



# An Overview of the CFPB's Final Arbitration Agreements Rule

**September 12, 2017**

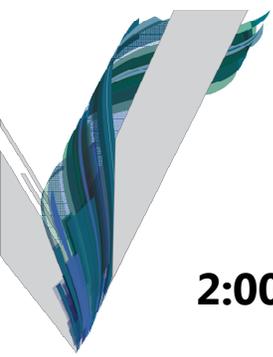
**Panelists:**

**Andy Arculin**, Partner, Venable LLP

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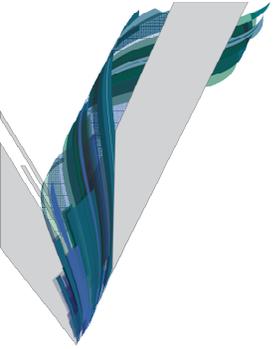
**John F. Cooney**, Partner, Venable LLP

**Peter S. Frechette**, Associate, Venable LLP



# Agenda

<b>2:00 pm - 2:05 pm</b>	Introduction
<b>2:05 pm - 2:20 pm</b>	An overview of the rule, its scope, requirements, and effective dates
<b>2:20 pm - 2:35 pm</b>	The path to the rule, including statutory underpinnings, and the CFPB's rulemaking process
<b>2:35 pm - 2:45 pm</b>	The CFPB's enforcement tools for the rule
<b>2:45 pm - 2:55 pm</b>	APA & CRA – Overview and discussion of the various challenges to the rule
<b>2:55 pm - 3:05 pm</b>	Forecasting – The rule's effect on businesses
<b>3:05 pm - 3:15 pm</b>	Complaint resolution and how to minimize new risks
<b>3:15 pm - 3:30 pm</b>	Questions



# Overview of the CFPB's Final Rule



# Arbitration Rule Timeline

May 24, 2016	The Bureau issues the NPRM and publishes the Proposed Rule in the <i>Federal Register</i> .
Aug. 22, 2016	Deadline for comments on the Proposed Rule.
July 19, 2017	The Bureau publishes the Final Rule in the <i>Federal Register</i> .
Sept. 18, 2017	Effective date of the Final Rule.
Mar. 19, 2018	Compliance deadline of the Final Rule.
July 1, 2019	Deadline for the Bureau to begin public posting of arbitral records submitted by providers.



# The Arbitration Rule

- Creates a new section of 12 C.F.R.: Section 1040.
- Three elements to the CFPB's Rule:
  - 1) Elimination of class action waivers in arbitration agreements. Covered providers are barred relying on class action bans in arbitration clauses ""in any way."
  - 2) Inclusion of mandatory language in arbitration agreements: *"We agree that neither we nor anyone else will rely on this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action filed by someone else."*
  - 3) Submission to the CFPB of arbitral claims, awards, and other details about the arbitration process, generally within 60 days, for posting on the CFPB's website.



## Scope of the Rule

Applies to pre-dispute arbitration agreements “**entered into**” after the compliance date.

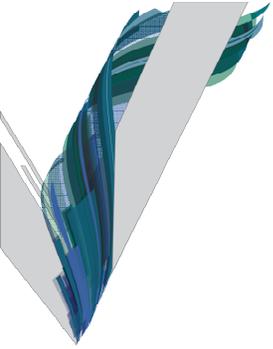
- The term “entered into” is included in Section 1028(d), but not defined.
- “Entered into” generally includes any circumstance in which a person agrees to undertake obligations or gains rights in an agreement.
- Under the Final Rule, the term “entered into” includes the following scenarios:
  - Providing to a consumer a new covered product or service;
  - Acquiring or purchasing a product or service that is subject to a pre-dispute arbitration agreement and the purchaser becomes a party to it; and
  - Adding a pre-dispute arbitration agreement.



## Affected Products and Services

The Rule applies to certain consumer financial products and services in the core consumer financial markets of lending money, storing money, and moving or exchanging money, including, among others:

- Most types of consumer lending (extending consumer credit under Regulation B, such as making loans, issuing credit cards, certain types of retail installment sales, and providing credit in certain other contexts);
- Providers of credit in the form of deferred third-party billing services;
- Participating in activities related to the extension or decision to extend consumer credit, such as providing referrals, servicing, credit monitoring and repair, debt relief, debt collection services, and purchasing consumer loans;
- Extending or brokering of automobile leases; and
- Other business related to storing, transmitting, or exchanging funds (including savings and deposit accounts, remittance transfer providers, providers of domestic money transfer services or currency exchange, general-purpose reloadable prepaid card issuers, and check cashing providers, among others).



