CFPB'S PROPOSED RULE WOULD PUT THE BRAKES ON PRE-DISPUTE ARBITRATION CLAUSES IN CONSUMER FINANCIAL CONTRACTS

Date: 12 May 2016

Commercial Disputes and Financial Institutions and Services Litigation Alert

Congress enacted the Federal Arbitration Act[1] in the 1920s to deter hostility toward arbitration. Despite numerous Supreme Court rulings over the decades upholding that goal, arbitration continues to face hostility. The Consumer Financial Protection Bureau ("CFPB"), for example, recently issued a proposed rule that would significantly expand the scope of the Dodd-Frank Act's[2] restrictions on arbitration agreements. The rule would severely restrict the use of pre-dispute arbitration clauses by providers of consumer products and services, primarily by prohibiting the use of class action waivers. And under the proposed rule, the CFPB would exercise close scrutiny over arbitration proceedings by requiring consumer financial services providers to report certain information about arbitrations to the CFPB.

THE DODD-FRANK ACT AND THE CFPB'S ARBITRATION AGREEMENT STUDY

The Dodd-Frank Act expressly prohibits the use of pre-dispute arbitration agreements in specific circumstances, namely in residential mortgage loan and home-equity lines-of-credit agreements.[3] At the same time, the Act requires the CFPB to study the use of pre-dispute arbitration agreements in a broader scope of consumer financial services contracts and to report its findings to Congress.[4] The Act authorizes the CFPB to regulate the use of such agreements, conditioned on finding that prohibiting or restricting their use is "in the public interest and for the protection of consumers."[5]

The CFPB conducted the requisite study, the results of which the CFPB reported to Congress in March 2015.[6] In the study, the CFPB compared the outcomes of arbitrations to the outcomes of both individual lawsuits and class action lawsuits. The study reported an average of 616 consumer finance-related individual arbitrations initiated per year and an average of 187 consumer finance-related putative class actions filed in court per year.[7] Based on the study, the CFPB was unable to conclude that individual litigation is more fair or efficient than individual arbitration.[8] The CFPB concluded, however, that class actions are more effective at providing consumers with relief, and in changing corporate behavior, than either individual arbitrations or individual lawsuits.[9]

THE CFPB'S PROPOSED ARBITRATION RULE

Bases on its findings, the CFPB now proposes a rule that limits the use and scope of arbitration agreements and would apply those limitations to a broad array of consumer financial servicers and product providers. And despite Congress's repeated rejection of proposed legislation to achieve similar ends,[10] the CFPB determined that the proposed rule is "in the public interest and for the protection of consumers."[11]

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The proposed CFPB rule would apply to many types of providers of consumer finance products and services, including, among others, entities that extend credit under the Equal Credit Opportunity Act, extend or broker automobile leases, provide services to assist with debt management or foreclosure avoidance, provide consumer reports directly to consumers, provide accountings under the Truth in Savings Act, provide payment processing or check-cashing services, or collect debt arising from a financial product. The proposed rule would prohibit these providers from enforcing an arbitration agreement that "bar[s] the consumer from filing or participating in a class action with respect to the covered consumer financial product or service."[12] In addition, the proposed rule would require providers involved in an arbitration pursuant to a pre-dispute arbitration agreement to submit certain arbitration related records to the CFPB.[13] The records required for submission to the CFPB would include the initial claim form and any counterclaim, the pre-dispute arbitration agreement filed with the arbitrator or administrator, and the judgment or award if any.[14] And, the CFPB has made clear its intention to publish much, if not all, of those records without regard to confidentiality, except to the extent that the CFPB determines that certain personal consumer information warrants redaction.[15]

WHAT HAPPENS NEXT?

Certain members of the consumer finance industry have questioned the CFPB's basis for expanding the scope of providers subject to the Dodd-Frank Act's pre-dispute arbitration agreement limitations.[16] Indeed, the CFPB study highlights the fact that arbitration *benefits* both consumers and covered providers by providing a quick and efficient dispute mechanism. Yet, the CFPB's "restriction" on class action waivers in arbitration agreements would effectively eliminate arbitration as a dispute-resolution option for consumer finance products and service providers.[17] Few, if any, covered providers would likely choose to give up the procedural protections of the judicial system, and the right to meaningful appellate review, in favor of defending class claims in arbitration.

In addition, the U.S. House of Representatives Committee on Financial Services has begun an investigation into the CFPB's process in promulgating the proposed rule.[18] Among other points of contention, Committee Chairman Representative Jeb Hensarling has criticized the proposed rule for providing a windfall to the plaintiffs' bar.[19]

The CFPB will accept public comments on the proposed rule until ninety days after the proposed rule's publication in the Federal Register. Given the strong industry reaction to the proposed rule, it is possible that the CFPB may revise the rule before promulgating the final version. Yet, based on past conduct, the CFPB does not often accede to external pressure, congressional or otherwise. In sum, while the CFPB has set class action waivers and consumer finance related arbitrations in its crosshairs, the ultimate substance of the final arbitration rule, and how it will impact the consumer financial industry, remain to be seen.

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[1] 9 U.S.C. §§ 1, *et seq.*

[2] Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1375 (2010).

[3] *Id.* § 1414(a), 124 Stat. at 1375, *codified at* 15 U.S.C. § 1639c(e).

[4] *Id.* § 1028(a), 124 Stat. at 2003–04, *codified* at 12 U.S.C. § 5518(a).

[5] *Id.* § 1028(b), 124 Stat. at 2004, *codified* at 12 U.S.C. § 5518(b).

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[6] CFPB, Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform & Consumer Protection Act § 1028(a) (2015)

[7] *Id.* at 11, 13.

[8] Consumer Financial Protection Bureau, Proposed Rule with Request for Public Comment on Arbitration Agreements, at 92 (May 3, 2016) ("Proposed CFPB Rule"), http://files.consumerfinance.gov/f/documents/CFPB_Arbitration_Agreements_Notice_of_Proposed_Rulemaking.pdf.

[9] *Id.* at 103.

[10] *See, e.g.*, Arbitration Fairness Act of 2015, S. 1133, 114th Cong. (2015) (referred to committee but no further action taken); Arbitration Fairness Act of 2013, S. 878, 113th Cong. (2013) (same). Similar legislation has recently been introduced that seeks to ban the use of pre-dispute arbitration agreements in wireless services contracts. *See* Justice for Telecommunications Consumers Act, S. 2897, 114th Cong. (2016) (referred to committee).

[11] Proposed CFPB Rule at 114.

[12] *Id.* at 1.

[13] *Id.*

[14] *Id.* at 234.

[15] *Id.* at 232.

[16] *See, e.g.*, Press Release, American Bankers Association, ABA Statement on CFPB Proposed Arbitration Rule (May 5, 2016), http://www.aba.com/Press/Pages/050516CFPBArbitrationRuleStatement.aspx.

[17] *See* Press Release, U.S. Chamber of Commerce, CFPB Announces "Biggest Gift to Plaintiffs' Lawyers in a Half Century" (May 5, 2016), https://www.uschamber.com/press-release/us-chamber-cfpb-announces-biggest-gift-plaintiffs-lawyers-half-century.

[18] Letter from Sean Duffy, U.S. Representative, to Richard Corday, Director of the CFPB (Apr. 20, 2016).

[19] *See* Yuki Hayashi & Christina Rexrode, *Proposed Rule Would Allow Consumers to Sue Banks, Credit-Card Companies*, Wall St. J., May 5, 2016, http://www.wsj.com/articles/cfpb-unveils-proposed-rule-to-let-consumers-sue-banks-credit-card-companies-1462420862.

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