as defined in the Fair Credit Reporting Act (15 U.S.C. 1681 et seq.) for the purposes of monitoring, on behalf of the consumer, the consumer's credit; and
- collecting debt related to any of these consumer financial products or services.

This includes but is not limited to banks, credit unions, credit card issuers, certain auto lenders, small-dollar or payday lenders, auto title lenders, installment and open-end lenders, private student lenders, providers of other credit in certain other contexts, loan originators that are not creditors, providers of credit in the form of deferred third-party billing services, providers of certain auto leases for at least 90 days, servicers of covered credit and auto leases, remittance transfer providers, providers of domestic money transfer services or currency exchange, general-purpose reloadable prepaid card issuers, certain providers of virtual currency products and services, check cashing providers, credit service/repair organizations, debt settlement firms, providers of credit monitoring services, and debt buyers.

The Bureau is also considering whether to cover additional consumer financial products and services; for example, payment processing. The Bureau is considering excluding from its proposed regulation products or services that are in any of the following categories: (1) already subject to arbitration rules issued by the Securities and Exchange Commission or the Commodity Futures Trading Commission,[63] (2) provided by persons when not regularly engaged in business activity (*e.g.*, an individual who may loan money to a friend), (3) provided by the federal government; (4) provided by state, local, and tribal governments and government entities to persons in their jurisdiction, or to persons outside their jurisdiction if not credit that is subject to the Truth in Lending Act or Regulation Z; and (5) credit a business extends for the consumer's purchase of its own nonfinancial goods or services when covered by Dodd-Frank Act section 1027(a)(2)(B)(ii). The Bureau is still evaluating whether regulatory action is warranted in these categories of activity, but does not want to delay action with regard to the operation of arbitration agreements in contracts for other types of consumer financial products or services in the meantime.

The Bureau seeks input on whether it should cover consumer financial products or services that are subject to other consumer laws and regulations or activities under a broader set of laws over which the Bureau has some authority. The Bureau further seeks input on each of these exclusions under consideration and also on whether additional consumer financial products or services should be excluded from the proposals under consideration.

V. Potential Impacts on Small Entities

A. Overview

The Regulatory Flexibility Act (RFA) generally requires an agency to carefully consider the economic impacts rules will have on small entities.[64] For purposes of the RFA analysis, the proposal the Bureau is considering may apply to those covered persons providing the consumer financial products or services outlined in part IV.C.2 above.

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[63] *See generally* FINRA Code of Arbitration Procedure (subject to review and approval by the SEC); *see also* 17 CFR 166.5(b) (CFTC regulations implementing Commodity Exchange Act and requiring that arbitration agreements be voluntary).
[64] 5 U.S.C. 601.

In order to estimate the potential impacts on small entities the Bureau needs to both ascertain the number of covered entities that are small entities and the percentage of these entities that have arbitration agreements, realizing that these percentages might vary across markets.[65] The entities to which the proposals under consideration might apply can be roughly subdivided into two categories. The first category is comprised of entities that primarily provide consumer financial products or services. For example, a bank that issues credit cards and provides checking accounts or an entity that provides payday loans would generally fall into this category because providing that product or service is the entity's primary business. The second category is comprised of entities that provide consumer financial products or services ancillary or incidental to the provision of nonfinancial goods or services. For example, a college that provides financial advice to its students or a seller of nonfinancial goods or services providing deferred third-party billing services would generally fall into this category.

The Study provided the proportion of entities that currently have arbitration agreements in their contracts in a subset of the markets that have covered entities: credit cards, checking accounts, general purpose reloadable prepaid cards, payday loans, private student loans, and mobile wireless third-party billing. In terms of the categorization described above, five are primary consumer financial product and service providers and one provides financial products or services ancillary or incidental to nonfinancial services. For other markets, anecdotal data that the Bureau has obtained suggests that at least some of these covered persons use arbitration agreements. The Bureau continues to analyze public data sources and other publicly available information, but has not arrived at an estimate of the percentage of entities that use arbitration agreements in these other markets. In connection with this SBREFA process, the Bureau seeks data from market participants on the prevalence of arbitration agreements in contracts for these products or services among small entities and on whether these arbitration agreements contain provisions that effectively prohibit class proceedings.

