# What Happens if the CFPB Arbitration Rule Isn't Overturned? – Ten Practical Tips to Think About Now

August 8, 2017

Since the CFPB issued its Arbitration Rule in July, most commentators have focused on ways the rule may be blocked from going into effect. Chief among these is the possibility that Congress will vote to overturn the rule under the Congressional Review Act, and the House did promptly vote in favor of overturning the rule on July 26, 2017. Last week, the Senate began its August recess without a vote to overturn the CFPB Arbitration Rule and with no indication for when it might take the matter up again. In light of that uncertainty, it is now time for financial institutions to consider contingency planning and prepare for the possibility that the rule may go into effect. With a compliance date of March 19, 2018, the rule's transition period to prepare for compliance is among the shortest we have seen in a Dodd-Frank Act regulation.

Set forth below are ten practical tips we think covered providers should consider taking to prepare for compliance. Of course, the Senate may still vote to overturn—and some of our observations below, which inform these practical tips, could provide additional reasons for it to do so—but covered providers would be wise to prepare in case the Senate does not act.

For readers who are less familiar with the rule, we have summarized its basic elements in the attached appendix.

1. ***Scope out the Universe of Consumer Contracts.*** The first step to prepare for compliance with the rule is to scope out the universe of covered contracts within the organization. While contracts for consumer financial products and services will be based on standard forms, different business lines are likely to have different contracts for different products and services entered into at different times. There may also be variants based on past acquisitions.
    - The review should include contracts for products or services offered by an affiliate, even if the affiliate may be an excluded person.
    - Providers should consider documenting the basis for deciding that certain contracts are or are not covered by the rule.
    - Bear in mind that the rule applies not only to stand-alone pre-dispute arbitration agreements, but also to pre-dispute arbitration agreements that are included within, annexed to, incorporated into, or otherwise made part of, a larger agreement. The rule also applies to delegation provisions, which may appear in provisions separate from the pre-dispute arbitration agreements.

Once a covered provider has mapped out the universe of relevant contracts, it should consider updating its policies and procedures to cover the rule's requirements, including when contracts must be amended or notices distributed to consumers, and should designate personnel responsible for ensuring compliance, as well as target deadlines for completion.

2. ***Assess Existing Consumer Practices and Put in Place an Early Warning System.*** Covered providers should consider reviewing their existing consumer practices in order to mitigate the risk of class action lawsuits.
    - As part of this review, covered providers should determine which business lines are most at risk for consumer complaints and assess their practices and policies for tracking and responding to those complaints. Tracking complaint trends in the CFPB's current complaints database, and later in the arbitral records database established under the Arbitration Rule, could provide one

way to develop an early warning system to identify and mitigate the risk of a class action suit by dissatisfied customers. Class actions often come in waves. Such an early warning system should track trends both at the covered provider and at competitors, as well as at other consumer-facing companies.

3. ***Review Standard Forms to Mitigate Class Action Risk.***

   - Covered providers should review key provisions in their contracts for covered products and services, including disclaimers and waivers, to assess whether any amendments are appropriate or whether notice period waivers and other clauses should be updated to mitigate the risk of class action liability. Motions to dismiss will assume greater importance in class action litigation because they will afford an opportunity to resolve cases early, before expensive and burdensome discovery. The quality of disclosures in key documents like the relevant contracts will be centrally important to motions to dismiss and therefore to defeating class actions early.[1]
   - Variations in consumer protection laws, usury laws, and other state law causes of action will also impact how litigation proceeds. To the extent permitted by state law, covered providers will need to consider choice of law, forum and other provisions in their contracts to attempt to litigate as many disputes as possible under more favorable laws and with more predictable court systems.[2] Relatedly, covered providers may want to weigh the relative costs of litigating in certain jurisdictions against the benefits of continuing to offer covered products and services there.
   - In a world with heightened litigation risks, covered providers should recognize that their internal reviews could become discoverable, particularly if the review is not conducted by or at the direction of counsel.

4. ***Refresh and Update Relevant Employees on Class Action Risks.*** Because the rule may lead to an increase in consumer class action litigation, litigation discovery will likely become more of a risk for covered providers. Anticipating this result, covered providers may wish to refresh and update their training program on appropriate email and telephone communication for employees in consumer-facing business lines.

