CBA Regulatory Compliance Bulletin

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CFPB Issues Final Rule Banning Mandatory Arbitrations; Legal Challenges Likely to Follow

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On Monday July 10, 2017, the CFPB released its controversial final rule banning mandatory arbitrations in consumer financial product or service contracts and establishing a new public database covering these agreements. This move is widely expected to result in legislative and court challenges to its validity.

The final rule, which is effective on the 60th day after publication in the Federal Register, addresses arbitration agreements between consumers and a broad range of financial service providers, including banks. The agreements covered by the rule are those that include arbitration clauses for future disputes and are established on or after the compliance date, which is the 241st day after the rule is published in the Federal Register. (As of July 13, the rule had not yet been published.) In these contracts, referred to as "pre-dispute arbitration agreements" in the rule, mandatory arbitration clauses are banned if they prevent class actions unless the clause is restricted to individual claims.

The rule covers providers of consumer financial services involving lending, storing, moving or exchanging money, a vast scope that certainly includes banks. Some of the covered activities are participating in consumer credit decisions, extending consumer credit, providing consumers information about their credit files, acquiring or selling consumer credit, extending or brokering certain automobile leasing, and engaging in consumer credit repair, servicing or debt collection or management. Activities such as providing deposit accounts or prepaid accounts to consumers, as well as remittance transfers and check cashing for consumers, are also covered. Notably, the rule does not apply to the residential mortgage market where arbitration agreements have been prohibited by Congress under Dodd-Frank. The CFPB implemented that prohibition in the Truth in Lending Act regulations. Among others to whom the rule does not apply are financial services industry members regulated by other government agencies, such as the Securities and Exchange Commission, the Commodity Futures Trading Commission or broker dealers and investment advisers regulated by state securities commissions. There is also an exemption for parties engaging in activities covered under the rule if they and any affiliates collectively provide those products to no more than 25 consumers in the current calendar year and the preceding one, respectively.

For covered products and services, the rule mandates language informing consumers that the agreement cannot be used to block transactions for inclusion in pre-dispute arbitration agreements. The rule also covers circumstances where a subject provider,

including a bank, entering a pre-dispute arbitration agreement can use alternative mandated language or need not add it all. Alternative language specified in the rule is permitted for pre-arbitration agreements applying to multiple products and services of which only some are subject to the rule. General purpose reloadable prepaid cards meeting specifications in the rule are not required to contain the mandated language if the agreement is packaged before the compliance date (i.e., the 241st day after publishing in the Federal Register).

For previously existing pre-dispute arbitration agreements that a bank enters into after the rule compliance date – for example, where one bank acquires another bank that has this agreement with consumers for a product or service covered under the rule and the acquiring bank also becomes a party to that pre-dispute arbitration agreement ,the bank must amend the agreement to add the generally required or alternative language, or provide a standard written notice of the arbitration ban within 60 days of entering the agreement.

Additionally, the rule includes optional language that a bank can include at the end of the required disclosures (a) for any subset of consumers it contracts with for whom the mandatory arbitration ban does not apply or (b) to clarify that the disclosures apply to any delegation provision that may be in the agreement (i.e., agreements to delegate to arbitration decisions regarding threshold issues in an arbitration agreement, such as enforceability).

In addition to the language requirements, banks must submit to the CFPB records regarding individual arbitrations that will be published on a new online public database. Banks must provide the records with personally identifiable information redacted, and the CFPB may make further redactions as necessary to comply with applicable privacy laws. The records required include those related to pre-dispute arbitration agreements entered on or after the rule compliance date in which (a) certain arbitration or court filings are made based on a party's reliance on that agreement (e.g., seeking dismissal, deferral or stay of any aspect of a class action, or a bank filing a claim in arbitration against a consumer who filed a claim on the same issue in a class action) or (b) banks receive communications from an arbitrator or arbitral administrator regarding a determination that the agreement does not comply with an arbitrator's due process or fairness standards. Banks must also submit communications from the arbitrator regarding dismissal or refusal to administer a claim based on the bank failing to pay filing or administrative fees.

Required records must be submitted to the CFPB within 60 days of filing them with an arbitration administrator or court. The CFPB plans to have the database publicly available by July 1, 2019.

The new rule, which was first proposed in May 2016, has been unpopular with the financial services industry and primarily Republican lawmakers, and is expected to face congressional and court challenges that could delay or curtail implementation. It will likely impact large banks hardest, as they are more likely to have these pre-arbitration dispute agreements in consumer contracts than small or mid-sized banks. All banks should consider how the rule impacts their current and future agreements with consumers and be prepared to make appropriate changes to those agreements if the rule takes effect.