As noted above, the Dodd-Frank Act prohibits arbitration agreements in mortgage lending credit agreements. The prevalence of arbitration agreements in mortgage agreements was small for at least a decade prior to the passage of the Dodd-Frank Act, partially stemming from the Government Sponsored Entities' policies to not purchase residential mortgage contracts that contained arbitration agreements. Thus, although the Bureau is not considering an explicit exemption for residential mortgage lending, the Bureau does not expect this market to be impacted, except with respect to participants in the market who are not party to the credit agreement.

The Bureau believes that affected entities generally could face three types of costs from the proposals under consideration with respect to class arbitrations: (1) administrative costs due to a requirement that covered entities update their contracts to revise arbitration agreement language that otherwise would not comply with the Bureau's proposal (*i.e.* to include language in new agreements providing that arbitration agreements do not apply to cases filed on a class basis), (2) costs related to additional potential liability due to class litigation exposure (including defense costs, court costs, substantive settlement and damages exposure), and (3) increased cost of compliance with existing consumer finance and other laws and other costs due to entities attempting to minimize any such additional class litigation exposure in the future. The three types of costs are described in more detail below. The Bureau seeks SERs' input on each cost, as well as any other costs that affected entities might face.

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[65] See Section 2 of the Study, *supra* note 2, where the Bureau analyzed the prevalence of use of arbitration agreements in several markets.

The Bureau is also considering a proposal that would require covered entities to submit to the Bureau arbitral awards and initial claim filings for any arbitration in connection with consumer financial products or services in which the covered entity is involved. The Bureau would then consider publishing information regarding the awards and the claims on its website. Given the current low prevalence of individual arbitrations as noted in the Study, the Bureau believes that this requirement imposes a negligible cost on each entity that includes arbitration agreements in its contracts. The vast majority of the entities covered are unlikely to face this cost at all – the Bureau counted individual arbitrations administered yearly in major markets in the major administrator (AAA) to be in the hundreds in total. This number included individual arbitrations involving entities above the SBA thresholds that delineate small entities for the purpose of the RFA and SBREFA. For the few small entities that would be directly affected because they participate in an arbitration proceeding, they likely would be required to send the Bureau an electronic file with documents that the entity already possesses. The Bureau seeks input on this cost, but believes that it is less than $100 per individual arbitration and that most small entities will not be participating in any consumer finance arbitrations in a given year. The Bureau further seeks input on whether a redaction requirement would materially impact this cost.

In theory, some of the costs of this rule might be passed from covered entities through to their customers. For example, credit card issuers might increase their interest rates or fees in response to the costs identified above. However, the Bureau's detailed analysis of data regarding credit card issuers in the Study did not find statistically significant evidence of that occurring. The Bureau nonetheless seeks input, particularly any empirical evidence, on the proportion of the costs the entities expect to pass through to consumers, either in terms of higher prices or in other ways (for example, lower quality products).

Entities that do not currently use arbitration agreements in their consumer financial products or services might benefit from this rulemaking. Such entities may tend to prioritize compliance and customer service investments to manage their litigation risk, but find that the costs of that approach put them at a competitive disadvantage relative to companies that simply rely on the clauses as a shield. The rule could create a more level playing field that would tend to encourage their competitors to make similar investments. Furthermore, certain statutes actually limit liability for companies that fail to comply with the statute notwithstanding valid efforts to comply, thus rewarding companies that invest more in compliance.[66]

B. Administrative cost of including new language in future contracts between covered persons and consumers

As is noted above, arbitration agreements are typically included in contracts between covered persons and consumers for consumer financial products or services. In many cases, these

[66] *E.g.,* Truth in Lending Act, 15 U.S.C. § 1640(c) ("A creditor or assignee may not be held liable in any action brought under this section or section 1635 of this title for a violation of this subchapter if the creditor or assignee shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error."); Fair Debt Collection Practices Act, 15 U.S.C. § 1692k(b) (requiring a court to consider whether a debt collector's noncompliance was "intentional" in determining liability).

