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What Real Estate Settlement Service and Other Consumer Financial Services Providers Need to Know About the CFPB's Final Arbitration Rule

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On July 10, 2017, in a surprise move, the Consumer Financial Protection Bureau (CFPB or Bureau) issued its long awaited final rule on arbitration (Final Arbitration Rule). This rule-making has been a lightning rod issue for the Bureau, and its Final Arbitration Rule is likely to face serious political and legal challenges in the weeks and months to come. Even if the rule survives those challenges – and that if a big if – it does not become mandatory until early March 2018 and its provisions are not necessarily as sweeping as some press accounts may suggest. Here is what real estate settlement service and other consumer financial services providers need to know about the Final Arbitration Rule, at a glance.

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The Rule imposes new restrictions on class waivers, issues a requirement to disclose that limitation in certain arbitration agreements, and requires some information collection.

As we have previously reported, well-crafted pre-dispute arbitration clauses with class action waivers can be an important tool for businesses to manage cost and risk from class actions or other multi-party lawsuits, as well as a generally accessible and efficient avenue for consumers to seek relief.

The Final Arbitration Rule, however, prohibits providers of certain consumer financial products and services from using class waivers in pre-dispute arbitration agreements, and requires covered providers that enter into arbitration agreements with consumers to insert prescribed language into their arbitration agreements reflecting this limitation. The Bureau's assumption continues to be that pre-dispute class waivers are used to prevent consumers from seeking relief from legal violations, and that consumers are less likely to obtain meaningful relief through arbitration or individual suits than in a class action.

The Final Arbitration Rule also requires providers that use pre-dispute arbitration agreements to submit to the Bureau certain records of claims and awards reached through arbitration, which the Bureau intends to monitor for "consumer protection concerns that may warrant further Bureau action." The Bureau will be finalizing provisions that will require it to publish the materials it collects on its website (with certain redactions) beginning in July 2019. The Bureau believes that such public information will be useful to third parties, including state and federal regulators, as well as private attorneys, whom the Bureau contends may need access to such records to "guide their forecasting of the success of claims and defenses in arbitration and litigation."

The Final Arbitration Rule applies only to providers of certain consumer financial products and services (as well as an affiliate *if* it is acting in a service provider capacity to the provider covered by the Rule).

In 2013, pursuant to requirements in the Dodd-Frank Act, Congress amended the Truth in Lending Act to prohibit the use of arbitration agreements in connection with residential mortgage loans. The Bureau's Final Arbitration Rule now applies to providers of consumer financial products and services in certain core consumer financial

markets of lending money, storing money, and moving or exchanging money. This generally includes most providers engaged in the following activities:

- Consumer credit decisions governed by the Equal Credit Opportunity Act, and the acquiring, purchasing, selling, or servicing or such credit;
- Delivering consumer reports and consumer report information directly to consumers pursuant to the Fair Credit Reporting Act (except for adverse action notices provided by an employer);
- Managing consumer debt, debt settlement, credit modification or foreclosure avoidance services;
- Providing accounts under the Truth in Savings Act, as well as accounts and remittance transfers subject to the Electronic Fund Transfer Act;
- Transmitting or exchanging funds, certain other payment processing services, and check cashing, check collection, or check guaranty services consistent with the Dodd-Frank Act;
- Extending or brokering of automobile leases as defined in Bureau regulation; and
- Collecting debt arising from any of the above products or services by a provider of any of the above products or services, their affiliates, an acquirer or purchaser of consumer credit, or a person acting on behalf of any of these persons, or by a debt collector as defined by the Fair Debt Collection Practices Act.[1]

Under the Final Arbitration Rule, a "provider"— defined as a person that provides any of the foregoing consumer financial products or services (subject to certain exclusions), as well as the person's affiliate if the affiliate is acting as a "service provider"[2] — is subject to the rule's provisions. Thus, if the Final Arbitration Rule stands, a "provider" may not rely in any way on a pre-dispute arbitration agreement with respect to any aspect of a class action that concerns products or services covered by the rule. A "provider" must also ensure that any such pre-dispute arbitration agreement gives consumers notice of this limitation, and must provide specified arbitral records to the Bureau.

Based on this framework, a "provider" would include mortgage brokers and lenders, but under most circumstances should not implicate real estate brokers, builders, title agents or insurers, hazard insurers, escrow providers, or home warranty companies.