# The Path to the Rule



## Discretionary Rulemaking

- The Arbitration Rule was not required by Congress; CFPB used its discretionary authority under the Dodd-Frank Act.
- Dodd-Frank Act gave the CFPB authority to conduct a study around arbitration agreements and make rules consistent with the study.



# 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.
- (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.



# **Dodd-Frank Act Section 1022 - 12 U.S.C. § 5512(b)(1)-(2)(A)**

## **Section 1022. RULEMAKING AUTHORITY.**

### **(b) RULEMAKING, ORDERS, AND GUIDANCE**

(1) General authority: The Director may prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof.

(2) Standards for rulemaking: In prescribing a rule under the Federal consumer financial laws—

(A) the Bureau shall consider—

(i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule; and

(ii) the impact of proposed rules on covered persons, as described in section 5516 of this title, and the impact on consumers in rural areas . . . .



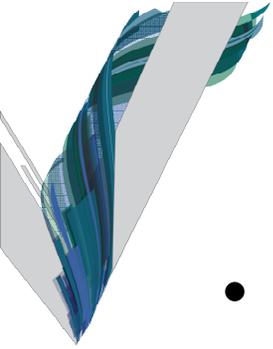
## Arbitration Study

- Conducted primarily by CFPB Office of Research, Markets, and Regulation (“RMR”).
- Preliminary results in 2013; report to Congress in 2015.
- Study focused on pre-dispute arbitration clauses in light of the landmark Supreme Court case *AT&T Mobility LLC v. Concepcion*, which upheld pre-dispute class action waivers in binding arbitration clauses.
- Determined study gave CFPB authority to promulgate rules limiting pre-dispute class action waivers and requiring companies that use pre-dispute arbitration clauses to report records relating to arbitral and court proceedings to CFPB.
- Also notable that Congress limited binding arbitration clauses for mortgages under the Dodd-Frank Act and loans to service members under the Military Lending Act.



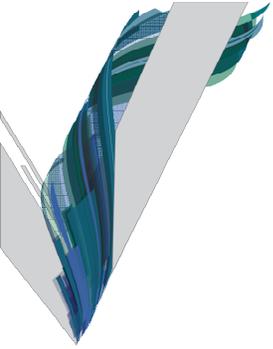
## Proposed Rulemaking

- CFPB convened a small business review panel in 2015, with a report issued December 11, 2015.
- CFPB published proposed rulemaking and a request for public comment on May 24, 2016, with the comment period closing August 22, 2016.
- Received over 100,000 comments across multiple industries; industry commenters raised questions about CFPB's authority under the study to promulgate rules without further analysis.
- CFPB evaluated and addressed comments with potential Administrative Procedures Act challenges in mind.



## Final Rule

- Finalized proposal with only minor modifications.
- Published in *Federal Register* July 19, 2017, with an effective date of September 18, 2017 and mandatory compliance date of March 19, 2018.
- Industry counting on challenges to the rule, but nothing to date.



# The Bureau's Enforcement Options



## Enforcement Options

How may the Bureau enforce the Rule?

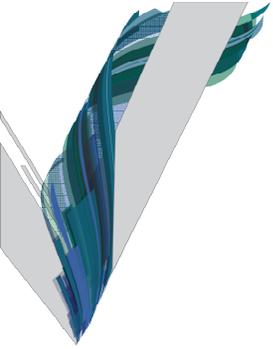
- The CFPB, and State Attorneys General, may seek penalties under Title X of the Dodd-Frank Act for violations of the Rule, including:
  - Rescission or reformation of contracts;
  - Refund of moneys or return of real property;
  - Restitution;
  - Disgorgement or compensation for unjust enrichment;
  - Payment of damages or other monetary relief;
  - Public notification regarding the violation, including the costs of notification;
  - Limits on the activities or functions of the person; and
  - Civil money penalties



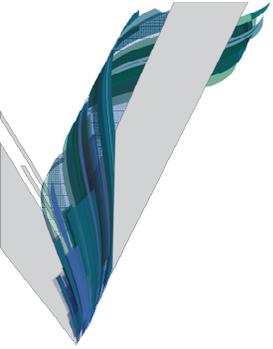
## Enforcement Options

What enforcement options are not available?