contracts are provided in writing to consumers either in paper or online, but in some cases are posted in a storefront when consumers contract for a new product or service. If the Bureau adopts the proposals being considered, affected small entities would be required to include new language in the standard-form contracts used starting at a certain point in the future – *i.e.,* those contracts with arbitration agreements entered into after approximately 210 days after any rule is published. (Arbitration agreements already entered into would not need to be changed or amended.) This model or Bureau-mandated language would provide that the arbitration agreements cannot be applied to class litigation. For the reasons listed below, the administrative cost of including this new language in the affected form contract is difficult to ascertain in the abstract, without asking small entities for relevant data. Accordingly, the Bureau seeks input on the administrative cost of including this new language in the affected form contracts that a given small entity would use in the future for covered consumer financial services or products. In addition, whether entities choose to maintain arbitration agreements under the rule may vary significantly. For example, some entities may use arbitration agreements strictly to manage class proceeding risk and may remove them if the Bureau were to adopt the proposal under consideration, while others may also value the ability to use them in individual disputes and thus will continue to use them. The Bureau therefore also seeks input on the extent to which entities would choose to remove arbitration agreements from their contracts entirely as opposed to including new language in arbitration agreements they use in the future, and the cost of doing so.

There may be a number of different factors affecting this administrative cost. One factor is what type of labor the small entity deploys to add new language to such contracts. For example, an employee could simply insert the Bureau's model language into a version stored on a computer system. The small entity may use an in-house or outside vendor in this process, such as a lawyer, form provider, or other type of vendor. These services may be provided as part of a larger suite of services provided by the vendor (and thus the small entity may incur no charge to implement this contract change). Overall, the Bureau believes that there will be cost differences depending on whether, for a given product, the entity is using its own (customized and internally developed) contracts or arbitration agreements or whether the entity is using a form provider's contracts or arbitration agreement.

The Bureau seeks further input on the extent to which form providers are used. Because the Bureau anticipates providing model contract language, and form providers generally serve many entities, the Bureau anticipates the form provider's cost per entity for providing a new form contract would be minimal. Nevertheless, the Bureau seeks input on what costs, if any, are involved for entities that use contracts provided by a form provider, and in particular how much additional review the entity would typically engage in after receiving an updated form contract from a provider. The affected entities might also use the language of model agreements from AAA or other arbitral administrators. The Bureau seeks input on the costs of covered persons' updating contracts that are based on such models and input on why an entity might deviate from using model language provided by the Bureau.

Additionally, an entity might have several product lines, each product line with its own contract that the entity would need to update. The entities might need to update posted terms, whether they are physically posted, or posted on a website, or made available in a mobile application. Again, costs could be impacted, as described above, by whether an entity uses its own forms or those created by a form provider.

Finally, the Bureau expects that entities will be able to use existing inventory of preprinted contracts they have, if any, before the rule is in effect. However, for some affected entities this

length of time might be too short to allow it to clear out the existing inventory of contracts and other materials that would need to be updated. The Bureau seeks input on the existence and the magnitude of such costs.

C. Legal cost due to possible additional class litigation exposure

If affected entities are no longer able to use arbitration agreements to effectively terminate class litigation, those entities would likely be exposed to the possibility of additional class litigation or threats of class litigation.

In its Study, the Bureau found on average 187 class actions per year in the credit card, checking/debit card, prepaid card, payday loan, auto loan, and private student loan markets (including cases against debt collectors in these markets) filed in federal courts and a sample of state courts representing about a fifth of the U.S. population. Some companies – particularly larger firms over SBA size limits for small entities – faced multiple class actions. These cases were filed against companies that used arbitration agreements as well as companies that did not. The Study did not disaggregate the number of these cases that were filed against small entities. As a point of comparison, however, a very preliminary estimate is that there are over 40,000 small entities in these six markets.

To the extent that the adoption of the proposal under consideration would increase exposure of small entities using arbitration agreements to class litigation, these entities might incur the following directly related cost increases: legal defense costs (including attorneys' fees, court costs and expert witness fees), settlement costs, and the costs attributable to the time that management and staff of the affected entity would have to spend dealing with related matters. In the Study, the Bureau documented the incidence of class litigation in particular markets, both in federal courts as well as in a sample of state courts. The Bureau is seeking input on: (1) the prevalence of actual filed or threatened class cases against affected small entities and whether the proposals under consideration would alter that prevalence, (2) costs related to defending against a class case, and (3) other possible costs associated with a potential increase in the incidence of class cases. This last category of costs could include, for example, expenditures that occur before a case is filed. While the Study documented the settlement amounts in federal class litigation settlements, such settlements typically do not reflect both the defendants' own legal defense and court costs and the opportunity costs of the defendants' employees' time spent on class litigation.

