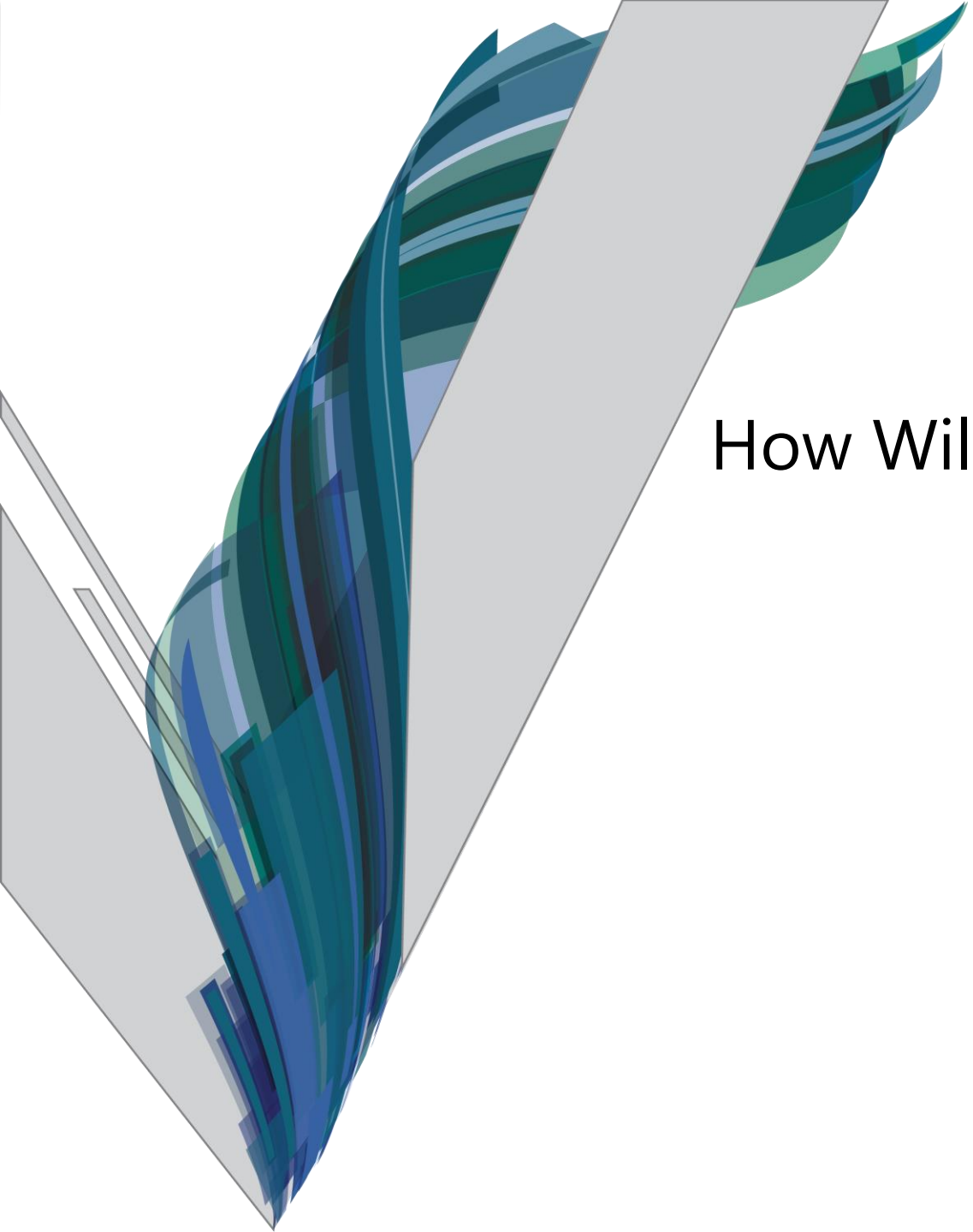

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How Will the CFPB's Proposed Arbitration Clause Ban Impact You?

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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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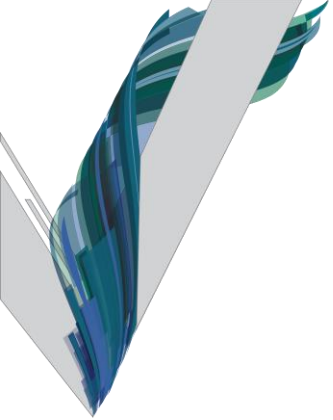

Arbitration Rule: Overview of the CFPB's Proposal

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.

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

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

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.

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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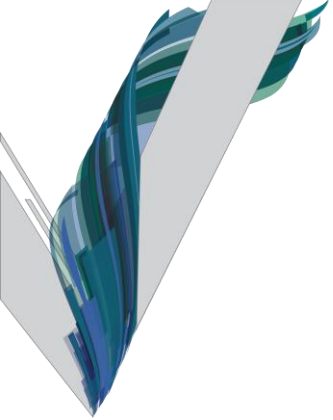

In Perspective: Arbitration and Class Action Litigation

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

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

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."

***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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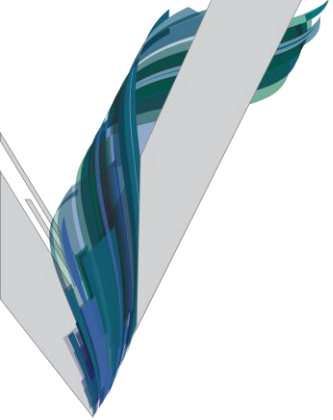

Tomorrowland: What's Next?

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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Questions?

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