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COMMENTARY

The Future of Mandatory Consumer Arbitration Clauses

Arbitration as a means of dispute resolution is intended to help consumers and businesses save time and money and achieve fair results when compared to traditional litigation. Millions of contracts for consumer financial products and services have a pre-dispute arbitration clause ("arbitration clause") that requires consumers and financial institutions to resolve their disputes through arbitration, rather than through the court system.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") required the Consumer Financial Protection Bureau ("CFPB" or "Bureau") to study arbitration agreements and submit its findings in a report to Congress ("CFPB Study").[1] In sharp contrast to the intent of arbitration clauses, the CFPB Study, released in March 2015, concluded that the overwhelming majority of consumers are unaware whether their financial products and services contracts require resolution of disputes through arbitration or through litigation, and even when consumers are aware of arbitration clauses, very few consumers (fewer than seven percent, according to the CFPB Study) understand what arbitration means or requires.[2] Since its release, the CFPB Study has generated a substantial discourse on the merits of arbitration among trade groups that represent the interests of industry and consumers alike, as well as among academics and members of Congress.

Based in part on the findings of the CFPB Study, at a field hearing in Denver, Colorado on October 7, 2015, the CFPB announced that it is "considering proposing rules that would ban consumer financial companies from using 'free pass' arbitration clauses to block consumers from suing in groups to obtain relief."[3] At the same time, the CFPB published an outline of proposals that includes (i) prohibiting pre-dispute arbitration clauses from foreclosing class litigation; and (ii) requiring submission of any arbitral claims and awards to the CFPB for collection and possible publication ("CFPB Proposal Outline").[4] Notably, however, the "Bureau is not considering at this time a proposal that would prohibit entirely the use of pre-dispute arbitration agreements."[5]

The CFPB's Proposal Outline would permit pre-dispute arbitration clauses in contracts for consumer financial products and services under two conditions only:

- **Arbitration could not block class actions without court action**. First, the contract must state that the arbitration clause does not apply to class action litigation, unless and until class certification is denied by a court or the class claims are dismissed in court. The CFPB intends to propose model contract language.
- **Companies would be required to submit arbitration claims filed and awards issued to the CFPB**

for review and possible publication. Second, companies that are subject to the jurisdiction of the CFPB would be required to submit any filings made by or against them in connection with arbitration disputes, as well as any resultant decisions, to the CFPB.[6]

The CFPB is engaging in stakeholder outreach activities, including hosting meetings with industry and consumer groups for the purpose of gathering comments and information. A Small Business Advocacy Review Panel has provided its views on the CFPB Proposal Outline, and the CFPB is considering those views, which will be made public in a final report that will become a part of the administrative rulemaking record. The CFPB must produce a final report based upon the advice, input, and recommendations of the Small Business Advocacy Review Panel and the small entity representatives no later than 60 days after the date of the Panel meeting, which was held on October 20, 2015.

Thereafter, the CFPB will publish a notice of proposed rulemaking to solicit public comments. Publication of the CFPB's notice of proposed rulemaking will describe how the CFPB intends to regulate the use of arbitration clauses in contracts for consumer financial products and services, and interested persons will have the opportunity to submit comments to the CFPB that the agency will consider in developing a final rule.

The CFPB Proposal Outline and the findings of the CFPB Study leave little doubt that regulation of arbitration clauses in consumer financial products and services contracts is firmly on the agenda for prompt consideration. And timing matters, because the 2016 elections could alter the direction of the CFPB's rulemaking and enforcement initiatives generally, and specifically with respect to arbitration clauses. Although the exact timing for publication of the CFPB's final rule on arbitration is uncertain, any final rule would not likely take effect until 2018 or later and would not likely affect contracts entered into prior to the effective date of the final rule.

Companies that are subject to the CFPB's oversight should take steps now to ensure their compliance with all applicable consumer financial services laws and to prepare for the CFPB's impending rulemaking. These steps could help to diminish companies' litigation, reputational, operational, and other risks that would result from the CFPB's anticipated placement of substantial limitations on the use of arbitration clauses to resolve disputes related to consumer financial products and services. Filing a public comment would also help shape the CFPB's final rule on arbitration.