The Bureau continues to seek input and data on these costs.[67] Specifically, wages for in-house lawyers and support staff and, where used, outside defense lawyers vary widely by geography, skill level, practice area, and size of firm, among other variables. According to a survey by a

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[67] In response to the Bureau's 2012 Request for Information, several industry trade associations noted that calculating defense costs may be difficult, if not impossible, because most businesses do not track such costs separately. Another industry trade association did, however, point to an annual survey of firms relating to class action defense costs. *See* Carlton Fields Jorden Burt 2015 Class Action Survey, available at http://classactionsurvey.com. That survey states that it covers "350 companies of all sizes," and it did not break out defense costs for small entities. The survey also covered cases of varying types (consumer fraud and other types, such as securities class actions), and did not contain data on the cost of retaining outside counsel on a per-year per-case basis for the sorts of cases that affected entities might be defending.

legal consultancy, small companies (with revenue up to $25 million) pay in-house attorneys a salary between $81,500 and $181,000 and paralegals/legal assistants between $41,250 and $75,250 depending on experience.[68] Outside law firms may utilize paralegals/legal assistants, associate attorneys, partner attorneys, or some combination of these on a given matter. One recent survey found that during 2014 the average hourly rate charged by a law firm partner in a general litigation practice was $350, and the average hourly rate charged by a law firm partner practicing in the area of finance, loans, and investments was $450.[69] Another survey found that associates charge average rates between $274 and $400 depending on the size of the firm.[70] Another survey found that paralegal/legal assistant hourly rates ranged between $60 and $170.[71] Use of alternative fee arrangements, as well as fee caps, also may be increasing and may further vary costs incurred in defending class proceedings.

As to how long class cases take to defend, the Study reported data at Table 7 of Section 6, finding the median time to closure for closed class cases analyzed in the Study was 218 days. Class cases closed after a non-class settlement or potential non-class settlement (68% of the closed class cases cases) took a median of less than 200 days. Cases resulting in final approval of class settlements closed in a median of 670 days.

The Bureau is further interested in the breakdown of settlement costs in class litigation. In particular, the proportion of costs that goes to pay the class members themselves. The Study sheds some light on this topic, showing that in 419 class litigations concerning consumer finance, the plaintiffs' attorney's fees were on average 21% of cash relief to the class at the time the Bureau was able to assess cash relief. The Bureau seeks further input on these costs.

To be able to measure these costs accurately, the Bureau encourages SERs to consider similar costs that the SERs presumably faced before they adopted arbitration agreements. This information will aid the Bureau in evaluating the impact of arbitration agreements on the SERs' litigation costs.

On the one hand, the proposal under consideration would prohibit an entity from blocking a class proceeding using an arbitration agreement. This may increase the incentive for consumers to file such cases. However, due to the increased potential for these cases, as discussed in part D below, companies may invest more in compliance to limit their exposure to class proceedings. As a result, this increased compliance may, in turn, decrease the incentive to file such cases. For these reasons, it is difficult to project frequency of future class litigation based on historical data. For reference, the Bureau believes that the expected cost of facing class litigation historically has

[68] *See* Robert Half, Legal 2015 Salary Guide at 13, available at http://www.roberthalf.com/legal/the-2015-legal-salary-guide (also noting that medium size companies (annual revenue between $25 million and $250 million) pay in-house attorneys between $97,500 and $225,000). Relatedly, the Bureau of Labor Statistics reports that the median annual wage for a lawyer in the finance industry in 2012 was $134,940. *See* Bureau of Labor Statistics, U.S. Department of Labor, Occupational Outlook Handbook, 2014-15 Edition, Lawyers, available at http://www.bls.gov/ooh/legal/lawyers.htm. The mean annual wage for paralegals and legal assistants was $49,680. *See* Bureau of Labor Statistics, U.S. Department of Labor, Occupational Employment and Wages, May 2014 – 23-2011 Paralegals and Legal Assistants, available at http://www.bls.gov/oes/current/oes232011.htm.