- No private right of action.
- Non-compliant arbitration agreements are not automatically null and void (but are unenforceable with respect to class actions under the Rule).



# Challenges Facing the Final Rule



# Alternative Approaches to Overturning the Final Rule

- Adoption of a Resolution of Disapproval under the Congressional Review Act
- Possible Administrative Action to Stay, Modify, or Revoke the Final Rule
- Legal Challenges to the Final Rule



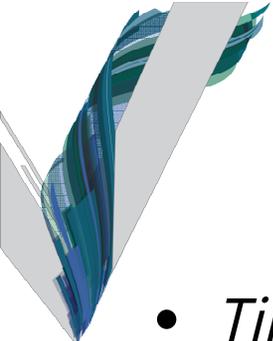
# Alternative Approaches to Overturning the Final Rule

- Disapproval Resolution under the Congressional Review Act
  - The House has passed a Disapproval Resolution
  - The Senate has not yet acted. The Senate must pass a Resolution of Disapproval within 60 Session Days (Oct. 29) of the CFPB's Submission of the Rule for Review.
- A Disapproval Resolution cannot be filibustered. If adopted, the CFPB would be barred from adopting a "similar" rule.
- Potential Obstacles in the Senate
  - Do backers of a Disapproval Resolution have 50 votes?
  - Scarcity of floor time – Conflict with other legislation that Senate leadership considers a higher priority?



## Possible Administrative Action to Stay, Modify, or Revoke the Final Rule

- If Director Cordray resigns, the President could appoint an Acting Director. That official could initiate a new regulatory process to stay or modify the Final Rule before the deadline for the prohibition on new arbitration provisions is reached.
- Under the Federal Vacancies Reform Act, the President could select an Acting Director from three categories:
  - Cordray's Deputy. Strong supporter of the Final Rule.
  - An officer of another agency who has been confirmed by the Senate. Likely to be a Treasury official?
  - A lower-ranking, non-confirmed CFPB official. Unlikely changes will occur – lack of political support.



## Possible Administrative Action To Stay, Modify or Revoke the Final Rule

- *Time frame:* The Final Rule has taken effect. The phase-in date for the prohibition on new arbitration agreements has not been reached.
- To prevent the Final Rule from governing regulated entities by administrative action, the Acting Director would have to conduct two rulemakings:
  - Issue a Notice of Proposed Rulemaking on a new rule proposing to stay the rule pending further consideration of its terms.
  - A final rule staying the Rule could be issued after CFPB review of the public comments.



## **Possible Administrative Action To Stay, Modify or Revoke the Final Rule**

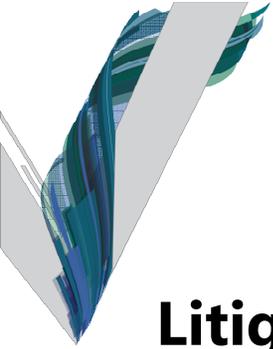
- Issue a Notice of Proposed Rulemaking on a rule to amend the substantive provisions of the Final Rule. Upon review of the comments, the CFPB could issue a new rule upon finding that it would be “consistent with the study,” as reinterpreted, and would be “in the public interest and for the protection of consumers.”
- The process of conducting two rulemakings can be complex and generally takes a significant number of months to complete.
- Litigation is under way challenging several rules that the new Trump appointees are trying to change by similar administrative action.



# Legal Challenges to the Final Rule

## Governing Legal Requirements

- **The Study Requirement.** The CFPB conducted “a study” of arbitration before issuing a rule prohibiting or imposing conditions on the use of arbitration agreements. The findings in the Final Rule must be “consistent with the study.”
- **The Substantive Standards.** The CFPB may prohibit or impose limits on the use of arbitration agreements if it finds such restrictions would be “in the public interest and for the protection of consumers.” The “public interest” test is the broadest and most deferential rule recognized by the courts.
- **Cost-Benefit Analysis.** The CFPB must consider “the potential benefits and costs to consumers, . . . including the potential reduction of access by consumers to consumer financial products or services resulting from such a rule . . . .”
  - There is no requirement that the benefits to consumers must exceed the costs to regulated entities of prohibiting arbitration provisions. The CFPB is required only to “consider” the costs and benefits. Costs lawfully can exceed benefits of the Arbitration rule as long as the CFPB has a reasonable justification for its decision. *See Michigan v. EPA.*