5. ***Assess the Capabilities of the Consumer Contract Databases.*** A covered provider should assess whether it needs system improvements to comply with the rule, including developing a consumer contracts database or enhancing an existing one. A database of relevant contracts could help a covered provider to:

   - Distinguish between contracts that contain pre-dispute arbitration clauses and those that do not;
   - Monitor when new contracts are put in place, when a "new" product or service is offered or provided, or when existing contracts are amended or modified in such a way that the covered provider is deemed to have entered into a pre-dispute arbitration agreement; and
   - Track whether contracts have been amended to include the required language and whether required notices have been delivered to the relevant consumers.

In light of the large number of contracts to track, many of which will likely change over time, it may be necessary to develop intelligent searching or innovative systems solutions to help monitor compliance

[1] Such documents would typically be deemed incorporated by reference in a complaint—even if not cited directly—and therefore available for a court to consider on a motion to dismiss.

[2] In light of *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), and *Consumer Financial Protection Bureau v. CashCall, Inc. et al.*, No. 15-cv-7522-JFW, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016), nonbank lenders will have concerns about the application of state usury laws and their interaction with class actions.

with the rule. Given the short time frame to comply with the rule, a covered provider should consider appropriate system improvements now.

6. ***Assess the Capability to Comply with the Requirement to Submit Arbitral Records.*** Covered providers should also assess the capability of their systems for complying with the requirement to submit certain arbitral and court records to the CFPB. Covered providers might benefit from developing a separate database to track and monitor ongoing consumer-focused arbitrations and litigations.

7. ***Consider Whether and How to Structure Sales of Consumer Agreements.*** The rule could have a significant impact on the practice of repackaging and selling consumer contracts, such as loan portfolios.

   - Consumer loans, except for residential mortgages, often include mandatory arbitration clauses with class action waivers which providers have relied upon to compel individual arbitration of potential class actions, including for claims alleging violation of state consumer and usury laws.[3]
   - A covered provider that sells consumer agreements may have to reconsider how to structure the sale of these agreements, or the terms to include in the contracts of sale, in order for both the covered provider and the acquiring party to remain in compliance with the rule.

8. ***Consider the Rule's Effect on Mergers and Acquisitions.*** Covered providers should consider whether a prospective merger or acquisition agreement will result in existing contracts coming within the scope of the rule. When acquiring a new business or loan portfolio, a covered provider should make this issue a focus of its due diligence.

9. ***Consider the Benefits and Costs of the Continued Use of Pre-Dispute Arbitration Agreements.*** The rule's records submission requirements, and the repository of such records that the CFPB will maintain on its public website, mean that many details concerning arbitrations that likely would have been confidential will instead become widely and easily accessible.

   - The disclosure of these materials would undermine one frequently cited advantage of arbitration. Setting aside any potential reputational harm to covered providers caused by public disclosure, the CFPB arbitration database could become a source of information and ideas for enterprising plaintiffs' lawyers eager to bring copycat claims and cases.
   - For this reason, covered providers will need to consider whether the perceived advantages of arbitration, which can include more limited discovery and the ability of the parties to select a decision-maker, justify the continued use and enforcement of pre-dispute arbitration agreements under the rule. In the alternative, some covered providers may determine that litigation, including the possibility of a quick dismissal on the pleadings, and, in some jurisdictions, the opportunity for immediate interlocutory review of an adverse court's decision on a motion to dismiss, is preferable to publicly disclosed arbitration proceedings.
   - Interestingly, the CFPB acknowledges in the preamble that covered providers may choose to discard pre-dispute arbitration agreements altogther and instead add more general waivers that would bar contractual counterparties from resolving disputes in class actions. As the CFPB recognizes, such a waiver would be outside of the scope of the rule, which addresses only pre-dispute arbitration agreements. Covered providers may wish to consider this possibility, although

[3] For example, in *Bethune v. Lendingclub Corporation, et al.*, the court recently granted the defendants' motion to compel arbitration of the plaintiff's claim that Lendingclub had violated New York's usury and consumer protection laws, on the basis that the plaintiff's particular loan agreement was governed by an arbitration agreement. No. 16-cv-2578, 2017 WL 462287 (S.D.N.Y. Jan. 30, 2017).

the CFPB, at least under its current leadership, has stated that it will actively monitor consumer financial markets for this practice.

10. ***Class Action Policy Considerations.*** The choice between class actions and arbitration is a choice between two flawed systems. The trend toward arbitration has lessened the pressure to have serious public policy discussions on class action reform. In light of the CFPB's new rule, covered providers and other companies should consider pursuing reforms to improve the class action system and the arbitration system for both consumers and covered providers. There are many ways to more appropriately balance the goal of providing a way for those with small claims to seek redress without unleashing the extensive burdens of fishing expedition discovery embedded in a class action system where a significant amount of the payout goes to plaintiffs' lawyers rather than consumers.