Arbitration Clauses in Financial Products and Services Contracts

Millions of consumer financial products and services contracts, such as those for credit cards and mortgage loans, contain arbitration clauses. Arbitration clauses "require that disputes that may arise about that product or service be resolved through arbitration, rather than through the [state or federal] court system. Where such a clause exists, either side can generally block lawsuits, including class actions, from proceeding in court."[7] Arbitration clauses "generally give each party to the contract two distinct contractual rights. First, either side can file claims against the other in arbitration and obtain a binding decision from the arbitrator. Second, if one side sues the other in court, the party that has been sued in court can invoke the arbitration clause to require that the dispute proceed, if at all, in arbitration instead."[8]

According to the CFPB Study, the existence of arbitration clauses in contracts for financial products and services is unknown to most consumers, and even if consumers are aware, generally they do not understand how such clauses operate. More than three quarters of credit card consumers do "not know whether their credit card agreement contain[s] an arbitration clause," and among consumers "whose contract include[s] an arbitration clause, fewer than 7 percent recognized that they could not sue their credit card issuer in court."[9] According to the CFPB Study, more than 50 percent of outstanding credit card loans and 99 percent of payday loan agreements are subject to arbitration clauses, as are approximately 44 percent of insured deposits and most student loan contracts.[10]

There are varying views of the advantages and disadvantages of arbitration. Some believe that the cost savings of arbitration are overstated, and that because most arbitration clauses also contain class-action waivers, which prevent consumers from filing formal claims as a group, the amounts consumers may successfully recover are artificially reduced.[11] After comparing consumer prices for credit card

issuers that eliminated their arbitration clauses versus prices for credit card issuers that maintained them, the CFPB Study concluded there was no "statistically significant evidence of an increase in prices among those companies that dropped their arbitration clauses and thus increased their exposure to class action litigation risk."[12] "Using the same 'difference-in-differences' methodology," the CFPB was "unable to identify evidence that companies that eliminated arbitration clauses reduced their provision of credit to consumers relative to companies that did not change their arbitration clauses."[13] Shortly after the CFPB Study was released, 58 House and Senate Democrats wrote to the Director of the CFPB "urg[ing] the CFPB swiftly to undertake a rulemaking to eliminate the use of forced arbitration clauses in [consumer financial products or services] contracts."[14]

Others believe that arbitration and other alternative dispute resolution mechanisms are less expensive, faster, and more efficient than traditional litigation, in no small part because arbitrations are subject to their own streamlined procedures as opposed to those in state and federal courts that include time-consuming and costly discovery obligations.[15] Scholars and industry groups, including the American Bankers Association ("ABA"), the Consumer Bankers Association ("CBA"), and the Financial Services Roundtable ("FSR"), expressed immediate and strong criticism of the CFPB Study's methodologies and conclusions.[16] For instance, the ABA, CBA, and FSR contend that consumers who prevail in arbitration actually recover "166 times more in financial payments than the average class member in class action settlements," thereby undermining a central tenet of the CFPB Study.[17]

Supporters claim these cost savings are passed to consumers in the form of lower prices and greater availability of credit. Scholars also noted that the "CFPB's data do not allow for meaningful comparison between arbitration and class actions" because the data set in the CFPB Study consisted of a "false apples-to-oranges comparison between class action *settlements* and arbitral *awards*."[18] Additionally, some commenters claim that there is little evidence to suggest arbitration clauses are as pronounced or restrictive as the CFPB Study suggests, given "abundant competition in the financial services marketplace to accommodate customers who prefer to resolve disputes via litigation as opposed to arbitration. Rather, according to these commenters, the data show that 85 percent of credit card issuers and 92.3 percent of banks do not include arbitration provisions in their customer contracts."[19] Based on these and other concerns, more than 80 House and Senate Republicans wrote to the Director of the CFPB criticizing what they saw as "the flawed process [that] produced a fatally-flawed study" and asking that the CFPB reopen the study and seek public comment before embarking on any rulemaking.[20]