# Litigation Challenges to the Final Rule

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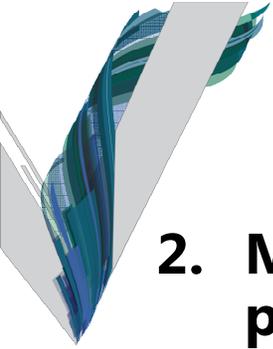
- The litigation will be complicated and lengthy.
- Key question: Will challengers seek and obtain an injunction against the prohibition on arbitration clauses pending appeal?



# Litigation Challenges to the Final Rule

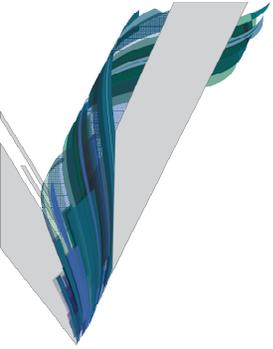
## Likely Features of the Litigation

- Several salient aspects of the litigation can be identified in advance.
  - 1. The litigation will resemble trench warfare as to whether the Final Rule is arbitrary and capricious based on the facts.**
    - There is no cut-across issue of statutory interpretation that will determine whether the Rule is lawful. The question will be whether the CFPB's interpretation of the information collected in its study is reasonable.
    - In analyzing whether the rule would serve the public interest, the CFPB took a global approach. It relied extensively on the same evidence to justify prohibition of arbitration clauses in many product markets, rather than collecting information and making decisions on a product-by-product basis. It reached a single conclusion that a prohibition on arbitration clauses was in the public interest for all products considered.
    - Risk to the CFPB: The whole rule will rise or fall together.



## Litigation Challenges to the Final Rule

- 2. Much of the CFPB's analysis was based on abstract economic principles. One of the principal benefits to consumers considered was the deterrent effect on providers of the threat of class action lawsuits.**
  - Risk: The CFPB did not consider the deterrent effect of its own recent enforcement efforts in compelling compliance. Overstated benefits of the Rule?
- 3. Many of regulated entities' costs of compliance are quantifiable, while the benefits to consumers are largely unquantifiable. Will the court defer to the CFPB's judgment as to what is in the public interest in this situation?**



## Further Discussion



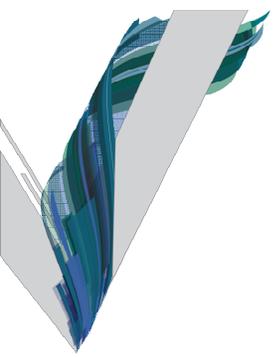
## Further Discussion

- Forecasting the Rule's effect on businesses
  - Experiences of mortgage industry and lenders to military borrowers?
  - Effect on new/novel business models or ideas?
- Minimizing new risks through complaint/dispute resolution
  - Rapid and robust complaint responses
  - Escalate complaints as appropriate
  - Track and monitor complaints to identify and forestall trends
- Increased emphasis on compliance
  - Costs on noncompliance with certain laws and regulations could go up
  - Compliance Management System helps prevent violations
- New risks must be incorporated into risk management process



## Who needs to be involved in the conversation?

- Compliance Management Committee
  - Litigation counsel
  - Regulatory counsel
  - Compliance team
- Business owners (each product and service)
- Customer Support
- Other?



# What needs to be considered?

## Assess Litigation Exposure

(What's your new last line of defense? How does this impact vendor relationships?)

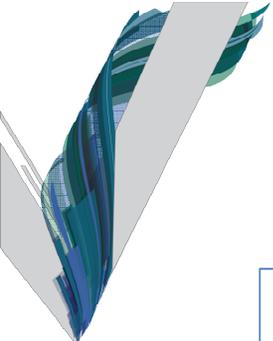
Assess Recourse Available to Consumers

Know the Terms of Your Contract

Know Plans for Resale/Purchase

Understand Implementation Periods

Consider Product and Service Enhancements



# Questions and Closing Observations



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