# Appendix

This appendix provides a brief overview of the CFPB's Arbitration Rule, including a general discussion of its scope and requirements.

## Overview of Rule Requirements

***Pre-Dispute Arbitration Agreements.*** The rule covers certain pre-dispute arbitration agreements[4] entered into with consumers on or after the compliance date, which is March 19, 2018. Under the rule, covered providers:

(1) are prohibited from using pre-dispute arbitration agreements to bar class actions;

(2) must include certain language in their pre-dispute arbitration agreements and/or provide required notifications to consumers that are parties to these agreements, and

(3) must provide certain court and arbitral records to the CFPB for online publication within 60 days of any such record being filed with an arbitrator, arbitration administrator or court.

## Who and What are Covered?

***Covered Products and Services.*** The rule applies broadly to providers of most consumer financial products and services, meaning that they are offered or provided for use by consumers primarily for personal, family or household purposes.

***Covered Providers.*** Covered providers are those persons[5] subject to the substantive requirements of the rule and include a broad swath of consumer financial services providers, such as banks, credit unions, credit card issuers, small dollar or payday lenders, private student lenders, payment advance companies, loan originators, loan servicers, and debt collectors. A covered provider under the rule may be a direct provider of covered products or services to consumers or an affiliate that provides certain services to the direct provider. Consequently, as the rule's official interpretation clarifies, an affiliate could be a covered provider under the rule even if it is not itself directly offering or providing a covered product or service to consumers. Under certain circumstances, an affiliate could be a covered provider under the rule even if it is providing a service to another affiliate that is an excluded person under the rule.

***Examples of Covered Products and Services***:

- Consumer credit services, including:
  - Loans;
  - Credit references; and
  - Credit servicing
- Automobile leases
- Debt management, settlement and collection services
- Consumer credit reports and scores
- Credit repair services
- Deposit accounts, electronic funds transfers and money transfer services
- Payment processing, check cashing and check collection services

If a covered provider offers or provides a broad range of products or services, only some of which are covered by the rule, then the covered provider will need to comply with the rule's requirements only with respect to those products or services covered by the rule.

## Key Concepts in Applying the Pre-Dispute Arbitration Agreement Requirements

[4] The rule also clarifies that pre-dispute arbitration agreements include delegation provisions, which are agreements to arbitrate decisions regarding threshold issues pertaining to arbitration agreements, such as the question of whether an arbitration agreement is enforceable. A delegation provision may appear in a separate provision of the contract from the mandatory arbitration provision.

[5] A person is defined as an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization or other entity.

***Applies to Agreements Entered into on or after the Compliance Date.*** A covered provider must ensure that pre-dispute arbitration agreements for covered products and services that are "entered into" on or after the compliance date comply with the rule. The CFPB interprets the phrase "entered into" quite broadly, such that it may include certain agreements that were initially signed before the compliance date. The CFPB's official interpretation of the rule provides specific examples of when a covered provider is deemed to have entered into a pre-dispute arbitration agreement that will be subject to the rule. Some of these examples are listed below.

- ***New Product or Service.*** A covered provider will have entered into a pre-dispute arbitration agreement if it offers or provides to a consumer a new covered product or service on or after the compliance date, even if the new product or service is subject to an existing pre-dispute arbitration agreement. The rule does not define "new product or service," but the preamble states that contractual modifications that result in the provision of a new account on or after the compliance date, such as a deposit account or credit card account, or a new closed-end consumer credit transaction, would constitute a new product or service for purposes of the rule.
- ***Amendment, Modification, Implementation.*** Covered providers may modify, amend, and/or implement the terms governing a preexisting covered product or service without triggering the rule. If, however, the modification, amendment, or implementation would constitute the provision of a new product or service, as discussed above, the rule requirements would apply as they would to any other new covered product or service.
- ***Mergers and Acquisitions.*** If a covered provider acquires a covered product or service—for example, through a sale or transfer of contracts, or through a merger or acquisition of the company itself—on or after the compliance date, and becomes a party to an existing pre-dispute arbitration agreement that had previously been between two other parties, then the covered provider is responsible for ensuring that the agreement complies with the rule. For example, if Bank A acquires the contracts of Bank B and becomes a party to the pre-dispute arbitration agreements on or after the compliance date, then Bank A must ensure that the agreements conform to the rule's requirements.