How we got here: an embattled Bureau issued the Final Arbitration Rule amidst controversy

The Consumer Financial Protection Act of 2010 (CFPA), the provision of the Dodd-Frank Act that created the Bureau, authorized the Bureau to study use of arbitration clauses related to financial products and services. In particular, Dodd-Frank Section 1028 empowered the Bureau to "prohibit or impose conditions or limitations on the use" of arbitration clauses if it determines that restricting such provisions "is in the public interest and for the protection of consumers."[3]

Pursuant to this authority, the Bureau (then under the Obama administration), undertook a years-long study into how arbitration clauses are used in certain consumer finance markets. In March 2015, the Bureau released a 728-page report to Congress, in which the Bureau concluded that arbitration clauses restrict consumer relief in disputes with financial companies by limiting class actions. The Bureau's study was immediately subject to criticism, including a working paper issued by two law professors that criticized the Bureau for its flawed methodology, such as the Bureau's inclusion of data on consumer recoveries when arbitrators rule in their favor but exclusion of data about recoveries when an arbitration is settled by the parties (which results in a skewed comparison between class action *settlements* and arbitration *awards*).

On May 5, 2016, the Bureau issued its proposed arbitration rule. In addition to banning class action waivers in certain arbitration agreements, the Bureau proposed to mandate new disclosures in pre-dispute arbitration agreements. Based on the Bureau's assumptions about the increase in federal and court class actions that would occur if the rule was finalized as proposed[4] (roughly, an additional 6,042 class cases over the next five years), the estimate of the cost of the proposed rule to providers who fell within the coverage of the proposed rule and who had an arbitration agreement was in the billions of dollars in settlement and defense costs.

Industry and legal observers alike worried that the Bureau was promoting class action litigation as the preferred means to resolve consumer disputes without recognizing the reality that many class claims lack substantive merit and that the class action device presents its own risks and harms.

Following the Bureau's issuance of the proposed arbitration rule, the underlying issues (and the Bureau itself) remained contentious. In May 2016, the House Financial Services Committee's Subcommittee on Financial Institutions and Consumer Credit held a hearing on the Bureau's proposed arbitration rule, and in April 2016, the Financial Services Committee initiated an investigation of the Bureau's activities relating to arbitration agreements, issuing a subpoena to request Bureau records on the subject. By early 2017, the Bureau faced a Republican-controlled White House and Congress, as well as a federal court challenge to the constitutionality of the Bureau's structure, with the Department of Justice shifting its position in that case to withdraw support for the Bureau's constitutionality arguments. On March 9, 2017, the House of Representatives passed the Fairness in Class Action Litigation Act of 2017, a bill aimed at addressing abuses in class action and mass tort litigation by way of amendments to the judicial procedures that apply to federal court class actions.[5] In April 2017, the Chairman of the House Financial Services Committee, Jeb Hensarling (R-Tex.), authored the Financial Choice Act, a bill designed to roll back financial reforms and weaken the Bureau; among other things, the bill proposed to repeal Section 1028 of the CFPA, the Bureau's source of authority for arbitration rulemaking. And the federal spending plan released on May 23rd by the Trump administration proposes to limit Bureau funding in 2018 as part of a shift in the Bureau's funding from the Federal Reserve to the regular Congressional appropriations process.

Only days ago, the House Financial Services Committee Chairman issued a letter to the Director of the Bureau, Richard Cordray, advising the Director of possible contempt proceedings if the Bureau introduced its final rule on arbitration before supplying the House Financial Services Committee with records responsive to its 2016 subpoena.

On July 10, 2017, the Bureau proceeded to issue a Final Arbitration Rule.[6]

The Final Arbitration Rule is set to take full effect in eight months, but expect the Rule to encounter major obstacles.

For covered providers, the Final Arbitration Rule is set to become effective 60 days after it is published in the Federal Register, with mandatory compliance 180 days after that, yielding a compliance period of approximately eight months.[7]

But response from critics has been swift,[8] and as Director Cordray acknowledged in his prepared remarks announcing the final rule, Congress may well take action to undo it.

How could this play out?