[69] LexisNexis, 2014 CounselLink Enterprise Legal Management Trends Report at 26.

[70] ABA Journal, "A lawyer's value, hour by hour," Sept. 1, 2014, available at http://www.abajournal.com/magazine/article/a_lawyers_value_hour_by_hour/.

[71] National Association of Legal Assistants 2015 National Utilization and Compensation Survey Report, Section 3 Billing Rates, at 7-8, available at http://www.nala.org/Upload/file/PDF-Files/News-Articles/15SEC3.pdf.

been small for any given entity; that is, considering the low frequency of class litigation, the likelihood that any given small entity would be sued has been low. The Bureau identified fewer than 100 consumer finance class litigation settlements per year in federal court in its Study, many of which involved entities above the SBA small entity thresholds. In total, the Bureau could only find fewer than 160 class litigations filed per year in federal courts in six markets. While the Bureau could not analyze all cases filed on the state level, it did review cases filed in a set of states accounting for roughly one fifth of the U.S. population. There, the Bureau found roughly 30 cases filed per year in six markets. Also, note that the Bureau found that while 15% of the cases result in a final class settlement and an additional 2% had a class settlement pending approval as of August 31, 2014 (the latest date such outcomes were analyzed in the Study), the rest did not (at least in the time frame analyzed in the Study). For example, the most common outcome in class cases that were filed and analyzed in the Study was for a settlement or a potential settlement with the plaintiff consumer before the case was certified as a class case. The Bureau requests comments on costs related to both the cases that result in a final class settlement and to the other cases as well. These numbers include filings that involved entities above the SBA small entity thresholds; however, the numbers of small entities affected might increase to the extent that more cases are filed due to the inability of defendants to invoke arbitration agreements to effectively terminate class litigation.

Furthermore, the Bureau expects that private class litigation attorneys may have fewer incentives to file class litigation against a smaller entity than a larger entity. For example, several consumer finance statutes feature explicit damages caps which may be related to an entity's revenue, and smaller entities generally have fewer consumers, which also may limit what can be recovered.[72]

D. Possible cost due to managing any perceived risk of increased exposure to class litigation

One of the possible effects of a prohibition on the use of arbitration agreements in class litigation is that entities might take steps to decrease the risk of class litigation exposure in the future (to the extent they perceive that the proposals under consideration would create increased exposure). These adjustments could come in several forms, such as increased investments in compliance, changes to product design, increased purchase of insurance (or increased insurance premiums). The potential for a given entity to engage in some or all of these adjustments will depend upon, among other things, their existing practices and level of compliance with laws that have private remedies. These practices and compliance levels vary both within and across markets and jurisdictions.

It is difficult to quantify these costs for the proposal, in part because covered entities may each respond differently to it. Even for existing regulations, it is difficult to quantify such costs. In 2013, the Bureau published a report seeking to understand the effects of compliance with parts of Regulations DD, E, P, and V on bank operations (the 2013 Report).[73] In the 2013 Report, the

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[72] *See, e.g.,* Fair Debt Collection Practices Act, 15 U.S.C. 1692k(a)(2)(B) (limiting statutory damages in class actions to "the lesser of $500,000 or 1 per centum of the net worth of the debt collector."); Truth in Lending Act, 15 U.S.C. 1640(a)(2)(B) (limiting damages class actions to "the lesser of $1,000,000 or 1 per centum of the net worth of the creditor").

[73] CFPB Report, "Understanding the Effects of Certain Deposit Regulations on Financial Institutions' Operations: Findings on Relative Costs for Systems, Personnel, and Processes at Seven Institutions"

Bureau conducted a detailed analysis of operations at seven banks and, among other findings, analyzed how compliance with aforementioned regulations is spread across the banks' business functions depending on regulatory requirements.[74] While working on the 2013 Report, the Bureau did not find any other relevant data sources providing similar information. The 2013 Report outlined the difficulties involved in measuring the incremental cost of such compliance activities, including that financial institutions do not generally keep such statistics requiring that the data be collected through detailed personnel interviews at the financial institution that required a significant investment of time from both Bureau and institution personnel. These same difficulties arise in quantifying the cost of compliance for the proposal under consideration across the various markets that would be covered.