***Examples of Excluded Persons***:

- A person regulated by the SEC (e.g. a broker-dealer, investment adviser, self-regulatory organization)
- A broker-dealer or an investment adviser regulated by a state securities commission
- A person registered or required to be registered with the CFTC
- A federal agency
- A state, tribe or other person that qualifies as an "arm" of the state or tribe under federal sovereign immunity law
- A person that, along with its affiliates, provides a given covered product or service to no more than 25 consumers in the current and the preceding calendar years
- A merchant, retailer or other seller of nonfinancial goods or services, subject to certain conditions
- An employer providing these covered products or services as employee benefits

***Ability to Rely on Pre-Dispute Arbitration Agreements.*** The rule prohibits a covered provider from relying on a pre-dispute arbitration agreement that bars class actions for covered products or services, if the agreement was entered into on or after the compliance date. This prohibition does not apply where the court has already ruled that a case may not proceed as a class action and either the time for appellate review has lapsed or the review was resolved such that the case cannot proceed as a class action. This provision therefore prohibits a covered provider from seeking a stay or dismissal of claims based on any pre-dispute arbitration agreement (even if it is not a party to that agreement).

***Must Include Contractual Language or Provide Notice.*** Upon entering into a new pre-dispute arbitration agreement for a covered product or service on or after the compliance date, a covered provider must include the following language in the agreement: "We agree that neither we nor anyone else will use

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 even if you do not file it." Variations of this language are also provided for different factual situations.

If, on or after the compliance date, the covered provider enters into a pre-dispute arbitration agreement that had previously existed between other parties that does not conform to the rule's requirements, then the covered provider must amend the agreement or provide notice to consumers within 60 days of entering into the agreement.

If a pre-dispute arbitration agreement applies to multiple products or services, only some of which are covered by the rule, the covered provider can specify that the required contractual language applies only to the products or services covered by the rule. In addition, where a covered provider adds a new covered product or service on or after the compliance date to a preexisting agreement, the rule permits the covered provider to note that the required contractual language does not apply to products or services first provided before the compliance date that are subject to an arbitration agreement entered into before that date.

### Records Submission Requirements

For pre-dispute arbitration agreements for covered products or services that are entered into on or after the compliance date, covered providers must submit certain arbitral and court records to the CFPB. The CFPB will make these records publicly available in redacted form on the CFPB's website.

***Specific Records.***

With respect to arbitration concerning any covered product or service, a covered provider must submit to the CFPB:

- The initial claim and counterclaim;
- The answer to any initial claim or counterclaim;
- The pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;
- The judgment or award, if any; and
- Certain communications related to the covered provider's alleged failure to pay fees or to a determination that the pre-dispute arbitration agreement does not comply with the administrator's fairness principles or rules.

With respect to court proceedings concerning any covered product or service, the covered provider must submit:

- Any submission that the covered provider relies on in support of an attempt to seek dismissal, deferral, or stay of any aspect of the case, and
- The pre-dispute arbitration agreement relied upon in that filing.

Certain information, such as the names of individuals and other personally identifiable information, must be redacted before the records are submitted to the CFPB. The redaction may be performed by the covered provider or another person on its behalf, but the compliance obligation ultimately rests with the covered provider.

***Timing.*** Covered providers must submit the specified records to the CFPB within 60 days of the provider filing such records with the arbitrator, arbitration administrator, or court or receiving such records that were filed by someone else.

***Other Submission Requirements.*** A covered provider is permitted to arrange for another person, including an agent, to submit the records on its behalf, but the obligation to comply with the submission requirements ultimately rests with the covered provider.

The rule requires that records be submitted in the form and manner specified by the CFPB. As explained in the proposed rule, the CFPB anticipates providing further technical details regarding the submission process before the compliance date.

***CFPB Records Repository.*** The records submitted to the CFPB under this requirement will be maintained in a central repository on the CFPB's publicly available website, so that the records are easily accessible and retrievable by the public. The initial set of records will be available no later than July 1, 2019, and the online repository will be updated at least annually thereafter for documents received by the end of the prior calendar year. According to the CFPB, the records are expected to be searchable by their text, date, the name of the arbitration administrator, the name of the covered provider, and the type of consumer financial product or service at issue.

The CFPB stated that, using the records collected and other sources, it intends to continue to evaluate the impacts on consumers of arbitration and arbitration agreements and to draw upon its statutorily authorized tools to address conduct that harms consumers.

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