CFPB Proposal Outline on Arbitration Clauses

Based on the findings in its Study, on October 7, 2015, the CFPB issued a Proposal Outline for future rulemaking regarding the use of pre-dispute arbitration clauses in contracts for consumer financial products and services.[21] While the CFPB Proposal Outline does not contemplate a complete banning of companies subject to the CFPB's jurisdiction from using arbitration clauses, the two proposals under consideration—(i) prohibiting arbitration clauses from including class-action waivers; and (ii) requiring submission of all arbitral claims and awards to the CFPB for collection and possible publication—will severely limit the use and benefits of arbitration clauses in contracts for consumer financial products and services, including for credit cards, checking and deposit accounts, prepaid cards, money transfer services, certain auto loans, payday loans, and private student loans.[22] In issuing its Proposal Outline, the CFPB analyzed the effect of legal precedent upholding the validity of arbitration clauses and the availability of class-action waivers, but nevertheless concluded it has authority under the Dodd-Frank Act to issue rules limiting the scope of such clauses.[23]

If the features of the Proposal Outline are adopted in final form without change, companies that are subject to the jurisdiction of the CFPB would no longer be able to use arbitration clauses to prevent disaffected consumers from filing class actions in state or federal court, potentially leading to significantly larger liability and expense. Specifically, any arbitration clause "would have to say explicitly that [it does] not apply to cases filed as class actions unless and until the class certification is denied by the court or the class claims are dismissed in court."[23] While the Bureau is not currently proposing barring arbitration clauses entirely, this condition for class actions would effectively eviscerate the efficacy and cost savings associated with the use of arbitration clauses. In theory, companies would still

be able to require the submission of individual disputes to arbitration; however, the Bureau's additional Proposal of creating a database of all arbitral claims and awards for public consumption would likely deter many companies from using such clauses in the first place due to the risk of heightened regulatory and public scrutiny.[24]

On October 20, 2015, the CFPB convened a Small Business Advocacy Review Panel to gather feedback from small industry stakeholders regarding its proposals.[25] Prior to the meeting, small entity representatives were provided with a questionnaire designed to frame discussion of the issues and cost of credit matters during the meeting. The small entity representatives were asked about their experiences using arbitration agreements, in arbitration proceedings, and with class litigation.[26] They were also asked about their investment in compliance with consumer protection laws and how, if at all, the CFPB Proposal Outline would change that investment.

Later this year or early in 2016, the CFPB plans to publish a formal notice of proposed rulemaking through which the agency solicits public comments for a period of time.[27] As with the CFPB Study, the CFPB Proposal Outline has met with some stiff opposition: some opponents claim that any rule based upon the Proposal Outline will result in additional, meritless class litigation that will drive up dispute resolution costs, eventually resulting in higher costs to consumers for financial products and services.[28] Some trade associations have opined that arbitration "is a very valuable forum for customers to resolve disputes" and that the "CFPB should focus on improving the arbitration system for financial services customers rather than encouraging arbitration effectively be abandoned in favor of lengthy and expensive class action lawsuits, which often only benefit plaintiff lawyers and not consumers."[29]

Steps to Consider Taking Now

Companies that are subject to CFPB supervision and regulation, and that rely upon arbitration clauses in contracts for consumer financial products and services, should consider taking steps now both to prepare for the upcoming rulemaking and also to reduce reputational, operational, litigation, and other risks. Comments filed in response to the CFPB's notice of proposed rulemaking will be available for public review.

