

May 16, 2016

CFPB Issues Proposed Rule to Restrict the Use of Mandatory Arbitration Clauses and Class Action Waivers

If implemented, the Proposed Rule will result in an increase in class action lawsuits against consumer finance companies that currently include class action waivers in their contracts.

On May 5, in one of its most impactful moves since its inception, the Consumer Financial Protection Bureau (CFPB) unveiled a proposed rule to restrict the use of arbitration clauses in consumer financial contracts (Proposed Rule). This Proposed Rule will prohibit most providers of consumer financial products or services from using a pre-dispute arbitration provision that prevents consumers from filing or participating in a related class action lawsuit.

Arbitration agreements were a target of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). Section 1028 of the Act required the CFPB to both (1) study pre-dispute arbitration agreements, which resulted in a March 2015 CFPB report to Congress; and (2) regulate the use of pre-dispute arbitration agreements. The Proposed Rule is derived from these requirements.

In its March 2015 study, the CFPB found such clauses were used in hundreds of millions of consumer contracts, including: 53 percent of outstanding credit-card loans; 86 percent of the loans from the largest private student lenders; 44 percent of insured deposits from financial institutions; 92 percent of prepaid card agreements; and in some states, 99 percent of storefront payday loan contracts.

Important aspects of the Proposed Rule include the following:

- The scope of the rule touches a range of products including: credit cards, checking and deposit accounts, prepaid cards, money-transfer services, specific auto and auto title loans, payday and installment loans, and student loans.
- The Proposed Rule will create two sets of limitations on pre-dispute arbitration agreements used by covered providers:
 - First, providers will be prohibited from using a pre-dispute arbitration clause to block consumer class action suits, and providers will be required to include language in agreements that memorializes this limitation. To guarantee compliance, the CFPB is offering language that providers would be required to include in arbitration agreements to explain the rule.
 - Second, covered providers that use pre-dispute arbitration agreements must submit certain records relating to arbitration to the CFPB. This is intended to allow the CFPB to collect further data regarding arbitral proceedings, which may hint at future rule-making to address patterns of perceived consumer protection issues.

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- The Proposed Rule will apply to agreements entered into after the rule's effective date.

When implemented, this rule will be a game-changer for nearly all consumer financial contracts. Affected companies should use this time, before implementation, to mitigate class action claims that previously might have been subject to arbitration. Companies should consider a review of all consumer-facing documents to confirm language complies with applicable federal and state law. Additionally, internal policies and procedures must be reviewed to ensure that product origination and servicing is consistent with all legal requirements. Likewise, vendor agreements must be reviewed in relation to applicable law—including, most importantly, principal-agency theories. It is imperative that companies anticipate ways to limit liability and manage future class action risks now—as class action defense litigation spending is anticipated to surge in every consumer finance sector.

Notably, this rule should be considered in the context of the CFPB's pending rules related to the collection of certain credit-related information linked to the commercial "small businesses" market as required by Section 1071 of the Dodd-Frank Act.

The public comment period will close 90 days after publication of the Proposed Rule in the *Federal Register*. The CFPB has proposed that the final rule not be effective until 180 days after its publication.

A preview is available [here](#).

The March 2015 CFPB Report regarding arbitration is available [here](#).

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