With respect to the potential for increased investment in compliance, there might be a one-time component of this effect, such as reviewing existing products, policies and procedures in response to a rule from the Bureau. For example, an entity might decide to go through a one-time review of its policies and procedures and staff training materials to ensure that the risks of a future class litigation exposure are minimized. This review might result in revisions to policies and related additional staff training. There might also be an ongoing component of systematic policies, reviews of procedures, and staff training to ensure a consistently low level of conduct of the type that companies perceive can create exposure to class litigation. There might also be additional expense to the extent that laws change, court decisions interpreting those laws are publicized, or new products are developed. The ongoing component could also include additional periodic personnel time spent on review of policies and procedures, additional periodic training that employees and third-party service providers must receive, as well as any outside audits or legal reviews that the entity might perform.

Another example of an ongoing component is entities' purchase of insurance that would cover some or all of the costs of class litigation. Insurance policies can vary widely in their scope, exclusions, and levels of coverage. Pricing also depends on underwriting the risk specific to the entity. Anecdotal reports suggest that general commercial liability policies may cover defense costs in some class cases, and that larger companies may seek specialized class action insurance. However, the Bureau has not found data indicating the incremental cost of insuring against consumer financial class action defense and liability costs, availability of such policies, and whether they would cover all potential class claims and related attorney's fees. The Bureau believes that while there would be some one-time upfront costs of selecting the right insurance provider, most of the cost would stem from the ongoing insurance premium payments once a company selected a policy. The Bureau seeks input on the extent that affected small entities would seek such insurance if they do not have it already and what the entities believe the payments would be if such insurance is available.

The ongoing component could also include costs due to changes in product and services. For example, an entity might decide that a particular feature of a product makes the entity more susceptible to class litigation, and therefore the entity would decide to remove that feature from the product, possibly resulting in decreased revenue. For example, lenders may abandon an aggressive business practice for the fear that it will violate laws with private remedies. Similarly, an entity might update its product features based on external information, such as actions by either regulators or private actors against the entity's competitors. The ongoing component could also include changes to the product design process. Product design could consume more

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(Nov. 2013) (the 2013 Report), available at http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

[74] *See* the 2013 Report at 65, Table 5.

time due to additional rounds of legal and compliance review. The prohibition on the use of the arbitration agreements in class litigation could result in some products not being developed and marketed primarily due to the risk associated with class litigation. The Bureau encourages the SERs to provide specific examples of products that might not have been developed absent the ability to include arbitration agreements in their terms.

Finally, the ongoing component could also include entities investing additional resources into informal dispute resolution. Similarly, the entities could invest more in customer service in order to minimize the number of disputes arising.

E. Cost of credit to small entities

Pursuant to the RFA, the Bureau considers the impact of the proposals under consideration on the cost of credit to small entities. For several reasons, the Bureau believes that the proposals under consideration would have a minimal impact on the cost of credit to small entities. As noted in part IV.C.2 above, the Bureau is considering an exemption for credit a business extends for the consumer's purchase of the business's own nonfinancial goods or services that are covered by Dodd-Frank Act section 1027(a)(2)(B)(ii).[75] Absent such an exemption, merchants granting credit to consumers would be covered by the scope proposed above if the merchant sells, assigns, or otherwise conveys that consumer credit to a third party. Such sale, assignment, or conveyance could occur, for example, in certain types of commercial borrowing engaged in by merchants. However, due to the exemption under consideration, such merchants would not be covered on this basis. Thus the proposal would not affect the cost of credit of such merchants when they are engaged in such borrowing activities.

In addition, there is a potential for an indirect impact on the cost of credit for at least some of those small entities that would be covered by the proposal under consideration. In particular, this impact could occur for small entities that use credit cards and other financial products or services that are primarily used by consumers. However, the Bureau believes this impact would only occur to the extent any costs of the proposals under consideration are passed through to consumers. Such a pass through of costs to consumers could also affect small entities using these financial products or services because covered persons, such as credit card issuers, might not be able to perfectly price discriminate between consumers and small entities. The Bureau does not believe that this increase, even if it were to occur, would significantly impact small entities or their access to credit, but the Bureau seeks input on this question and more generally on any impact on the cost of credit to small entities.