Below are several key steps to consider:

- **Conduct a review of your compliance management system**. Evaluate your consumer compliance management system to identify and fill any gaps in processes and procedures that inure to the detriment of consumers under standards of unfair, deceptive, and abusive acts or practices, and that could result in groups of consumers taking action.
- **Ensure clear and timely customer communications**. Clearly and timely communicate with consumers regarding changes in policy and price increases.
- **Commit sufficient resources to customer service**. Devote adequate resources to customer service, including training of customer service representatives.
- **Adhere to an effective consumer complaint system**. Ensure that your consumer complaint processes are effective and provide feedback throughout the company.
- **Make sure arbitration clauses are prominent and understandable**. Ensure that contract arbitration clauses are brought to the attention of the consumer at the time of entering the agreement for consumer financial products and services, using prominent and understandable language.
- **Be prepared for class action litigation**. Be prepared to litigate customer disputes in court, just in case.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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Endnotes

1 Dodd-Frank Act, § 1028(a).

2 Consumer Financial Protection Bureau, "Arbitration Study" (March 10, 2015) ("CFPB Study").

3 Consumer Financial Protection Bureau, "CFPB Considers Proposal to Ban Arbitration Clauses that Allow Companies to Avoid Accountability to Their Customers" (Oct. 7, 2015) (the "CFPB Proposal Release").

4 Consumer Financial Protection Bureau, "Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements; Outline of Proposals Under Consideration and Alternatives Considered" at 1-21 (Oct. 7, 2015) ("CFPB Proposal Outline").

5 CFPB Proposal Outline at 14.

6 CFPB Proposal Outline at 13-21.

7 Consumer Financial Protection Bureau, "Consumer Financial Protection Bureau Study Finds That Arbitration Agreements Limit Relief for Consumers" 1 (Mar. 10, 2015) ("CFPB Fact Sheet").

8 CFPB Study at 4.

9 Consumer Financial Protection Bureau, "CFPB Study Finds That Arbitration Agreements Limit Relief for Consumers" (Mar. 10, 2015) ("CFPB News Release").

10 CFPB Fact Sheet at 1; CFPB Study at 9.

11 CFPB Fact Sheet at 2-4; *see* CFPB News Release.

12 CFPB Study at 18.

13 CFPB Study at 18.

14 Letter from Sen. Al Franken *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau at 1 (May 21, 2015) ("Democrat letter").

15 *See* Jenny N. Perkins, "CFPB Holds Field Hearing on Arbitration Report," CFPB Monitor (March 13, 2015).

16 *See*, *e.g.*, Jason Scott Johnston & Todd Zywicki, "The Consumer Financial Protection Bureau's Arbitration Study, A Summary and Critique" at 6, Mercatus Working Paper, Mercatus Center at George Mason University, Aug. 2015; Letter from American Bankers Association *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau (May 21, 2015) ("May 21 ABA Letter"); Letter from American Bankers Association *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau at 2 (July 13, 2015) ("July 13 Trade Group Letter").

17 July 13 Trade Group Letter at 4.

18 Johnston, "The Consumer Financial Protection Bureau's Arbitration Study" at 6 (adding that the Bureau did not have access to arbitral settlements).

19 July 13 Trade Group Letter at 4.

20 Letter from Rep. Patrick McHenry *et al.* to Richard Cordray, Director, Consumer Financial Protection Bureau at 1 (June 17, 2015), ("Republican letter").

21 CFPB Proposal Release; *see* CFPB Proposal Outline.

22 CFPB Proposal Release; CFPB Proposal Outline at 19-20; *see* Yuka Hayashi, "Sue the Bank? You May Get Your Shot," *The Wall Street Journal* (Oct. 7, 2015); Jenna Greene, "Say Goodbye to Mandatory Arbitration—And Hello to Class Actions," *Am Law Litigation Daily* (Oct. 6, 2015).

23 CFPB Proposal Outline at 5-7, 12.

24 CFPB Proposal Release.

25 *See* Jim Puzzanghera, "Agency targets the fine print preventing customers from joining class actions," *The Los Angeles Times* (Oct. 6, 2015).

26 CFPB Proposal Release.

27 Consumer Financial Protection Bureau, Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements, Discussion Issues for Small Entity Representatives (Oct. 7, 2015).

28 Hayashi, "Sue the Bank?."

29 Puzzanghera, "Agency targets the fine print"; Greene, "Say Goodbye."

30 *See* Financial Services Roundtable, "CFPB Should Not Diminish Arbitration as Efficient Way for Customers to Resolve Disputes" (Oct. 7, 2015).