



Financial Services & Products ADVISORY ■

MAY 6, 2016

Consumer Financial Protection Bureau Looks to Prohibit Mandatory Arbitration

It should come as no surprise that earlier today the Consumer Financial Protection Bureau (CFPB or Bureau) announced that it is seeking comments on a [proposed rule](#) that would prohibit mandatory arbitration clauses that deny groups of consumers the right to litigate disputes with certain financial services providers. Many consumer financial products like credit cards, student loans and bank accounts have mandatory arbitration provisions in the account contract that generally prevent consumers from joining together as a class to sue their bank or financial company. These common arbitration clauses require consumers to seek relief on their own. The rule will not be retroactive; thus, previously entered agreements with mandatory arbitration provisions barring class actions will not violate the rule. However, such provisions might still be scrutinized under unfair, deceptive or abusive acts or practices (UDAAP) theories.

According to the [CFPB release accompanying the proposed rule](#), these “contract gotchas” enable companies to “sidestep the legal system, avoid accountability, and continue to pursue profitable practices that may violate the law and harm countless consumers.” The CFPB claims the proposed rule is “designed to protect consumers’ right to pursue justice and relief and deter companies from violating the law.” And the Bureau will require notice of arbitrations in order to monitor that process.

In October 2015, the Bureau published an outline of the proposals and convened a Small Business Review Panel to gather feedback from small companies and seek input from the public, consumer groups, industry and other stakeholders. That process concluded in December 2015 with a [written report](#) to the Bureau’s director.

“Signing up for a credit card or opening a bank account can often mean signing away your right to take the company to court if things go wrong,” said CFPB Director Richard Cordray. “Many banks and financial companies avoid accountability by putting arbitration clauses in their contracts that block groups of their customers from suing them. Our proposal seeks comment on whether to ban this contract gotcha that effectively denies groups of consumers the right to seek justice and relief for wrongdoing.”

Many contracts for consumer financial products and services include mandatory arbitration clauses that effectively block either side from going to court (other than small claims court) and require disputes to be resolved privately by arbitrators. Consumers are forced to act individually through the arbitration process even if many others face the same injury.

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Under the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted in 2010, the CFPB is required to study mandatory arbitration clauses in consumer financial markets and has the power to issue regulations consistent with the study. Released in March 2015, the [CFPB's study](#) showed that very few consumers ever even consider bringing individual actions, concluding that class actions provide "a more effective means for consumers to challenge problematic practices." Over the five-year period studied, class action settlements totaled \$2.7 billion in cash, in-kind relief and attorneys' fees and expenses. That figure does not include what the CFPB calls "the potential value ... of class action settlements requiring companies to change their behavior." Mandatory arbitration clauses, however, enable companies to block class actions.

The CFPB is now seeking comment on a rule that would prohibit mandatory arbitration clauses that prevent class action lawsuits, opening the legal system to consumers to file or join a class action. *But even under the proposed rule, companies would be allowed to include mandatory arbitration clauses (provided by the rule) in their contracts, but they would have to explicitly state that they "cannot be used to stop consumers from being part of a class action in court."* The proposal would also require companies with arbitration clauses to submit to the CFPB information that would allow the Bureau to monitor consumer finance arbitrations, information that could be made available to the public much the same as the CFPB publication of certain consumer complaints and complaint statistics.

According to the press release issued by the CFPB, the benefits to the CFPB proposal would include:

- **A day in court for consumers:** The proposed rule would allow groups of consumers to obtain relief via class action lawsuits. Most consumers do not even realize their rights have been violated, and often the harm may be too small for a single consumer to consult an attorney or otherwise pursue legal action, even when the cumulative harm is significant. But class action lawsuits allow consumers opportunities to obtain relief that they otherwise would not receive.
- **Deterrent effect:** The proposed rule would provide incentives for companies to comply with the law to avoid class actions. Arbitration clauses, says the CFPB, enable companies to avoid public attention and accountability for their conduct. "When companies know they can be called to account for their misconduct, they are less likely to engage in unlawful practices that can harm consumers."
- **Increased transparency:** The proposed rule would require companies that use arbitration clauses to submit any claims filed and awards issued to the CFPB. The Bureau would also collect correspondence from arbitration administrators regarding a company's poor conduct, enabling the CFPB to better understand and monitor arbitration and provide insight into whether the process itself is fair.

The proposed rule would apply to most consumer financial products and services that the CFPB oversees, including those that "involve lending money, storing money, and moving or exchanging money." Arbitration agreements in the residential mortgage market, the largest market the Bureau oversees, are already prohibited.

Alston & Bird Observations

Although the proposed rule was expected, the financial services industry reaction to it is likely to be staunchly negative. Most companies that have mandatory arbitration clauses in their contracts firmly believe arbitration's ability to handle small individual claims is faster and more cost efficient. Often a consumer can participate in arbitration without hiring a lawyer. Moreover, the industry will likely continue to cite the proposed rule as a boondoggle for class action lawyers. That said, it seems to be a foregone conclusion that the CFPB will endeavor to publish a final rule in the coming months and that all that is left to debate is the exact wording of the CFPB arbitration provision (which will specifically allow for class actions). Any such provision will likely cause most companies that currently have mandatory arbitration clauses to consider removing arbitration altogether.

Because the underlying data in the CFPB study is controversial and lends itself to other conclusions, it seems likely that there will be significant judicial challenges to the rule. Accordingly, while the proposed rule was expected, it represents the conclusion of the preliminary rounds. Now the main event begins.

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Scott Samlin
212.210.9408
scott.samlin@alston.com

Frank Hirsch
919.862.2278
frank.hirsch@alston.com

Colgate Selden
202.239.3751
colgate.selden@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777

BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN

BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719

CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111

DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899

LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100

NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444

RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260

SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650.838.2000 ■ Fax: 650.838.2001

WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333