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The Bureau seeks input on the costs outlined above and on any related costs. Many of these costs are opportunity costs (*e.g.* management time involved and extra time spent on product

[75] Under the Dodd-Frank Act, the Bureau generally does not have authority to regulate credit that merchants, retailers, or other persons provide to consumers to purchase their own goods or services that are not financial in nature. However, if such merchants, retailers, or other persons sell, convey, or otherwise assign this consumer credit to a third-party (when the credit is not in default or delinquent), the Bureau does have authority to regulate such credit. *See* Dodd-Frank Act section 1027(a)(2)(B)(ii). The Bureau understands that it may be common for merchants, retailers, and other persons to make such sales, assignment, or conveyances of consumer credit as part of their business commercial borrowing arrangements. One example is through "factoring," in which a business sells its accounts receivable at a discount, in order to generate cash flow.

design and development in additional rounds of legal and compliance review) that may be difficult to quantify. Nonetheless, the Bureau encourages SERs to attempt quantification to the extent possible and also to provide specific examples. To be able to measure these costs more accurately, the Bureau encourages SERs to consider similar costs that the SERs presumably faced before they adopted their arbitration agreements.

Appendix A: Legal Authority

Dodd-Frank Wall Street Reform and Consumer Protection Act,
Pub. L. 111-2013, 124 Stat. 1376 (approved July 21, 2010)

Sec. 1028. Authority to Restrict Mandatory Pre-Dispute Arbitration.

(a) STUDY AND REPORT.—The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.

(b) FURTHER AUTHORITY.—The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).

(c) LIMITATION.—The authority described in subsection (b) may not be construed to prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person after a dispute has arisen.

(d) EFFECTIVE DATE.—Notwithstanding any other provision of law, any regulation prescribed by the Bureau under subsection (b) shall apply, consistent with the terms of the regulation, to any agreement between a consumer and a covered person entered into after the end of the 180-day period beginning on the effective date of the regulation, as established by the Bureau.

Appendix B: Glossary

Arbitration means a form of alternative dispute resolution in which a privately-appointed individual — an arbitrator — is empowered to resolve disputes that arise between the parties, including both contractual disputes and disputes under state or federal law.

Class Arbitration means a class case that proceeds in arbitration. Like other forms of arbitration, a privately-appointed individual — an arbitrator — is empowered to resolve the dispute. The arbitrator (or arbitrators) will typically first decide whether a class can be certified and then will decide the merits of the underlying dispute.

Class Proceeding or Class Case means a lawsuit that allows a large number of people with a common interest in a matter to sue or be sued as a group. In federal courts, such actions are brought in accordance with Rule 23 of the Federal Rules of Civil Procedure, which requires the party seeking class certification to demonstrate that (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class. Similar rules exist in the states that permit class cases.

Dodd-Frank Act means the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (July 21, 2010), section 1028 of which provide the Bureau with the authority to promulgate rules related to the proposals under consideration.

Pre-Dispute Arbitration Agreement means an agreement or part of an agreement that requires future disputes between the parties to the agreement to be resolved by an arbitrator. (Often referred to as an **Arbitration Agreement** in this document.)

Small Business Regulatory Enforcement Fairness Act of 1996 or **SBREFA**, Pub. L. No. 104-121 (Mar. 29, 1996), refers to the statute that establishes the Small Business Review Panel process for certain Bureau, Environmental Protection Agency, and Occupational Health and Safety Administration rulemakings.

Small Business Review Panel or **Panel** means a panel formed of representatives from the Bureau, the Chief Counsel for Advocacy of the Small Business Administration, and the Office of Information and Regulatory Affairs in the Office of Management and Budget. A Panel is convened in accordance with SBREFA when a rule under development may have a significant economic impact on a substantial number of small entities. The Panel for the Bureau's rulemaking on arbitration agreements will prepare a report of its recommendations after discussing with small entity representatives the Outline of Proposals Under Consideration and Alternatives Considered.

Small Entity means a small business, small organization, or a small government as defined by the Regulatory Flexibility Act. The size standards for classifying a business as small vary by industry and are established by the Small Business Administration.

Small Entity Representative or **SER** means a representative of a small entity who participates in the SBREFA process to provide input on costs and benefits of the proposals under consideration in a rulemaking.