Congress is likely to attack the Final Arbitration Rule under the Congressional Review Act (CRA). The CRA is a legislative tool that gives lawmakers a period of time to review and undo regulations enacted by the legislative branch with a simple majority vote, not subject to filibuster. The time frame can vary but, in general, Congress has at least 60 days to act under the CRA. Rarely utilized under previous administrations, the CRA has been employed numerous times in 2017 to rollback Obama-era regulations, such as Congress' vote in April to repeal strict broadband privacy rules implemented by the Federal Communications Commission in 2016. Already, members of Congress have come forward to say that the Bureau's Final Arbitration Rule should be repealed through the CRA.

Moreover, Director Cordray's time with the Bureau could be limited,[9] and if new Bureau leadership came in with a different agenda, it might be able to shift course and take action to reconsider the Final Arbitration Rule.

If the Final Arbitration Rule makes it to the compliance date, legal challenge is also on the table. The U.S. Chamber of Commerce, which has been critical of the Bureau's exercise of authority and the arbitration rule, has expressed intent to consider every approach to address its concerns with the arbitration rule, which potentially could include legal challenge in the courts.

Providers not covered by the Final Arbitration Rule should consider appropriate use of pre-dispute arbitration clauses with class action waivers.

The Final Arbitration still faces significant hurdles. And even if it goes into effect unencumbered by political and legal challenges, its provisions would only apply to covered providers and their consumer agreements entered into on or after the compliance date.

For providers not directly implicated by the Final Arbitration Rule (or Truth in Lending Act restrictions), it remains a good time to consider employing a properly drafted arbitration clause with a class action waiver. The federal law on arbitration agreements remains generally favorable, with the U.S. Supreme Court issuing several major decisions in recent years upholding arbitration clauses in the face of various challenges under state laws.

[1] Arbitration Agreements, Final Rule, Docket No. CFPB-2016-0020, *available at* https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201707_cfpb_Arbitration-Agreements-Rule.pdf.

[2] A "service provider" means any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service, including a person that (i) participates in designing, operating, or maintaining the consumer financial product or service; or (ii) processes transactions relating to the consumer financial product or service (other than unknowingly or incidentally transmitting or processing financial data in a manner that such data is undifferentiated from other types of data of the same form as the person transmits or processes). 12 U.S.C. § 5481(26)(A). This does not include a person solely by virtue of such person offering or providing general business support or a similar ministerial service, or time or space for an advertisement for a consumer financial product or service through print, newspaper, or electronic media. *Id.* at § 5481(26)(B).

[3] Codified at 12 U.S.C. § 5518.

[4] *See* Arbitration Agreements, Proposed Rule, 81 Fed. Reg. 32,830, 32,907-09 (May 24, 2016).

[5] The Institute for Legal Reform, an affiliate of the U.S. Chamber of Commerce, supported the FCALA as a potential correction to "many of the abuses that have turned class actions and mass tort MDL proceedings into cash machines for the plaintiffs' trial bar." *See* https://www.uschamber.com/letter/hr-985-the-fairness-class-action-litigation-act-2017.

[6] In the Final Arbitration Rule, the Bureau has acknowledged certain criticisms of its previous arbitration study, acknowledging that the Bureau had no "feasible way of studying the actual costs that financial service providers incur in defending class actions or studying the outcomes of arbitration or individual litigation cases that were settled . . . " Final Arbitration Rule, at 37. In the Bureau's view, however, it was not required to "research every conceivably relevant question or to exhaust every conceivable data source" in order to exercise rulemaking authority to restrict the use of arbitration agreements in contracts for consumer financial products and services. *Id.*

[7] While the Bureau acknowledges that some providers will need to implement revisions to a large number of consumer agreements and related forms, its assumption is that "the revisions required for each document will be modest" and will not impose a substantial burden. Final Arbitration Rule, at 615-16.

[8] As reported by Rachel Witkowski, Andrew Ackerman and Brent Kendall for the Wall Street Journal, "[t]he move prompted a rebuke from acting Comptroller of the Currency Keith Noreika." A July 11th article in the American Banker quoted Jeb Hensarling as saying "[a]s a matter of principle, policy, and process, this anti-consumer rule should be thoroughly rejected by Congress under the Congressional Review Act," and indicated that the Consumer Bankers Association would support such a move by Congress.

[9] Director Cordray's terms is not set to end until July 2018, but if the D.C. Circuit Court of Appeals' decision in the *PHH* case is confirmed by the full court (which could happen soon), President Trump might act to terminate Cordray swiftly; there has also been speculation that Cordray could opt to leave the Bureau early, possibly to run for governor of Ohio.